Rate Case Timing: Alertness or Auto-Pilot?

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A thoughtful regulator recently asked, "How frequently should we reset rates? Regularly—say, every two years? Only when someone asks? Or when some trigger gets pulled, like a new plant entering operation?"

The question has a technical side: Are the large cost drivers growing or shrinking? Are riders, surcharges, and adjustment clauses dominating the revenue picture? Is the utility over-earning or under-earning relative to the authorized return on equity?

But there is more to this matter than technique. Try rephrasing the question: "When setting rates, which works better—alertness or auto-pilot? Then consider these four thoughts.

Commission Role: Umpire or Initiator?

[*Tutorial for regulatory newcomers*: A utility's "annual revenue requirement" is the total dollars the utility needs annually to pay its prudent expenses, invest prudently in capital plant, pay down debt principal, pay interest on debt, and earn a reasonable return for shareholders. To get rates, we allocate the revenue requirement among customer classes, then divide each class's revenue requirement by the predicted sales to that class, yielding a rate of dollar/unit of sales.]

A utility's revenue requirement is a prediction, the sum of hundreds of cost accounts. At any point in time, every account's actual level deviates from the predicted. Traditional ratemaking assumes that these deviations, above and below the predicted levels, balance out. When there is imbalance, sustained and unidirectional, someone notices—then initiates a rate case. The theory works-if someone notices the imbalance and initiates.

The alert regulator therefore has a continuous monitoring system, distinguishing bumps from trends. When she sees the trend, she starts the rate case. Others can initiate a case as well, but the regulator's own preparation will keep her in the lead. For the alert regulator, a rate case is not a contest between the parties, with the regulator keeping score; a rate case is an inquiry led by the regulator, using the parties' information and expertise to produce a public-interest answer.

Commission Leadership: Will Customers Accept Rate Increases?

If a commission converts from umpire to initiator, does it risk appearing responsible for rate increases? Is this a bad thing?

Utility cost increases are inevitable. See the essay "Low Rates, High Rates, Wrong Rates, Right Rates." Long-deferred capital needs, renewables-induced transmission demands, broadband investment, gas pipeline safety, and aging water mains are facts we cannot ignore. We want the public to view these factors as public obligations to embrace, not utility profit-seeking to resent. The commission-as-initiator is better positioned to make this case. The regulatory leader treats customers not as victims to protect but as public-interest partners to persuade.

Commission-as-risk-taker has a second benefit: an incentive to mitigate unavoidable rate increases by finding cost decreases. In traditional ratemaking, the utility seeks to cut costs between¬ rate cases, because a dollar saved is a profit earned. But during a rate case, the utility's incentive is the opposite: argue expenses are high, creating a cushion for cost-cutting between cases. Knowing this, the commission can lean forward, instructing the utility to add testimony on operational efficiency options. The commission is not compelling the company to self-incriminate; the utility can argue against the cost cuts it has identified. But this self-exam will make the record richer. When else in regulation do we press for cost-effectiveness?

Commission Focus: Revenue or Performance?

The typical rate case is about rates: lining up revenue with cost. It treats the public as ratepayers. But if we view the public as customers of a service, we would use rate cases to test performance—to ensure that customers get what they pay for. If we time rate cases based on cost factors only, we focus more on revenue than on performance.

To erase this asymmetry, why not call for rate cases not only when actual costs trend away from the predicted, but when we learn of new cost-saving opportunities? By requiring the utility to report on the industry's newest best practices, regulators will have a basis for ordering cost savings. We can make performance the attention-equal of revenues by asking two annual questions: "What are the five main improvements that your industry has made in utility operations, planning, and investment?" and "What actions have you taken to embed those improvements in your company's culture and practices?" Rate cases will no longer be about revenues only.

Summing up: A utility initiates a rate case to have its revenues raised, not to have its performance assessed. The reactive regulator will address revenues. The active regulator will also pursue performance.

Commission Calibration: Are the Protagonists Aligned With the Public?

To regulate, we calibrate: We intervene as necessary, and only as necessary, to align a utility's business interest with the public interest. In the rate-case context, consider the two possible scenarios:

When rates are high relative to cost: The utility is not likely to propose a rate reduction. If the utility has better cost information than does the regulator, this situation—producing actual returns above authorized returns—can last indefinitely. This behavior is neither unlawful nor immoral; it is plain-vanilla profit pursuit. But it diverges from the public interest. (Some utilities do offer rate decreases, especially when necessary to retain customers.) So the alert regulator intervenes, by establishing rate case timing.

When rates are low relative to cost: One would expect utilities to seek rate increases timely. Like all public actors, though, utilities make political judgments, including delaying rate increases when the public is irritable. These decisions may seem public-spirited, but they can end up weakening the utility's finances or producing balloon increases later. Gradual, small rate increases are less disruptive-to personal finance and public trust-than infrequent but larger ones. So when rates are too low, the alert regulator again intervenes.

Conclusion

What seemed like a mechanical question—"How should we time rate cases?"— raises challenging questions of commission posture and preparedness. Connecting all the possible responses are two nouns-revenue and performance; and four verbs-initiate, lead, focus, and align.