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# **Energy & Utilities Subcommittee**

**Wednesday, January 11, 2017**

**9:00 AM**

**Webster Hall (212 Knott)**

**MEETING PACKET**



# **The Florida House of Representatives**

**Commerce Committee**

**Energy & Utilities Subcommittee**

**Richard Corcoran**  
Speaker

**Kathleen Peters**  
Chair

## **AGENDA**

**Wednesday, January 11, 2017**

**212 Knott**

**9:00 am – 11:00 am**

- I. Call to Order
- II. Roll Call
- III. Panel Discussion on Ratemaking for Investor-Owned Electric Utilities
  - A. Regulatory Compact
  - B. Ratemaking Mechanisms
  - C. Initiation of a Base Rate Proceeding
  - D. Components of a Base Rate Proceeding
  - E. Outcomes of Base Rate Case Proceedings
  - F. Monitoring between Base Rate Proceedings
- IV. Adjournment

# Committee Meeting Notice

## HOUSE OF REPRESENTATIVES

### Energy & Utilities Subcommittee

**Start Date and Time:** Wednesday, January 11, 2017 09:00 am  
**End Date and Time:** Wednesday, January 11, 2017 11:00 am  
**Location:** Webster Hall (212 Knott)  
**Duration:** 2.00 hrs

Panel Discussion on Ratemaking for Investor-Owned Electric Utilities

NOTICE FINALIZED on 01/04/2017 4:07PM by Locke.Lindsey

# Overview of the Florida Public Service Commission and The Ratemaking Process



Cayce Hinton, Director  
Office of Industry Development and Market Analysis

# Regulatory Compact

- Rate regulation occurs for essential services that are provided by monopoly firms
- Government protects the interests of both the consumer and the supplier
- In return, the supplier has rights AND responsibilities



# Regulatory Compact

- **Rights of the Utility:**
  - Natural monopoly
  - Franchise for defined territories
  - Can charge rates to recover the prudent costs of service
  - Entitled to an opportunity to earn a fair and reasonable return on investments
- **Responsibilities of the Utility:**
  - Obligation to serve all customers in the defined territory
  - May not unduly discriminate in providing service or charging rates
  - Must provide safe and reliable service
  - May not build unnecessary facilities or incur costs for unnecessary services
  - Must open books to regulators



# The “Public Interest”

- Regulators are tasked with making decisions that are in the public interest
- Composite of economic efficiency, sympathetic gradualism, and political accountability
- Involves balancing several interests



# FPSC Balancing Act

Balance the interests of customers with those of the utility and its shareholders



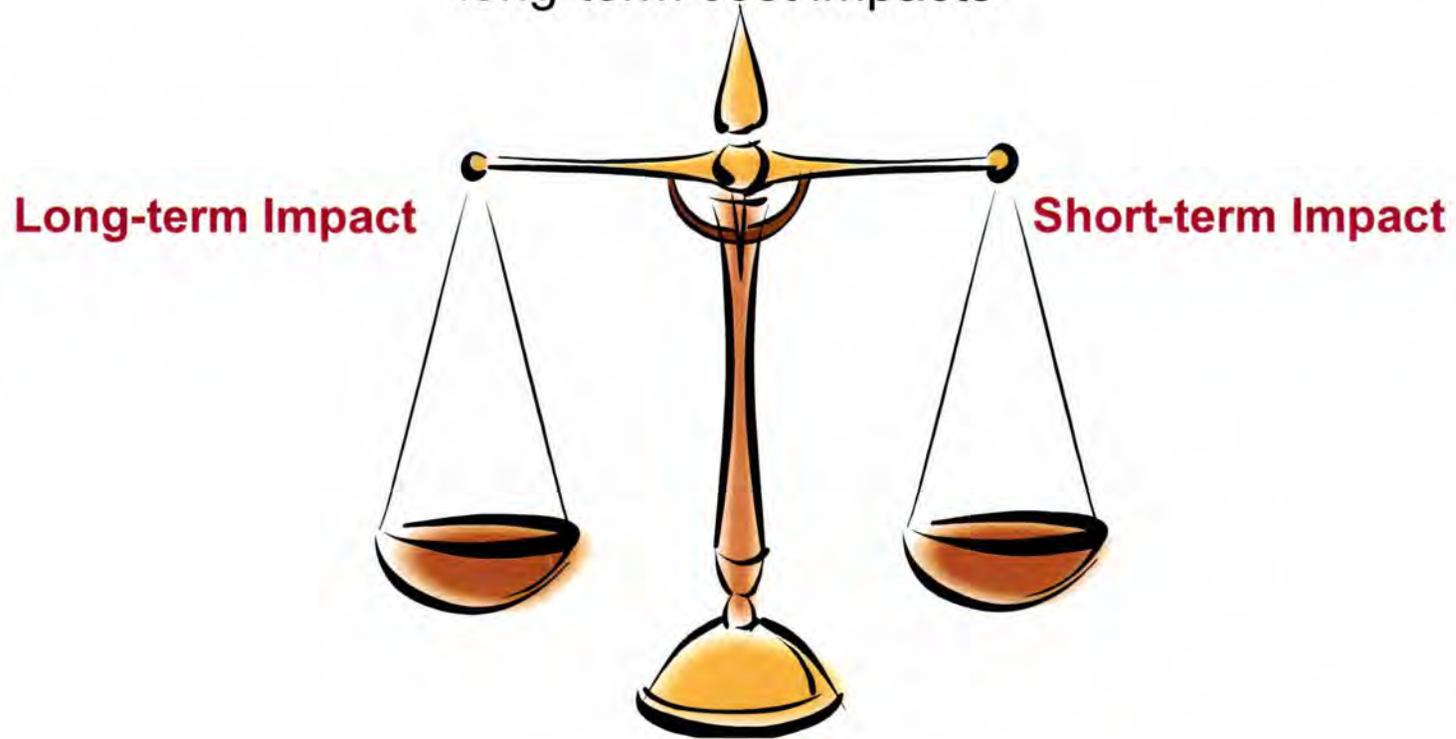
# FPSC Balancing Act

Balance the need for reliability with the desire for low rates



# FPSC Balancing Act

Balance the need for long-term planning with the effect of short- and long-term cost impacts



# Methods for Changing Rates

- The Annual Cost Recovery Clauses
- General Rate Base Proceedings



# Cost Recovery Clauses

- Base rate cases typically can take up to a year to complete
- The Commission has authority to allow certain expenses that can vary year-to-year to be recovered through annual adjustment clauses
- Formal hearings held annually to determine prudence of requested expenses
- These include:
  - Fuel costs, including purchased power
  - Conservation program costs
  - Environmental compliance costs
  - Nuclear pre-construction costs



# Rate Base and Rate of Return

- Rate Base = the net investment in facilities, equipment, and other property necessary to provide utility service, minus accrued depreciation
- Rate of Return = (r) the % return earned, or allowed to be earned, on the utility's rate base, including a return on equity and recovery of debt expense
- Utility systems are capital intensive industries with long lived assets of 40-60 years. Once costs are deemed prudent, cost recovery is permitted
- During a rate case, “base rates” are changed and are fixed until the next rate case



# Revenue Requirement

- Base rates are set to permit a utility to recover its costs, or Revenue Requirement, and have the opportunity to earn a fair rate of return on its capital investments for a test year

- Formula:

$$\text{Revenue Requirement, RR} = r \overbrace{(V-D)}^{\text{"Rate Base"}} + \overbrace{O + T + d}^{\text{"Expenses"}}$$

$r$  = % Overall Rate of Return (weighted-average cost of capital)

$V$  = Gross Investment

$D$  = Accumulated Depreciation (sum of past "d")

$O$  = Operating Expenses (O&M, Personnel, Administration, etc.)

$T$  = Taxes (corporate income taxes + other taxes)

$d$  = Annual Depreciation Expense



# Key Supreme Court Cases

- In 1923, in Bluefield Water Works v. Public Service Commission of West Virginia, the Supreme Court ruled that:
  - A public utility is entitled to rates that allow it to earn a return on the value of the plant and equipment it owns
  - While the public utility has no right to profits from speculative ventures
- In 1944, in FPC v. Hope Natural Gas, the Supreme Court ruled that:
  - From the investor or company perspective, prices are set such that there be enough revenue for operating expenses and to cover the costs of capital and debt expenses
  - Additionally, the return to equity owners should be commensurate with returns on firms with similar risks and to allow the utility to maintain its ability to attract capital



# The Electric Rate Case Process

- Any substantially affected party can intervene and the Office of Public Counsel intervenes on behalf of the customers
- The Commission conducts service hearings in the territory of the affected utility to take public testimony on the quality of service
- The rate case is conducted as a Chapter 120 hearing process—sworn testimony, witnesses, and post hearing filings
- All aspects of the revenue requirement equation can be disputed and the return on equity is always at issue
- After the Commission votes, the order changing rates is effective in 30 days



# Steps in Designing Rates

- Develop estimate of how many kilowatt-hours will be sold during the test period (“billing determinants”)
- Classify costs as to function and determine if they are fixed or variable costs
- Try to assign fixed costs on demand (kW) basis and assign variable costs on energy (kWh)
- The industry practice is to use “cost of service” assignment of costs to each homogenous class of customer to reflect the actual cost to serve that class



# How are Rate Classes Determined?

- Customers are grouped together into a rate class based on common energy use characteristics (meter type, demand size, voltage level)
- Residential: Single Family and multi-family dwellings
- General Service or Commercial Class: small, medium, large (usually based on kW demand and/or voltage level)
- Industrial Rate Class
- Other rate classes: Street Lighting, Irrigation, Water Pumping, Standby Service



# Fundamental Rate Elements

- Demand Charge:
  - Measured in dollars per kW of monthly metered customer billing demand (maximum demand during the month). Mainly designed to recover fixed costs.
- Energy Charge:
  - Measured in dollars per kWh of monthly customer energy usage. Mainly designed to recover variable costs.
- Customer Charge:
  - Measured in dollars per customer per month. Mainly designed to recover directly assignable costs.



# Post Rate Case Monitoring

- Once new rates are established utilities file monthly surveillance reports and staff evaluates if the utility is over or under earning based on reported Return on Equity (ROE)
- If the utility is overearning, the utility can be called in for a rate case to lower rates. Likewise, if it's earnings are below the authorized ROE, the utility can petition to increase its rates.
- Earnings can change due to change in sales, change in debt cost, new or unpredictable regulatory costs, and change in customer consumption patterns
- In all cases, rates must be adjusted to meet the Hope and Bluefield standards

