Is It Time for Smart Regulation to Reflect Tomorrow’s Realities?

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Who Is AEP?

- Industry-leading size and scale of assets
  - 39,000 MW generation
  - 38,953 miles transmission
  - 212,781 miles distribution
  - Annual sales: ~200 million MWh
- 5.2 million customers in 11 states
- 21,000 employees
- Coal & transportation assets
  - Control over 8,000 railcars
  - Own/lease and operate over 2,600 barges & 51 towboats
  - Coal handling terminal with 20 million tons of capacity
Smart regulation is...

“...enacted to protect the public interest inherent in the rates and services of public utilities. The purpose of this title is to establish a comprehensive and adequate regulatory system for public utilities to assure rates, operations, and services that are just and reasonable to the consumers and to the utilities.”

-- extracted from the Public Utility Regulatory Act of Texas
Incredible cost pressures will continue to plague industry/customers

- Environmental compliance
- Infrastructure expansion
- Aging infrastructure
  - Replacement costs for assets measured in multiples
  - Nationally, more than 100 power plants set to retire between 2010-2015
  - Generation, transmission and distribution
- Advanced metering, smart grid projects
- Renewable mandates
  - RPS programs have been enacted in 30 states and DC
  - National RPS may be enacted
  - Feed-in tariffs
- Energy efficiency
- O&M
  - Aging workforce
  - Healthcare costs
  - Pension funding
Investors’ perceptions of the utility industry are influenced by:

- Business model and operations
- Strength of the balance sheet
  - Debt/equity mix and cash flows
  - Capital budget requirements
- Stable and supportive regulatory environment
- Ability to fully and timely recover costs and earn authorized returns
Some alternative models

- Construction work in progress (CWIP) in rate base – Florida, Virginia, Georgia
- Single issue rate approvals/rate adjustment clauses (RACs) – Texas, Kentucky, Florida, Ohio, Virginia
- Future test years – Georgia
- Regulatory pre-approvals/multi-year strategic plans – Iowa
Some alternative models

- Formula rates – Louisiana, FERC
- Securitization – Texas, Pennsylvania
- Long-term strategic purchased power capacity contracts – West Virginia
- Incentive-based ratemaking – Tennessee, North Dakota
- Decoupling – Connecticut, Maryland, California
Some alternative models in AEP’s footprint

- Rate adjustment clauses (RACs exist in all 11 states)
- Formula-based rates (FERC/LA)
- Future test years (Michigan, Virginia)
- Pre-approval (Texas AMI, FERC for major transmission JVs)
- Cash return on CWIP (LA for Turk Plant)
Comprehensive alternative regulation plans in AEP’s footprint

**Virginia**
- Automatic rate reviews
- Forward-looking adjustments (similar to future test years)
- Use of periodic Rate Adjustment Clauses (RACs) for deferral and true-up recovery of certain major costs components
- ROE based on regional peer group performance
- Incentive adders (for items such as voluntary RPS compliance)

**Texas**
- TCOS (Transmission Cost of Service)
- TCRF (Transmission Cost Recovery Factor)
- EECRF (Energy Efficiency Cost Recovery Factor)
- AMI surcharge
- DCOS – proposed
Electricity is getting more expensive. We need tools to mitigate and manage costs in a manner that is compatible with customer’s and policy-makers expectations of service and price while satisfying all forms of regulatory compliance (e.g. environmental, reliability, program) and maintaining the financial integrity of the utility.

This is the challenge to *all* stakeholders.
Conclusion

**How can utilities help?**
- Manage spend.
- Evaluate least-cost strategies.
- Look for rate increase mitigation tools, especially for low-income consumers.
- Become more surgical in strategies and seek collaboration with stakeholders.
- Be creative.
- Educate.

**How can policymakers help?**
- Manage spend.
- Recognize that there is no quick fix and embrace multi-year strategies.
- Embrace tariff rates that send true price signals.
- Evaluate and encourage alternative ratemaking scenarios.
- Educate.
For more information

If you would like to receive an electronic version of AEP’s presentation on alternative regulation, e-mail Sherri Monteith at samonteith@aep.com.