



Celebrating 40 Years

Multiyear Rate Plans and the Public Interest

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Topics

- Definition of multiyear rate plans (MRPs)
- Criticisms of traditional ratemaking addressed by MRPs
- Core and add-on features of MRPs
- Challenges for regulators
- What's good about MRPs?
- What are some concerns?
- Parting comments

MRPs in Comparison with Traditional Ratemaking

- A MRP is a mechanism for setting a utility's rates or revenue requirements for longer than a single 12-month period
- It specifies rates beyond the rate effective year of a rate case by applying a formula or index, or detailed forecasts for allowable rate changes over the duration of the plan (via attrition allowance)
- Instead of a utility filing a new general rate case when conditions change, for example, a MRP may forecast what these conditions are and adjust rates within the confines of a single rate case

Criticisms of Traditional Ratemaking

- Fixed base rates between general rate cases in spite of conditions
- Excessive regulatory lag jeopardizing a utility's financial health
- Problems from delays, for example, in a utility's recovery of capital costs
- Regulatory lag deferring the benefits of utility efficiency gains to customers
- High regulatory costs
- Frequent rate cases in a dynamic environment where the utility's average cost increases
- Weak incentives for long-term cost efficiency and innovation
- Incentive for cost-shifting and affiliate abuses
- Incentive for excessive capital investments
- Disincentive for utility-funded energy efficiency and distributed energy resources

How do MRPs address these criticisms compared with other ratemaking mechanisms?

Core and Add-On Features of MRPs

Core Structure

- Starting base rate or revenue
- Changes in base rates or revenue outside the rate effective year
- Duration of a MRP (e.g., 3 years)

Add-Ons

- “Off-ramps”
- Cap or floor (“collar”) on annual rate increases
- Earnings test
- True-ups/deferrals
- Stay-out period
- Refunds to customers
- Efficiency carryover

Issues for Regulators

- Articulating a rationale
- Length of the multiyear period
- Base period revenues and costs
- Allowed costs in base rates
- Focus on rate changes or revenue changes
- Need for “off-ramps”
- Conditions for “earnings” adjustments
- Post-test year cost calculations by forecasting or indexing, or a hybrid (i.e., attrition allowance)
- Conditions for recovery of capital costs
- Capital costs included in an MRP
- Inclusion of a “stretch factor”

How MRPs Can Benefit Customers

- For a utility to earn its authorized rate of return, the regulator could motivate the utility to improve its cost efficiency (via, e.g., “stretch factor”)
- Facilitation of cost recovery for capital projects can induce additional socially desirable investments and produce other benefits to customers
- Reduction of regulatory costs
- An attrition allowance not linked to a utility’s actual cost changes can motivate the utility to achieve higher cost efficiency

How MRPs Can Benefit Customers

- Consolidation of different ratemaking mechanisms can make ratemaking more holistic (e.g., elimination of some cost trackers with poor utility incentives for cost control)
- Performance metrics can provide utilities with an added incentive to improve their performance in non-cost functions
- Price flexibility, which some MRPs allow, gives utilities the ability to vary their price to different customers based on economic and other circumstances.
- A “fair” share of benefits from improved utility performance between the utility and its customers can occur prior to the next general rate case

Concerns

- Information asymmetry
- Biased forecasts
- Generic issues with forecasts
- Use of budget data for forecasting
- Dubious incentives for cost efficiency
- Premature utility recovery of capital costs
- Unexpected outcomes leading to abnormally high or low rates of return, and subpar utility performance

Parting Comments

- The litmus test for MRPs is whether they improve the performance of utilities so as to ultimately benefit their customers
- Utilities to date, in my opinion, have made less-than-compelling arguments in support of MRPs; their main argument is that MRPs would improve the regulatory process and their financial condition (e.g., from less regulatory lag)
- Why MRPs are not more common for U.S. energy utilities is somewhat puzzling – but perhaps not
- A big challenge for regulators is knowing whether under a proposed MRP a utility's forecasts over a three- or five-year period are reasonably accurate
- Utility regulators may want to take the *initiative* in advancing MRPs whose main focus should be to advance the public interest, rather than just the narrow interests of individual stakeholders
- Their efforts can produce dividends, as well structured and implemented MRPs have the potential to benefit both utility customers and society at large