

# Increasing Use of Surcharges on Consumer Utility Bills



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## EXECUTIVE SUMMARY

For many consumers, home utility bills are becoming more and more cluttered with new fees and surcharges to pay for everything from the investment in new gas pipelines to environmental compliance costs. The imposition of these surcharges are a departure from the traditional utility rate setting process, and regulators need to carefully evaluate utility requests for additional surcharges on a case-by-case basis to determine whether there is a proper balance of meeting utility needs and assuring ratepayer protections.

A surcharge is an additional fee imposed on a ratepayer's utility bill in addition to the base rate charge for utility service. In the past, surcharges were only approved by regulators in rare circumstances to address substantial, volatile and uncontrollable costs that, if *not* addressed outside of a base rate case, could threaten to harm a utility's financial health. Examples of such surcharges include fuel and purchased power adjustment mechanisms for electric utilities and gas cost recovery mechanisms for natural gas distribution utilities. In recent years, however, requests for other types of surcharges and tracking mechanisms by utilities have significantly increased.<sup>1</sup> Indeed, the National Regulatory Research Institute characterizes the use of cost trackers and mechanisms as the "latest trend."<sup>2</sup>

Utilities have requested surcharge rate mechanisms as a means to accelerate the recovery of a variety of costs, many of which are not volatile or uncontrollable. In some instances, the use of surcharges and other tracking mechanisms have proliferated so as to be baffling and expensive for consumers and burdensome for regulators to monitor.

Utilities say the surcharges are needed so they can make investments in aging infrastructure and comply with environmental regulations, among other claims, without compromising their financial health. Utilities also claim that the surcharges will result in smaller and less frequent rate increases as well as reduce the frequency of their general rate cases, which can be time consuming and costly to process.

But the increasing imposition of surcharges and other alternative ratemaking mechanisms can also defeat some of the primary principles of the rate-setting and regulatory review process. Besides increased costs to consumers, surcharges can also result in such additional undesirable consequences as reducing utility incentives to control costs and shifting utility business risks away from investors and onto customers.

Regulators need to carefully evaluate utility requests for additional surcharges on a case-by-case basis to determine whether there is a proper balance of utility and ratepayer needs. If the regulator decides to approve a utility's request to impose new surcharges on ratepayers, adequate safeguards to protect consumers are a must.

## INTRODUCTION

For many consumers, home utility bills are becoming more and more cluttered with new fees and surcharges to pay for everything from the investment in new gas pipelines to environmental compliance costs. Not only are these charges often confusing and frustrating to consumers, they also represent a shift from the traditional utility ratesetting process. A surcharge is an additional cost added to utility customers' bills. Surcharges are also referred to by other terms such as riders, adjustment clauses, recovery mechanisms, and cost trackers. The proliferation of additional fees and surcharges generally shifts risks away from utility investors and onto consumers. This report describes why consumers should be concerned about the shift toward utilities collecting more costs outside of the traditional rate structure. Descriptions of some types of fees and surcharges proposed and/or collected by the nation's major utilities are outlined in Appendix I of this report.

## HOW FEES AND SURCHARGES DIVERGE FROM THE TRADITIONAL METHOD OF SETTING UTILITY RATES

Utilities must petition state regulators to increase utility rates. Utilities submit a formal request to regulators containing their proposed rates to charge customers. The utility's request is reviewed in a formal proceeding, which is called a "rate case." Interested parties, such as representatives of residential or business customers, are allowed to intervene and review the utility's documentation to determine if the utility's request is reasonable. The case is resolved by a hearing and the regulators issue a formal decision.

The utility's requested rate is called a "revenue requirement" which is the amount necessary for the utility to cover its financial obligations associated with providing safe, reliable service to customers, along with earning a reasonable "return." Basic accounting and ratemaking principles serve as the foundation in setting rates to be charged by utilities to provide safe, reliable service. The primary purpose of utility ratemaking is to establish rates that allow a utility to recover its prudently<sup>3</sup> incurred operating and maintenance expenses, plus a fair return on its investment in assets that are used and useful<sup>4</sup> in providing utility service. Rates are calculated based on a "test-year" which is a 12-month period to be representative of operating conditions when the rates being established will be in effect.<sup>5</sup> Utilities are generally required to "net" all costs and benefits of operation at the time rates are set to avoid "cherry-picking" individual cost increases that may be offset by other cost decreases.<sup>6</sup> Under traditional ratemaking, utilities cannot change rates charged to customers outside of a rate case.<sup>7</sup>

Consumers are most familiar with seeing the "base rate" charge on their bills. The base rate is defined as the rate gas and electric utilities charge customers for the cost of providing safe and reliable service, which includes an opportunity for the utility to earn a fair return on its prudently incurred utility plant investment. The base rates are set by state regulators in a rate case, and are often segregated between the basic service charge, distribution, transmission and, for electric service, generation.<sup>8</sup>

In addition to base rates, most utilities assess a fuel surcharge (gas cost adjustment or fuel and purchased power adjustment) and revenue-based taxes in addition to the base rate charge. Typical “standard” charges that appear on a customer’s electric utility bill may include:

- Customer Charge: The basic charge to recover costs for billing, meter reading, equipment, maintenance, etc. (state regulated)
- Generation Charge (or Commodity Charge): Charges for the production of electricity, based on usage (state regulated in non-deregulated states)
- Transmission Charge: Charges for moving high voltage electricity from a generation facility to the distribution lines of an electric distribution company [regulated by the Federal Energy Regulatory Commission (“FERC”)]
- Distribution Charge: Charges for the use of local wires, transformers, substations, and other equipment used to deliver electricity to end-use consumers from the high voltage transmission lines (state regulated, only shown as a separate charge in deregulated states)
- Fuel and Purchased Power Charges
- State Taxes

Typical standard charges that appear on a customer’s gas utility bill may include:

- Customer Charge
- Gas Transmission or Distribution charge
- Commodity Charge
- Purchased Gas Adjustment (true-up)
- State Taxes

Other fees and surcharges fall into the category of “single issue ratemaking,” which is a deviation from traditional ratemaking. Single issue ratemaking involves “singling out” specific expenditures from a company’s base rates and allowing a utility to separately recover those costs from ratepayers. Singling out specific costs can make the traditional ratemaking formula unbalanced. For example, if a utility replaces a large piece of equipment at its plant, the new equipment will affect multiple aspects of the business. The utility’s rate base plant will increase, and revenues may increase, if the plant addition is to serve new customers. Future maintenance expenses may decrease if the addition improves efficiency. The lower maintenance costs, which would reduce rates for ratepayers, may not be reflected within a surcharge that focuses only on the new investment.

In the past, single issue ratemaking was typically approved by regulators only in limited situations for costs that were considered:

1. Largely outside the control of the utility,
2. Unpredictable and volatile, and
3. Substantial and reoccurring, and which would have the potential to adversely impact the utility's financial health if cost recovery is not addressed outside of a traditional rate case.

Examples of such volatile and unpredictable costs traditionally include fuel costs and purchased power costs for electric utilities, and purchased gas costs for gas utilities. In contrast, capital investments for plant additions or replacing aging infrastructure are not generally considered to be highly volatile, uncontrollable and/or unpredictable. Management can control these costs to some extent by comparison shopping materials and contractors. The timing of projects can also be adjusted based on availability of funds.

Yet in recent years, many other types of costs are being proposed by utilities to be recovered through surcharges that do not meet the above criteria.<sup>9</sup> The National Regulatory Research Institute characterizes the use of cost trackers and mechanisms as the “latest trend.”<sup>10</sup>

Allowing a utility to recover lost revenues or discrete increased costs through a surcharge can also diminish the utility's incentive to control or reduce expenses because the utility is assured of full cost recovery. Since the utility is passing the cost on to customers, it has less incentive to seek ways to reduce the expense. Furthermore, in a rate case, the utility's costs are carefully scrutinized, whereas cost increases recovered in surcharges can become part of utility rates on an expedited basis, without being subjected to the same degree of review. In rate cases, utilities must provide documentation justifying its requested costs or they may be disallowed. Reviews of costs recovered via surcharges are usually done on a much more limited basis. By allowing a utility to recover cost changes through a surcharge, rider or balancing account, the utility is assured of the recovery of such costs, therefore diminishing the utility's incentive to control expenses, and reducing the utility's financial risk.

## **SURCHARGES, TRACKERS AND OTHER COST RECOVERY MECHANISMS**

### **DEFINITIONS**

There are different types of “single issue ratemaking” which include surcharges, trackers, riders, and other cost recovery mechanisms.<sup>11</sup>

**Surcharge:** A surcharge allows a utility to separately charge customers for costs that would have otherwise been part of the utility's standard base rates. This means the utility recovers dollar-for-dollar the level of costs incurred or estimated to be incurred. A surcharge appears as an additional charge on a ratepayer's utility bill, above and beyond the base rates, fuel surcharge and taxes. Some surcharges are a flat rate while others fluctuate, either based on usage or changes in the surcharge rate.

Surcharges are also referred to as riders, adjustment clauses, recovery mechanisms, and cost trackers, etc. Many utilities use the term “rider” in their tariffs with respect to surcharges. However, some utilities use the term “rider” to designate rates for a particular class of service. For example, Georgia Power defines “rider” as a modification to an existing tariff rate.<sup>12</sup> In these instances the “rider” is a type of rate on a customer’s bill associated to that type of specific utility service, rather than an additional “surcharge”. Therefore, one must read the Company’s applicable tariff sheet to understand what the rider or surcharge actually represents. Utility tariff sheets may be written in technical language, and this may be hard to understand for many consumers.

Sometimes the entire cost recovered by a surcharge is excluded from base rates and recovered separately through the surcharge (e.g., fuel costs). In other instances, only the incremental portion or the difference between what is included in the base rates and the changes in the cost (e.g., in some states vegetation management or storm damage costs) are recovered through the surcharge. For instance, if a utility is allowed to recover \$10 million in base rates for tree trimming expenses, but actually spends \$11 million, and the utility has a surcharge mechanism in place for such costs, the \$1 million difference would be assessed as a surcharge to ratepayers.

A surcharge can either be a fixed rate or adjusted periodically as the cost element it covers changes (i.e., monthly, quarterly or annually). Changes in costs addressed by the surcharge are typically reviewed by regulators periodically (e.g., annually or quarterly). However, the level of review of utility costs charged to customers through surcharges is usually more informal, expedited and less rigorous than in contrast to the in-depth review that would typically be conducted in a full utility rate case.

For example, in a recent utility case in Nebraska the utility requested three adjustment mechanisms (weather normalization, a billing adjustment factor and an inflation factor). However, the state regulator denied the surcharges:

Such automatic mechanisms can lead to excessive rates, an inappropriate shifting of risks from stockholders to ratepayers, and decreased incentives to operate efficiently.

...

Therefore the rate mechanisms should be denied.<sup>13</sup>

**Balancing Accounts:** Another form of single issue ratemaking, referred to as “balancing accounts,” also can result in new surcharges on bills for utility service. A balancing account tracks the difference in a certain cost allowed in base rates and the actual cost.<sup>14</sup> California is one state regulatory jurisdiction that makes extensive use of balancing accounts.<sup>15</sup> The ratemaking regime in California has become particularly complex. The extensive use of balancing accounts and cost trackers has made it challenging and difficult for the regulators to adequately audit the proliferation of special mechanisms being used by utilities. California utilities have a traditional three-year General Rate Case (“GRC”) cycle, though the cycle has been extended beyond that in some instances. The utility’s base rates are developed using



forecasted amounts and typically are adjusted annually for inflation. An added complexity is that many issues affecting the utility’s base rates may also be addressed separately in other dockets. The California utilities also utilize a variety of mechanisms to recover costs separately from base rates: surcharges, adjustment mechanisms, balancing accounts and memorandum accounts.<sup>16</sup>

Some believe that the use of balancing (and memorandum accounts) by California utilities has become excessive. A recent California American Water Company (“CalAm”) General Rate Case demonstrates how the use of surcharges and other alternative rate mechanisms can get out of control. In Application No. A.10-07-007, CalAm had 79 existing balancing and memorandum accounts. CalAm had requested six additional balancing and memorandum accounts, which if approved, would bring the total to 84. The Department of Ratepayer Advocates (“DRA”), which is charged with looking out for the consumer interest, acknowledged that it did not have the resources to fully review the Company’s numerous accounts:

These advice letters are generally approved without audit. There is little opportunity to review the recorded amounts for reasonableness before the balances are recovered, unless DRA requests the opportunity to audit the balances or request for a suspension of the advice letter.<sup>17</sup>

**Exhibit 1** is a table summarizing the number of balancing and memorandum accounts utilized by some of the larger California utilities:<sup>18</sup>

<b>EXHIBIT 1</b>				
UTILITY	BALANCING ACCOUNTS	MEMO ACCOUNTS	OTHER ACCOUNTS	TOTAL
Southern California Edison (SCE)	21	24	16	61
Southern California Gas Co. (SoCal)	22	24	10	56
San Diego Gas & Electric (SDG&E)	22	33	7	62
Pacific Gas & Electric (PG&E)	32	35	15	82
California American Water Company	*	*	*	79
Golden State Water Company	9	29		38
Total Accounts for Regulators to Review	106	145	48	299
* Information regarding the breakdown of the different accounts was not located; as noted above, CalAm’s requests, if approved, would increase the total to 84.				

Trackers: Another single issue ratemaking mechanism is a “tracker” which involves recording or “tracking” costs in a specified account, which are later reviewed by regulators. The costs are not initially included in the utility’s base rates, but are accumulated or “set aside” for future review. They may be incorporated into the development of the utility’s base rates in its next base rate case or may show up as a separate charge on ratepayers’ bills. This type of mechanism is sometimes utilized to “track” whether the authorized level is being spent. In some situations, underspending by a utility of a “tracked costs” is eventually returned to ratepayers.

An example of utility expenses that have been “tracked” are vegetation management (tree trimming) costs. For example, a utility may have issues with its reliability and regulators may decide to monitor the level of the utility’s tree trimming expenditures as a means of assessing whether the utility is conducting an adequate level of maintenance near its wires and poles.

Another example of a cost that has been “tracked” and deferred by a utility for future review are storm damage costs. A utility may incur substantial repair costs to its distribution system as a result of a catastrophic storm. Some utilities have petitioned regulators to accumulate and defer the extraordinary storm repair costs for review and inclusion in rates at a later date, rather than merely recording such costs as expenses in the current period, which may result in utility investors bearing the risk of such costs if they result in the utility reporting lower earnings for that accounting period.

Depending on the definition of “tracker” in a particular jurisdiction, by allowing a utility to recover costs through a tracker account, the utility may effectively be guaranteed recovery of the tracked expense. Sometimes the deferrals are limited to a pre-specified level; in other cases, the subsequent recovery by the utility of the tracked cost may be subject to an “earnings test”. An earnings test may prevent the utility from subsequently charging all of the tracked/deferred costs to ratepayers if it would result in excess earnings.

## **SURCHARGES HAVE BEEN IMPOSED THROUGH REGULATION AND LEGISLATION**

A utility must obtain permission from its state regulator to apply an additional surcharge to customers’ bills. Typically, a utility will present the mechanics for its proposed surcharge to the regulator for approval. Consumer advocates and intervenors may participate in the proceeding and make recommendations to adjust or modify the utility’s proposal. The regulator will weigh the information and make its decision. Again, if a surcharge mechanism is approved, there are time and resource limits to the review of the costs, making it difficult for intervenors to participate. Once cost categories are approved for recovery in a surcharge, the categories can no longer be questioned, and the only aspect that can be disputed is whether the level of such costs are reasonable and prudently incurred to provide utility service. Some jurisdictions allow use of surcharges consistently between utilities, while others approve surcharges on a case-by-case basis.

In several states, surcharges have been adopted through legislation, often requiring the use of a surcharge and limiting the discretion of regulators. An example of where legislation now limits what the state utility regulatory commissions can do is the state of Virginia. Virginia has passed legislation allowing utilities to recover many types of costs through surcharges, includ-

ing environmental costs, costs for constructing new generation, generation and demand side management, and other types of costs.

In Utah, legislation has been passed allowing gas or electric utilities to recover the costs of major plant additions by filing an application for approval of a major plant addition within 150 days from the capital addition's scheduled in-service date. The statute defines "major plant addition" as "any single capital investment project of a gas corporation or an electrical corporation that in total exceeds 1% of the gas corporation's or electrical corporation's rate base."<sup>19</sup>

On October 26, 2011, the Illinois legislature overrode the Governor's veto of Senate Bill 1652, which became effective as Public Act 97-0616. Among those changes was the addition of a new Section 16-108.5 entitled "Infrastructure Investment and Modernization; Regulatory Reform." This legislation provides for utilities to file for a performance based formula rate plan process. On November 8, 2011 Commonwealth Edison Company, the state's largest utility, filed for a new tariff called Rate DSPP (Delivery Service Pricing and Performance), pursuant to that legislation. A formula rate plan is a mechanism or "formula" which resets a utility's rates annually, and is used in place of a rate case.

Due to the utility mergers and acquisitions over the years, many local utilities are now subsidiaries of large holding companies that have utility operations in multiple state jurisdictions. These large corporations have the resources to effectively lobby their positions to benefit their operations.

American Electric Power Company ("AEP"), one of the nation's largest electric utilities, affirms this by stating in its 2010 Form 10-K:

Given the long lead times in construction, the high costs of plant and equipment and difficult capital markets, we are actively pursuing strategies to accelerate rate recognition of investments and cash flow. AEP representatives continue to engage our state commissioners and legislators on alternative ratemaking options to reduce regulatory lag and enhance certainty in the process.

As another example, Xcel Energy, stated in its 2010 Form 10-K that:

Xcel Energy files periodic rate cases and establishes formula rate or automatic rate adjustment mechanisms with state and federal regulators to earn a return on its investments and recover costs of operations.

A utility's proposal for cost recovery under the legislatively authorized mechanisms are typically reviewed via the regulatory process, albeit on a limited basis, as described above. The review may be primarily performed by utility commission staff as active participation in reviewing a proliferation of utility surcharges by resource constrained consumer advocate groups is difficult to sustain.

**Exhibit 2** is a table summarizing types of costs utilities are charging customers through surcharges. This is not a comprehensive listing, but rather a summary to illustrate various types of surcharges that were identified in the process of preparing this report.

<b>EXHIBIT 2: EXAMPLES OF SURCHARGES</b>	
DESCRIPTION	STATES
Aging infrastructure	GA, KY, MO, NJ, OH
Decoupling/Weather Normalization	CA, GA, KS, KY, LA, MD, MS, NJ, NV, TN, TX, VA
Energy Efficiency/DSM/Conservation	CA, OR, MD, MA, SC, NC, IN, AR, KY, MI, OH, OK, TX, CO, IA, GA, FL, IL, MO
Environmental Compliance	WA, DE, NJ, IA, IN, KY, MN, SD, MI, OH, TN, TX, VA, GA, NJ, IL
Franchise Fees	MN, TX, AR, KY, LA, MI, VA, WV, GA, NJ, TN, IL, CO
New Plant (Coal, Nuclear)	AL, AR, GA, IN, MS
Pension/OPEB	MA, SC
Property Taxes	KS, MS
Renewable Energy	IL, NC, OH, MA, CA, IA, OR, UT, WA, CO, MN, NM
Smart Meters/Smart Grid	CO, OH, TX
Storm Damage	MA, OH, OK
Stranded Costs	CT, NH, NJ, MA
System Reliability/Vegetation Management	KS, OH, OK, TN, TX
Transmission Investment	OH, TX, VA
Uncollectibles	IA, IL, OH, NV
Universal Service/Low Income	AZ, CA, CO, DC, TX, GA, IL, OH, OR, UT, WA, MD

## WHY DO SURCHARGES, RIDERS AND ADJUSTMENT MECHANISMS PUT CONSUMERS AT RISK?

In many instances surcharges are unnecessary and are not beneficial to ratepayers. Surcharges are costs added to utility customers' bills in addition to the basic charge for providing safe and reliable utility service. Surcharges can effectively guarantee utilities recovery of their fluctuating costs, thereby, shifting financial risk away from the investors and onto consumers. The surcharge is often applied to consumers' bills without first being subject to a thorough review by regulators and consumer groups. Additionally, some surcharges may recover costs that are not necessary for providing basic safe and reliable service. Surcharges may put consumers at risk for being overcharged by utilities for basic utility service.

Reasons why surcharges pose a risk for consumers include:

### REDUCES THE UTILITY'S INCENTIVE TO CONTROL COSTS

In a rate case a utility is allowed a reasonable level of revenues to recover its operating expenses as well as an opportunity to earn a fair return on its prudently incurred investment in used and useful plant. In between rate cases, the benefit of any cost reductions would flow back to the utility as higher profits. For costs that are to be "tracked" through a surcharge, the utility is usually required to return any under-spending to ratepayers, so the utility is not benefitted by cost-cutting efforts. The surcharge can thus remove or reduce the utility's incentive to reduce costs. Guaranteeing recovery of a specific expense reduces the utility's incentives to control costs, and thus shifts the burden of cost increases between rate cases from shareholders onto ratepayers.

### REVIEW OF SURCHARGES IS TYPICALLY MORE LIMITED

Utilities typically submit reports to regulators for costs recovered via a surcharge on an annual or quarterly basis. This usually involves submitting some calculations and workpapers identifying and supporting the amounts. The review by regulators is typically conducted on an expedited basis, as opposed to the thorough review that would typically occur in a full rate case. In rate case, a thorough review of costs can also be conducted by intervening parties, and the utility must adequately support its costs or they risk being disallowed.

### VIOLATION OF THE MATCHING PRINCIPLE, A FUNDAMENTAL ACCOUNTING AND RATEMAKING PRINCIPLE

A key concept in accounting and ratemaking is the matching principle. The matching principle involves matching revenues with related expenses and investments in the time period they occur. Accounting and ratemaking require the cost of capital investments to be spread over the period in which they will be used. Capital investments, such as replacement of equipment at the utility's plant can produce efficiencies such as reducing future O&M costs or enable new revenues. If the cost of the capital expenditure is recovered through a surcharge, these efficiencies may not be captured in the surcharge. Recovering capital investments via a surcharge can thus violate the matching principle.

### UTILITY MAY OVER-COLLECT THESE COSTS

In some cases, the utility may overestimate the costs to be recovered. Therefore, it may over-collect these costs from ratepayers. For example, if a utility collects a surcharge to fund

the cost of a new plant or a large piece of equipment while it is still being constructed, the amount being collected from customers may be more than the actual cost. While the funds should ultimately be returned to ratepayers, until then, these funds can be used by the utility and represent a source of cost-free capital to the utility.

For example, San Diego Gas & Electric Company stated in its current 2012 general rate case (“GRC”), in its direct testimony, that its Advanced Metering Infrastructure Balancing Account (AMIBA) was forecasted to be \$48.546 million overcollected on the electric side and \$6.33 million overcollected on the gas side at December 31, 2011. This means that the utility collected \$54.876 million more from customers than it needed. The Company also stated that it forecasted its Distribution Integrity Management Program Balancing Account (DIMPBA) and Research Development & Demonstration Expense Account (RDDEA) to be over-recovered by \$3.304 million and \$0.191 million, respectively. The RDDEA was authorized in D. 08-07-046 and went into effect on January 1, 2008. The Company was collecting the surcharge from customers for most of the year; however, the Company stated the related R&D program spending did not begin until late in 2008.<sup>20</sup>

There is also the risk that overpayment of costs may be not be returned to customers, because if the surcharge costs are reviewed only on a cursory basis, any errors or overcharges may not be detected and/or returned to customers.

## JUSTIFICATIONS FOR SURCHARGES DO NOT HOLD UP

Below are some reasons utilities may use to justify the use of surcharges, along with a comment concerning why the reasoning may be invalid.

### FREQUENCY OF GENERAL RATE CASES

Utilities may cite reduced frequency of general rate cases, which can be costly to litigate, as a reason for surcharges. The purpose of general rate cases is to thoroughly evaluate the utility’s rates and costs for reasonableness. Eliminating or bypassing that opportunity to review the utility’s costs may result in costs being charged to ratepayers without adequate regulatory scrutiny. Implementation of surcharges may also result in burdening regulators with additional work, as they will need to review these surcharges between general rate cases.

### “RATE SHOCK”

Utilities will sometimes argue that surcharges and trackers reduce “rate shock” because the surcharge produces smaller, more frequent rate increases, rather than a future sharp hike in rates from a base rate case. In a rate case, many factors comprise a utility’s base rates: capital structure, capital investments, and operating expenses. While some costs may increase, they could be offset by decreases in other expenses. A rate case review may not necessarily result in a rate increase. A utility may be found to be over-earning and rate decrease may be ordered. Therefore, one cannot assume that utility base rate cases will always result in larger rate increases.

### AGING INFRASTRUCTURE

Many utilities have requested surcharges to recover the costs of investments to upgrade aging infrastructure. However, utility capital expenditures are not volatile or outside the control of a utility. Management is able to influence the timing and extent of these costs. Utilities, similar to

other non-regulated companies, issue bids for large scale projects to evaluate the most cost-effective options. Maintaining and upgrading the utility infrastructure is a normal aspect of operating a utility. Also, cost efficiencies may result from the improvements, but such savings may not be recognized as an element that reduces the surcharge.

#### COMPLIANCE WITH ENVIRONMENTAL REGULATIONS

Similarly, a utility might cite expenditures that it must make to comply with environmental regulations as a reason to implement a surcharge. This is not a new concept. Environmental regulations have been in existence for many years and are continuously evolving. Complying with environmental regulations is also a normal aspect of operating a utility. How best to deploy capital and O&M resources to comply with these regulations is not entirely outside the control of a utility. Also, cost efficiencies associated with the environmental investment may not be recognized as an offsetting element that reduces the surcharge.

#### SITUATIONS WHERE TRACKING MECHANISMS BENEFIT CUSTOMERS

There have been limited situations where surcharges have benefited customers. As one example of this, in the 1980s, Entergy implemented a return sharing mechanism in Arkansas which was primarily weather driven. The effects of the hot summer weather that had not been captured in the base rate case generated higher revenues for the Company and customers received credits on their bills.

### RECOMMENDED CONSUMER SAFEGUARDS

When regulators are considering whether to allow certain expenditures to be recovered via a surcharge or other special rate mechanism the following consumer protections should be considered, and included, if a surcharge is approved:

#### COST RECOVERY SHOULD BE SPECIFIC

If a surcharge is approved, it should be strictly for the specific expenditure. The surcharge should not contain multiple types of costs or be vaguely defined, which will make reviews difficult. The surcharge should not be allowed to be expanded at a later date to include additional items. As an example, of surcharge coverage expansion, Atlanta Gas Light was permitted to implement a pipeline replacement surcharge to recover costs associated with implementing an aging pipeline replacement program over a ten year period. The need to replace aging pipe to address safety issues resulted from an investigation of the utility's alleged violations of minimum federal safety standards. Years later, the utility proposed and was allowed to expand this surcharge to include other types of capital costs associated with installing new distribution pipeline and infrastructure upgrades that were not strictly related to addressing the public safety concerns that were the basis for allowing the original surcharge.

#### NUMBER OF SURCHARGES SHOULD BE LIMITED

A utility should not be permitted to have a complex myriad of surcharges and trackers. This defeats the purpose of reducing rate cases and the rate setting process in general and places a bigger burden on the regulator to have to monitor numerous surcharges outside of rate cases.

The extensive use of surcharges, trackers, memorandum accounts, and other recovery mechanisms by California utilities has resulted in an almost overwhelming burden on regulators and consumer advocates.

#### TIME PERIOD OF SURCHARGE SHOULD BE DEFINED, NOT INDEFINITE

The surcharge or tracker should be for a set time period rather than indefinitely. For example, some states have implemented revenue decoupling as a pilot. After the pilot period, regulators can then review the results to determine the cost-effectiveness of implementing the special rate mechanism and determine whether it should continue.

#### MECHANICS OF SURCHARGES SHOULD BE STRUCTURED TO BENEFIT THE RATEPAYER

The surcharge should be structured so that cost overruns are absorbed by the utility and under-spending is returned to ratepayers. Some of the utility cost tacking accounts used by California utilities have this feature. A “one-way” balancing account, for example tracks and returns utility under-spending for the tracked cost (such as tree-trimming) to ratepayers.

#### RELATED COST SAVINGS AND EFFICIENCY IMPACTS SHOULD BE INCORPORATED

If the surcharge is to recover costs associated with replacing plant equipment, or for investments which improve efficiency, an efficiency factor to reflect lower O&M costs should be considered.

#### LOWER RETURN ON EQUITY (“ROE”) TO REFLECT REDUCED RISK

A utility’s ROE is the return investors expect, or require, in order to invest in the Company. In a rate case, utilities request a specific ROE percentage which is reviewed by the parties and a fair and reasonable ROE is authorized by the Commission. While a utility’s ROE is based on several factors, depending on the utility’s specific circumstances, a reduction in ROE may be appropriate if a surcharge is approved. A portion of the Company’s business risk has been transferred from investors and is now being borne by ratepayers.

#### REDUCE FREQUENCY OF RATE CASES

Many utilities allege that surcharges will reduce the frequency of rate cases or large rate increases. A possible condition for approving a surcharge could be that the utility agrees to not file for a base rate increase for a specified period. Conversely, if a utility has annual rate cases or multi-year rates, a surcharge may not be necessary as the utility’s rates are already being adjusted more frequently.

#### AVOID APPROVAL OF NEW SURCHARGES IN A SETTLEMENT

Although settlements are typically non-precedential (i.e., non-authoritative) if a surcharge is approved in a settlement, it may be unlikely or difficult to have it reversed or denied in future proceedings. Also, other utilities may imitate and cite the use by the existing utility as justification for their proposed surcharges for similar costs.

#### AUDIT/REVIEW FOR PRUDENCE AND REASONABLENESS

If a surcharge is approved to recover costs associated with a substantial project such as construction of a new power plant, significant environmental retrofits, or Smart Grid, a recommendation could be made that a full audit or a detailed review of the prudence and reasonableness of the costs should be conducted. For example, the Mississippi PSC is conducting



a prudence review of the costs associated with Mississippi Power Company's (MPCo) Integrated Coal-Gasification Combined Cycle ("IGCC") Plant that is currently under construction in Kemper County. MPCo is proposing to recover the Construction Work In Progress ("CWIP") financing costs associated with the Kemper Project through a surcharge.

## RECENTLY PROPOSED SURCHARGES THAT HAVE BEEN DENIED

Regulators are still relying on traditional ratesetting and have not been persuaded by utilities' requests to implement surcharges. Below is a brief discussion of some recent instances:

### PENSION/OTHER POST RETIREMENT BENEFITS (OPEB)

Narragansett Electric (d/b/a National Grid), Rhode Island; Docket No. 4065 (2010). The Company proposed a mechanism to recover pension and other post employment benefits expense incurred each year over the amount included in base rates. The Rhode Island Commission denied Narragansett's request. The Order stated:

...the Commission finds that this expense is a business risk that should be managed by the Company like any other business risk facing a business enterprise. Also important to note is that the State of Rhode Island, whose pension fund is severely underfunded, has not proposed that the Rhode Island taxpayers be burdened with a reconciling mechanism to ensure adequate funding of the state pension program. The General Assembly has proactively modified the existing plan to address this underfunding by changing the benefit eligibility, increasing the level of employee contributions, among other options under consideration.

Delmarva, Maryland; Docket No. 9093 (2007). The Company requested a Pension and Other Post-Employment Benefits ("POPEB") rider, to capture yearly differences between the pension and OPEB costs embedded in the Company's base rates and the actual expenses properly chargeable to the Company's distribution operating costs. The Maryland Commission denied the Company's request. The final Order stated:

Implementation of a tracker mechanism is an extraordinary form of ratemaking usually reserved for very large expense items that have the potential to impair seriously a utility's financial well-being, which is not the case here for OPEB and pension costs. We therefore deny the Company's request for a POPEB rider.

Delmarva, Delaware; Docket No. 09-414 (2011). Delmarva proposed a surcharge mechanism called a Volatility Mitigation Rider ("Rider VM") to collect a rolling three-year average of pension, OPEB and uncollectible expenses, which it claimed were volatile and largely beyond its control. The Delaware Commission denied the Company's request and stated in its Decision:

These are normal utility expenses; allowing dollar for dollar recovery of them would depart from traditional ratemaking practices and would reduce Delmarva's incentive to try to control them. We also note that our sister commissions in Maryland and

the District of Columbia rejected the same proposal when Delmarva and its affiliates presented it to them, and we find their reasoning convincing. Thus, for the reasons advanced by Staff and the DPA, we reject Delmarva's request to implement Rider VM.

## ENVIRONMENTAL COMPLIANCE COSTS

Kansas City Power & Light, (KCPL) Case No. 11-KCPE-581-PRE (2011)

KCPL requested recovery of environmental upgrade costs at its La Cygne Plant through a surcharge. The Commission's decision to deny the surcharge was based in part on an observation that "the potential future cost that utility companies will undoubtedly expect customers to bear is presently unforeseeable or speculative at best, but undoubtedly will be significant."

## DECOUPLING

Many utilities have claimed that they require "revenue decoupling" in order to eliminate disincentives which prevent them from vigorously promoting energy-efficiency.

Despite the utility industry's attempt to convince regulators that decoupling is the latest concept, several states are still reluctant to implement decoupling mechanisms.<sup>21</sup> For example, Connecticut denied two utilities' requests for decoupling, despite legislation enacted permitting decoupling (Connecticut Light & Power; Docket No. 09-12-05; 2010, and Connecticut Natural Gas; Docket No. 08-12-06; 2009).

The following states have also rejected decoupling mechanisms:

- Indiana, Southern Indiana Gas; Cause No. 43839 (2011)
- Montana, Northwestern Energy; Docket No. D2009-0-129 (2011)
- Tennessee, Piedmont Natural Gas; Docket No. 09-00104 (2010)
- Rhode Island, Narragansett Electric (d/b/a National Grid), Docket No. 3493 (2009)

In the above cases, the regulators decided to reject decoupling because benefits to customers were speculative and the risk was shifted away from the company and onto customers.

Notably, the regulator's order in the Narragansett case stated:

Revenue decoupling would protect the Company from revenue declines attributable to any causes, not only conservation and efficiency efforts. . . . Over the last four years, decoupling would have resulted in an additional \$34 million payment to the Company.

One of the concerns about decoupling is that it insulates utilities from economic conditions such as the impacts of a recession. As Dr. David Dismukes has explained:

Decreases in sales associated with economic downturns have nothing to do with energy efficiency programs offered by the Company. Instead, they are the natural reaction of households trying to reduce their expenditures during difficult economic times of, or alternatively, businesses and industries idling or shutting down their operations. Under revenue decoupling, ratepayers would be required to make a utility whole for

revenue losses during these economic downturns, whereas under traditional regulation, utilities bear the risk of these economic contractions, just like many other types of businesses and industries.<sup>22</sup>

On January 26, 2009, Detroit Edison Company (“DTE”) filed an application with the Michigan Public Service Commission (“MPSC”), Case No. U-15768. Among other things, DTE requested that the MPSC approve an electric rate decoupling mechanism and an advanced metering infrastructure (“AMI”) program. Both of those requests were approved by the MPSC in its January 11, 2010 order. On April 10, 2012, DTE’s electric rate decoupling mechanism and the AMI program funding mechanism were rejected by the Michigan Court of Appeals.<sup>23</sup> The Court ruled that the MPSC did not have the authority to direct or approve decoupling for electric utilities, but only had authority to conduct research and report on the operations of a decoupling mechanism with electric utilities. Michigan Statute MCL 460.1097(4) states that:

[T]he commission shall submit a report on the potential rate impacts on all classes of customers if the electric providers whose rates are regulated by the commission decouple rates. . . . The commission’s report shall review whether decoupling would be cost-effective and would reduce the overall consumption of fossil fuels in this state.

The Court also ruled that DTE’s AMI program funding that had been approved by the MPSC “was unreasonable, because it was not supported by ‘competent, material and substantial evidence on the whole record’.”<sup>24</sup> The Court noted that the Manager of the Energy Efficiency Section in the Electric Reliability Division of the MPSC had agreed that the AMI was not commercially tested, and required large amounts of capital, which could result in great economic risk and highly impact rates. No alternative considerations were discussed, nor were the needs for AMI or the net-benefits (if any) to the affected customers. The Court also stated that in reviewing the MPSC’s decision, it “will not rubber stamp a decision permitting such a substantial expenditure—a cost to be borne by the citizens of this state—that is not properly supported.”<sup>25</sup>

## CAPITAL ADDITIONS

In New Mexico, in a 2011 decision, the commission rejected a stipulated capital additions rider for Public Service New Mexico Company, stating such a rider would represent “a major departure from and violation of the Commission’s long-standing policy against piecemeal ratemaking.”

In a recent Washington Gas Light Company (“WGL”) rate case (Case No. 9267) the Maryland Public Service Commission’s order issued on November 14, 2011 rejected WGL’s request for an automatic surcharge on all customers to improve its distribution system. In denying that request, the Commission found that WGL was capable of carrying out a pipeline replacement program and ensuring the safety and reliability of its distribution system without getting automatic cost recovery through a surcharge:

Although we agree fully with the Company that safe and reliable infrastructure is its highest priority and that it should accelerate its program to replace pipe, we decline to authorize a surcharge for the recovery of future pipe replacement expenses. Based on the record in this case, we find that the Company has historically demonstrated the ability to replace its

infrastructure when necessary to ensure safety and reliability, and that it can do so using traditional ratemaking procedures without compromising its ability to earn an appropriate return. The Company's witnesses confirm that WGL has the operational and financial ability to accelerate its existing pipe replacement program, and we authorize the Company to do so. But the mere fact that the Company plans increased infrastructure investments does not justify a surcharge, which would represent a fundamental shift from long-standing rate-making principles. To the contrary, the record in this case demonstrates that the Company can invest significant amounts in infrastructure and can readily recover those costs in rates with an appropriate return. . . . We recognize that accelerating its pipe replacement program may require the Company to file somewhat more frequent rate cases than it would prefer. That is not, in our view, a negative outcome—rate cases afford all parties, and this Commission, the opportunity to ensure that rates are just and reasonable, and we understand that accelerated infrastructure investment may require more frequent adjustments. But ratepayers and the Company are better served if base rates are adjusted more frequently in smaller increments, and waiting longer between rate cases could lead to other undesirable results, including greater mismatches between costs and rates.

## CONCLUSION

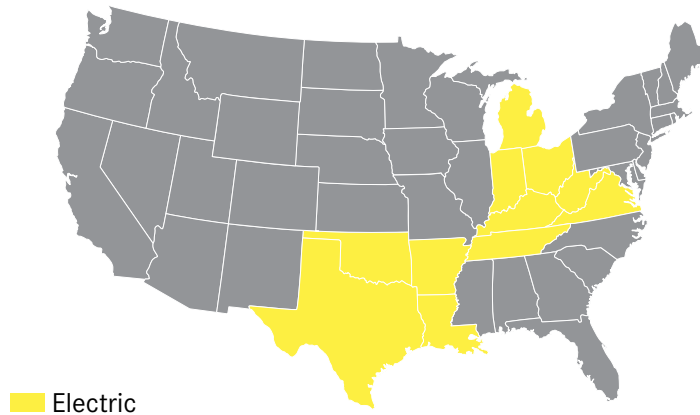
In the past, surcharges were only permitted in limited circumstances for costs that were substantial, volatile and uncontrollable, and that could harm the utilities' financial health. Examples of such traditional surcharges include fuel and purchased power adjustment mechanisms for electric utilities and gas cost recovery mechanisms for natural gas distribution utilities. In recent years, however, requests for surcharges and tracking mechanisms by utilities have significantly increased, for many different types of costs, including capital investments, for specific operating and maintenance expenses and even for revenue losses. In some instances, the use of special rate-making mechanisms such as surcharges and other tracking mechanisms have proliferated to the point of becoming excessive and burdensome for regulators to monitor. The use of surcharges is a deviation from traditional ratemaking and puts customers at risk for overpaying for safe and reliable utility service. The use of numerous alternative ratemaking mechanisms and surcharges can defeat some of the primary principles of the rate-setting and regulatory review process. Surcharges can also result in undesirable consequences, such as reducing utility incentives to control costs, and shifting utility business risks away from investors and onto customers.

## COMPARISON OF SURCHARGES USED BY COMPANIES WITH MULTI-STATE UTILITY OPERATIONS

Many of the larger utility companies serve customers in multiple states. The following section illustrates the surcharges assessed by these companies to residential customers in the states in which the utility provides service. As can be seen from the tables, the use of surcharges for most utilities varies among the states it serves. Some companies have similar surcharges for the states they serve, while the use of surcharges varies among jurisdictions for others. Whether specific surcharges are approved by regulators appears to be based on the regulatory regime in the state, not whether the company has similar existing surcharges in other states.<sup>26</sup> The following sections contain maps illustrating the states in which the utility serves customers.<sup>27</sup>

### AMERICAN ELECTRIC POWER (ELECTRIC)

American Electric Power (“AEP”) Company is headquartered in Columbus, Ohio. The public utility subsidiaries of AEP have traditionally provided electric service, consisting of generation, transmission and distribution, on an integrated basis to their retail customers. AEP has approximately 5.3 million retail customers. AEP serves customers in the following states:



The public utility subsidiaries and jurisdictions of AEP Company include:

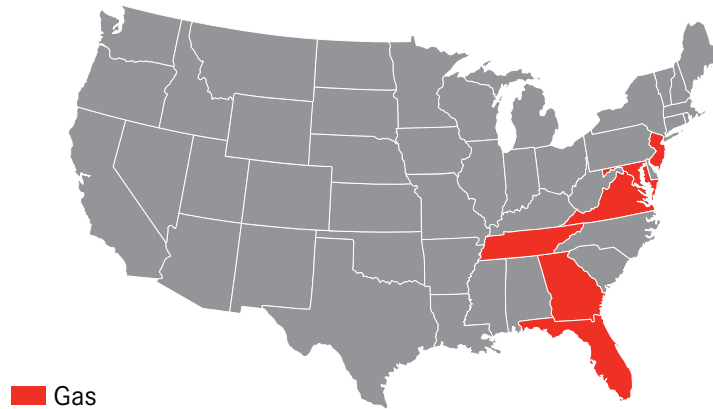
- Appalachian Power Company
- Columbus Southern Power Company
- Indiana Michigan Power Company
- Ohio Power Company
- Public Service Company of Oklahoma
- Southwestern Electric Power Company

Exhibit 3 is a comparison of costs recovered through surcharges in AEP's jurisdictions:

EXHIBIT 3											
DESCRIPTION	AR	IN	KY	LA	MI	OH	OK	TN	TX	VA	WV
Advanced Metering (Voluntary)									•		
Alternative Generation	•										
Capital Expenditures											•
Capacity Charge			•								
Clean Coal Technology		•									
Energy Efficiency/DSM	•	•	•		•	•	•		•		•
Environmental Investment/ Compliance		•	•		•	•		•	•	•	
Federal Litigation Consulting Fees	•					•					
Franchise/Municipal Taxes	•		•	•	•					•	•
Inspection Fee								•			
Off System Sales		•									
PJM Cost		•									
Rate Case Expense									• <sup>1</sup>		
Reliability Expenditures/ Vegetation Management	•					•	•	•	•		
Sales & Use Tax			•					•		•	
Smart Grid						•					
Storm Expenses							•				
System Benefits/Universal Service									•		
Transmission Cost Recovery						•			•	•	
True-Up Case Expense									•		
<sup>1</sup> Two rate case expense surcharges Source: 2010 Form 10-K and tariffs											

## AGL RESOURCES (GAS)

AGL is headquartered in Atlanta.<sup>28</sup> AGL Resources is an energy services company whose principal business is the distribution of natural gas in six states. AGL's six utilities serve approximately 2.3 million end-use customers.<sup>29</sup> AGL serves customers in the following states:



The public utility subsidiaries of AGL Resources include:

- Atlanta Gas Light
- Chattanooga Gas
- Elizabethtown Gas
- Elkton Gas
- Virginia Natural Gas
- Florida City Gas

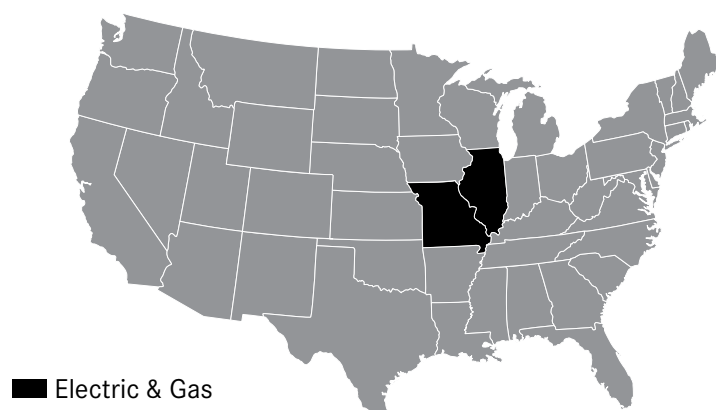
**Exhibit 4** is a comparison of revenues and costs recovered through surcharges in AGL's jurisdictions.

EXHIBIT 4						
DESCRIPTION	FL	GA	MD	NJ	TN	VA
Conservation	•					
Environmental/Green House Gas Initiative		•		•		
Franchise Fees		•		•	•	
Pipeline Replacement/Utility Infrastructure Enhancement		•		•		
Revenue Normalization			•		•	•
Social Responsibility/Societal Benefits		•		• <sup>1</sup>		
Transitional Energy Facility Adj.				•		
Weather Normalization				•	•	•

<sup>1</sup>In NJ, Societal Benefits includes costs for clean energy program, environmental remediation and universal service  
 Source: 2010 Form 10-K and tariffs

## AMEREN CORPORATION (ELECTRIC & GAS)

Ameren is a public utility holding company headquartered in St. Louis, Missouri. Ameren’s subsidiaries operate rate-regulated electric generation, transmission, and distribution businesses, rate-regulated natural gas transmission and distribution businesses, and merchant generation businesses.<sup>30</sup> Ameren has approximately 2.4 million electric customers and 900,000 natural gas customers.<sup>31</sup> Ameren serves customers in Missouri and Illinois.



The public utility subsidiaries of Ameren include:

- Union Electric Company (electric & gas)
- Ameren Illinois (electric & gas)

**Exhibit 5** is a comparison of costs recovered through surcharges in Ameren’s jurisdictions.

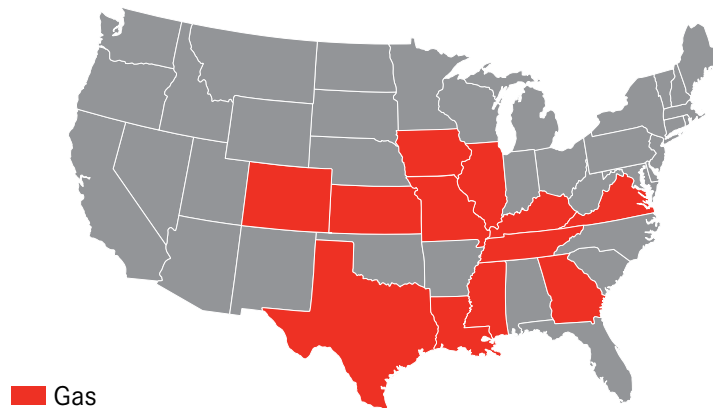
<b>EXHIBIT 5</b>				
DESCRIPTION	ILLINOIS		MISSOURI	
	Electric	Gas	Electric	Gas
Coal Tar Cleanup <sup>1</sup>		•		
Energy Efficiency Costs	•	•		
Environmental Costs	•	•		
Excess Franchise Fees	•	•		
Government Compliance Costs	•	•		
Hazardous Materials (Asbestos)	•			
Infrastructure Maintenance	•			
Infrastructure Replacement				•
Uncollectibles	•	•		

<sup>1</sup>Zone 3 customers only  
Source: 2010 Form 10-K and tariffs



## ATMOS ENERGY CORPORATION (GAS)

Atmos Energy Corporation, headquartered in Dallas, Texas, is engaged primarily in the regulated natural gas distribution and transmission and storage businesses as well as other non-regulated natural gas businesses. The Company's primary service areas are located in Colorado, Kansas, Kentucky, Louisiana, Mississippi, Tennessee and Texas. It also has more limited service areas in Georgia, Illinois, Iowa, Missouri and Virginia. In addition, Atmos transports natural gas for others through its distribution system. Atmos has approximately three million residential, commercial, public authority and industrial customers in 12 states located primarily in the South. Atmos serves customers in the following states:



Atmos' natural gas distribution segments include:

- Mid-Tex Division
- Kentucky/Mid-States Division
- Louisiana Division
- West Texas Division
- Colorado-Kansas Division
- Mississippi Division

Exhibit 6 is a comparison of costs recovered through surcharges in Atmos' jurisdictions:

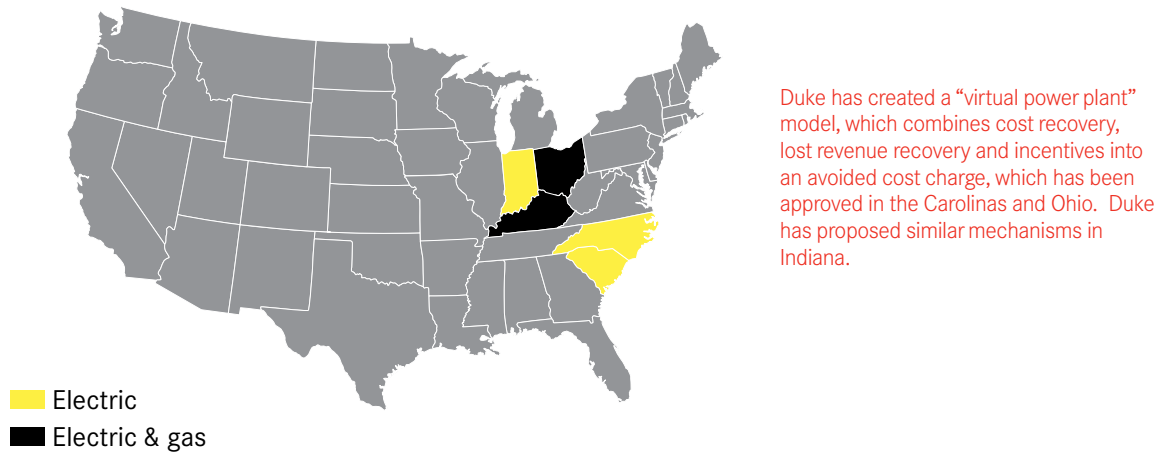
EXHIBIT 6													
DESCRIPTION	CO	GA	IA	IL	KS	KY	LA	MO	MS	TN	MID TX	WEST TX	VA
Ad Valorem					•								
Automated Metering Incentive	•												
Demand Side Management	•					•							
Energy Efficiency			•								•	•	
Environmental										•			
Franchise Fee	•	•											
Low Income				•									
Municipal Fee											•		
Performance Based Rate Mechanism (experimental)						•							
Pipe Replacement		•				•							
Rate Case Expense											•		
Rate Stabilization/ Rate Review <sup>1</sup>							•		•			•	
Renewable Energy				•									
Research & Development <sup>2</sup>						•							
System Reliability					•								
Taxes				•							•		
Transportation Service Cost	•												
Uncollectibles			•										
Weather Normalization		•			•	•	•		•	•	•	•	•

<sup>1</sup>Atmos' Louisiana and Mississippi jurisdictional base rates are based on Formula Rates, which are adjusted annually, as opposed to a rate case.  
<sup>2</sup>Voluntary participation by the Company in R&D funding for Gas Technology Institute or other research facilities.  
Source: 2010 Form 10-K and tariffs

## DUKE ENERGY (ELECTRIC AND GAS)

Duke Energy Corporation is an energy company that operates in the United States primarily through its direct and indirect wholly-owned subsidiaries. The Company is headquartered in North Carolina. Duke Energy supplies and delivers energy to approximately 4 million customers in the U.S.

Duke serves customers in the following states:



The public utility subsidiaries of Duke Energy currently include:

- Duke Energy Carolinas (electric)
- Duke Energy Indiana (electric)
- Duke Energy Ohio (electric and gas)

On January 8, 2011, Duke Energy Corporation (“Duke Energy”) entered into a Merger Agreement and Plan of Merger between and among Diamond Acquisition Corporation, a North Carolina corporation and Duke Energy’s wholly-owned subsidiary (Merger Sub) and Progress Energy, Inc., a North Carolina corporation.<sup>32</sup> Progress Energy includes two major electric utilities that serve about 3.1 million customers in the Carolinas and Florida.<sup>33</sup> The merger is still pending.

Exhibit 7 is a comparison of costs recovered through surcharges in Duke’s jurisdictions:

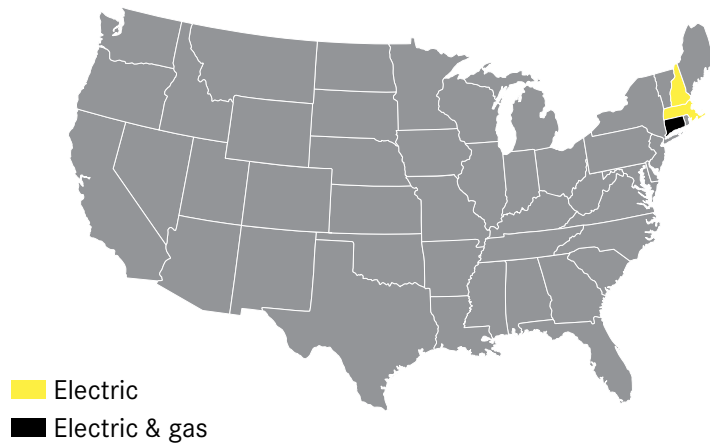
EXHIBIT 7	KY		IN	NC	OH		SC
	ELEC	GAS	ELEC	ELEC	ELEC	GAS	ELEC
Accelerated Main Replacement						•	
Annually Adjusted Component					•		
Clean Coal Operating Cost Revenue Adjustment			•				
Demand Side Management	•	•	•	•			
Economic Competitiveness					•		
Emmission Allowances			•				
Energy Efficiency				•	•		•
Excise Tax					•	•	
Franchise Fee	•	•					
Infrastructure Modernization					•		
New Generation			•				
Non-fuel purchased power				•			
Off-system Power sales & Emission Allowance Sales Profit Sharing	•						
Pension Costs							•
Pollution Control			•				
Regulatory Transition Charge					•		
Reliability Adj (Capacity)			•				
Renewable Energy				•	•		
State Tax					•		
Storm Recovery					•		
System Reliability Tracker					•		
Transmission Cost					•		
Uncollectible					•	•	
Universal Service					•		

Source: 2010 Form 10-K and tariffs

## NORTHEAST UTILITIES (ELECTRIC AND GAS)

Northeast Utilities (“NU”) is a public utility holding company headquartered in Connecticut. The Company is engaged primarily in the energy delivery business through its wholly-owned utility subsidiaries.

NU serves customers in Connecticut, Massachusetts and New Hampshire.



The public utility subsidiaries of NU include:

- Connecticut Light & Power
- Public Service Company of New Hampshire
- Western Massachusetts
- Yankee Gas

On October 18, 2010, NU and NSTAR announced a Merger Agreement to combine the two companies. The post-transaction company will provide electric and natural gas energy delivery service to nearly 3.5 million electric and natural gas customers through six regulated electric and natural gas utilities in Connecticut, Massachusetts and New Hampshire, representing over half of all the customers in New England. The merger is still pending.

**Exhibit 8** is a comparison of costs and revenues recovered through surcharges in NU's jurisdictions:

<b>EXHIBIT 8</b>				
	CT		NH	MA
DESCRIPTION	ELEC	GAS	ELEC	ELEC
Competitive Transition Assessment <sup>1</sup>	•		•	•
Decoupling				•
Electricity Consumption Tax			•	
Energy Efficiency Programs				• <sup>2</sup>
Exogenous Costs				•
FERC Congestion Charge	•			
Low Income				•
Pension/PBOP				•
Renewable Energy				•
Storm Recovery Costs				•
System Benefit			•	
<sup>1</sup> Stranded investment, conservation load management, renewable energy <sup>2</sup> Two separate charges for energy efficiency & DSM <i>Source: 2010 Form 10-K and tariffs</i>				

## MIDAMERICAN ENERGY HOLDINGS COMPANY (ELECTRIC AND GAS)

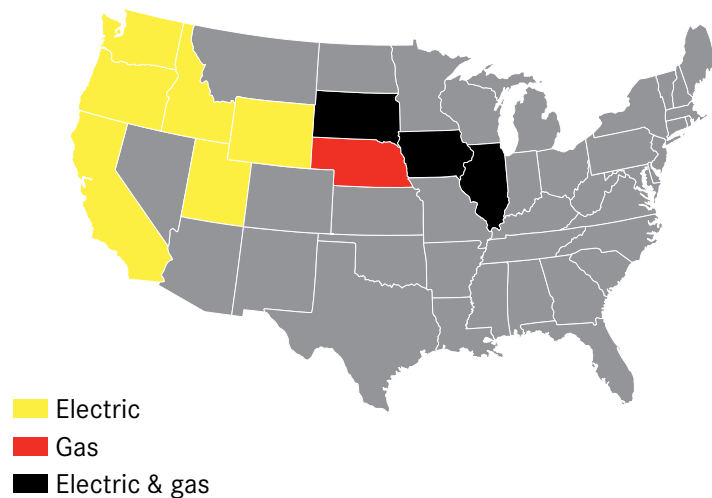
MidAmerican Energy Holdings Company (“MEHC”) is a holding company that owns subsidiaries principally engaged in energy businesses (collectively with its subsidiaries, the “Company”). MEHC is a consolidated subsidiary of Berkshire Hathaway Inc. (“Berkshire Hathaway”).

The Company’s operations are organized and managed as eight distinct platforms: PacifiCorp, MidAmerican Funding, LLC, Northern Natural Gas Company, Kern River Gas Transmission Company, CE ElectricUKFunding Company, CalEnergy Philippines, CalEnergy U.S. and HomeServices of America, Inc. Through these platforms, the Company owns and operates an electric utility company in the Western United States, an electric and natural gas utility company in the Midwestern United States, two interstate natural gas pipeline companies in the United States, two electricity distribution companies in Great Britain, a diversified portfolio of independent power projects and the second largest residential real estate brokerage firm in the United States.

As of December 31, 2010, MEHC’s electric and natural gas utility subsidiaries served 6.2 million electricity customers and end-users and 0.7 million natural gas customers. MEHC’s natural gas pipeline subsidiaries operate interstate natural gas transmission systems that transported approximately 8% of the total natural gas consumed in the United States during 2010.

PacifiCorp, an indirect wholly owned subsidiary of MEHC, is a United States regulated electric utility company headquartered in Oregon that serves 1.7 million retail electric customers. PacifiCorp is principally engaged in the business of generating, transmitting, distributing and selling electricity.

MEHC serves customers in:



The public utility subsidiaries of MEHC include:

- PacifiCorp
- Pacific Power (electric)
- Rocky Mountain Power (electric)
- MidAmerican Energy (electric & gas)
- Northern Natural Gas (gas-regulated by FERC)

Exhibit 9 is a comparison of costs recovered through surcharges in MEHC's jurisdictions:

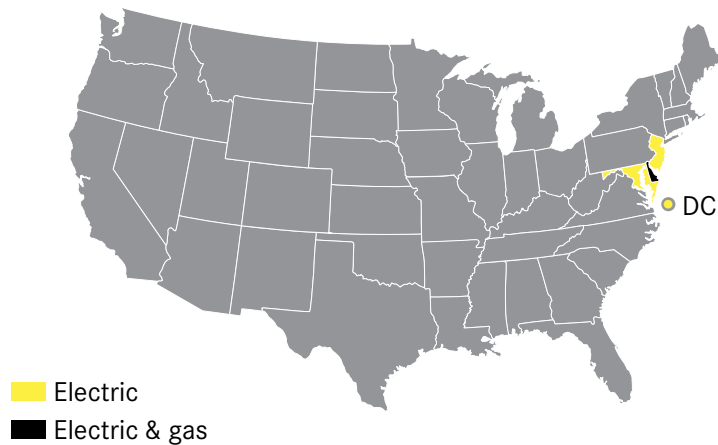
EXHIBIT 9													
	CA	IA		ID	IL		NE	OR	SD		UT	WA	WY
DESCRIPTION	Elec	Elec	Gas	Elec	Elec	Gas	Gas	Elec	Elec	Gas	Elec	Elec	Elec
Alternate Energy Producer Cost Recovery		•											
Btu Adjustment			•				•			•			
Capital Investments		•											
Carbon Reduction Costs			•									•	
CARE Program	•												
Catastrophic Event Memo Account	•												
Commission Fees/ Government Fees	•	•											
Energy Efficiency/DSM <sup>2,3</sup>	•	•	•		•	•		•	•	•	•	•	•
Franchise Fees						•						•	
GridWest Regulatory Asset								•					
Hydro Cost Deferral												•	
Independent Evaluator Cost								•					
Intervenor Funding								•					
Klamath Dam Removal								•					
Klamath Rate Reconciliation Adjustment								•					
Low Income	•					•		•			•	•	
Nuclear Decommissioning					•								
Property Sales								•					
Public Purpose Charge								•					
Rate Mitigation Adjustment			•					•					
Renewable Energy/Solar Energy Programs/Research <sup>1</sup>	•	•			•	•		•			•	•	
Severance-Regulatory Asset								•					
Taxes		•	•		•	•	•	•	•	•		•	
Transition Balancing Account (includes franchise fees & uncollectibles)	•											•	•

<sup>1</sup>Voluntary in IA, IL and UT  
<sup>2</sup>DSM charge in SD does not apply to all customers  
<sup>3</sup>DSM suspended in Wyoming  
Source: 2010 Form 10-K and tariffs



## PEPCO HOLDINGS, INC. (ELECTRIC AND GAS)

Pepco Holdings Inc. (“PHI”) is a diversified energy company that through its operating companies is engaged primarily in two businesses: the distribution, transmission and default supply of electricity and the delivery and supply of natural gas (power delivery), conducted through its regulated public utility companies. PHI has approximately 1.9 million customers in the following jurisdictions: Delaware, Maryland, New Jersey, and the District of Columbia.



The public utility subsidiaries of PHI include:

- Potomac Electric Power Company (electric)
- Atlantic City Electric (electric)
- Delmarva Power & Light (electric & gas)

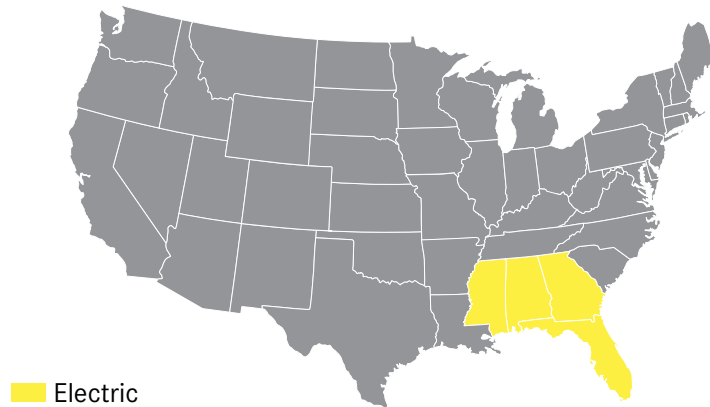
Exhibit 10 is a comparison of revenues and costs recovered via surcharges in PHI’s jurisdictions:

EXHIBIT 10					
	DC	DE		MD	NJ
DESCRIPTION	ELEC	ELEC	GAS	ELEC	ELEC
Bill Stabilization	•			•	
Corporate Business Tax					•
Delivery Tax	•				
Demand Side Management				•	
Energy Assistance Fund <sup>3</sup>	•				
Environmental Expenses			•		•
Infrastructure Investment					•
Public Space Occupancy Fees	•				
Regulatory Assets Recovery <sup>1</sup>					•
Sales and Use Tax					•
Securitization of Stranded Costs					•
Societal Benefits <sup>3</sup>	•				•
Sustainable Energy Fund	•				
Transitional Facility Assessment					•
Universal Service Costs	•			•	

<sup>1</sup>Asbestos removal, FAS 106 Costs and other regulatory assets  
<sup>2</sup>A new Reliability Investment Recovery Mechanism (RIM) surcharge is currently being proposed in all of PHI’s regulated electric utility operating jurisdictions.  
<sup>3</sup>Customer will pay either Societal Benefits Charge or the Energy Assistance Fund Charge, not both  
Source: 2010 Form 10-K and tariffs

## SOUTHERN COMPANY (ELECTRIC)

Southern Company was incorporated under the laws of Delaware on November 9, 1945 and is headquartered in Atlanta. Its traditional operating companies (which are also referred to as the Southern Company System) supply electric service to approximately 4.4 million customers, in four southeastern states: <sup>34</sup>



The public utility subsidiaries of Southern Company include:

- Alabama Power Company
- Georgia Power Company
- Gulf Power (serves utility customers in the Florida panhandle)
- Mississippi Power

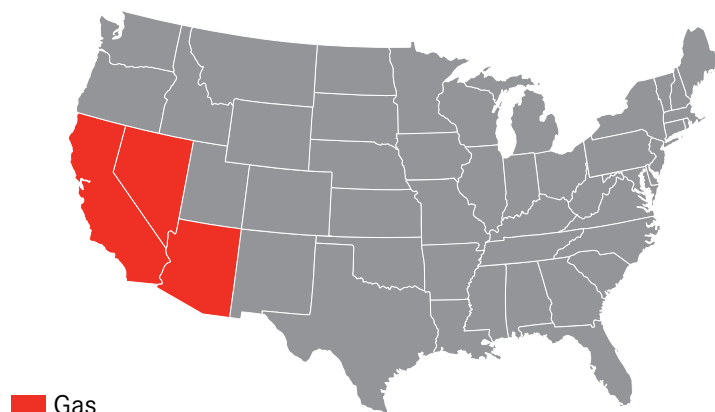
**Exhibit 11** is a comparison of costs recovered via surcharges in Southern Company's jurisdictions:

<b>EXHIBIT 11</b>				
DESCRIPTION	AL <sup>1</sup>	FL	GA	MS
Ad Valorem				•
Demand Side Management/ Conservation		•	•	
Environmental Compliance		•	•	•
New Plant Construction Costs	•		•	• <sup>2</sup>
Performance Evaluation Plan				•
Regulatory Taxes				•
System Restoration				•
Taxes (franchise, gross receipts, etc.)	•	•	•	

<sup>1</sup>Alabama Power's rates are adjusted annually by the Rate Stabilization and Equalization Factor (a formula rate plan) since 1982, as opposed to setting rates based on the traditional rate case process  
<sup>2</sup>Rider CNP to recover Construction Work In Progress costs associated with the Kemper Plant, is pending in Mississippi.  
Source: 2010 Form 10-K and tariffs

## SOUTHWEST GAS CORPORATION (GAS)

Southwest Gas (“SWG”) is engaged in the business of purchasing, distributing and transporting natural gas in portions of Arizona, Nevada, and California. SWG is the largest distributor of natural gas in Arizona and Nevada. As of December 31, 2010, SWG purchased and distributed or transported natural gas to 1,837,000 residential, commercial and industrial customers.<sup>35</sup>



**Exhibit 12** a comparison of revenues and costs recovered through surcharges in SWG’s jurisdictions:

<b>EXHIBIT 12</b>			
DESCRIPTION	AZ	CA	NV
California Alternate Rates for Energy Balancing Account		•	
Catastrophic Event Memorandum Account		•	
Customer Owned Yard Line (COYL) Cost Recovery Mechanism	•		
CPUC Reimbursement Fee		•	
Decoupling	•	•	•
Demand Side Management (DSM) Surcharge	•		
Energy Efficiency/Renewable Energy Tariff Plan	•		
Facilities Surcharge		•	
Fixed Cost Adjustment		•	
Intrastate Transportation Cost Balancing Account		•	
Low Income	•		
Low Income Energy Efficiency Balancing Account		•	
Public Interest R&D Balancing Account		•	
Research and Development Surcharge	•		
Taxes (not included in rates)			•
Transportation Franchise Fee		•	
TRIMP Surcharge	•		
Uncollectibles			•

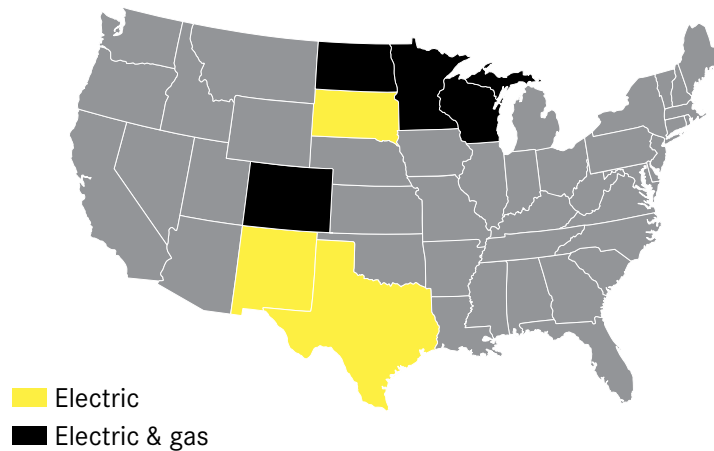
*Source: 2010 Form 10-K and tariffs. In SWG’s most recent rate case, Docket No. G-01551A-10-0458 before the Arizona Corporation Commission, a full revenue decoupling mechanism alternative was adopted from a settlement agreement that had been reached by most of the parties to the rate case.*

Some consumer safeguards adopted in Docket No. G-01551A-10-0458 require SWG to:

- Starting April 30, 2012, file quarterly reports regarding the decoupling mechanism's performance.
- Starting April 2013, file annual reports permitting the Commission and all parties the opportunity to review the decoupling mechanism's performance.
- Be subject to an annual earnings test that would prohibit SWG from recovering any decoupling deferral amounts to the extent that the deferral recovery would increase its earnings above the authorized return on common equity.
- Provide \$75,000 for the hiring of an independent consultant to conduct the annual Staff review of SWG's annual filing.
- Cap at 5 percent any surcharge developed through the decoupling mechanism that would result in a non-gas revenue surcharge of greater than 5 percent, and SWG will carry the deferral account balance forward for recovery in the following and subsequent years with no carrying charge; however, there will be no cap on annual surcharge decreases.
- Not to file a general rate application prior to April 30, 2016, with a test year ending no earlier than November 30, 2015.
- Submit a proposed customer outreach/education plan to Staff for review and approval, to outline how SWG intends to explain decoupling to customers.<sup>36</sup>

## XCEL ENERGY (ELECTRIC AND GAS)

Xcel Energy is a holding company, with subsidiaries engaged primarily in the utility business. In 2010, Xcel Energy's continuing operations included the activity of four wholly-owned utility subsidiaries that serve electric and natural gas customers in eight states. Along with WYCO, a joint venture formed with Colorado Interstate Gas Company (CIG) to develop and lease natural gas pipeline, storage, and compression facilities, and WGI, an interstate natural gas pipeline company, these companies comprise the continuing regulated utility operations.<sup>37</sup> Xcel Energy serves 1.36 million electricity customers and 1.3 million natural gas customers.<sup>38</sup> Xcel serves customers in the following states:



The public utility subsidiaries of Xcel include:

- Northern States Power
- Public Service Company of Colorado
- United Water
- SPS

Exhibit 13 is a comparison of costs recovered through surcharges in Xcel’s jurisdictions:

EXHIBIT 13													
DESCRIPTION	CO		MI		MN		ND		NM	SD	TX	WI	
	Elec	Gas	Elec	Gas	Elec	Gas	Elec	Gas	Elec	Elec	Elec	Elec	Gas
Conservation/Energy Efficiency Program					•	•			•				
Demand Side Management	•	•											
Energy Optimization			•	•									
Environmental Improvement					•					•			
Facilities Fees					•								
Franchise Fees	•	•			•	•					•		
General Rate Schedule Adjustment	•	•											
Interim Rate					•		•						
Low Income (Pilot)	•	•											
Mercury Emmissions Reduction					•								
Other Taxes/Fees	•	•			•	•	•	•		•			
Pipeline System Integrity Adjustment		•											
Renewable Development					•								
Renewable Energy Standard	•				•				•				
State Energy Policy					•	•							
Transmission Capital Costs	•				•					•			

Source: 2010 Form 10-K and tariffs

## APPENDIX I – DESCRIPTIONS OF TYPES OF COSTS BEING ASSESSED AS SURCHARGES

The following discussion focuses on proposed surcharges which would appear as an additional charge on ratepayers' bills, above and beyond the basic service charge and charges for fuel and taxes. Below are examples of various surcharges proposed and employed by utilities and a brief description of the costs being recovered through surcharges.

### LOST REVENUES

Lost revenue surcharges are an added charge to ratepayers' bills which serve to compensate the utility for loss of revenue due to various factors. Some lost revenue surcharges include:

### REVENUE DECOUPLING

Revenue decoupling helps assure that the utility's actual earnings will be at the level of authorized earnings. Under some forms of full decoupling, customers' rates are automatically adjusted to insulate the utility's earnings from fluctuations in sales. The rationale for this is that it removes existing disincentives which make utility management reluctant to aggressively promote energy conservation. Revenue decoupling can take on different approaches, including: decoupling true up plans, lost revenue adjustment mechanisms, and fixed/variable pricing rate design, which shifts costs into the "fixed" portion of the customer's bill and out of the "variable" portion of the bill.

Straight Fixed Variable or (SFV) is a rate design where fixed costs of service would be collected through fixed charges and only variable costs of service would be collected through usage charges. This approach would require very high basic service charges.<sup>39</sup>

Fixed costs are the portion of utility costs that do not change with the level of energy consumption. Within each rate class that does not have a demand charge, each customer is charged the same amount for fixed costs. Variable costs are those costs that differ depending on the amount a customer consumes (e.g., the volumetric charge per kilowatt-hour). Some items that would be considered a variable charge include fuel, some maintenance, and often purchased power. By separating these two charges, a utility's ability to recover its revenue requirement is completely separated from sales volume. By ensuring the recovery of all fixed charges, the revenue level of the company under SFV remains fairly consistent, providing a high level of certainty for investors. Additionally, SFV insulates the utility company from feeling the effects of external forces such as loss of sales due to poor weather or customer investment in energy efficiency would typically have on revenues. Alternatively, the utility company's upside from increased sales is limited.



The use of SFV can reduce savings experienced by customers from energy efficiency investments as presented in the following example<sup>40</sup>:

Reduction of Monthly Customer Usage from 1,000 to 900 Units Energy Efficiency Investment of \$200

	STANDARD TWO-PART TARIFF	SFV
	\$15 Fixed Charge	\$50 Fixed Charge
	\$0.075/kWh	\$0.04/kWh
1,000 Units	Fixed: \$15.00 Variable: \$17.00 Total: \$90.00	Fixed: \$50.00 Variable: \$40.00 Total: \$90.00
900 Units	Fixed: \$15.00 Variable: \$67.50 Total: \$82.50	Fixed: \$50.00 Variable: \$36.00 Total: \$86.00
Savings	\$7.50/month \$90/year	\$4/month \$48/year

WEATHER NORMALIZATION ADJUSTMENT (PARTIAL FORM OF DECOUPLING)

A weather normalization adjustment (“WNA”) applies a surcharge to ratepayers’ bills so that the bills reflect an amount that would be billed for utility services under normal weather conditions. For example, if gas utility customers use less gas for space heating because winter is warmer than normal, their savings are limited to the avoided gas commodity charges, and the rest of their utility bill effectively reflects the higher usage that is based on “normal” weather. Similarly, if electric customers use less air conditioning during a cooler than normal summer, what would have been their savings is reduced by having to pay the utility as if the normal hot summer weather had occurred. The opposite is also true; higher utility bills from extreme weather can be somewhat mitigated by a WNA surcredit. Weather normalization is a regulatory procedure that removes weather-related volatility from customer bills; that is, adjusts the non-gas (or distribution) charges on customers’ bills to reflect normal weather instead of actual weather which may be colder or warmer than normal.<sup>41</sup>

EARNINGS SHARING MECHANISM/RATE OF RETURN TRACKER

An earnings sharing mechanism is a single adjustment based on the utility’s rate of return. Adjustments are made outside of rate cases when actual costs deviate from test year costs and/or actual revenues deviate from test year revenues, in a manner that affects utility earnings.<sup>42</sup> Some earnings sharing mechanisms are based upon whether the utility earns within a band

around its authorized rate of return. As an illustrative example, if a utility's authorized return on equity was 10%, an earnings sharing mechanism could have a "band" of 50 basis points (plus or minus) around that authorized ROE, earnings above a 10.5% ROE are "shared" with ratepayers via the earnings sharing mechanism as a credit, while earnings below 9.5% would result in a surcharge.

#### TRANSITION ADJUSTMENT

A transition or stranded cost surcharge recovers revenues lost to utilities when customers purchase their energy supply through independent marketers. The rationale for this type of surcharge is that the migration to another supplier creates "stranded costs" for the utility.

#### CAPITAL EXPENDITURES

##### GAS PIPELINE/AGING INFRASTRUCTURE REPLACEMENT

Infrastructure surcharges provide for utility recovery of capital investments made to upgrade a utility's aging electric distribution infrastructure or gas distribution pipeline system.

##### *ATLANTA GAS LIGHT*

In 1998, AGL was permitted to implement a surcharge to recover prudently incurred costs associated with a ten-year pipe replacement program ("PRP") to address specific pipeline safety violations. The PRP was scheduled to be completed but was extended to 2013 as part of a settlement in Docket No. 85616-U. The residential surcharge was \$1.29 per month in years 7-9 of the PRP and increased to \$1.95 in years 10-13. In 2009, the Company filed a request to rename the existing surcharge to the Strategic Infrastructure Development and Enhancement ("STRIDE") Program surcharge so that it would include the PRP costs as well as the Integrated System reinforcement Program ("i-SRP") costs and costs for expanding the distribution system. The Commission approved the Company's request for the STRIDE surcharge in its final decision dated in Docket No. 29950, dated January 20, 2010.

In contrast, Washington Gas Light ("WGL") recently sought, as part of its rate base increase, approval of an Accelerated Pipe Replacement Plan ("APRP") and a related cost recovery mechanism ("Rider") to accelerate the replacement of aging pipes, increase safety and reliability and provide environmental benefits through the reduction of greenhouse gas emissions. The APRP was approved by the regulators but the surcharge was denied by regulators because it departed from traditional ratemaking. In its order, the Maryland PSC stated it would rather review these costs in the context of a rate case, even if the filing of rate cases would be more frequent.

##### NEW GENERATION PLANT INVESTMENT (COAL FIRED, SOLAR, RENEWABLE, NUCLEAR GENERATION)

Some utilities have been authorized surcharges to recover investments made for the purposes of adding generation or capacity to serve more customers or meet increased demand, or for the investments in specific types of generation such as renewables or solar. For example, Progress Energy Florida ("PEF") obtained regulators' approval this year to recover \$86 million from ratepayers for the costs of constructing nuclear Units Levy 1 and 2. The estimated 2012 monthly cost to ratepayers is about \$2.93 for the first 1,000 kilowatt hours (kwh) for PEF customers.

Florida Power & Light Company (“FP&L”) also received regulators’ approval to recover \$196 million for costs associated with construction of two new units at its Turkey Point Plant and adding capacity to existing units at Turkey Point and St. Lucie Plants.<sup>43</sup>

#### SMART METERS/SMART GRID

“Smart Meters”<sup>44</sup> and “Smart Grid” generally refer to technology to convert and automate utility electricity delivery systems, and enable new functions, such as grid monitoring and time-of-use metering. Many utilities are proposing to rapidly implement these technologies, but some utilities and regulators have found that the costs are much higher than anticipated and/or ratepayer benefits were not commensurate. There have been requests by electric utilities for surcharge recovery of costs for Advanced metering Infrastructure (“AMI”). In 2010, regulators in Texas allowed Oncor Utilities to implement a monthly surcharge of \$2.19 per customer for 11 years to pay for the costs associated with installing smart meter as well as a public education campaign.<sup>45</sup>

The New York PSC authorized Con Edison to recover Smart Grid costs through a surcharge. While the monthly surcharge averages about 28¢/customer, or less than 0.3% of the average monthly bill, the surcharge will collect over \$145 million for the company. The surcharge continues at least until Con Edison’s next rate case, in April 2013, when it may be reset.<sup>46</sup>

However, other states have disallowed surcharges to recover these substantial and speculative costs:

#### MARYLAND

Baltimore Gas & Electric Proposed a SmartGrid Plan in Case No. 9208, Order 83410, and requested that the \$835 million cost to implement be recovered from customers via a surcharge. The Commission denied the company’s Smart Grid Plan and surcharge recovery. The Commission’s decision stated:

The Proposal asks BGE’s ratepayers to take significant financial and technological risks and adapt to categorical changes in rate design, all in exchange for savings that are largely indirect, highly contingent and a long way off. We are not persuaded that this bargain is cost-effective or serves the public interest, at least in its current form.

...

The Proposal is a ‘no-lose proposition’ for the Company and its investors.<sup>47</sup>

BGE submitted a modified SmartGrid plan in Case No. 9208. The Commission approved BGE’s modified SmartGrid plan, but again did not permit recovery of the project through a surcharge. The Commission supported intervenor, the Maryland Energy Administration’s (MEA), position that AMI deployment is analogous to an investment in a power plant, an investment of similar (or greater) magnitude that historically would be recovered through traditional ratemaking.<sup>48</sup>

#### RENEWABLE ENERGY

Renewable energy surcharges recover costs related to capital expenditures or purchased power contracts associated with a utility’s renewable energy program. Renewable energy is defined as

energy that can be replenished, such as wind, solar, geothermal, hydro, photovoltaic, wood and waste. Renewable energy typically also has environmental benefits. To encourage the development of renewable energy, many jurisdictions provide for utility cost recovery via surcharges. Non-renewable energy sources are finite, such as coal, oil, and gas.<sup>49</sup>

#### TRANSMISSION INFRASTRUCTURE

Transmission surcharges can include provisions for utility recovery of capital expenditures to upgrade a utility's aging transmission infrastructure and/or transmission cost increases which the utility incurs based on transmission costs approved by the FERC. Some state regulatory commission prefer to isolate the impacts on utility customer bills resulting from federal mandates, including FERC decisions, so those impacts are transparent to customers and are distinguished from state regulatory decision impacts.

### OPERATION AND MAINTENANCE EXPENSES

#### PIPELINE SAFETY PROGRAM FEES

Utilities have proposed surcharges to recover costs associated with inspecting gas distribution pipelines and safety related issues.

#### VEGETATION MANAGEMENT

Vegetation management activities can include: tree pruning (trimming), right-of-way mowing and clearing, and herbicide application.<sup>50</sup> A major cause of power outages can be due to improperly maintained vegetation or trees that can come in contact with power lines during severe storms.

#### ENVIRONMENTAL COMPLIANCE

Environmental compliance costs can include remediation costs associated with site investigation and removal of pollution or contaminants from soil or groundwater<sup>51</sup> or costs to implement environmental controls mandated by state and federal regulations.<sup>52</sup> A common example of environmental compliance costs is the emission control equipment that electric generation utilities are required to install on coal-fired plants to meet air quality standards.

#### UNCOLLECTIBLE CHARGES

Some utilities have requested surcharges to collect customers' bad debts. Some surcharges allow a utility to collect from (or refund) the difference between the uncollectible (or bad debt) expense allowed in base rates and the utility's actual prior calendar year uncollectible expense. Some utility uncollectible surcharges recover only the fuel or gas cost portion of uncollectible accounts.<sup>53</sup> In some cases, the uncollectible expense may be collected through the utility's fuel or gas clause.

#### PENSION/OTHER POST RETIREMENT BENEFITS ("OPEB")

Prior to 2008, many utilities' defined benefit pension plans were well funded. However, due to the sharp decline of the stock market in late 2008 with the onset of the world-wide financial crisis, many utilities' pension plans suffered substantial losses. In the following

years, some utilities requested substantial increases to their pension expense to replenish the funding of their pension plans, some via a surcharge. The stock market has since stabilized.

#### STORM DAMAGE

A catastrophic storm may cause significant damage to a utility's infrastructure (wires, poles, substations, etc.). Some utilities have petitioned regulators to recover the costs associated with repairing its infrastructure via a surcharge mechanism. Traditionally, utility storm damage repair costs have been addressed in base rates.

#### ENERGY EFFICIENCY/CONSERVATION/DEMAND SIDE MANAGEMENT (DSM) PROGRAMS

Costs associated with implementing energy efficiency, conservation and demand side management programs are increasingly being addressed for ratemaking purposes in utility surcharge mechanisms.

#### UNIVERSAL SERVICE COSTS (LOW INCOME PROGRAM COSTS)

A universal service cost is a fee paid by users of a utility service in some states to support the provision of providing utility service for low-income users. The fees help eligible customers pay their electricity bills and may also provide for energy conservation measures and weatherization.<sup>54</sup>

#### MUNICIPAL FEES/FRANCHISE FEES

Some utilities pass through fees imposed on the utility by the municipality for franchise, occupation taxes/fees, or any other tax/fee imposed on the company by the municipality to conduct business within the city limits and on the cities' rights-of-way to its customers.<sup>55</sup> Typically, special surcharges for municipal fees or taxes would be applicable to utility customers residing within the municipality that is imposing such surcharges on the utility.

#### AD VALOREM TAXES

Ad Valorem taxes are taxes based on assessed value of property (i.e., property taxes).

#### OTHER TAXES

Some utilities impose a surcharge to collect other taxes such as sales and use tax, gross receipts tax, etc.

#### STRANDED COSTS

Costs incurred by utilities to serve their customers that potentially may be unrecoverable in a newly-created market.<sup>56</sup> Stranded costs can be defined as the estimated decline in the value of electricity-generating assets due to restructuring of the industry.<sup>57</sup>

#### SOCIETAL BENEFITS CHARGE OR SYSTEM BENEFITS CHARGE

In some jurisdictions, such as New Jersey and Arizona, utilities collect from customers a "societal benefits charge" which allows the utility to recover a combination of costs: e.g., clean energy program costs, manufactured gas plant remediation expenses, universal service fund and other allowed costs.<sup>58</sup>

## REGULATORY FEES

These fees can include rate case costs, regulator fees, etc.

## LITIGATION COSTS

Legal fees and costs associated with a trial, if significant or unusual, would be the subject of a special surcharge request by a utility. Traditionally, utility legal costs are addressed in the determination of the utilities' base rates.

## CAPITAL/O&M COMBINED

### ECONOMIC STIMULUS PROGRAM ("ESP")

In some jurisdictions, such as New Jersey, costs and associated carrying costs incurred on behalf of the utility for reliability focused and energy efficiency focused infrastructure projects are within the Economic Stimulus Program ("ESP"), which is a specific utility cost recovery mechanism. ESP Costs include: (1) the carrying costs (depreciation and return on net investment, including tax effects) on capital investments and (2) the incremental operation and maintenance expenses associated with the infrastructure programs.

### ENVIRONMENTAL COMPLIANCE

Capital expenditures and O&M associated with installing environmentally compliant plant equipment that reduces or removes the level of harmful substances being emitted into the atmosphere. This can include costs for environmental remediation (i.e., clean-up).

### SYSTEM HARDENING/RELIABILITY COSTS

Proactive measures to increase a utility's transmission and distribution system to withstand the effects of high winds and storms. This can also include investments to upgrade or underground the infrastructure.

### SECURITY COSTS

Security costs include proactive measures to protect a utility's infrastructure from security threats. After the September 11, 2001 terrorist attacks on the World Trade Center, some utilities began requesting special cost recovery for the increased costs for security threats to water supply and treatment facilities and to other potential terrorist targets such as nuclear generating plants.

## ABOUT THE AUTHORS

Ralph Smith is a senior regulatory consultant with Larkin & Associates, PLLC. His professional credentials include being a Certified Financial Planner™ Professional, a licensed certified public accountant and attorney. He functions as project manager on consulting projects involving utility regulation, regulatory policy and ratemaking and utility management. He received a Bachelor of Science in Administration in Accounting, with distinction, University of Michigan, Dearborn, 1979; a Master of Science in Taxation, Walsh College, Michigan, 1981. His Master's thesis dealt with investment tax credit and property tax on various assets. He also graduated,

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Over the past 31 years, Mr. Smith has performed work in the field of utility regulation on behalf of industry, public service commission staffs, state attorney generals, municipalities, and consumer groups concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, Washington DC, West Virginia, Canada, Federal Energy Regulatory Commission and various state and federal courts of law. He has presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors, including AARP, on several occasions.

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Input for this report was also provided by Hugh Larkin, Jr., senior partner of Larkin & Associates; Helmuth W. Schultz, III, and Donna Ramas, senior regulatory analysts; Mark Dady and John Defever, regulatory analysts, and Kerry Niemiec, administrator.

## END NOTES

- <sup>1</sup> Public Utilities Commission of Minnesota, Utility Rates Study, 2010, Talking Points on Cost Trackers, The National Regulatory Research Institute Presentation, November 2009.
- <sup>2</sup> The Two Sides of Cost Trackers: Why Regulators Must Consider Both, October 27, 2009.
- <sup>3</sup> The International Accounting Standards Board (IASB) Framework lists prudence as a sub-quality of reliability, calling prudence “the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated” (paragraph 37). Also, Financial Accounting Standards Board (“FASB”) Concepts Statement 2 discusses conservatism—meaning prudence—at length in paragraphs 91–97.
- <sup>4</sup> Used and useful is defined by the Edison Electric Institute’s 2005 Glossary of Electric Terms as “A regulatory specification typically used to determine whether an item of “Plant” may be included in a utility’s rate base.
- <sup>5</sup> [http://nrrr2.org/index.php?option=com\\_content&task=view&id=97&Itemid=48](http://nrrr2.org/index.php?option=com_content&task=view&id=97&Itemid=48). Public Utilities Commission of Minnesota, Utility Rates Study, 2010.
- <sup>6</sup> Cost Recovery Mechanisms for Smart Grid Investment, Carl Peterson, Center for Business and Regulation, University of Illinois Springfield.
- <sup>7</sup> Public Utilities Commission of Minnesota, Utility Rates Study, 2010.
- <sup>8</sup> <http://www.nj.gov/bpu/residential/glossary/> In states which have restructured their retail electric markets, the transmission and distribution rates remain regulated.
- <sup>9</sup> Public Utilities Commission of Minnesota, Utility Rates Study, 2010.
- <sup>10</sup> The Two Sides of Cost Trackers: Why Regulators Must Consider Both, October 27, 2009.
- <sup>11</sup> The terms used may vary slightly between different jurisdictions and are not used uniformly by utility regulators.
- <sup>12</sup> <http://www.georgiapower.com/pricing/glossary.asp#rider>
- <sup>13</sup> Aquila, Order in Application No. NG-0041
- <sup>14</sup> Balancing accounts are usually classified as “one way” (or “asymmetrical”) where underspending is returned to ratepayers, but overspending is absorbed by company. Under a two-way (“or symmetrical”) balancing account, the impact of underspending and overspending, if deemed to be prudent, is ultimately passed on to the ratepayer.
- <sup>15</sup> A balancing account may be recorded as a regulatory asset or a deferred asset on the utility’s books. Qualifying costs are charged to the balancing account and the surcharge revenues collected are credited to the account. Balances in some balancing accounts earn the 90-day commercial payment rate.
- <sup>16</sup> Memorandum (“memo”) accounts are used extensively by California utilities, with more limited or no use in other jurisdictions. The costs being tracked may later be converted to a balancing account upon approval by the regulator. In California, information regarding memorandum accounts are reported by filing “Advice Letters”.



- <sup>17</sup> A.10-07-007
- <sup>18</sup> This information was obtained from the tariffs on the utilities' websites during the time-frame of this report.
- <sup>19</sup> Utah Code Annotated Section 54-7-13(4)
- <sup>20</sup> Direct Testimony of Greg Shimansky, GDS-1, A. 10-12-005
- <sup>21</sup> Direct Testimony of Jodi Jerich, on behalf of RUCO, Docket No. G-04204A-11-0158
- <sup>22</sup> Testimony of David Dismukes, Docket No. 09-00183, Testimony of Jodi Jerich, G-04204A-11-0158
- <sup>23</sup> [http://coa.courts.mi.gov/documents/OPINIONS/FINAL/COA/20120410\\_C296374\\_47\\_296374.OPN.PDF](http://coa.courts.mi.gov/documents/OPINIONS/FINAL/COA/20120410_C296374_47_296374.OPN.PDF)
- <sup>24</sup> *Id.*, at 8
- <sup>25</sup> *Id.*, at 8
- <sup>26</sup> The array of surcharges being proposed and implemented by utilities is continuously evolving. Information for the utilities listed is believed to be accurate at the time the research was conducted, but is subject to change as new regulatory developments occur.
- <sup>27</sup> It should be noted that the utility may only serve customers in a portion of the states shown.
- <sup>28</sup> [http://www.aglresources.com/about/about\\_us.aspx](http://www.aglresources.com/about/about_us.aspx)
- <sup>29</sup> AGL Resources 2010 Form 10-K p. 4
- <sup>30</sup> 2010 Form 10-K
- <sup>31</sup> <http://www.ameren.com/aboutameren/pages/aboutus.aspx>
- <sup>32</sup> 2010 Form 10-K
- <sup>33</sup> <https://www.progress-energy.com/company/about-us/index.page?>
- <sup>34</sup> <http://www.southerncompany.com/aboutus/home.aspx>
- <sup>35</sup> Southwest Gas Corporation, Form 10-K, 2010
- <sup>36</sup> Proposed Decision dated November 28, 2011
- <sup>37</sup> 2010 Form 10-K
- <sup>38</sup> <http://www.metrodenver.org/investor-center/2011/xcel-energy.html>
- <sup>39</sup> Direct Testimony of Leland Snook on behalf of APS, Docket No. E-01345A-11-0224
- <sup>40</sup> Source: <https://aep.com/about/IssuesAndPositions/Financial/Regulatory/AlternativeRegulation/StraightFixedVariable.aspx>
- <sup>41</sup> Ralph Miller Direct Testimony, Brooks Congdon, on behalf of Southwest Gas Corp., Docket No. G-01551A-07-0504
- <sup>42</sup> Utility Rates Study, July 22, 2010 by the Minnesota Public Utilities Commission to the Senate Energy, Utilities, Technology & Communications Committee.
- <sup>43</sup> <http://citrusdaily.com/psc-approves-nuclear-cost-recovery-progress-energy-fpl/2011/10/25/87681.html>

<sup>44</sup> Also referred to as “Advanced Meters”.

<sup>45</sup> <http://www.greentechmedia.com/articles/read/smart-grid-cost-recovery-make-the-consumer-care/>

<sup>46</sup> [www.smartgridtoday.com/public/2174print.cfm](http://www.smartgridtoday.com/public/2174print.cfm), Order in Case 09-E-0310, <http://www.coned.com/documents/elec/159-164a.pdf>

<sup>47</sup> MD PSC Order No. 83410, pp. 1,3, dated June 21, 2010.

<sup>48</sup> MD PSC Order No. 83531, pp. 32-41.

<sup>49</sup> 2005 EEI Glossary.

<sup>50</sup> <http://www.oncor.com/community/vegetation/default.aspx>

<sup>51</sup> [http://en.wikipedia.org/wiki/Environmental\\_remediation](http://en.wikipedia.org/wiki/Environmental_remediation)

<sup>52</sup> <http://www.georgiapower.com/pricing/glossary.asp#r1>

<sup>53</sup> Atmos Energy

<sup>54</sup> <http://www.nj.gov/bpu/residential/glossary/>

<sup>55</sup> <http://www.georgiapower.com/pricing/glossary.asp#r2>

<sup>56</sup> 2005 EEI Glossary

<sup>57</sup> <http://www.cbo.gov/doc.cfm?index=976&type=o>

<sup>58</sup> South Jersey Gas





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