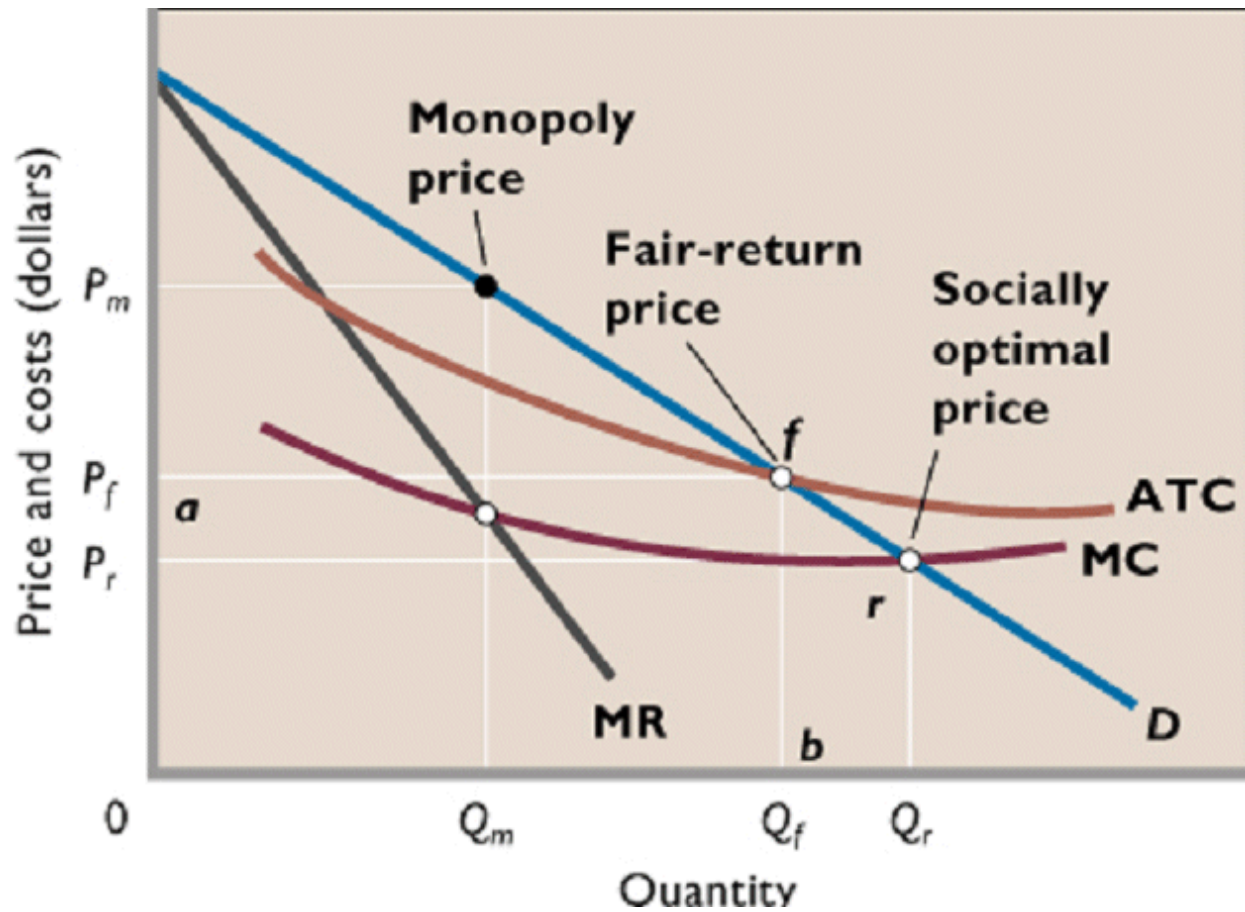


There'll Be Some Changes Made: Power System Realignment or Death Spiral?

Climate Week NYC
Urban Future Lab, NYC ACRE
September 9, 2014

Michael J. Gergen, Partner
Latham & Watkins LLP

The Regulatory Problem



Average Cost-Based Rates

$$R = O + (V - D) * r$$

R is revenue requirement

O is operating costs

(V - D) is rate base

gross value of tangible and intangible property (**V**) less accumulated depreciation (**D**)

r is allowed rate of return

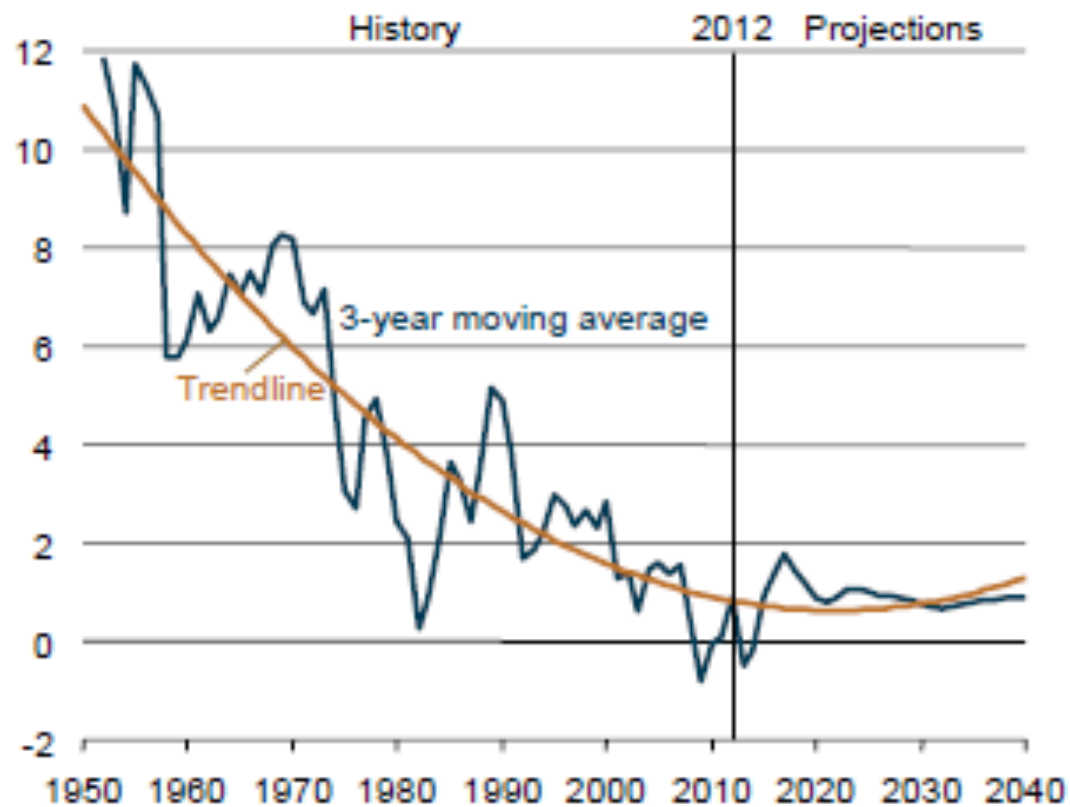
r is weighted average cost of equity and debt capital

$$\text{Price} = R/Q$$

Q is quantity to be sold (or expected to be sold)

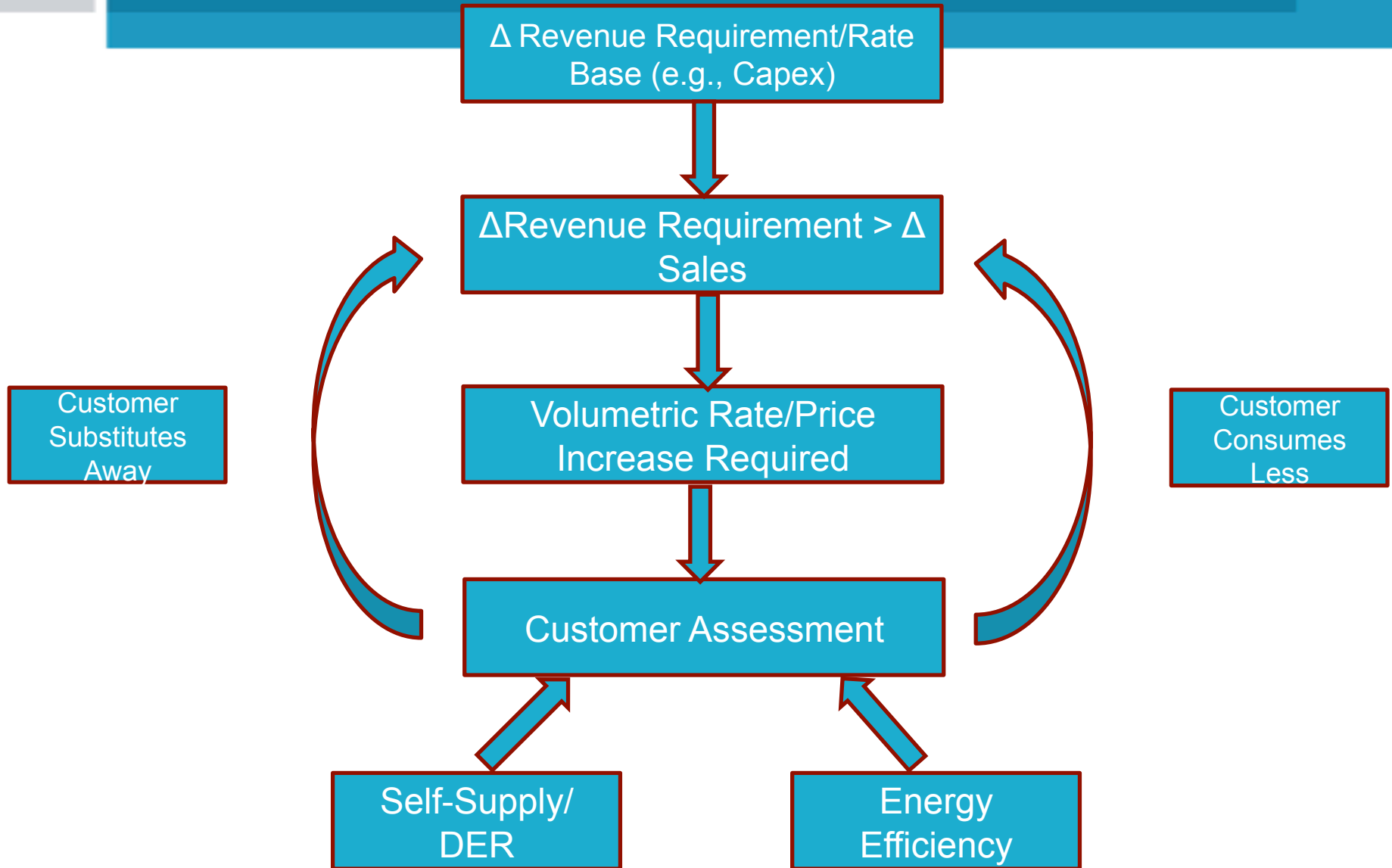
Secular Decline in Demand Growth

U.S. electricity demand growth, 1950-2040
(percent, 3-year moving average)



Source: EIA, Annual Energy Outlook 2014

Vicious Cycle of Volumetric Rates/Prices



Fundamental REV-like Policy and Regulatory Issues in Play in Other States

- Hawaii – *“Commission’s Inclinations on the Future of Hawaii’s Electric Utilities”* (April 2014)
 - Modernize generation sector
 - Transform T&D grids
 - Policy and regulatory reforms to move utilities into role of network systems integrator and operator
 - Reasonable and in the public interest to preclude the HECO Companies from ownership of new generation? Move to a “tolling model”?
- California – Order Instituting Rulemaking to incorporate DERs into grid planning process for IOUs, Rulemaking 14-08-013 (August 14, 2014)
 - Assembly Bill No. 327 (2013)
 - *“More than Smart: A Framework to Make the Distribution Grid More Open, Efficient and Resilient”* (2013)
 - Consider locational benefits and costs of DERs
 - Move to “open, flexible, and node-friendly network system”
 - DSOs should act as technology-neutral network coordinator
 - Expedite DER participation in wholesale markets and resource adequacy, unbundle distribution system operations