F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 02/24/09
SPONSOR Payne **LAST UPDATED** 03/04/09 **HB**

SHORT TITLE Public Utility Future Test Periods **SB** 477/aSCONC

ANALYST Lucero

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY09	FY10	FY11	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		Moderate	Moderate	Moderate	Recurring	General fund and utility funds

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals and Natural Resources Department (EMNRD)
Public Regulation Commission (PRC)

SUMMARY

Synopsis of SCONC Amendment

Senate Conservation Committee (SCONC) amendment eliminates the requirement that the Public Regulation Commission (PRC) base the future test period on substantial evidence in the whole record. It sets the test period as the 12 months following the date the proposed rate change is expected to start.

The amendment eliminates a rebuttable presumption that a proposed test period best reflects the conditions that will prevail during the period of the proposed change.

The amendment requires PRC's approval of in-progress construction in a rate base upon finding that a project's costs are reasonable but shall not include the associated allowance for funds used during construction in income. The amendment applies to the following type projects: environmental improvement projects and generation and transmission investments that have a certificate of public convenience and necessity, provided that such projects are expected to be in service at least 5 months after the utility's test period and twenty four months after filing for the rate proceeding.

Synopsis of Original Bill

The bill would establish a rebuttable presumption in favor of the use of a "future test period" to establish the just and reasonable rates of electric, gas, water and sewer public utilities subject to the jurisdiction of the Public Regulation Commission ("PRC"). The phrase "future test year" period is defined as the twelve-month period beginning on the date a utility's proposed rate is expected to take effect. The bill further provides that to the extent that "construction work in progress" ("CWIP") is included in a utility's rate base, the PRC is directed to determine whether the income, if any, used in determining the utility's revenue requirements shall include an "allowance for funds used during construction" ("AFUDC"), after considering:

1) the magnitude of the CWIP as a percentage of rate base;
2) the impact on cash flow and the utility's capital costs;
3) the effect on customer rates;
4) whether the construction confers a present benefit upon an identifiable class of customers;
5) whether the construction is short-term in nature or provides an imminent use in the provision of utility service; and
6) whether additional revenue will be produced as a result of the construction works.

Generally, CWIP is a utility's capital investment in utility plant under construction before it is completed and in service. Under CWIP, a utility's investment in its plant is added to its rate base as those costs are incurred, and before the plant is placed into service. AFUDC generally is an allowance for the return on the capital costs of financing the construction of utility plant and generally reflects the fact that it may take a considerable amount of time to construct certain types of utility plant. . Where AFUDC is allowed, the utility's actual cost of constructing the utility plant and AFUDC are added to the utility's rate base on the date the utility plant is placed into service.

The bill further provides that PRC shall include CWIP without including the associated AFUDC in income for renewable energy, energy efficiency, smart-grid technologies, environmental improvement project and generation and transmission investments.

Finally, the bill makes a number of what appear to be editorial, non-substantive changes to the existing provision of NMSA 1978, Section 62-6-14.

FISCAL IMPLICATIONS

There may be a moderate administrative impact to the PRC to adjust how public utilities rates would be determined, changes to rules and policy, and rate cases.

SIGNIFICANT ISSUES

The SONCS amendment gives the PRC more discretion in its selection and use of the future test period and in the decision of whether to include in-progress construction work in the rate base.

Under the bill, the PRC's method of determining the just and reasonable rates of public utilities would change substantially. In the vast majority of utility rate cases, the Commission has determined those rates based upon the utility's costs incurred during a 12-month period ending not more than five months before the rates are filed, as adjusted to reflect "known and measureable changes". Although the Commission's regulations currently permit utility's to base their rate requests using a future 12-month period that commences immediately after the utility's most recent 12-months of actual experience, the Commission has seldom used the 12-month future period because of the uncertainties in establishing rates using estimated future costs rather than actually incurred costs to establish rates. The bill's "future test year period" would commence approximately one year later than the future test year period set forth under the PRC's regulations, and thus would likely require an even greater degree of estimation than would the PRC's seldom-used future test year period.

With regard to the treatment of CWIP and AFUDC, the PRC's policy generally has been to allow either CWIP or AFUDC, but not both, with respect to any specific utility plant constructed by a utility. Although proposed Paragraph E of Section 62-6-14 provides for the inclusion of AFUDC and CWIP for certain plant investments, proposed Paragraph F of Section 62-6-14 further provides that AFUDC would not be included with CWIP for a significant portion of utility plant that has generally been constructed by utilities. Because these two provision appear to be inconsistent with each other, it is unclear whether and the extent to which the bill would impact the PRC's current policy on AFUDC and CWIP.

SB 477 adds "construction work in progress" (CWIP) to the determination of the value of an investor-owned utility and to its rate base. Construction for items for renewable energy, energy efficiency, smart-grid technology, environmental improvement project and generation and transmission investments pursuant to a certificate of public convenience and necessity are required to be included in the rate base with <u>no allowance</u> for funds used during construction. Other construction may be included in the rate base by action of the PRC and the <u>PRC shall include an allowance for funds used in construction</u>.

Utilities have historically sold stocks and bonds to private investors to pay for the construction of new power plants, and the finance charges for the use of this money were paid after the plant was producing electricity. According to comments filed with the Federal Energy Regulatory Commission in 1975 by the American Public Power Association: "[CWIP] abandons the traditional practice that the capital markets furnish capital for the construction of new plants. Instead, the Commission desires consumers to supply money for the growth of a private business, and the consumer receives no financial return for a company's use of his capital…The proposal removes incentive for utility management to curb costs. If a utility is guaranteed revenues for all costs incurred during construction, e.g. labor, equipment, property, engineering studies, etc., some incentive is removed for utility management to operate efficiently and be conscious of costs, because the consumer is supplying the capital, and the risk to management and to the investor is diminished." In other words, CWIP would allow electric utilities to charge current customers for future projects that are not yet providing any service or before they are audited.

PERFORMANCE IMPLICATIONS

Project funds would continue to be backed by shareholder profits rather than customer rates. Construction work in progress will continue to not be allowed when utilities set valuations or rates.

ADMINISTRATIVE IMPLICATIONS

According to the PRC, the bill would require the use of estimated or projected future costs to determine each public utility's just and reasonable rates, rather than using actual historical costs, adjusted for annualized and known and measureable changes, it is possible that the bill would require PRC staff and other interested parties to spend more time and resources in rate cases to determine whether a utility's projected costs are reasonable. This may impact staff resources, but quantification of that impact cannot be made at this time.

TECHNICAL ISSUES

The provisions of the bill which provide for the inclusion of AFUDC with CWIP (proposed Paragraph E of Section 62-6-14) appears to be inconsistent with the provisions of proposed Paragraph F of Section 62-6-14, which provides that AFUDC associated with CWIP shall NOT be reflected in rates.

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