

Developments in Regulatory and Ratemaking Mechanisms To Support Infrastructure Investment

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So you just purchased a small system



Mechanisms to support system investment: Broader

- Decoupling
 - Decouples revenues from sales
 - Ensures revenues = authorized revenue requirement
 - Supports investment, particularly for increased efficiency
- Formula Rates
- Rate Designs
- Not just an issue for water and wastewater systems

Mechanisms to support investment: more specific

- Infrastructure Riders
 - Provides specific recovery for infrastructure investments, often replacements
- Specific provisions in small system acquisition legislation
 - IL Systems Viability Act

Decoupling - Illinois

- Water Rider VBA (first approved in 2016; ICC Docket 16-0093)
 - Tariff provision to adjust for new system acquisition.
- Gas Rider VBA (pilot in 2008; approved on a permanent basis in 2012 and upheld by IL Supreme Court in 2013)
- SB 2814 Future Energy Jobs Act (FEJA) Decoupling provisions
 - Electric utilities may file Revenue Balancing Adjustment Tariff to adjust under- or overcollections of distribution revenues as compared to the revenue requirement approved by the Commission. (New 220 ILCS 5/9-107)
 - Revenue Balancing Adjustment Tariff is filed outside the context of a general rate case or formula rate proceeding. Utilities are required to submit an annual revenue balancing reconciliation.

Developments: Other States' Decoupling Provisions

- Recent Legislative Activity
 - Michigan: PA 341 (2016) allows Commission to approve revenue decoupling mechanism for electric utilities with fewer than 200,000 customers in the state. Mich. Comp. Laws 460.6a(12).
- Older Legislative and Commission Activity
 - Ohio: SB 221 (2008) authorized revenue decoupling mechanisms for electric and natural gas companies. Ohio Rev. Code 4928.143 (B)(2)(h), 4929.051.
 - Indiana: Ind. Code 8-1-2.5 allows utilities to submit alternative regulatory plans; gas utilities have been approved for decoupling mechanism under this section (Sales Reconciliation Adjustment).
 - Wisconsin: In 2008, Commission approved decoupling as a Revenue Stabilization Mechanism and allowed the Wisconsin Public Service Corporation to pursue a four-year pilot program. Pilot program was extended in 2012.
- States with decoupling for water utilities: California, Nevada, Arizona, New York, Connecticut

Investment provisions in Illinois Systems Viability Act

- Illinois 2013 Water Systems Viability Act, 220 ILCS 5/9-210.5
 - Post-acquisition improvements made by the large utility:
 - accrue a cost for financing set at the utility's rate for allowance for funds used during construction (AFUDC), and
 - are not depreciated for ratemaking purposes,
 - for four years or until next rate case, whichever comes sooner.

Infrastructure Riders - Illinois

- Water Surcharge: Section 9-220.2 of the Illinois Public Utilities Act, enacted in 2000. 220 ILCS 5/9-220.2
- The Commission may authorize a water or sewer utility to file a surcharge that provides for recovery of costs associated with investment in “qualifying infrastructure plant”.
 - “Costs associated with an investment in qualifying infrastructure plant” include:
 - a return on the investment in, and depreciation expense related to, plant items or facilities (including, but not limited to, replacement mains, meters, services, and hydrants) which:
 - are not reflected in the rate base used to establish the utility's base rates, and
 - are non-revenue producing.
- The surcharge may operate on an historical or a prospective basis.
- Also: Illinois gas QIP surcharge - 220 ILCS 5/9-220.3(g).

Developments : Other States' Infrastructure Surcharge Programs

- Indiana Distribution System Improvement Charge (DSIC) – Ind. Code 8-1-31-1 *et seq.*
 - DSIC may not produce revenues of more than 10% of the utility's base revenue level.
 - Utility must reconcile DSIC revenues against actual infrastructure improvement costs and refund/surcharge the difference.
- Missouri Infrastructure Replacement Surcharge (ISRS) - Mo. Rev. Stat. 393.1000 *et seq.*
 - Permits recovery of costs for eligible infrastructure replacements in a county with more than 1 million inhabitants.
 - ISRS must produce at least \$1million in revenue, but no more than 10% of total utility revenue annually.
 - Utility may not use ISRS for more than 3 years without filing a rate case.
- Ohio Infrastructure Improvement Charge (IIC) – Ohio Rev. Code 4909.172
 - Surcharge may not exceed 4.25% (water) or 3% (sewer) of the total rates applicable to any class.
- Other States: California, Connecticut, Delaware, New Hampshire, New Jersey, New York, Pennsylvania

Developments: Fair Market Value Legislation

- Fair market value legislation applicable to water and sewer service utilities allows large public utilities to elect for the Commission to establish the ratemaking base of a smaller utility during an acquisition. Creates certainty regarding the recoverability of the large utility's investment.
- Missouri: Acquisition of Small Water Utilities HB 142 (2013), Mo. Rev. Stat. 393.320.1.
 - Ratemaking rate base of small water utility established as the lesser of the purchase price and an appraised value. Appraisal must be prepared jointly by three appraisers.
- Illinois: Water Systems Viability Act HB 1379 (2013), 220 ILCS 5/9-210.5.
 - Ratemaking rate base of small water utility established as the lesser of the purchase price and an appraised value. Appraised value is chosen as the average of three appraisals.
- Indiana: Ind. Code 8-1-30; Acquisition of Distressed Water or Wastewater Utilities HB 1319 (2015), Ind. Code 8-1-30.3.
 - Upon finding a system in violation under Ind. Code 8-1-30-4, Commission may provide for the acquisition of a violating utility at fair market value, and must specify the appraisal procedures by which the fair market value of the subject utility is to be determined.
 - In the acquisition of a distressed water or wastewater utility under Ind. Code 8-1-30.3, acquiring utility may include the difference between the purchase price and the original cost of the system in its rate base.
- Other States with Fair Market Value legislation: California, Pennsylvania, New Jersey

Recent Illinois Development: Revisions to QIP Surcharge Rules



Illinois QIP Rules

- The Commission's Part 656 Rules, "Qualifying Infrastructure Plant Surcharge"
 - 83 Ill. Admin. Code §§ 656.10, *et seq.*, adopted in 2001.
 - Implement Section 9-220.2.
- The Part 656 Rules established a surcharge mechanism that permits water and sewer utilities to recover a return on, and depreciation expense related to, their annual investment in certain QIP.
 - Specifically, replacement of water transmission and distribution mains, services, meters, hydrants, and collecting sewers (force and gravity) and sewer services.
- The first QIP surcharge rider was authorized in 2001.

Basic Requirements for QIP

- Plant additions are replacements of existing plant items in designated accounts;
- The replacements must be non-revenue producing;
- Installed to replace facilities that are worn out or deteriorated or that are obsolete and at the end of their useful service lives due to a change in law or a change in the regulations of a governmental agency;
- Installed after the conclusion of the test year in the utility's latest rate case for the rate zone; and
- Not included in the calculation of the rate base in the utility's last rate case for the rate zone.

83 Ill. Admin. Code § 656.40(a).

Original QIP Rules

- 5% static surcharge cap
- Eligible Infrastructure and Costs:
 - Replacement of facilities in:
 - Water accounts 331 (mains), 333 (services), 334 (meters), 335 (hydrants)
 - Sewer accounts 360/361 (collecting sewers), 363 (services)
 - Main extensions for water utilities that are constructed to eliminate dead ends
 - Unreimbursed costs associated with relocations of mains, services, hydrants and sewers occasioned by street or highway construction
- QIP surcharge revenues that cause utility revenues to exceed the overall rate of return authorized by the Commission in the utility's last water or sewer rate case are treated as a credit to customers

Key Revision 1 – Percent Cap

- Revised rule modifies the annual 5% cap to an annual average increase of 2.5%, with an ultimate cap of an increase no greater than 3.5% in any year.
- Matches methodology of Illinois gas QIP surcharge. 220 ILCS 5/9-220.3(g).

Key Revision 2 – Expanded Accounts

- Expanded eligible QIP to include replacement of other non-rate base, non-revenue producing aging plant items or facilities, such as
 - pumping equipment;
 - generators; and
 - treatment equipment.
- Also permits recovery of certain rehabilitation projects—to eliminate water loss from water main breaks and to eliminate inflow and infiltration—even if they are not undertaken in replacement of other facilities.

83 Admin. Code 656.40(c)-(d).

Original Water Accounts

- 331– Transmission and Distribution Mains:
 - Air chambers; Blow-offs and overflows; Bridges and culverts; Electrolysis control equipment; Gauges and recorders; Meters and appurtenances; Pipes; Fire mains.
- 333 – Services:
 - Corporation stops or tees; Gate valves and boxes; Pipes; Service or curb boxes; Service or curb stops (curb stop cocks); Tapping main; Tapping saddle.
- 334 – Meters and Meter Installations:
 - Meter fittings, connections and shelves; Meter vaults or boxes; Stops.
- 335 – Hydrants:
 - Hydrants and fittings, including barrel and shoe; Pipe including leads and drains; Tee at main; Valves and valve boxes.

New Water Accounts

- 304 – Structures and Improvements
- 305 – Collecting and Impounding Reservoirs
- 306 – Lake, River and Other Intakes
- 307 – Wells and Springs
- 308 – Infiltration Galleries and Tunnels
- 309 – Supply Mains
- 310 – Power Generation Equipment
- 311 – Pumping Equipment
- 320 – Water Treatment Equipment
- 330 – Distribution Reservoirs and Standpipes
- 336 – Backflow Prevention Devices

Original Sewer Accounts

- 360 – Collecting Sewers – Force.
- 361 – Collecting Sewers – Gravity.
- 363 – Services to Customers:
 - Service sewers, from collection sewer to the customer's property or curb line.

New Sewer Accounts

- 354 – Structures and Improvements
- 355 – Power Generation Equipment
- 362 – Special Collecting Structures
- 364 – Flow Measuring Devices
- 365 – Flow Measuring Installations
- 366 – Reuse Services
- 367 – Reuse Meters and Meter Installations
- 370 – Receiving Wells
- 371 – Pumping Equipment
- 374 – Reuse Distribution Reservoirs
- 375 – Reuse Transmission and Distribution System
- 380 – Treatment and Disposal Equipment
- 381 – Plant Sewers
- 382 – Outfall Sewer Line

Other Recoverable Investments

- Water main lining and related rehabilitation projects to eliminate water loss from water main breaks.
- Sewer collection main and manhole lining/grouting for sewer utilities that are rehabilitating collection systems to eliminate inflow and infiltration, as well as rehabilitation of sewer structures and receiving wells when rehabilitated as part of the scope of eliminating inflow and infiltration.

Key Revision 3 – Expanded Audit and Information Requirements

- Requires annual internal audit reports.
- Audit determines whether the QIP surcharge and information provided under the annual reconciliation have been calculated properly, including whether:
 - Internal controls are effectively preventing the double recovery of costs through the QIP surcharge and other approved tariffs;
 - Costs recovered through the QIP surcharge are recorded in the appropriate accounts;
 - Costs recovered through the QIP surcharge are properly reflected in the calculation of the QIP surcharge percentage and the annual reconciliation;
 - The QIP surcharge percentage and annual reconciliation properly reflect all applicable adjustments from prior QIP surcharge reconciliation orders;
 - The QIP surcharges are properly calculated; and
 - The QIP surcharge percentage is being properly billed to customers.

83 Ill. Admin. Code § 656.100.

Expanded Audit and Information (cont.)

- Annual reconciliation filing must include testimony and schedules that support the accuracy and prudence of the qualifying infrastructure investment for the reconciliation year. 83 Ill. Admin. Code § 656.80(a).
- The schedules must:
 - reflect all carry forward adjustments from prior QIP surcharge reconciliation orders; and
 - address how adjustments ordered in prior QIP surcharge reconciliations are reflected in the current reconciliation. 83 Ill. Admin. Code § 656.80(a).
- Following the final order in each rate case, the utility shall file a public document in the rate case that provides the calculation for specified QIP components. 83 Ill. Admin. Code § 656.60(b)(2).

Important Customer Protections Retained

- Annual reconciliation filing with ICC. See 83 Ill. Admin. Code § 656.80.
- Continue to impose a cap on annual QIP surcharge recovery. 83 Ill. Admin. Code § 656.30(a).
- Retain the “earnings test” which prohibits a utility from recovering QIP surcharge revenues that cause it to earn an actual rate of return that exceeds the overall rate of return authorized in the utility’s last rate case. 83 Ill. Adm. Code § 656.80(f)(4).

Revised Calculation of QIP Investment

- Revision to definition of QIP costs to reflect accumulated deferred income taxes:
 - The average forecasted cost of the investment in QIP for the rate zone for the operation year less forecasted accumulated depreciation and accumulated deferred income taxes (ADIT) in QIP for the rate zone for the operation year. 83 Ill. Admin. Code § 656.60(b).
- Same provision in Illinois gas QIP rules. See 83 Ill. Admin. Code § 556.60(b).