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## IF IT AIN'T BROKE: CONSIDERING LEGISLATIVELY MANDATED FORMULA RATE PLANS FOR OKLAHOMA'S ELECTRIC UTILITIES

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### *I. Introduction*

During the legislative session of 2023, the Oklahoma House and Senate considered two proposed measures that, if enacted, would have fundamentally changed how the Oklahoma Corporation Commission (“OCC” or “Commission”) regulates Oklahoma’s electric utilities.<sup>1</sup> The proposed legislation aimed to overhaul the ratemaking process by replacing the current system, which involves periodic rate cases every two to three years based on a historical test year, with an annual formula-based rate plan (FRP) for all Oklahoma electric utilities.<sup>2</sup> The FRP methodology would increase the frequency of rate adjustments based on an abbreviated review process. Although the legislative measures failed in the 2023 session, proponents of the mandatory FRP mechanism for Oklahoma’s electric utilities continue to pursue changes to the regulatory process.

Oklahoma’s two major investor-owned electric utilities, along with various customer groups, presented to the Oklahoma House Utilities Committee on the advantages and disadvantages of the proposed ratemaking change.<sup>3</sup> Company representatives of Oklahoma Gas & Electric (“OG&E”) and Public Service of Oklahoma (“PSO”) argued that an alternative ratemaking approach would streamline the electric utility ratesetting process,

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1. Ratepayer Protection Act of 2023, S.B. 1103, 59th Leg. (Okla. 2023); Rate Stabilization Act of 2023, S.B. 694, 59th Leg. (Okla. 2023).

2. The terms formula-based rate plans (FRPs) and performance-based rate plans (PBRs) are substantially similar and are used interchangeably throughout this comment.

3. Randy Krehbiel, *Electric Utilities, Consumer Groups Square Off Over Rate Proposal*, Tulsa World, Oct 23, 2023, [https://tulsaworld.com/news/state-regional/governmentpolitics/electric-utilities-consumer-groups-square-off-over-rate-proposal/article\\_184576ac-71d2-11ee-8599-1b7e783af427.html](https://tulsaworld.com/news/state-regional/governmentpolitics/electric-utilities-consumer-groups-square-off-over-rate-proposal/article_184576ac-71d2-11ee-8599-1b7e783af427.html).

“increase the accountability of the utilities, and increase the scrutiny of our costs.”<sup>4</sup> Opponents raised concerns to the legislative panel that formulaic annual reviews would *reduce* public scrutiny and oversight and lead to higher electric costs.<sup>5</sup> Customers particularly “questioned the likelihood that utilities are really that gung-ho for more accountability and scrutiny.”<sup>6</sup>

Customers and regulators are concerned that the proposed legislation would make mandatory a ratemaking approach that is already available to the OCC. In 2004 (without a legislative mandate), the OCC approved an FRP for an Oklahoma gas utility.<sup>7</sup> In its discretion, however, the OCC has not approved FRPs for any of the state’s electric utilities.<sup>8</sup> Todd Hiatt, Chairman of the OCC, raised concerns that the utilities’ recent push for a legislative mandate is an end-run around the OCC’s decision-making authority that, if enacted, would significantly curtail the OCC’s regulatory effectiveness.<sup>9</sup>

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4. *Id.* (quoting Kimber Shoop, OG&E’s Director of Regulatory Affairs).

5. *See* Krehbiel, *supra* note 3. In the meeting before the legislative committee, several customers and customer groups opposed to the legislation and made comments including American Association of Retired Persons (“AARP”); Oklahoma Industrial Energy Consumers (“OIEC”); Federal Executive Agencies/Department of Defense (“FEA/DoD”); Petroleum Alliance; and Walmart.

6. *Id.*

7. *See* In the Matter of An Application for a General Change or Modification in CenterPoint Energy Arkla, a Division of CenterPoint Energy Resources, Okla. Corp. Comm’n., Cause No. PUD 200400187, Order No. 499253, (Dec. 28, 2004).

8. *See e.g.*, In re Application of Public Service Company of Oklahoma, for an Adjustment in its Rates and Charges for Electric Service in the State of Oklahoma, Cause No. PUD 200600285, Order No. 545168, at 150, (Oct. 9, 2007) (denying implementation of PSO’s FRP); In the Matter of the Application of Oklahoma Gas and Elec. Co., for an Order of the Commission Authorizing Applicant to Modify its Rates Charges, and Tariffs for Retail Electric Service in Oklahoma, Okla. Corp. Comm’n, Cause No. PUD 2021, Order No. 499253, at 1,7 (Sep. 8, 2022) (approving a stipulation in which OG& E’s agreed to withdraw its proposed FRP); Application of Public Service Company of Oklahoma, for an Adjustment in its Rates and Charges and the Electric Service Rules, Regulations and Conditions of Service for Electric Service in the State of Oklahoma and to Approve a Formula Base Rate Proposal, Okla. Corp. Comm’n, Case No PUD 2022-000093, Order No. 738226 at 4, (Nov. 3, 2023) (approving a stipulation in which PSO agreed to withdraw its proposed FRP).

9. *See* Todd Hiatt, Opinion, *Corporation Commissioner: SB 1103 Will Increase Ratepayers’ Costs, Limit Panel’s Oversight*, The Oklahoman, Mar. 16, 2023, <https://www.oklahoman.com/story/opinion/2023/03/16/commission-chairman-oklahoma-bill-will-not-help-utility-ratepayers/70016647007/>. Hiatt was elected Chairman of the OCC Apr. 1, 2019. Prior to becoming an OCC commissioner, Hiatt served in the Oklahoma Legislature for twelve years, culminating his tenure as Speaker of the House in 2004. <https://oklahoma.gov/occ/about/commissioners/todd-hiatt.html>.

Hiett states:

This legislation isn't needed. The commission currently has the authority to grant PBR status to a utility after all groups impacted have had a chance to have input on the question.

SB 1103 would eliminate the existing process at the commission, which allows for testimony and evidence from consumer groups, business groups, the utility, and any other party with a stake in the outcome. That process has resulted in some of the lowest electric rates in the nation.

Further, the consumer protections contained in the PBR legislation already exist in Corporation Commission rules. In fact, many of the "consumer benefits" claimed in the measure are taken word-for-word from the commission's present rules.

The bottom line: SB 1103 will increase the cost to ratepayers and greatly limit the voice they currently have and the commission's role in determining those costs, forcing ratepayers to foot the bill for things that will only benefit the electric utility and its shareholders.<sup>10</sup>

On August 1, 2023, in response to the proposed legislative measures which would significantly alter the OCC's long-standing ratemaking approach, the OCC opened a Notice of Inquiry<sup>11</sup> in which all stakeholders in the regulatory process could publicly present information regarding potential benefits and detriments of alternative ratemaking methodologies (including FRPs) for Oklahoma's electric utility companies.<sup>12</sup>

While the OCC must comply with legislative requirements in its ratemaking process, the responsibility rests with the OCC to ensure that public utility rates are just and reasonable. The OCC's determinations can be

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10. *Id.*

11. *See* In re: Inquiry of the Okla. Corp. Comm'n to Examine Alternative Ratemaking Methodologies for and Issue of Electric Public Utilities, including but not Limited to Performance Based Rates and Right of First Refusal, ("Notice of Inquiry") Okla. Corp. Comm'n., Case No. GD 2023-000005, Order No. 736158 (Aug. 1, 2023). Interested parties submitted comments to the OCC on Oct. 1, 2023, and a public meeting to consider the issues is scheduled for Feb. 6, 2024.

12. *Id.* at 4. The OCC's Notice of Inquiry established a procedure by which stakeholders affected by these issues could submit written comments to the OCC by Oct. 1, 2023, with a public meeting to consider the issues scheduled on Feb. 6, 2024.

reviewed by the Oklahoma Supreme Court<sup>13</sup> and are ultimately subject to review by the United States Supreme Court to ensure compliance with the constitutional requirements of the Fifth and Fourteenth Amendments.<sup>14</sup> Although the legislature may have the legal authority to mandate formula-based ratemaking procedures, this comment asserts that it would be ill-advised to do so.

The FRP legislative measures purport to benefit customers, as is reflected in their titles: the “Ratepayer Protection Act”<sup>15</sup> and the “Rate Stabilization Act.”<sup>16</sup> However, important questions remain. Many of the Oklahoma customers voicing concerns about the proposed FRP legislation have a national presence and, therefore, have first-hand experience with the results of FRP ratemaking approaches in other jurisdictions. A review of the results in other jurisdictions that have enacted FRPs illustrates why this legislative mandate could do more harm than good for Oklahoma ratepayers.<sup>17</sup>

If a mandatory FRP for all electric utilities would truly result in ratepayer protection and rate stabilization, why are Oklahoma utility customers so vehemently opposed to it? Would an FRP approach curtail the Commission’s ability to implement a wide array of time-tested ratemaking methods in favor of one-size-fits-all ratemaking? Have the proponents shown that a mandatory FRP best suits the state’s overarching regulatory goals? Even more importantly, would the mandatory provisions of the FRP legislation interfere with the Commission’s ability to set just and reasonable utility rates, thereby contravening constitutional requirements established by the United States Constitution, the Oklahoma Constitution, and the Oklahoma courts? These important questions merit close examination.

This comment explores the ratemaking process in Oklahoma, focusing on the interplay between the OCC, the Oklahoma legislature, and the courts that review public utility regulation within the requisite constitutional framework. Section II reviews the jurisprudence that established the constitutional framework for setting just and reasonable rates for public utility companies. Section III examines the legal structure of the OCC, which is established by the Oklahoma Constitution, with its powers and procedures further defined by statute. Section IV discusses how traditional ratemaking balances the interests of investor-owned utilities and ratepayers to satisfy constitutional

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13. Okla. Const., art. 9, §20.

14. See *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 690 (1923); *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 601 (1944).

15. Ratepayer Protection Act of 2023, S.B. 1103, 59th Leg. (Okla. 2023).

16. Rate Stabilization Act of 2023, S.B. 694, 59th Leg. (Okla. 2023).

17. See *infra* Sec. VIII.

requirements. Section V examines the OCC's decisions to approve FRPs for Oklahoma's natural gas utilities and sets forth important distinctions between the state's natural gas utilities and electric utilities. Section VI presents the details of the proposed FRP legislation. Section VII explains how alternative ratemaking mechanisms, like the FRP, modify the traditional ratemaking approach and tend to shift risk to customers. Section VIII reviews the experiences from other jurisdictions in which FRPs have caused detrimental consequences for ratepayers. Section IX discusses the role of stakeholder participation in public utility regulation. Finally, Section X concludes that a legislatively mandated formula-based rates would likely have unintended consequences—namely, less public participation and higher electric utility rates due to reduced scrutiny under a formula-based ratemaking system.

## *II. The Constitutional Requirements in Utility Ratemaking: Just and Reasonable Rates*

State legislatures have broad discretion in determining how utility regulation will be conducted in their respective states. As the Supreme Court stated in *Duquesne Light Co. v. Barasch*: “[i]t cannot seriously be contended that the Constitution prevents state legislatures from giving specific instructions to their utility commissions. We have never doubted that state legislatures are competent bodies to set utility rates.”<sup>18</sup> This broad discretion, however, is bound by the overarching constitutional requirement that any ratesetting methodology employed must result in just and reasonable utility rates.<sup>19</sup>

The Supreme Court's starting point in interpreting the term “just and reasonable” is an analysis of the Takings Clause under the Fifth and Fourteenth Amendments.<sup>20</sup> The Fifth Amendment states that “private property [shall not] be taken for public use, without just compensation.”<sup>21</sup> The “just compensation” clause of the Fifth Amendment applies to the States through the due process clause of the Fourteenth Amendment.<sup>22</sup> Based on the Takings Clause requirement of the Fifth Amendment and the Due Process

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18. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 313 (1989).

19. *Hope*, 320 U.S. at 602 (holding that the “just and reasonable” standard is evaluated by the Court based on the end result reached, not the method employed.)

20. Patrick J. McCormick III & Sean B. Cunningham, *The Requirements of the "Just and Reasonable" Standard: Legal Bases for Reform of Electric Transmission Rates*, 21 *Energy L.J.* 389, 396 (2000).

21. U.S. Const. amend. V.

22. *See generally* U.S. Const. amend. XIV (“[No] State shall deprive any person of life, liberty, or property, without due process of law. . .”).

requirement of the Fourteenth Amendment, courts have interpreted the United States Constitution to require a non-confiscatory ratesetting process.<sup>23</sup> In *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*, the United States Supreme Court held that confiscatory rates are beyond legislative power:

Rates that are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.<sup>24</sup>

Similarly, in *Duquesne Light Co. v. Barasch*, the Supreme Court held that where a rate “does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments.”<sup>25</sup> This case law establishes the floor for setting “just and reasonable” rates.

There also exists a ceiling above which rates are considered unjust and unreasonable for the public. In *Federal Power Commission v. Hope Natural Gas Co.*, the Supreme Court held that “the fixing of ‘just and reasonable’ rates involves a balancing of the investor and the consumer interests.”<sup>26</sup> While regulatory commissions must protect utility investors from confiscatory rates, they also must protect the public from exploitive utility rates.<sup>27</sup> Thus, there is a “zone of reasonableness” within which rates may properly fall—it is bound at one end by the investor interests against confiscation and at the other end by the consumer interests against exorbitant utility rates.<sup>28</sup>

The Supreme Court has recognized that the economic judgments required to determine the zone of reasonableness are often “hopelessly complex.”<sup>29</sup> The balance of consumers’ and investors’ interests may vary widely according to various circumstances. As a result, regulators must be free to use whatever method will yield a reasonable rate.<sup>30</sup> Commissions must also be free to change their regulatory methodologies in response to changes in

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23. *Bluefield*, 262 U.S. at 690.

24. *Id.*

25. 488 U.S. at 307-8.

26. *Hope*, 320 U.S. at 603.

27. *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1176–77 (D.C. Cir. 1987).

28. *Id.*

29. *Duquesne*, 488 U.S. at 314.

30. *McCormick & Cunningham*, *supra* note 20, at 401.

circumstances over time.<sup>31</sup> As the Supreme Court explained in *Bluefield*, “[a] rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.”<sup>32</sup>

Due to the recognized need for flexibility in ratemaking, the Supreme Court has not imposed any specific ratesetting formula on regulatory commissions.<sup>33</sup> Instead, the Supreme Court has emphasized the importance of leaving state commissions “free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.”<sup>34</sup> In *Duquesne Light Co. v. Barasch*, the Court held that designating any single theory of ratemaking would unnecessarily foreclose alternatives that could benefit both consumers and investors<sup>35</sup>:

[T]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates. It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates.<sup>36</sup>

The Supreme Court has further held that the breadth and complexity of commissions' responsibilities demand that they be given “every reasonable opportunity to formulate methods of regulation” that are appropriate to address the “intensely practical difficulties” they face in setting just and reasonable rates.<sup>37</sup>

Thus, Supreme Court jurisprudence surrounding public utility regulation indicates that there is no single ratesetting method prescribed for achieving just and reasonable rates. This is in part due to the Court's recognition of the highly complex nature of public utility regulation.<sup>38</sup> Any ratesetting method employed by the states ultimately must be evaluated based on the end result.<sup>39</sup>

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31. *Id.* at 405.

32. *Bluefield*, 262 U.S. at 693.

33. *Hope*, 320 U.S. at 602 ([T]he Commission [is] not bound to the use of any single formula or combination of formula in determining rates.”).

34. *Duquesne*, 488 U.S. 299 at 313.

35. *Id.* at 316.

36. *Id.*

37. *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968).

38. *Duquesne*, 488 U.S. 299 at 314.

39. *Id.*, at 310.

Therefore, although state legislative bodies can define the methods of ratesetting, these methods must still result in just and reasonable rates for both the utilities and the public.<sup>40</sup> The legislative body charged with setting just and reasonable utility rates in Oklahoma is the OCC.

### *III. Legal Structure of the Oklahoma Corporation Commission (OCC)*

The OCC's authority to set public utility rates in Oklahoma is derived from the Oklahoma Constitution.<sup>41</sup> Article 9 of the Oklahoma Constitution grants the OCC broad authority to regulate all public service corporations.<sup>42</sup> The Oklahoma Supreme Court, in *In the Matter of Application of Oklahoma Gas and Electric Co.*, explains that the Commission's regulatory authority was "initially created and outlined in the Oklahoma Constitution, and its scope has been further defined by statute."<sup>43</sup>

The Oklahoma Constitution grants the OCC the authority to prescribe and enforce rates for public utilities.<sup>44</sup> Based on its constitutional mandate, the OCC has executive, judicial, and legislative powers to carry out the purposes for which it was created: namely, to regulate public service corporations and protect against abuse, discrimination, and excessive charges for essential services.<sup>45</sup> In setting rate schedules for the public, the Commission acts in a legislative capacity.<sup>46</sup> The Oklahoma Supreme Court has recognized that the ratemaking process is not an exact science involving precise mathematical

40. *See id.*

41. Okla. Const., art. 9, §§18, 34.

42. Okla. Const., art. 9, §§18, 34. The OCC has the authority to regulate "all transportation and transmission companies doing business in this State" to include "all gas, electric, heat, light and power companies, and all persons, firms, corporations, receivers or trustees engaged in said businesses, . . . and all persons, firms, corporations, receivers and trustees engaged in any business which is a public utility."

43. 2018 OK 31, ¶19, 417 P.3d 1196, 1203 (Okla. 2018).

44. Okla. Const., art. 9, §18.

45. *State of Oklahoma ex rel. Williams v. Oklahoma Nat. Gas Corp.*, 89 F.2d 416, 421 (10th Cir. 1937).

46. Ratemaking is a legislative function because it sets prospective rates. As the court noted in *In re Okla. Gas & Elec. Co.*, 2018 OK at ¶¶13-14, "A proceeding is judicial if it investigates, declares, and enforces liabilities as they stand on present and past facts and under laws supposed already to exist . . . A proceeding is legislative, conversely, if it looks to the future and changes existing conditions by making a new rule to be applied thereafter." A ratemaking hearing is always a legislative proceeding because it establishes a rule for the future." (citations and internal quotations omitted); *see also* *Wiley v. Okla Natural Gas Co.*, 1967 OK 152, ¶3, 429 P.2d 957; *Turpen v. Okla. Corp. Comm'n.*, 1988 OK 126, ¶ 76, 769 P.2d 1309.

calculations.<sup>47</sup> Accordingly, the Commission “has wide discretion in the performance of its duties” and is “not limited to any particular theory or method in fixing rates.”<sup>48</sup> The following section discusses the fundamental principles of traditional ratemaking.

#### *IV. Traditional Ratemaking*

##### *A. Why Regulate Public Utilities?*

States have police power to regulate public utilities because affordable and reliable access to water, heat, and electricity is vital to the health, safety, and welfare of the people.<sup>49</sup> Without governmental regulation, utility providers could operate as natural monopolies, and customers would have little recourse for the unreliable or unaffordable provision of essential services. A natural monopoly occurs when providing a particular service requires such a significant investment of capital that it becomes difficult for multiple service providers to compete in the same market.<sup>50</sup> To remedy this situation, utilities are given “the privilege of providing service on a monopolistic basis subject to regulation by Commission, when and if competition between utilities selling a like commodity results in wasteful and costly duplication of facilities, the cost of which will eventually be borne by the public served.”<sup>51</sup> In exchange for receiving monopoly status, utilities are required to enter into a “regulatory compact” with the state.<sup>52</sup> Under this regulatory compact, utility providers are protected from unreasonable competition, while customers are protected from unreliable service, discriminatory practices, and monopolistic pricing.<sup>53</sup>

##### *B. Regulation Serves as a Proxy for Competition and Protects the Public Interest*

Because the government grants electric utilities monopolistic service territories, regulation is needed to serve as a substitute for competition.<sup>54</sup> Commissions are granted regulatory authority over public utilities to 1)

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47. *Turpen*, 1988 OK at ¶ 86.

48. *Id.*

49. 64 Am. Jur. 2d Public Utilities § 14.

50. Inara Scott, *Teaching an Old Dog New Tricks: Adapting Public Utility Commissions to Meet Twenty-First Century Climate Challenges*, 38 Harv. Envtl. L. Rev. 371, 384 (2014).

51. *Data Transmission Co. v. Corp. Comm'n*, 1976 OK 148, ¶ 14, 561 P.2d 50, 55.

52. Scott, *supra* note 50, at 384.

53. *Id.* at 385.

54. *Id.*

counteract the lack of competition within the electric industry, 2) promote widely available utility services, and 3) ensure utility companies charge the public reasonable rates.”<sup>55</sup> In theory, although not a perfect substitute, a regulated monopoly and a competitive marketplace should reach fundamentally similar economic allocations of resources.<sup>56</sup>

The Supreme Court established the legal foundation for this type of regulation in *Munn v. Illinois*.<sup>57</sup> In *Munn*, the Court held that a grain storage elevator company that operated as a monopoly and provided essential services to the community at large was a public entity subject to state regulation.<sup>58</sup> Because utilities are crucial for providing essential services, supporting public health and welfare, and contributing to the state's economic well-being, effective regulation of these utilities is regarded as a vital state interest. In fact, the United States Supreme Court has described utility regulation as “one of the most important of the functions traditionally associated with the police power of the States.”<sup>59</sup>

In Oklahoma, the agency entrusted with this police power is the OCC. Fulfilling its role in the regulatory compact, the OCC serves as a proxy for competition by holding administrative hearings to ensure proposed rates for public utility services are set in accordance with State and U.S. Constitution requirements.<sup>60</sup> The OCC’s main goal is to safeguard the public interest by ensuring that public utility services are provided at just and reasonable rates.<sup>61</sup> The OCC has traditionally achieved this objective via rate cases, an administrative process by which the regulated utility, the Office of the Attorney General, and other intervening stakeholders litigate to determine reasonable utility rates based on the utility company’s revenue requirement. Before establishing rates, the Commission fully examines the utility’s books and records and holds a public hearing.<sup>62</sup> The specific rates are then determined by examining the utility’s assets and expenses in providing its service to the public.<sup>63</sup>

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55. *Id.* at 386.

56. Roger D. Colton, *Prudence, Planning, and Principled Ratemaking-A Reply to Professor Schwartz*, 35 *Hastings L.J.* 723, 728-729 (1984).

57. 94 U.S. 113 (1877).

58. *Id.*

59. *Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm’n*, 461 U.S. 375, 377, 103 S.Ct. 1905 (1983).

60. Okla. Const., art. 9, §18; U.S. Const. amend. V&XIV.

61. Okla. Const., art. 9, §18.

62. Okla. Stat. tit. 17 § 152 (1994).

63. *Turpen v. Okla. Corp. Comm’n*, 1988 OK 126, 769 P.2d 1309, 1316, n. 7; *State ex rel. Cartwright v. Okla. Nat. Gas Co.*, 1982 OK 11, 640 P.2d 1341, 1349.

This traditional ratesetting process ensures that the costs for services rendered under monopoly conditions remain reasonable. The commission imposes regulatory measures to approximate the competitive market conditions in a field where monopolies are granted and protected by the government.<sup>64</sup> Instead of competitive market forces causing utility providers to set reasonable rates based on supply and demand, the OCC's three-member body ensures just and reasonable rates based on the evidence presented at periodic administrative hearings.<sup>65</sup> Therefore, the rate case plays a critical role in the ratemaking process—it is the regulatory mechanism that ensures just and reasonable rates and prevents captive consumers from paying excessive prices for essential services.

*C. Rate Cases Are Specialized Proceedings In Which Stakeholders Participate*

In Oklahoma, a rate case occurs whenever a utility company seeks to increase its rates.<sup>66</sup> A rate case has the following goals: (1) to provide a public forum for the OCC to examine and discuss the rate increase request and (2) to balance the needs of customers and utilities with public policy objectives.<sup>67</sup> Parties to a rate case typically include the OCC's Public Utility Staff; the Office of the Attorney General (representing residential customers); commercial and industrial customer groups, customer associations, and public interest advocates; community action groups and private citizens.<sup>68</sup>

To initiate a rate case, the utility files an application with the OCC, along with substantial supporting documentation to justify the proposed rate increase.<sup>69</sup> The utility's documentation will include "the cost of labor, materials, taxes, and depreciation on the plant used to provide and deliver service, as well as the interest for debt issued by the utility to finance the

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64. See Scott, *supra* note 50, at 385.

65. See Okla. Stat. tit. 17 § 152(B); see also Okla. Corp. Comm'n, *Rate Cases and the Ratemaking Process*, <https://oklahoma.gov/occ/divisions/public-utility/ratecase.html> (last updated on Oct. 07, 2021).

66. Okla. Corp. Comm'n, *Rate Cases and the Ratemaking Process*, <https://oklahoma.gov/occ/divisions/public-utility/ratecase.html> (last updated on Oct. 07, 2021).

67. Office of the Attorney General of Oklahoma, *Public Utilities; How Does My Utility Decide What to Charge Me?*, <https://oklahoma.gov/oag/about/divisions/utility-regulation/public-utilities.html> (last visited Jan. 18, 2024).

68. See Okla. Stat. tit. 17 § 152(B); see also Okla. Corp. Comm'n, *Rate Cases and the Ratemaking Process*, <https://oklahoma.gov/occ/divisions/public-utility/ratecase.html> (last updated on Oct. 07, 2021).

69. Okla. Corp. Comm'n, *Rate Cases and the Ratemaking Process*, <https://oklahoma.gov/occ/divisions/public-utility/ratecase.html> (last updated on Oct. 07, 2021).

construction of that plant.”<sup>70</sup> The proposed rate will also include a reasonable return on investment for the utility’s shareholders.<sup>71</sup> Together, these inputs establish the utility’s revenue requirement: the amount of money it needs to recover from customers to cover its costs and make a reasonable profit.<sup>72</sup> This traditional ratesetting approach is known as “cost of service” (COS) ratemaking because it is based on the utility’s actual cost of providing service.<sup>73</sup>

After a utility initiates a rate case, the OCC moves to the hearing phase. The hearing phase involves the presentation of witness testimony on all sides of the issue.<sup>74</sup> Witnesses on all sides of the issue file testimony and submit to cross-examination, under oath, on their positions.<sup>75</sup> After the presentation of evidence, an Administrative Law Judge typically files a report with the Commissioners, who in turn deliberate in open court and decide the outcome of the utility’s application.<sup>76</sup> The OCC balances the interests of a utility and its residential, commercial, and industrial customers, as well as public interest advocacy groups.<sup>77</sup>

The OCC’s approach has functioned well over the years, resulting in some of the lowest electricity rates in the country.<sup>78</sup> The OCC’s approach is designed to use a variety of ratemaking tools to meet the needs of the individual utility, and its customers, within the specific set of market conditions at the time of the rate case. As the Supreme Court explained in *Duquesne*, flexibility is important in ratemaking, and whether a particular rate for a utility is just and reasonable “will depend to some extent on what is a fair rate of return given the risks under a particular ratesetting system,

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70. *Id.*

71. *Id.*

72. *Id.*

73. See Darryl Tietjen, Pub. Util. Comm’n of Tex., *Briefing for the NARUC/INE Partnership: Tariff Development I: The Basic Ratemaking Process* (2017), at 3, <https://pubs.naruc.org/pub.cfm?id=538E730E-2354-D714-51A6-5B621A9534CB> (outlining the process and inputs for determining the ratemaking for the “Cost of Service” Regulation).

74. Oklahoma Corporation Commission, *Rate Cases and the Ratemaking Process*, <https://oklahoma.gov/occ/divisions/public-utility/ratecase.html> (last updated on Oct. 07, 2021).

75. *Id.*

76. *Id.*

77. *Id.*

78. U.S. News and World Reports, *Electricity Price*, <https://www.usnews.com/news/best-states/rankings/infrastructure/energy/electricity-price> (last accessed Feb. 1, 2024) (Oklahoma ranked 13th in lowest electric prices. The report considered prices in residential, commercial, industrial, transportation and other sectors that were averaged by the U.S. Energy Information Administration to determine a state’s electricity costs.).

and on the amount of capital upon which the investors are entitled to earn that return . . . [a]t the margins, these questions have constitutional overtones.”<sup>79</sup> Given the success of the OCC’s traditional ratemaking approach in maintaining reliable service at relatively low electricity rates, it is important to carefully consider whether alternative methodologies are warranted.

#### *V. The History of Formula Rate Plans in Oklahoma Ratemaking*

In recent years, Oklahoma’s two largest electric Investor-Owned Utilities (“IOUs”), PSO and OG&E, have requested that the OCC implement alternative ratemaking plans, including FRPs and performance-based rate plans (PBRs).<sup>80</sup> First, in 2006, PSO filed a request for an FRP as part of a general rate case in Cause No. PUD 200600285. At the conclusion of that litigated rate case, the OCC declined to adopt the proposed FRP.<sup>81</sup> In its 2018 rate case, PSO submitted another plan similar to PBRs that the OCC had approved for the natural gas utilities in the state.<sup>82</sup> Finally, in its 2021 rate case, OG&E asserted that the OCC should implement its proposed FRP approach, in part because its proposed plan was “consistent with the PBR mechanisms approved by the Commission for natural gas utilities in Oklahoma.”<sup>83</sup>

Proponents of the legislatively mandated FRP argue, “[i]f it’s good policy for the gas utilities to have, it should be good policy for the electric utilities to have as well.”<sup>84</sup> However, a review of the OCC Orders approving the natural gas companies’ FRP requests demonstrates several factors unique to

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79. *Duquesne*, 488 U.S. at 310.

80. In re: Inquiry of the Okla. Corp. Comm’n to Examine Alternative Ratemaking Methodologies for and Issues of Electric Public Utilities, including but not limited to Performance Based Rates, and Right of First Refusal, Okla. Corp. Comm’n, Case No. GD 2023-000005, Order No. 736158 at 1 (Aug. 1, 2023).

81. In re Application of Public Service Company of Oklahoma, an Oklahoma Corporation, for an Adjustment in its Rates and Charges for Electric Service in the State of Oklahoma, Cause No. PUD 200600285, Final Order, Order No. 545168 at 150, (Oct. 9, 2007).

82. See Direct Testimony of Steven L. Fate on behalf of PSO, Okla. Corp. Comm’n, Cause No. PUD 201800097, at 18-19.

83. See Direct Testimony of Jennifer E. Nelson on behalf of OG&E, Okla. Corp. Comm’n, Cause No. PUD 202100164, at 5.

84. Paul Monies, *Ratepayer or Shareholder Protection Act? Consumer Groups, Utilities Square Off on Pending Bill*, Oklahoma Watch, Mar. 21, 2023, <https://oklahomawatch.org/2023/03/21/ratepayer-or-shareholder-protection-act-consumer-groups-utilities-square-off-on-pending-bill/> (quoting Kimber Shoop, OG&E’s director of regulatory affairs).

the gas utility companies that are distinguishable from the current posture of the state's electric IOUs.<sup>85</sup>

*A. 2004: CenterPoint Energy Resources Corporation*

The OCC first approved the use of an FRP for CenterPoint Energy Resources Corp., (“CenterPoint”) in 2004.<sup>86</sup> CenterPoint asserted that in the decade preceding the 2004 rate case, its customer base had declined by 5,850 residential customers (a 5.7% decrease).<sup>87</sup> CenterPoint also presented cost of service data to support its contention that its total revenue deficiency for service provided to its Oklahoma customers was approximately \$7.4 million annually.<sup>88</sup> The Commission approved the implementation of CenterPoint’s FRP based on a unanimous stipulation of all the parties to the rate case, including CenterPoint, Staff, the Attorney General, and intervenors.<sup>89</sup> The Commission found that the stipulation and PBR plan did not preclude CenterPoint or the Commission from initiating a general rate proceeding, nor did they limit the OCC from requesting information from the Company based on the OCC’s general jurisdiction.<sup>90</sup> In a concurring opinion, Commissioner Bob Anthony stated,

The need for the rate increase contained in the stipulated agreement is caused by noticeable declines in the revenue generated by the utility's customer base. Some of this is understandably beyond the company's control due to shifting population and the economy of rural Oklahoma in the area that Centerpoint Arkla serves . . . [T]his should be encouraged, allowing frequent review by the Commission's auditing staff of the utility's financial health. But, if not tightly managed, *it has the potential of shifting risk to the ratepayer*. . . [E]ither the utility or the Commission retains the right to apply for a full rate case should financial conditions dramatically change during the plan's five-year cycle.<sup>91</sup>

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85. *See infra* Sec. V(a-b).

86. *See* In the Matter of an Application for a General Change or Modification in CenterPoint Energy Arkla, a Division of CenterPoint Energy Resources, Okla. Corp. Comm’n., Cause No. PUD 200400187, Order No. 499253, (Dec. 28, 2004).

87. *Id.* at 3.

88. *Id.*

89. *Id.* at 6.

90. *Id.* at 7.

91. *Id.* at 9 (Emphasis added).

2008: Oklahoma Natural Gas Company The OCC approved the adoption of an FRP for Oklahoma Natural Gas Company, (“ONG”) in 2009.<sup>92</sup> As with CenterPoint in 2004, the OCC order approved a joint stipulation of the parties, all unanimously agreeing to accept ONG’s proposed FRP.<sup>93</sup> The Joint Stipulation<sup>94</sup> described the conditions that gave rise to the need for the FRP:

The Company is currently *experiencing declining usage and little customer growth*, including a reduction in the number of gas appliances in homes, more energy efficient homes, and space heating market share loss. The Company maintains that these conditions and the resulting effects on the Company *make traditional ratemaking principles more difficult to apply . . .* The Stipulating Parties agree that *unique conditions*, as set out in the testimony made during the hearing on the merits, *constitute an extraordinary situation that justifies the Implementation of the attached tariff*.<sup>95</sup>

Public utility regulation is a specialized and complex field. Regulators routinely use a varied mix of methods to set just and reasonable rates based on evidence presented by the utility company and stakeholders.<sup>96</sup> Sound regulatory policy, therefore, requires that the insufficiency of traditional ratemaking should be a *precondition* for adopting formula rates so that the FRP plan can be devised to solve a utility’s specific problems.<sup>97</sup> This is exactly what occurred when the OCC approved FRPs for CenterPoint and ONG.

Rather than a one-size-fits-all mandate, the OCC approved the FRPs for the Oklahoma gas utilities based on the unique circumstances that demonstrated a financial need for the OCC to deviate from the traditional

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92. See Joint Application of David B. Dykeman, Director of the Public Utility Division of the Okla. Corp. Comm’n, and Oklahoma Natural Gas Co., a division of ONEOK, Inc. for approval of a Performance Based Rate Tariff, Okla. Corp. Comm’n., Cause No. PUD 200800348, Final Order Approving Joint Stipulation, Order No. 567498, (May 7, 2009) [hereinafter Joint Stipulation].

93. *Id.* at 1.

94. The stipulating parties included ONG, the Staff of the Public Utility Division of the OCC, the Attorney General, and the Oklahoma Industrial Energy Consumers (“OIEC”). See Joint Stipulation, *supra* note 92, Attachment A to the Final Order.

95. See Joint Stipulation, *supra* note 92, Attachment A to the Final Order.

96. Ken Costello, *Formula Rate Plans: Do They Promote the Public Interest?* The National Regulatory Research Institute, Aug. 2010, at 15.

97. *Id.*

ratemaking approach.<sup>98</sup> Oklahoma's electric IOUs have not demonstrated declining economic circumstances under the OCC's traditional ratemaking methods—to the contrary, the parent companies of both PSO and OGE report strong profits and projected earnings growth.<sup>99</sup>

Second, the FRPs approved for Oklahoma's gas utilities were implemented based on the joint stipulations of the parties in light of the unique circumstances. The FRPs were not imposed based on a legislative mandate with only an abbreviated rate review process. Since the OCC (as opposed to the legislature) created the FRP ratemaking mechanism for the state's gas utilities, it also has the power to change ratemaking methods in the future. If the OCC finds that the FRP no longer serves the public interest, it can revert to traditional ratemaking methods. Under a legislatively mandated FRP, however, the OCC may lose this flexibility.

Third, the gas utilities' rate class customer mix differs dramatically from Oklahoma's two largest electric IOUs. For example, in the 2004 CenterPoint case, the Large Commercial Service Class (LCS-1) provided \$885,912 of CenterPoint's \$33,626,700 total rates—meaning that the large customer class represented only 2.6% of the total rates collected by ONG.<sup>100</sup> By contrast, the percentage of industrial and large commercial customers on OG&E's system is significantly larger at 35%.<sup>101</sup> Because electric utility rates have a much greater impact on Oklahoma's large industrial customers, increases in these rates cause a greater impact on the state's economy.<sup>102</sup> The OCC is aware of the impacts its decisions have on the state's residents, businesses, and economy, and it has successfully balanced these interests by keeping the electric utilities profitable and financially sound while also maintaining Oklahoma's industrial rates at reasonable levels. Considering the risks and benefits of FRPs unique to the electric sector, the OCC has declined to

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98. See CenterPoint, *supra* note 86; and ONG, *supra* note 92.

99. See OGE Energy Corp Earnings Call Transcript, Nov. 2, 2023, 5:57 PM ET; see also Value Line OGE Energy Corp. Q3 2023 (Dec. 8, 2023) and Value Line American Elec. Pwr. Q3 2023 (Dec. 8, 2023), showing the Financial Strength of the companies as "A" and "A+" ratings, respectively.

100. See Attachment 2 to Order No. 499253, (Dec. 28, 2004), In the Matter of an Application for a General Change or Modification in CenterPoint Energy Arkla, a Division of CenterPoint Energy Resources, Okla. Corp. Comm'n., Cause No. PUD 200400187.

101. See OG&E's Application in Case No. PUD 2023-00087, Schedule M-1 showing the Oklahoma Proforma Base Rate Revenues. Power & Light customer classes constitute \$455 million (35%) of the \$1.318 billion total revenues.

102. See *infra*, Sec. IX, NOI comments from industrial companies, the petroleum industry, the FEA/DoD and other major employers across the state.

implement FRPs for Oklahoma electric utilities.<sup>103</sup> Perhaps frustrated by the OCC's refusal to implement an FRP approach, the utilities have come out strongly in favor of a legislative mandate for their preferred regulation method.

#### VI. Analysis of Oklahoma's Proposed Legislation

Senate Bill 1103, known as the Ratepayer Protection Act of 2023, allowed electric utilities in Oklahoma to file a "performance-based rate plan" each year for five years.<sup>104</sup> Under the proposed legislation, rates would be adjusted each year based on a comparison of the earned return on equity to the target return on equity.<sup>105</sup> The target return on equity is the return on equity authorized by the commission in the utility's most recent general rate case.<sup>106</sup> To adjust rates, the plan establishes a "dead band"<sup>107</sup>—the range of the utility's rate of return within which no rate adjustment occurs.<sup>108</sup> The statute provides that no rate change will occur if the earned return is within fifty basis points of the target return.<sup>109</sup> However, if the earned return is more than fifty basis points above the target return, a refund to ratepayers will be issued.<sup>110</sup> If the earned return exceeds fifty basis points below the dead band, rates will be increased to reach the target return.<sup>111</sup>

The legislation is short on a description of which adjustments, if any, can be made during the annual review. It only says that "rate base and cost of service shall be *computed* in the same manner as approved in the utility's most recent general rate case application."<sup>112</sup> The text says "computed," not "adjusted," which brings into question whether any adjustments, up or down, to rate base and operating expense are allowed.<sup>113</sup> However, the proposed

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103. *See supra* note 8.

104. This section of the comment will focus on the framework and language of SB 1103 as opposed to SB 694. The content of the bills was substantially similar. Of note, S.B. 694 improved S.B. 1103 by adding a provision that allows the OCC to discontinue the FRP (after its first five-year period) if it finds the FRP is no longer in the public interest. S.B. 694, 59th Leg. § 3.B.1, 4.E (2023).

105. Ratepayer Protection Act of 2023, S.B. 1103, 59th Leg. § 5.A.1 (2023).

106. *Id.* at § 5.A.2.

107. *Id.* at § 5.B.2.

108. *See e.g.*, Costello, *supra* note 96, at 8.

109. S.B. 1103 § 5.B.2.

110. *Id.* at § 5.C.1.

111. *Id.* at § 5.B.3.

112. *Id.* at § 5.D. (emphasis added).

113. *Id.*

legislation does specify several items that *cannot* be adjusted.<sup>114</sup> During the PBR period (generally 5+ years), the capital structure (debt to equity ratio) from the most recent general rate case will not change<sup>115</sup>, nor will the utility's return on equity.<sup>116</sup> Moreover, there is no provision for changes in depreciation rates or cost of service allocations to the customer classes.<sup>117</sup> Thus, though not completely clear, it appears the drafters of SB 1103 intend for the computation of rates each year to be very formulaic, with limited opportunity to adjust investment and operation expense levels up or down as would be done in a regular rate case to mirror expected levels in the future. In other words, the numbers are what they are, and rates will be adjusted to accommodate them.

The only full rate case reviews of proposed utility costs would occur once at the beginning of the 5-year plan and once at the end of the plan.<sup>118</sup> Regarding timing, the utility files an election to be regulated under a performance-based rate plan as part of a general rate case application.<sup>119</sup> The first annual review can be filed 180 days after new rates from the initial rate case go into effect.<sup>120</sup> The commission must issue a final order in the annual review within 180 days.<sup>121</sup> At the end of the 5-year plan, the utility must file another rate case. This means that, at a minimum, a 5-year formula rate base plan would cover an approximately six-year cycle.

YR 1	YR 2	YR 3	YR 4	YR 5	YR 6	YR 7
General Rate Case 1	Annual Review 1	Annual Review 2	Annual Review 3	Annual Review 4	Annual Review 5	General Rate Case 2

The proposed legislation also outlines the timing of each annual review. The commission shall conduct a hearing no later than 120 days after each performance-based rate filing and issue new rates within 180 days.<sup>122</sup>

The ratemaking approach in this proposed legislation undermines the OCC's regulatory authority because it would *mandate* an alternative

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114. *Id.* at § 5.A.3.

115. *Id.*

116. *Id.* at § 2.13.

117. *Id.*

118. *Id.* at §§ 2.11-12, 4.D.

119. *Id.* at § 3.A.1.

120. *Id.* at § 3.C.

121. *Id.* at § 3.F.2.

122. *Id.* at § 3.F.1-2.

ratemaking mechanism that the OCC has considered, but not implemented, for electric utilities in the state.<sup>123</sup> Alternative ratemaking mechanisms, including formula-based rates or performance-based rates, are tools that the OCC already has at its disposal. Moreover, the OCC has approved the use of performance-based rates where it deems them appropriate.<sup>124</sup> Here, the state's electric utilities vigorously promote the controversial proposed legislation while its residential, industrial, and commercial customers universally oppose it.<sup>125</sup> The question is whether a legislative mandate that requires the OCC to implement formula rates for electric utilities amounts to unnecessary legislative overreach that would do more harm than good for Oklahoma ratepayers.

### *VII. Comparison of Traditional Approach to Formula-Based Rate Mechanism*

This section examines the benefits and costs of traditional and formula-based ratemaking. Several states have adopted formula rate plans, either by legislative mandate or commission order, and several more are currently considering proposals to adopt FRP mechanisms. Therefore, a deeper exploration of the costs and benefits of both traditional and alternative ratemaking approaches is warranted.

#### *A. Traditional Cost of Service Ratemaking*

There are two traditional approaches for regulating public utilities: (1) the "fair value" approach and (2) the "historical cost" approach.<sup>126</sup> Under a fair value approach, public utilities are entitled to ask for a fair return on the market value of any investment they make to provide utility services to the public.<sup>127</sup> This approach mimics the competitive market in that the utility is only entitled to recover on successful investments.<sup>128</sup> Under the "historical cost" or "cost of service" (COS) approach, the utility is entitled to compensation for all prudent investments at their actual historical cost, regardless of whether the investments are deemed necessary or beneficial in

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123. *See supra* notes 80-83.

124. The OCC has approved the use of performance-based rates for Oklahoma's natural gas utilities, primarily in response to periods of declining load for those utilities, which has not been a concern for the electric utilities in the state. *See supra* Sec. V, The History of Formula Rate Plans in Oklahoma.

125. *See supra* Sec. IX, The Importance of Customer Perspectives.

126. *Duquesne*, 488 U.S. 308-10.

127. *Id.* at 308-09.

128. *Id.*

hindsight.<sup>129</sup> As a result, the utilities incur fewer risks with the COS approach than under a fair value approach but are also limited to a standard rate of return on the actual amount of money reasonably invested.<sup>130</sup>

Oklahoma follows the historical cost approach.<sup>131</sup> Under Oklahoma law, a public utility must furnish service “at the lowest reasonable rates consistent with the interests of the public and the utilities.”<sup>132</sup> In accordance with this guidance, the OCC has adopted traditional cost-of-service ratemaking mechanisms to balance the interests of the utility investors on one hand and the ratepayers on the other.

Under a cost-of-service ratemaking approach, public utilities are entitled to earn a reasonable rate of return on capital investments.<sup>133</sup> In *Lone Star Gas Co. v. Corporation Commission*, the Oklahoma Supreme Court held that a public utility is entitled to earn a return “sufficient to enable the public utility to operate successfully, maintain its financial integrity, attract capital, and compensate its investors for the risk assumed.”<sup>134</sup> Thus, for any capital investments made, an investor-owned utility is entitled to earn back the full cost of the investment in infrastructure plus a return on equity (“ROE”)—additional profit expressed as a percentage of the investment.<sup>135</sup> Under this model, every increase in capital spending (and every increase in allowed ROE) leads directly to higher utility earnings.<sup>136</sup> In other words, the more a utility spends, the more it makes.<sup>137</sup> A simple version of the formula is set forth as follows:<sup>138</sup>

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129. *Id.* at 309.

130. *Id.*

131. *State v. Okla. Gas & Elec. Co.*, 1975 OK 40, ¶ 20, 536 P.2d 887, 891.

132. *Id.*

133. *Lone Star Gas Co. v. Corp. Comm’n*, 1982 OK 79, ¶ 13, 648 P.2d 36, 39.

134. *Id.* (citing *Federal Power Commission v. Hope*, 320 U.S. 591 (1943)).

135. See Heather Payne, *Private (Utility) Regulators*, 50 ENV’T L. 999, 1019-1025 (2020)

136. *Id.* at 1020.

137. See Michael West, ‘Gold Plating’ Rife, *Assets in for a Hiding*, AGE (Jan. 31, 2013, 12:42 PM), <https://www.theage.com.au/business/gold-plating-rife-assets-in-for-a-hiding-20130131-2dmjg.html> (“[G]old plating is the excessive expenditure by electricity networks on poles and wires to increase their revenue (under the National Electricity Market regulatory framework, the more the power companies spend, the more they get paid – and this spending constitutes the single biggest component of the rise in our power bills.”)

138. See Tietjen, *supra* note 73.

$$\begin{array}{l}
 \text{Rate Base (Invested Capital) x Allowed ROE} \\
 + \text{ Operating Expenses} \\
 + \text{ Depreciation Expense} \\
 + \text{ Taxes} \\
 \hline
 \text{Revenue Requirement (Rates)}
 \end{array}$$

Critics of this formula claim that it provides an incentive for a utility to overinvest in the rate base to increase profits and that it provides little incentive for a utility to control its expenses.<sup>139</sup>

*1. Gold-Plating: Perverse Incentive Structures for Investor-Owned Utilities*

Because every increase in capital spending leads directly to higher earnings, utilities are incentivized to overcapitalize their systems, whether needed or not.<sup>140</sup> Known as the Averch-Johnson effect, this rate-of-return model for regulated monopolies creates a perverse incentive for utilities to gold-plate their systems to increase their profits.<sup>141</sup>

Unsurprisingly then, capital spending by U.S. investor-owned utilities has skyrocketed from \$69 billion in 2008 to about \$115 billion in 2016.<sup>142</sup> And thanks to high profits earned from high spending, the electric power industry has “outperformed the broader market indices for ten years ending in 2015, providing greater shareholder return than the Dow Jones Industrial Average, the S&P 500, or the Nasdaq.”<sup>143</sup> Similarly, Oklahoma IOUs have enjoyed steady load growth and financial success. For example, in its Q3 2023 Earnings call, OG&E stated:

OG&E continues to experience solid growth in weather normalized load, which increased approximately 2% compared to the third quarter of 2022. We are forecasting full year weather normalized load growth at 3% to 3.5%, and are on track for two consecutive years of at least 3% growth and three years of better

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139. The tendency for a regulated monopoly to overcapitalize is known as the Averch-Johnson effect. See Harvey Averch & Leland L. Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 AM. ECON. REV. 1052 (1962).

140. Payne, *supra* note 135, at 1020.

141. See *supra* note 140.

142. Ruhan Nagra, Jeanne Bergman, Jasmine Graham, *Regulatory Theater: How Investor-Owned Utilities and Captured Oversight Agencies Perpetuate Environmental Racism*, 25 CUNY L. Rev. 355 (2022).

143. Payne, *supra* note 135, at 1021, citing Thomas R. Kuhn & David K. Owens, Edison Electric Institute's 2016 Wall Street Briefing, *The Promise of Tomorrow: Electric Power Industry Outlook* (Feb. 10, 2016), <https://perma.cc/FV6T-XTYR>, at 2.

than 2% growth. We are proud of the sustained level of tremendous economic development and load growth [and] we are just getting started . . . Our balance sheet continues to be one of the best in the industry with no need to issue equity for our current capital forecast . . .<sup>144</sup>

## 2. Regulatory Lag

One important component of the traditional ratemaking approach is regulatory lag. Regulatory lag refers to the time between rate cases.<sup>145</sup> In effect, it is the “lag” that occurs from the time a utility’s rates are set in one rate case until its rates are reset in the next case.<sup>146</sup> Regulatory lag provides multiple ratemaking benefits.

First, regulatory lag provides a natural incentive for the utility to control its costs between rate cases.<sup>147</sup> When the OCC sets rates, it does so for the utility to recover a certain level of expense. If overall net cost levels *decrease* between rate cases, the utility keeps the additional profits.<sup>148</sup> If, on the other hand, there is a net *increase* in overall costs, the utility pays the difference.<sup>149</sup> With the utility bearing the risk of cost level increases between rate cases, it has a built-in incentive to control its costs during the periods between rate cases.<sup>150</sup> With such an incentive, regulatory lag plays an important role in the ratemaking formula and is included by design to promote cost control measures by the utility.

Second, regulatory lag is one tool regulators can use to manage a utility’s tendency to overcapitalize or “gold-plate” the system.<sup>151</sup> A utility is less likely to make unnecessarily large capital additions if it will have to bear the

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144. See OGE Energy Corp Earnings Call Transcript, Nov. 2, 2023, 5:57 PM ET; see also Value Line OGE Energy Corp. Q3 2023 (Dec. 8, 2023) (“We think OGE is well-positioned for the next few years due to rate relief, and the company’s improved prospects as a pure play electric utility.”).

145. David E. Dismukes, Ph.D., *Incentives, Risk and the Changing Nature of Utility Regulation*, Center for Energy Studies La. State Univ., NARUC Staff Subcommittee on Accounting and Finance Meetings, New Orleans, LA, Apr. 22, 2015, pp. 9-11. [https://www.lsu.edu/ces/presentations/2015/DISMUKES\\_NARUC-ACCT-STAFF-NOLA-MTG\\_final.pdf](https://www.lsu.edu/ces/presentations/2015/DISMUKES_NARUC-ACCT-STAFF-NOLA-MTG_final.pdf).

146. *Id.*

147. *Id.* at 11

148. *See id.*

149. *Id.*

150. *Id.*

151. *Id.* at pp. 9-11.

costs of these additions for some period of regulatory lag.<sup>152</sup> Periodic rate case reviews provide commissions with the necessary opportunities to evaluate the reasonableness of the utility's expenditures and capital investments.<sup>153</sup> On the other hand, with a formula rate plan, the utilities have almost no incentive to control costs. Utilities have virtually no reason to control costs if annual, expedited rate reviews include whatever annual costs and capital expenditures are incurred year to year. Oklahoma's legislatively proposed FRP reduces regulatory lag, and thus, would curtail the cost control advantages provided by traditional ratemaking.

Finally, regulatory lag also creates a degree of risk that utility companies bear between rate cases. Accepting risk associated with regulatory lag is one of the main reasons utilities receive returns on equity (ROE) above the level of "risk-free" capital.<sup>154</sup> In other words, without the risk of regulatory lag, a utility's authorized ROE should be set much lower than the currently authorized returns. Advocates of alternative regulatory schemes often encourage eliminating or reducing regulatory lag but fail to acknowledge that lower returns on investment should accompany the attendant risk reduction.<sup>155</sup> Regulatory lag enables utilities to assume a degree of risk and to manage that risk by controlling costs between rate cases. This is not a situation that regulators should strive to eliminate—it is an intentional feature of the regulatory paradigm.

### *3. Time, Expense, and Administrative Burden*

Critics of traditional ratemaking often cite the time, expense, and regulatory burden associated with rate cases to justify pursuing alternative ratemaking mechanisms.<sup>156</sup> They argue ratepayers should not be asked to

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152. *Id.*

153.

154. Risk-free capital is intended to capture the base level of returns from an effectively zero-risk investment. Even with traditional ratemaking, regulated utilities are generally seen as low risk, exhibiting lower levels of volatility than the market as a whole. *See e.g.*, Karl Dunkle Werner and Stephen Jarvis, *Rate of Return Regulation Revisited*, Energy Institute at Haas, Sept. 2022, pp. 17-18.

155. In re: Inquiry of the Okla. Corp. Comm'n to examine Alternative Ratemaking methodologies for and issues of Electric Public Utilities, Including, but not limited to, Performance Based Rates and Right of First Refusal, Okla. Corp. Comm'n, ("OCC Alternative Ratemaking Inquiry"), Cause No. GD 2023-000005, Oklahoma Industrial Energy Consumer's ("OIEC") Initial Comments in Response to Commission Notice of Inquiry, p. 4.

156. Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 16, *Public Service Co. of Oklahoma's Response to the Notice of Inquiry on Alternative Ratemaking*, p. 2; *see also* Kayla Carroway, Stefan Kasacavage, Tanya Monsanto, *Costs, Benefits, and Methods of*

bear the cost of these lengthy, litigious proceedings when alternative ratemaking processes, such as formula rate plans, can offer a more streamlined approach.<sup>157</sup> However, the costs associated with litigating a rate case pale in comparison to the money that ratepayers save by challenging utility revenue increase requests.<sup>158</sup> A cost-benefit analysis of a recent Oklahoma rate case demonstrates the value of stakeholder involvement in rate case proceedings from the customers' perspective.<sup>159</sup> In the 2022 OG&E rate case, the utility's application proposed a total rate increase of \$163.5M.<sup>160</sup> After the regulatory review and litigation were completed, the final rate increase approved by the OCC was only \$30M.<sup>161</sup> Thus, even with the \$490,000 rate case expense incurred by ratepayers included,<sup>162</sup> the rate case proceeding still saved ratepayers over \$133M—a 271:1 return on investment.<sup>163</sup>

#### *B. Formula-Based Rate Plans*

Proponents of formula rate plans—primarily utility companies—argue that this alternative ratemaking structure benefits both utilities and customers.<sup>164</sup> They argue that “rising interest rates, inflation, competition for capital, supply chain constraints, security threats, and the need to invest in technology are creating challenges and headwinds against investment that we need to address together through a less litigious but robust process.”<sup>165</sup> On the other hand, customers raise concerns that FRPs result in decreased stakeholder participation and increased risk for ratepayers.

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*Implementing Alternative Rate Mechanisms for Utility Ratemaking*, Legislative Research Commission, State of Kentucky (2022), at 13.

157. Carroway, *supra* note 156, at 13.

158. *Id.*

159. Application of Okla. Gas & Elec., Okla. Corp. Comm'n, Cause No. PUD 202100164, at 5. Cause No. PUD 2021000164.

160. *Id.*

161. See Stipulation Testimony of Donald Rowlett on behalf of OG&E, (filed Jul. 11, 2022) Okla. Corp. Comm'n, Cause No. PUD 202100164, at 3.

162. See Application of OG&E, Okla. Corp. Comm'n, Cause No. PUD 202100164, WP-H2.39; WP H-13a.

163. The Legislative Research Commission of Kentucky similarly evaluated the cost-benefit of the regulatory process by comparing the cost of general rate cases in the state to the amount of ratepayer money saved by each rate case. On average, a rate case cost ratepayers \$631,510, however, it saved ratepayers over \$21M. See Carroway, *supra* note 156, at 11, 13.

164. See *e.g.*, Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 16, *Public Service Co. of Oklahoma's Response to the Notice of Inquiry on Alternative Ratemaking*, p. 2.

165. *Id.*

### *1. Purported Benefits of Formula Rate Plans*

Under FRP ratemaking, utilities benefit from less regulatory lag, leading to more certainty in recovering costs.<sup>166</sup> Under the current system, cost fluctuations are only reviewed when a rate case is filed, which can range from two to ten years (depending on when the utility files a rate case) whereas cost fluctuations would be reviewed annually under the proposed.<sup>167</sup> To achieve these more frequent rate reviews and streamline the regulatory process, annual FRP reviews utilize the same return on equity, capitalization structure, and depreciation rates established in the general rate case that initiates the FRP term.<sup>168</sup> In other words, once these elements of the ratemaking process are set, the OCC cannot adjust these factors during the annual FRP review process. Utilities argue this approach is preferable since these three issues consume significant resources for all parties involved in a general rate review but do not often change significantly from rate case to rate case.<sup>169</sup>

Utilities claim customers benefit from fewer rate cases as these proceedings are costly and time-consuming.<sup>170</sup> Customers may benefit from the lower capital cost resulting from the lower business risk borne by the utilities under an FRP approach.<sup>171</sup> Customers can also benefit from FRPs if a utility earns above its authorized level of return. Under traditional ratemaking, the utility keeps unexpectedly high profits until the next rate case; under an FRP approach, some excess profits can be returned to customers sooner.<sup>172</sup> Customers may also benefit from gradual rate increases each year instead of a rate case proposing a double-digit rate increase.<sup>173</sup> Finally, customers may benefit under an FRP if the utility has “more motivation to advance social goals required by the regulator or state legislature (e.g., energy assistance to low-income households, energy

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166. Ken Costello, *Alternative Rate Mechanisms and Their Compatibility with State Utility Commission Objectives*, National Regulatory Research Institute, Apr. 2014, at 11; see also Okla. Corp. Comm’n, Case GD 2023-000005 Entry No. 16, *Pub. Serv. Co. of Okla. Response to the Notice of Inquiry on Alternative Ratemaking*, pp. 1-2.

167. Oklahoma Corporation Commission, Case GD 2023-000005 Entry No. 21, *Alternative Ratemaking Comments on behalf of Oklahoma Gas and Electric Company*, p. 6.

168. *Id.*, at 8.

169. *Id.*

170. *Id.*

171. Costello, *supra* note 166, at 11.

172. *Id.*

173. *Id.*

efficiency) to the extent that an FRP allows quicker compensation to the utility for any earnings losses that might otherwise ensue.”<sup>174</sup>

In response to the concern that FRPs create incentives for a utility to make large investments year after year, whether needed or not, proponents assert that an FRP approach prevents a utility from overcharging customers excess *profits*, as any profits above the authorized band are returned to the customer.<sup>175</sup> What these proponents fail to recognize, however, is that overcharging can also result from passing through excess *costs* to customers.<sup>176</sup> The concern is that FRP ratemaking methods increase the likelihood of a utility passing through excess, imprudently incurred costs to customers via less scrutinized annual reviews.<sup>177</sup>

Proponents of formula-based rate plans assert that gradualism—a steady annual rate increase—benefits both the customers and the utility.<sup>178</sup> However, this argument assumes that regular rate increases are needed. In other words, it assumes that investment levels in excess of annual depreciation recoveries each year are an inevitability. Critics fear this starting assumption may become a self-fulfilling prophecy. The utilities also contend that the proposed formula-based ratemaking approach will benefit customers by increasing regulatory oversight and eliminating the gaps between general rate investigations.<sup>179</sup> Opponents contend, however, that FRPs result in less effective regulation, even if more frequent reviews occur.

The traditional ratemaking process relies on public involvement to scrutinize utility findings and to establish a complete record that the Commission can use to make informed decisions in setting rates.<sup>180</sup> The concern with adopting a streamlined FRP ratemaking process is that it may inhibit public involvement and reduce the Commission’s ability to ensure just and reasonable rates.<sup>181</sup> A “less litigious” review of proposed utility rate adjustments may streamline the process at the expense of stakeholder participation.<sup>182</sup> The traditional model of ratemaking involves public

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174. *Id.* at 12.

175. *Id.*

176. *Id.*

177. *Id.*

178. Okla. Corp. Comm’n, Case GD 2023-000005 Entry No. 16, *Pub. Serv. Co. of Oklahoma’s Response to the Notice of Inquiry on Alternative Ratemaking*, pp. 2-3.

179. Okla. Corp. Comm’n, Case GD 2023-000005 Entry No. 21, *Alternative Ratemaking Comments on behalf of Okla. Gas and Elec. Co.*, p. 6.

180. *See Costello, supra* note 96, at 20.

181. *Id.*

182. *Id.*

evidentiary hearings, which include sworn testimony and supporting exhibits, detailed discovery, and a full review of the utilities' rate of return, non-fuel operations and maintenance costs, fuel costs, administrative and general expenses, and state and federal taxes.<sup>183</sup> In a general rate case, intervenors heavily scrutinize the utility's rate increase proposals, which aids regulators in determining whether the cost increases are necessary and prudent.<sup>184</sup> While proponents of FRPs tout the increased oversight provided by annual reviews, it is the quality (not the frequency) of these reviews that matters.

## *2. Shifting the Risk*

Formula rate plans shift financial risk from the utility to the ratepayer.<sup>185</sup> In traditional ratesetting, regulatory lag provides a cost-curtailment pressure that appropriately limits capital investment to what is reasonable and necessary. With annual reviews, however, utilities can fully recover investment costs (without the scrutiny that comes with litigation), which completely alters the risk analysis.<sup>186</sup> Utilities benefit from the higher stock prices that result from increased capital investments without bearing any risk that the costs will not be recovered. In light of this risk shift, the National Regulatory Research Institute recommends that regulators require the utility to accompany any FRP proposal with a calculation of the ROE effects.<sup>187</sup> Although a lower ROE should accompany the decrease in risk under an FRP,<sup>188</sup> this has not been the case for many states that have adopted FRP ratemaking mechanisms.<sup>189</sup>

## *VIII. Review of Experiences in Other Jurisdictions*

First, it is important to recognize that FRPs differ across various jurisdictions. Even within the same state, FRPs can differ between gas and electric providers, and vary based on whether they are legislatively mandated or voluntarily implemented by regulators. Due to the sheer number of

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183. See Tietjen, *supra* note 73.

184. Costello, *supra* note 166, at 23-24.

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.* at 18.

189. Daniel Tate, *Alabama Power earned \$1+ billion in profits over industry average on the backs of customers since 2014*, Energy and Policy Institute, (July 1, 2020), <https://energyandpolicy.org/alabama-power-earned-1-billion-in-profits-over-industry-average-on-the-backs-of-customers-since-2014/>.

variables that factor into ratemaking, comparing results across states may be instructive but not conclusive.

#### A. Arkansas

In its last Oklahoma rate case filing, OG&E indicated that the FRP it proposed was “conceptually similar to the Company’s FRP rider approved by the Arkansas Public Service Commission and found to be in the public interest of Arkansas customers.”<sup>190</sup> Therefore, Arkansas’ experience under a legislatively mandated FRP system is a helpful point of comparison for Oklahoma lawmakers.<sup>191</sup> OG&E, which provides electric power to both Oklahoma and Arkansas, points to its Arkansas jurisdiction as an example of FRP success.<sup>192</sup> In its comments to the OCC, OG&E stated that “the Company’s own experience with the FRP in its Arkansas jurisdiction demonstrate[s] the Commission need not speculate to know OG&E’s customers can benefit from the implementation of alternative ratemaking methodologies in Oklahoma.”<sup>193</sup> Arkansas regulators, however, don’t share OG&E’s enthusiasm for the legislatively mandated FRP.

Instead of a shining success story of FRP regulation, Arkansas’s experience serves as a cautionary tale for Oklahoma legislators. Arkansas’s formula rate plan was legislatively enacted in March 2015.<sup>194</sup> Since the adoption of the FRP in Arkansas, retail ratepayers have seen their electric rates increase (every year) to the statutory maximum level allowed in the state.<sup>195</sup> Based upon OG&E data reported to the U.S. Energy Information Administration for 2015-2021, the total residential electric costs for OG&E customers in Oklahoma grew by 8%, while OG&E’s Arkansas residential customers saw their electric rates increase by 31%.<sup>196</sup> Between 2018 and

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190. See Direct Testimony of Jennifer E. Nelson on behalf of OG&E, Okla. Corp. Comm’n, Cause No. PUD 202100164, at 5.

191. See Ark. Code §23-4-410.

192. Okla. Corp. Comm’n, Case GD 2023-000005 Entry No. 21, *Alternative Ratemaking Comments on behalf of Oklahoma Gas and Electric Company*, p. 3

193. *Id.*

194. Joy Niedao-Cuyugan, *Overview of Formula Rates in 7 State*, NARUC Staff Subcommittee on Accounting & Finance Meeting, Sept. 12, 2017, at 4, <https://pubs.naruc.org/pub.cfm?id=E3DA1263-C888-34FF-1720-3AB76A4C270B> (Act 25 and Administrative Code 23-41201 – Formula Rate Plan. The legislation applies to all independently owned utilities, including Entergy Arkansas, OG&E, and CenterPoint Energy Arkansas Gas).

195. Okla. Corp. Comm’n, Case GD 2023-000005 Entry No. 18, *Petroleum Alliance Comments*, p. 5.

196. *Id.*

2023, OG&E's industrial rates in Arkansas increased by 29.6%.<sup>197</sup> According to the Oklahoma Industrial Energy Consumer's ("OIEC"), OG&E's Arkansas formula rate plan has "benefitted company shareholders by increasing revenues and earnings, however, the formula rate plan has had a detrimental impact on industrial customers due to perennial rate increases."<sup>198</sup>

By 2017, the Arkansas Commission described the state's FRP system as devolving into an "automatic yearly four percent rate increase."<sup>199</sup> The Arkansas Commission also warned that "the FRP processes, including a reduction in the time afforded to review, the use of projection, and the annual rate adjustments do little to incentivize a utility to control its costs as compared to traditional ratemaking."<sup>200</sup>

In October of 2021, at the end of its first FRP period, OG&E filed a petition with the Arkansas Public Service Commission ("APSC") seeking to extend its Formula Rate Plan for another 5-year term.<sup>201</sup> The APSC denied OG&E's request, finding it was "not in the public interest to extend OG&E's FRP."<sup>202</sup> The APSC determined that OG&E's request to extend the existing FRP for another five years, without adjusting the company's capital structure and ROE, would "violate the Commission precedent that the ROE and the capital structure should be set in a congruent manner."<sup>203</sup> The APSC found that because the statutory FRP language prohibits the commission from adjusting OG&E's capital structure and ROE at the outset of the requested extension period, the resulting rates cannot be just and reasonable.<sup>204</sup> As a result, the APSC found "the only alternative to the Commission is to deny

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197. Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 24, *Oklahoma Industrial Energy Consumer's ("OIEC") Initial Comments in Response to Commission Notice of Inquiry*, p. 4.

198. *Id.*

199. Ark. Pub. Svc. Comm'n. Docket No. 16-036-FR, Order No. 21, issued 07/05/2019, at 41.

200. Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 18, *Petroleum Alliance Comments*, p. 6, citing Ark. Pub. Svc. Comm'n, Docket No. 16-036-FR, Order No. 21, issued 7/5/2019, at 40.

201. Ark. Pub. Svc. Comm'n, *In the Matter of Oklahoma Gas and Electric Company's Request to Extend its Formula Rate Plan Rider*, Docket No. 21-087-U, Application, (Oct. 1, 2021) at 4.

202. Ark. Pub. Svc. Comm'n, *In the Matter of Oklahoma Gas and Electric Company's Request to Extend its Formula Rate Plan Rider*, Docket No. 21-087-U, Order No. 11, (Sep. 19, 2022) at 5.

203. *Id.* at 4.

204. *Id.*

the FRP extension.”<sup>205</sup> This illustrates a shortcoming in legislatively mandated FRPs—the regulatory commission is not afforded the flexibility to set just and reasonable rates when financial and market conditions change and a regulatory adjustment is needed during the FRP period.

In reviewing Arkansas’s experience with a legislatively mandated FRP, it is important to highlight two key differences between the Arkansas and Oklahoma FRP legislations. First, the Arkansas FRP legislation included a four percent yearly cap for utility-proposed rate increases, while no cap is present in the Oklahoma legislation.<sup>206</sup> Additionally, the Arkansas legislation leaves the Commission free to abandon the FRP approach if the Commission finds that it is no longer in the public interest.<sup>207</sup> It appears no such escape hatch exists for the OCC in Oklahoma’s proposed FRP legislation. Instead, SB 1103 gives the *utility* unilateral authority to determine whether to continue or discontinue FRP regulation.<sup>208</sup>

### B. Alabama

The Alabama Public Service Commission (PSC) adopted a formula rate mechanism in 1982 that allows the utility to receive annual rate adjustments without filing annual rate increase applications.<sup>209</sup> According to the PSC, the state’s Rate Stabilization and Equalization formula for ratemaking was designed to “lessen the impact, frequency, and size of retail rate increase requests,” as well as to “avoid lengthy, expansive proceedings.”<sup>210</sup> The PSC contends that adopting a formula rate mechanism increases its ability to fulfill its statutory duty under Title 37 of the Code of Alabama (1975), namely, to supervise the operation of Alabama Power with appropriate representation of

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205. *Id.* at 5.

206. Ratepayer Protection Act of 2023, S.B. 1103, 59th Leg. (Okla. 2023); Rate Stabilization Act of 2023, S.B. 694, 59th Leg. (Okla. 2023).

207. “Upon a determination that it is in the public interest, a public utility may request, and the commission may extend the term of the formula rate review mechanism by a period of no more than five (5) years beyond the initial term.” Formula Rate Review Act (FRRRA), Ark. Code Ann. §§ 23-4-1208(a)(2)(A)(i) (emphasis added).

208. Ratepayer Protection Act of 2023, S.B. 1103, 59th Leg., (Okla. 2023). Section 6(D) provides: “The utility may withdraw its election to have its rates regulated pursuant to this act at any time.” S.B. 694, 59th Leg. (Okla. 2023), Section 4(E) does allow the Commission to discontinue the FRP after its first 5-year term.

209. David Schlissel, The Institute for Energy Economics & Financial Analysis, *Public Utility Regulation Without the Public: The Alabama Public Service Commission and Alabama* (2013), <https://media.al.com/wire/other/Arise%20report%20--%20Public%20Utility%20Regulation%20Without%20the%20Public%203-1-13.pdf>.

210. *Id.* at 5, quoting Alabama Public Service Commission Annual Report 2011, at 21.

the consumer interest.<sup>211</sup> This contention is dubious since Alabama's FRP mechanism removes customers from the ratemaking process altogether.

As a result of the state's FRP, there has not been a public rate case for the Alabama Power Company since 1982.<sup>212</sup> Instead, Alabama's formula rate mechanism allows Alabama Power to adjust utility costs each year "without any public evidentiary hearings and, indeed, without any participation by ratepaying customers whatsoever other than off-the-record and after-the-fact comments at an informal hearing that completely lacks public transparency."<sup>213</sup> This regulatory approach seems to validate customer fears that FRPs result in decreased stakeholder involvement.

The FRP system of regulation has resulted in high returns for Alabama Power. Though the state has operated under an FRP for over forty years, which decreases utility risk significantly, Alabama Power Co. consistently earns one of the highest ROEs in the country.<sup>214</sup> According to Advanced Energy Economy's Power Portal database, which tracks ROE for over 100 investor-owned utilities nationwide, Alabama Power Co. receives the highest allowed ROE.<sup>215</sup> Alabama Power has a significantly higher return on equity than any other utility, leading critics to wonder whether the Alabama Public Service Commission's FRP regulation system is properly balancing the interests of consumers and shareholders.<sup>216</sup>

For example, a report published by The Institute for Energy Economics and Financial Analysis found that between 2008-2011, Alabama Power earned an average 13.3% return on equity, some 40% higher than the average 9.4% earned by 76 other domestic U.S. utility operating companies.<sup>217</sup> In 2018, the average return on equity (ROE) for electric utilities nationwide was 9.51%, yet Alabama utilities earned an ROE of 12.69% that year.<sup>218</sup> To put these values in context, if Alabama Power's ROE had matched the average ROE for the industry each year from 2014 to 2018, Alabama Power customers would have saved \$1.02 billion.<sup>219</sup> These ROE profits, on top of the industry average, total \$715 per Alabama Power customer account each

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211. *Id.* at 6, citing Alabama PSC Special Rules Governing Operation of Rates RSE and CNP, Fifth Revision, effective date Oct. 16, 2005.

212. *See* Schlissel, *supra* note 209, at 1.

213. *Id.*

214. Niedao-Cuyugan, *supra* note 194, at 4; Tate, *supra* note 189.

215. Coley Girouard, *How Do Electric Utilities Make Money?*, ADVANCED ENERGY PERSPECTIVES (Apr. 23, 2015), <https://perma.cc/8DYP-KQ7K>.

216. *See id.*

217. Schlissel, *supra* note 209, at 2.

218. Tate, *supra* note 189.

219. *Id.*

year.<sup>220</sup> It is not difficult to see why utility companies across the country are pushing for formula rate plans—they result in lower risk and very high rewards.

### *IX. Importance of Customer Perspectives*

After the formula rate measures failed in the 2023 legislative session, the OCC opened a Notice of Inquiry (“NOI”) proceeding, Case No. GD 2023-000005, to make a public forum available for stakeholders to address the pros and cons of alternative ratemaking methodologies.<sup>221</sup> Nine stakeholders and interested parties filed comments: four utility companies and five customer groups. The four utility parties support formula rates,<sup>222</sup> while the five customers and groups opposed the adoption of formula rates.<sup>223</sup> The customers filing NOI comments represent a large cross-section of electric customer classes, including residential customers (“AARP”), commercial customers (“Walmart”), large industrial customers (“OIEC”), oil and gas industry customers (“Petroleum Alliance”), and military bases (“FEA/DoD”). These customer groups represent a large majority of the job-creators in the state, including manufacturing, oil and gas, military facilities, distribution centers, and retail stores.

Although customer participation is not strictly *eliminated* under the FRP approach, the reality is that the annual rate reviews of limited scope are not conducive to, or cost-effective for, customer participation. Ratemaking for electric utilities is complex and technical. It requires a delicate balancing of interests, and the OCC’s decisions critically impact a state’s economy. Mandating a process that forecloses customer participation is a bad idea. The stakeholders’ comments below address areas of concern that the OCC and the legislature should consider. The FRP process, though “streamlined,” may

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220. *Id.*

221. In re: Inquiry of the Oklahoma Corporation Commission to Examine Alternative Ratemaking Methodologies for and Issues of Electric Public Utilities, including but not limited to, Performance Based Rates, and Right of First Refusal, Okla. Corp. Comm’n, Case No. GD 2023-000005 Order No. 736158 (Aug.1, 2023).

222. The following public utilities submitted comments in support of formula-based rates: Oklahoma Gas and Electric (OG&E); OG&E Shareholders Association; Public Service Company of Oklahoma (PSO); and Empire District Electric Company (Empire).

223. The five customers, and customer groups, which filed comments to the OCC Alternative Ratemaking Notice of Inquiry include the following: American Association of Retired Persons (AARP); Oklahoma Industrial Energy Consumers (OIEC); Federal Executive Agencies (FEA); Petroleum Alliance; and Walmart.

result in the OCC making decisions in an echo chamber, devoid of customers' counter-balancing perspectives.

Electric utility customers express concern that the proposed alternative ratemaking approach would result in less effective regulatory oversight, impairing consumer groups' ability to review utility costs and investments thoroughly.<sup>224</sup> For example, the Federal Executive Agencies/Department of Defense (FEA/DoD)<sup>225</sup> argue that performance-based rate mechanisms allow for the pass-through of cost increases without the critical review provided by a traditional rate case, which in turn erodes the public utilities' incentive to manage the cost of service effectively.<sup>226</sup> Customers argue that implementing a regulatory mechanism that reduces critical review of costs (while simultaneously reducing the utilities' economic incentives to manage costs) is bad for both customers and the state's economy.<sup>227</sup>

The Petroleum Alliance asserts that the proposed alternative ratemaking approach is a "solution in search of a problem."<sup>228</sup> Customers argue that the traditional ratemaking method has worked well for Oklahoma electric utilities and customers for decades.<sup>229</sup> It has resulted in compensatory rates for utilities and fair and reasonable rates for customers.<sup>230</sup> In short, customers maintain that traditional ratemaking in Oklahoma is not broken and does not require a fix.<sup>231</sup>

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224. Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 24, *Oklahoma Industrial Energy Consumer's ("OIEC") Initial Comments in Response to Commission Notice of Inquiry*, p. 4.

225. The FEA/DoD in Oklahoma consists of all federal executive offices who receive utility services in the state of Oklahoma, including Tinker Air Force Base (AFB), Vance AFB, and the Army's Fort Sill. Utility costs, particularly electricity costs, represent one of the largest variable expenses of operating the FEA/DoD's offices, facilities, and installations and a change in how the rates for these utilities are approved by the OCC could have a significant impact on the interests of all FEA/DoD's customers including our Oklahoma military installations. Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 15, *Federal Executive Agencies' Public Comment*, p. 1.

226. *Id.* p. 16

227. *Id.*

228. Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 18, *Petroleum Alliance Comments*, p. 11; *see also* Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 13, *AARP Oklahoma Comments*, p. 2.

229. Okla. Corp. Comm'n, Case GD 2023-000005 Entry No. 24, *Oklahoma Industrial Energy Consumer's ("OIEC") Initial Comments in Response to Commission Notice of Inquiry*, p. 2.

230. *Id.*, at 3.

231. *Id.*

In summary, the state's retail, commercial, residential, and industrial customers are concerned that alternative ratemaking methodologies are unnecessary for Oklahoma electric utilities. They are also concerned that a legislatively mandated FRP would result in increased rates, decreased efficiencies, and negligible improvements in reliability or quality of service.

#### *X. Conclusion*

The proposed, legislatively mandated formula rate plan is not in the best interest of Oklahoma ratepayers. The FRP legislation purports to offer ratepayer protection and rate stabilization, yet proponents of the legislation fail to articulate any customer protection or rate stability problems that exist under the current system. Oklahoma ratepayers greatly prefer the traditional regulation methods, believe these methods are best for the Oklahoma economy, and stand together in opposition against legislatively mandated FRPs. Moreover, the traditional ratemaking approach has enabled Oklahoma electric utilities to remain financially sound with stable growth and increasing shareholder returns.

Oklahoma's investor-owned electric utilities argue that formula-based ratemaking is a proven regulatory model that the OCC has approved for the state's gas utilities since 2004.<sup>232</sup> They contend that the successful history of formula-based rates in the natural gas sector demonstrates that electric utility customers could also benefit from an FRP approach. However, a review of the history of FRPs in the gas sector reveals many distinctions between the two industries. The OCC's use of FRPs was justified for the gas sector due to declining load growth—in the electric sector, load growth is robust and is projected to continue. Additionally, the OCC adopted the FRP system on a case-by-case basis in response to a joint stipulation with the customers' agreement. In other words, the customers, utilities, and commissioners all agreed that FRP regulation was appropriate for the gas industry based on the “unique conditions” and “extraordinary situation” facing the industry at the time.<sup>233</sup> No such agreement exists here—customers have routinely opposed and the OCC has routinely rejected FRP regulation for the state's electric utilities.

Oklahoma's electric utility customers vehemently oppose the mandatory FRP because they have experienced excessive rate increases and decreased customer participation opportunities in other FRP jurisdictions. Furthermore,

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232. See Oklahoma Corporation Commission, Case GD 2023-000005 Entry No. 21, *Alternative Ratemaking Comments on behalf of Oklahoma Gas and Electric Company*, at 15.

233. See Joint Stipulation, Attachment A to the Final Order, *supra* note 94.

a sweeping FRP mandate for all electric utilities would curtail the Commission's ability to implement a wide array of time-tested ratemaking methods in favor of a one-size-fits-all ratemaking approach. Under these circumstances, a legislative mandate may impede the Commission's ability to engage in ratemaking practices that ensure just and reasonable rates, as required by Oklahoma and US constitutional law. For these reasons, the Oklahoma legislature should avoid mandating the use of FRPs. In short, if it ain't broke—don't fix it.