



WHITE PAPER

# What to Know Before Your Next Rate Case

*How Better Financial Insight Can Help Regulated Utilities Improve Performance*



## INTRODUCTION

Regulated utilities depend on rate cases to set customer rates at a price that covers costs and allows shareholders to earn an adequate return. Conducted by the utility regulator, rate cases are a formal process where the utility presents evidence to justify a new rate. Rate cases help ensure a utility's continued financial performance, but the process itself can put considerable stress on a utility's normal operations, as they require extensive preparation and discovery under tight timelines.

Utilities face many challenges when preparing for a rate case, including the fact that financial systems don't track and manage how regulatory requirements impact operations and rate base. The information must instead be pulled from across the organization and then manually reconciled using spreadsheets and ad hoc queries. This approach increases the chance of errors and makes it difficult to run scenarios and do comprehensive analysis. Additionally, if a Commission or an intervenor challenges an assumption, it can be hard to track back to where the supporting data originated from.

The lack of visibility into regulatory performance has implications beyond the rate case. Without a full, in-depth view picture of how regulatory strategy impacts budgets and forecasts, the utility is at a disadvantage.

PowerPlan has designed a solution that addresses the unique challenges regulated utilities face. The Regulatory Management Suite (RMS) improves the process of gathering regulatory data, while providing insight into the entire regulatory environment.

In this white paper, you'll learn:

- Market trends influencing today's regulated utilities
- Operational challenges that impact regulatory performance
- How PowerPlan's RMS can address these challenges



## MARKET TRENDS INFLUENCING TODAY'S REGULATED UTILITIES

Regulated utilities face an array of market forces that threaten their ability to effectively earn revenue and an adequate return on equity (ROE) for shareholders. These include:

### *Flat Energy Demand*

During the mid-20th century, energy demand in the U.S. outpaced GDP, and from 1975 to 1995, the two tracked closely together. However, beginning in the mid-90s, demand flattened, and the U.S. Energy Information Administration now projects that it will remain flat for the foreseeable future.<sup>1</sup> Many factors have contributed to this decline, including more energy efficient technologies, the migration of manufacturing plants outside of the U.S. and the movement toward conservation.

The growth of distributed generation such as rooftop solar panels and other small-scale, on-site power sources, has had a two-fold impact on electric utilities. Not only are they selling fewer kilowatt hours, but in states with net metering billing programs, utilities are required to buy back excess electricity generated by customers at retail rates. These credits along with the reduced power load makes it difficult for utilities to achieve their authorized return level.

### *Lower ROE from Rate Cases*

Over the last seven to eight years, utilities have filed a higher number of rate cases, but the returns awarded have been significantly lower. The average authorized ROE for electric utilities fell from 10.48% in 2009, to 10.02% in 2013 and to 10.0% in the nine-months ended Sept. 30, 2014. For gas utilities, the average allowed ROE was 10.19% in 2009, fell to 9.68% in 2013 and declined further to 9.63% in the first nine months of 2014.<sup>2</sup> Many experts attribute this to

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<sup>1</sup> U.S. Energy Information Administration, Annual Energy Outlook 2014, May 7, 2014.

<sup>2</sup> "Quality Measures - Utility Parent Companies, 12-Months-Ended Sept. 30, 2014 and Calendar Years 2011-2013," SNL Energy, December 8, 2014.

the dramatic reduction in interest rates and its impact on the risk-free debt rate. The economy may also play a factor. In areas of the country where the economy is still weak, there is often a political disincentive to increase customer rates.

### *Rising Operating Costs and Increased Infrastructure Investment*

Natural disasters are taking a toll on the U.S.'s aging utility infrastructure, and modernizing it will require a massive capital investment by the utilities. Some estimates put the cost of unearthing, removing and replacing an old cast-iron gas main at more than \$1 million a mile.<sup>3</sup> For electrical utilities, the Electric Power Research Institute (EPRI) estimates that implementing a fully functional smart grid will cost between \$338 and \$476 billion dollars over a 20-year period.<sup>4</sup>

## **OPERATIONAL CHALLENGES AND OPPORTUNITIES FOR IMPROVEMENT**

As they face a difficult market environment, regulated utilities should consider ways to improve internal processes and address gaps in existing information systems. PowerPlan's RMS is designed to address some of the more common challenges utilities face in managing the rate case process and optimizing financial performance.

### *Optimize Data Gathering and Integrity*

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***"I always wish we had more time for analysis," VP of Regulatory***

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Most ERPs don't adequately track regulatory information associated with a utility's assets base, so during the rate case the data must be manually compiled using spreadsheets and ad hoc queries. Given the tight deadlines and the number of resources involved, there's often not enough time to run different scenarios, test assumptions or fully analyze the results. Many executives attribute a less-than-optimal rate case decision to not having enough time to conduct due diligence on the data.

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3 Kelly, John, "Look out below: Danger lurks underground from aging gas pipes," *USA Today*, Sept. 23, 2014

4 Electric Power Research Institute, *Estimating the Costs and Benefits of the Smart Grid*, March, 2011.

## INTERNAL ASSESSMENT

In evaluating your organization's preparedness for a rate case, consider the following questions:

- How well does your data and testimony tell the story you want told in the rate case?
- How long does it take you to get through an average rate case?
- How would you assess the results of your last rate case?
- How many resources are involved in the rate case process? What percentage is allocated to high-value activities (analysis) vs. lower-value activities (data gathering)?
- How confident are you in the integrity of the data?
- Are you able to respond to interrogatories in a timely fashion and with the appropriate level of detail?

## OPERATIONAL IMPROVEMENTS

Improving the rate case process begins by automating manual tasks wherever possible. PowerPlan provides a system that captures and stores all information required for a rate case—from financial and tax data to budgets and forecasts—on a common platform. This data is then automatically organized into a regulatory ledger which maintains automatic reconciliation to historical actuals while separately tracking adjustments. Some of PowerPlan's customers have reduced the time it takes to gather monthly data by almost 80%.



## Improve Analysis and Decision Making

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***“I wish I could quickly see how riders and other non-base rate items are impacting earnings,” CFO, Regulated Utility***

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Utility executives want the ability to quickly evaluate current regulatory performance and to make long-range forecasts, but the picture they have to work with isn't always clear. Without a comprehensive view of the regulatory environment, it can be difficult to accurately answer questions like, “when is the best time to go in for a rate case” or “how will this rider impact our earnings?”

### INTERNAL ASSESSMENT

In evaluating your organization's ability to assess and forecast regulatory performance, consider the following questions:

- Do you know the best time to go in for a rate case? Do you have a method by which to evaluate this?
- Can you predict what projected ROE will be before you go in for a rate case?
- How do you determine when to pursue alternative regulatory mechanisms and how do you measure their performance?
- How are you measuring the performance of alternative regulatory mechanisms?
- How do you manage multijurisdictional requirements?

### OPPORTUNITIES FOR IMPROVEMENT

Ongoing surveillance of your regulatory environment can provide the foundation for better rate case results and improve overall financial performance. PowerPlan delivers this insight with dashboards and reports that allow you to combine historical actuals with your multi-year forecast to determine what 12-month period would be most advantageous for a rate case. You can also monitor how well your alternative recovery mechanisms are performing and use the drill-back capability to better understand the underlying causes of variances.

Additionally, PowerPlan allows you to test assumptions and run scenarios on many different variables, allowing you to see at a granular level how changes impact the overall picture. This is particularly important for utilities that operate across multiple jurisdictions where the overall strategy has to take into account the requirements of different states or counties. With PowerPlan, you are able to make decisions supported by data that is looking forward instead

of backward. This insight opens the door for regulatory management to have a key seat at the table when talking about budgets, forecasts and strategic company direction.

### *Maintain Transparency and Telling the Story*

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***“Credibility is my only currency with my regulators,” VP of Regulatory Affairs***

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Given the competing goals of the rate case—a utility is seeking to justify an increased ROE while the regulators want to protect consumers from higher rates—it’s not surprising that the process has the potential to become contentious. That’s especially true today as intervenors tend to place more scrutiny on costs and conservation and ask for more detailed justification. Additionally, turnover within regulatory agencies means some newer regulators and intervenors may not fully understand the rationale behind a utility’s projected costs, so it’s important for utility executives to maintain open lines of communication.

#### INTERNAL ASSESSMENT

In evaluating your relationship with your regulator, consider the following questions:

- Do you feel your organization’s credibility with regulators has been compromised by data issues discovered during a rate case?
- How would you categorize your relationship with the regulator?
- What would you need to do to change the relationship for the better?

#### OPPORTUNITIES FOR IMPROVEMENT

Working more cooperatively with commissioners and their staff can reenergize your regulatory relationships, reducing any animosity and improving the overall rate case process. Building this transparency and trust starts with visibility into the data that the rate case was built upon and confidence that the data is correct. When you can’t quickly respond to interrogatories, or worse, when the answers you provide turn out to be incorrect, it can prompt regulators to probe more deeply.

PowerPlan allows you to view the financial detail that supports the rate case, giving you the information you need to quickly and confidently respond to regulators. This access and visibility provides an opportunity to work more collaboratively with the regulators. Rather than scrambling to get them the data, you can focus on what it means from a strategic standpoint.

## CONCLUSION

Regulated utility executives face tremendous pressure to improve financial performance despite flat market demand and a changing regulatory environment. At the same time, the internal systems they depend on for budgeting and forecasting lack the full regulatory perspective.

PowerPlan helps regulated utilities address this shortcoming by automating the capture of regulatory data and storing it on a common, integrated platform. From there, you can monitor regulatory performance on an ongoing basis and make adjustments based on different business scenarios. With this insight, you are better equipped to evaluate operations and determine alternatives based on the strategic goals of the organization.

If you would like to learn more about how PowerPlan's solution can help your regulated utility optimize performance, contact us at 770-859-0402.



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