Hidden Power: The Story Behind Your Electric Bill

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For most of us, the monthly electric bill is a fact of life. Though its share of the household budget rises and falls with consumption, electricity ranks with water, food and shelter as an essential expense. Meeting this demand in homes and businesses across Alabama requires production and distribution on an enormous scale. Because of the unusual relationship between a "captive" market and what is often a single producer, states regulate power companies differently from most other commercial operations. In theory, one part of that regulation is allowing consumers to see how their utility rates are set. This fact sheet examines regulation of Alabama's largest utility company, with a focus on transparency in the rate-setting process.

The players

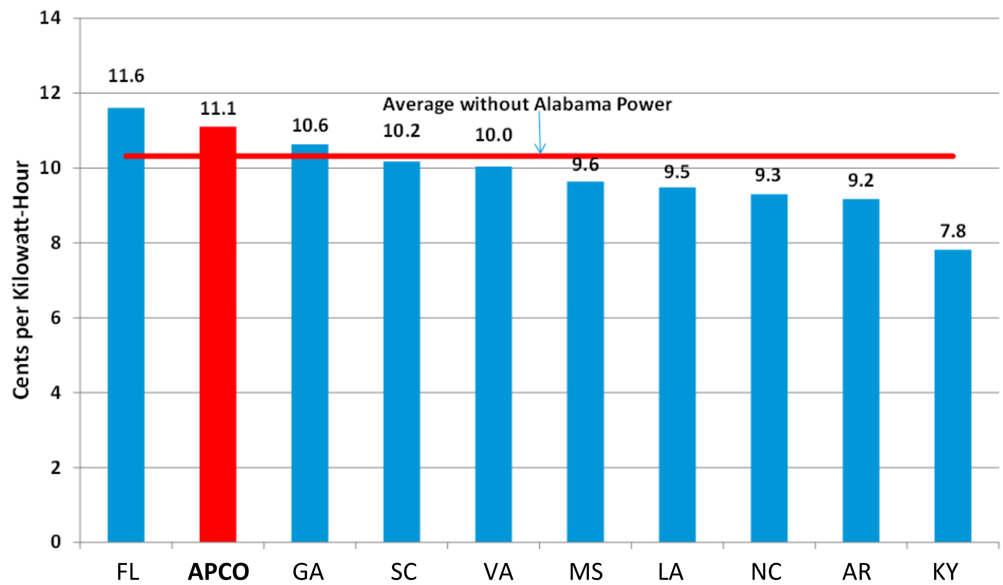
As he had promised in his campaign, newly elected Gov. Charles Henderson in 1915 created the Alabama Public Service Commission (PSC), expanding the powers of the Alabama Railroad Commission to include oversight of public utilities like electric, gas and telephone companies. In 1920, the Legislature authorized the commission to regulate utility rates. Nearly a century later, the PSC retains its original structure of three members – a president and two associate commissioners – each elected on a statewide ballot. The PSC is "committed to ensuring that the citizens of Alabama receive reliable and affordable utility and transportation services at rates that are fair and reasonable."

Alabama Power, founded in 1906, is the largest company regulated by the PSC. It provides electricity to approximately 1.2 million residential customers, 197,000 commercial customers and 5,200 industrial customers in the southern two-thirds of Alabama. Most residents in the northern third of the state are customers of the Tennessee Valley Authority (TVA), a federally owned, self-financed corporation.

Once upon a time: rate review

Customers of most commercial industries – such as appliance or automobile manufacturers – can "comparison shop" for prices and features that suit their needs. But customers of utility companies pay whatever the company charges for its electricity or gas service and usually can't shop for a better deal. States address this disparity by means of regulatory bodies to protect consumer interests in public services. In its original role, the PSC conducted detailed investigations and public hearings similar to court trials, with evidence from both sides, whenever Alabama Power proposed higher prices.

Average price per kilowatt-hour paid by residential customers of Alabama Power and customers of investor-owned utilities in other Southern states, 2008-11



SOURCE: *Public Utility Regulation Without the Public: The Alabama Public Service Commission and Alabama Power,* Institute for Energy Economics & Financial Analysis (2013)

From 1968 to 1982, Alabama Power filed 10 rate increase proposals. Such "rate cases" generally rested on the company's claim of rising production and distribution costs. The commission's proceedings on a case were usually combative, with the company defending its costs against consumer opposition, and could last six or seven months. Decisions were routinely appealed to the Alabama Supreme Court.

Concerned about the frequency and contentious nature of rate increase requests, the PSC in 1982 introduced a new process called rate stabilization and equalization (RSE). The premise is fairly simple. Each December, Alabama Power proposes to the PSC a rate of return (expressed as a targeted percentage range for its investors' profits) for the coming year. Once approved, the company can adjust its charges to achieve the approved profit, eliminating the need for contentious rate cases. The company raises consumer charges if the approved rate of return appears unlikely to be met, and lowers them if the rate of return will be exceeded. The current investor earnings range is between 13 percent and 14.5 percent.

Study highlights flaws in RSE

After more than three decades without a formal rate case, are Alabama consumers getting a fair deal for their electricity? A recent report by David Schlissel and Anna Sommer of the Institute for Energy Economics and Financial Analysis (IEEFA) raises serious concerns about the impact of the PSC's "hands-off" regulatory system on Alabama Power customers.

The interplay of two factors – average consumer prices and average investor earnings – is a useful indicator of rate fairness. Between 2008 and 2011, Alabama Power customers paid higher rates than residential power customers in all but one other Southern state. *(See graph on Page 1.)* During the same period, the 13.3 percent average return earned by Alabama Power investors was more than 40 percent higher than the average 9.4 percent earned by 76 other investor-owned utility companies in the United States, the study finds.

Why are Alabama Power customers paying more than consumers in neighboring states? While the RSE formula remains the same, much has changed in three decades. The demand for electricity is no longer growing at 8 percent annually, so Alabama Power no longer faces the same pressure to make large investments in new plants. Inflation is no longer at 13.5 percent a year, as it was in 1980. And utility financing costs are dramatically lower. Without formal hearings, such underlying factors never face rigorous scrutiny.

Minimal public involvement

Instead of the public evidentiary hearings used in states employing rate cases, the PSC conducts an expedited process for RSE review. Alabama Power submits calculations showing how much profit (within the approved range) the company would like to earn. An "informal" public meeting ensues, with no requirement that the company justify the reasonableness of its power generation expenses or its finances.

Alabama ratepayers have minimal participation in the rate-setting process. Though they may ask questions at the single annual informal meeting, there is no opportunity to submit data requests or expert testimony offering varied perspectives on energy production and regulation. The average PSC meeting in 2011 and 2012 was a mere 28 minutes long, according to the IEEFA report. Brief public meetings (often during weekdays when most people are at work) add to the impression that oversight is an insider's game. By law, Attorney General Luther Strange is supposed to represent consumer interests, but like his recent predecessors, he has not made PSC proceedings a high priority. Effective oversight is a challenge for his tiny consumer advocacy staff.

Only two other states – Louisiana and Mississippi – use RSE formulas to regulate electric utilities. However, those states have meaningful opportunities for public involvement in the regulatory process. Only in Alabama are consumers expected to trust without evidence that their interests are being effectively defended by the PSC and the attorney general.

"The Commission's isolation ... leads to secretive pro-utility decisions that fail to balance the interests of shareholders and ratepayers," the IEEFA report finds. "The current regulatory system in Alabama is unfair to customers, is no longer needed, unjustifiably rewards the company and is costly to the citizens of the state. The Commission should investigate moving back to more traditional ratemaking with periodic rate cases and public involvement in the rate-setting process."

Conclusion

Alabama Power is an essential and valued component of our state's infrastructure. The company supplies a vital commodity safely and reliably and is diligent about restoring service after storms. These high performance standards enhance the quality of life and build customer loyalty, but they do not override the need for meaningful public oversight. Comparing Alabama Power's profits and rates against those of electricity providers in other Southern states would be a good place to start.

This fact sheet was prepared by ACPP policy analyst Stephen Stetson. It may be reproduced with acknowledgment of Arise Citizens' Policy Project, Box 1188, Montgomery, AL 36101; (800) 832-9060; arisecitizens.org. ***To read the full IEEFA report, visit* arisecitizens.org *and click on "Utilities and PSC" in the Shortcuts column.***