

Main Elements of Tariffs which are Subject to Review by BPU

Revenue Requirement Equation

- $RR = P + T + (V - D) R$ where,
- RR = revenue requirement
- P = operating expenses and annual depreciation
- T = taxes
- V = value of utility plant
- D = accumulated depreciation
- R = rate of return

- The term $(V - D)$ is referred to as Rate Base
- Rate Base is determined based on the original cost of the investment and standardized accounting.
- Prudence of Rate Base Investments
- Supporting information.

Prudency of Investment

Rate of Return

- Return on equity is treated as a contested issue. The issue involves the rate of return, which common stockholders should be allowed to earn, consistent with the risk associated with their investment.

Rate of Return

- The problem with rate of return determination is that the cost of equity capital is not easily verifiable by empirical observation. It is a concept that exists within the theory of value of common stock, and thus the rate of return must be inferred from a conceptual model or formula

Methods for Rate of Return Determination

- Comparable earnings
- Discounted cash flow
- Capital assets pricing model

Generic Rate of Return Approaches

Rate of Return

- This should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economic management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Regulatory Risk and Rate of Return

Investors Have to Be Treated Fairly

Rate of Return Must Be Based on Market Reality

Cost Of Service Versus Value Of Service Ratemaking

Quality of Service

Price Can Only Be Set Relative to a Given Quality of Service

Quality Measures

- SAIFI – an outage frequency index
- CAIDI – an outage duration index
- Number of customer complaints
- Time taken to restore service

Bad Debt Expense
Societal Benefits Clause
Universal Service Fund

Adjustment Clauses