



**Public Service  
Commission**

# **Cost Management and Deferrals**

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**Michael Rieder  
Chief, Gas and Water Rates Section**

# Rate Plan

## Resulting from Litigation

- Occurs when Staff and the Company cannot come to an agreement on the projected revenue requirement for the Rate Year.
- The Administrative Law Judge (ALJ) makes a revenue requirement recommendation to the Commission based on the record in the proceeding.
- The revenue requirement recommendation is subsequently reviewed, adopted or/and modified by the Commission.
- The Commission typically adopts a one-year term.

## Resulting from Negotiations

- Occurs when Staff, Company and other active parties agree on the revenue requirement needed for safe and reliable service.
- Joint Proposals are reviewed, adopted and/or modified by the Commission.
- The terms are typically two or three years.

# Capital Investments

## During the rate case proceeding

- The capital budgets are proposed by the Company and review by Staff for reasonableness to meet the needs of safety and policy goals.
- The Commission will either adopt or modify the Joint Proposal or the ALJ's recommendations to ensure the revenue requirement meets the projected capital investment for the term of the rate plan.

## After the rate case proceeding

- The Company is responsible for ensuring capital projects are done on time and on budget.
- The Company has the flexibility to adjust its capital spending programs to meet emerging needs and contain costs.

# O&M Expenses

- Similar to the Capital Budgeting process, Operation and Maintenance (O&M) budgets are established in a rate case.
- The O&M budget is either agreed upon by the Company, Staff and/or Other Parties in a Joint Proposal or a level is recommended by the ALJ.
- To incentivize the utility to control its costs and improve efficiencies, most O&M costs are not reconcilable.
- After the Commission approves a Rate Plan, the utility is expected to operate within its O&M budget while maintaining safe and reliable service.
- Opportunity to increase earnings if the O&M is reduced.

# Financial Protections

## Protections for the Company

- Provisions within a rate plan which allow for deferrals of costs in certain circumstances (i.e. costs resulting from regulatory or accounting changes).
- Reconciliation of certain revenues (RDM).
- Partial/Full reconciliation of non-core revenues.
- Reconciliation of certain expenses (property taxes, SIR, LAUF, etc...).
- Deferral petitions can be filed for costs arising from unforeseen circumstances.

## Protections for the Rate Payers

- Net Plant Reconciliation.
- Certain O&M expenses are not reconcilable.
- Reconciliation of certain revenues (RDM).
- Partial/Full reconciliation of non-core revenues.

# Deferrals

- Deferrals are allowed in unusual circumstances beyond the control of the Company.
- To determine whether deferral treatment is appropriate, the Commission applies the following three prong test:
  1. Costs must be incremental to what was allowed in rates
  2. Costs must be material and extraordinary
    - A) Material – Costs must be in excess of 5% of net income
    - B) Extraordinary - Costs were unforeseen and outside of the utility's control
  3. The Company cannot be over-earning

# Examples

## Example of costs that pass the three prong test:

- Storm restoration expenses – Significant storms (i.e., Hurricane Sandy) can result in costs that are in excess of the rate allowance and material and extraordinary.

## Example of costs that do not pass the three prong test:

- Incremental inspection costs – If a utility chose to employ a new method of inspection (that was not mandated by changes to regulations) or chooses to do additional inspections above what was funded in rates, then the costs would likely not be eligible for deferral treatment. Even if the costs were incremental and the utility was not overearning, the event would not be deemed extraordinary as it was not outside of the utility's control.

# Expectations

- Companies should manage their business operations within the existing rate plan.
- If a Company believes that additional work is needed and the costs of such work meet the three prong test previously discussed, then the Company should file a deferral petition clearly outlining how all tests are met.
- If the Commission determines that all three prongs have not been met, then the Company will not be allowed deferral treatment of the costs in question.
- A Company has the option to file for a petition with the Commission before incurring incremental O&M costs.