



Revenue Decoupling: An Industrial Customer Perspective

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What is revenue decoupling?

- Revenue decoupling is a mechanism that adjusts customer rates automatically in response to system-wide changes in customer usage.
- Typically, revenue decoupling targets average usage per customer (e.g., average kWh per month per customer). Different targets may be set for residential and non-residential customers.
- Under a full revenue decoupling scheme, if average usage per customer increases, the kWh charge to customers (that recovers fixed costs) is decreased. Conversely, if average usage per customer decreases, say, in response to energy efficiency investments, the kWh charge to customers (that recovers fixed costs) is increased.



Why is revenue decoupling promoted?

- Some utilities argue that they have a financial disincentive toward supporting increased energy efficiency for their customers because decreased sales volumes erode the utilities' recovery of fixed costs that are embedded in volumetric rates (e.g., kWh charges).
- Revenue decoupling is promoted by some energy conservation advocates because they believe it removes any disincentive that utilities may have to support increased energy efficiency for the utility customers.
- Some utilities support revenue decoupling because it provides greater assurance of revenue recovery when average usage per customer decreases for *any* reason – energy conservation, weather, economic conditions, etc. In other words, full revenue decoupling reduces cashflow risk to utilities and their shareholders by transferring this risk to customers.



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The large majority of states have not adopted revenue decoupling for electric utilities.

- Outside of California, the only western utilities that have electric revenue decoupling are Idaho Power and Portland General Electric (“PGE”). Neither of these utilities applies revenue decoupling to large non-residential customers.
- Idaho Power’s decoupling mechanism applies only to residential customers and small commercial customers consuming 2,000 kWh per month or less.
- PGE’s revenue decoupling mechanism applies only to residential customers and small commercial customers with billing demands of 30 kW or less. Customers with demands between 30 kW and 1000 kW are subject to a lost fixed cost recovery mechanism, but not revenue decoupling. Customers with billing demands greater than 1000 kW are not subject to any lost fixed cost recovery mechanism.
- Revenue decoupling is under consideration by the WUTC for Puget Sound Energy (“PSE”). PSE’s proposal is strongly opposed by residential, commercial, and industrial customer advocates.



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Revenue decoupling is not a good idea for Seattle City Light customers.

- At the most fundamental level, decoupling is as much a “revenue assurance” mechanism as it is a “conservation enabling” mechanism. As such, it is sure to capture a much wider range of effects than just customer responses to utility-sponsored energy efficiency programs.
- To the extent that customers reduce usage in response to economic conditions or otherwise practice self-funded energy conservation, these behaviors will be captured in the decoupling adjustment and unduly increase rates to customers.
- Decoupling can also cause rates to be adjusted due to changes in weather-related usage.



Revenue decoupling is not a good idea for Seattle City Light customers (cont'd)

- As a not-for-profit entity, Seattle City Light serves the public, not private shareholders.
- Seattle City Light does not need pricing schemes such as revenue decoupling to overcome the financial disincentives to promoting customer energy efficiency as claimed by for-profit utilities. If promoting customer energy efficiency is in the public interest, then Seattle City Light can do so without concern about shareholder financial disincentives toward selling less power.
- Arguments advanced by utilities and other parties regarding financial disincentives that impede utility support for customer energy efficiency are largely overstated. Any “lost margins” from energy efficiency are short-term in nature. To the extent that energy efficiency reduces sales levels, the utility is able to re-establish its margins in its next rate filing reflecting the new sales volumes.



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Revenue decoupling is not a good idea for Seattle City Light customers (cont'd)

- Seattle City Light's use of a forecasted test period in setting rates enables it to include projections of customer power usage in the future test period, further weakening the justifications offered for adopting revenue decoupling.
- Decoupling provides unwarranted insulation to the utility from the effects of price elasticity. Generally, all sellers of goods face a risk that price increases will reduce sales. But, with decoupling, if customers respond to utility rate hikes by reducing their electricity consumption, fixed charges are increased to compensate the utility for any resultant reduction in per-customer usage. Such an increase reflects an undue transfer of risk to customers.
- Revenue decoupling is an example of single-issue ratemaking, which occurs when utility rates are adjusted in response to a change in a single cost or revenue item considered in isolation. Single-issue ratemaking ignores the multitude of other factors that otherwise influence rates, some of which could, if properly considered, move rates in the opposite direction from the single-issue change. To consider some costs in isolation might cause a utility to increase rates to recover higher costs in one area without recognizing counterbalancing savings in another area.



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If revenue decoupling is adopted, large customers should be excluded from it.

- Although MIC opposes the adoption of any decoupling mechanisms – for any customer classes – decoupling is especially inappropriate for large non-residential customers. MIC is strongly opposed to the application of revenue decoupling to large non-residential customers.
- The only western utilities outside of California that impose revenue decoupling on electric customers (Idaho Power and PGE) do not apply revenue decoupling to large commercial and industrial customers.
- In 2011, Arizona Public Service Company proposed full revenue decoupling, but withdrew its proposal and instead negotiated a lost fixed cost recovery mechanism with stakeholders that applies only to residential customers and non-residential customers with demands below 400 kW.



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Targeting “average usage per customer” as a ratemaking metric makes no sense for large customers.

- Typically, decoupling rate adjustments are made when average fixed-cost recovery per customer deviates from the baseline (used to set base rates) due to changes in average usage per customer.
- “Average fixed-cost recovery per customer” has greater meaning when applied to residential customers than non-residential customers, due to the relative homogeneity of the former compared to other customer classes.
- Given the tremendous diversity among non-residential customers, the concept of an “average” non-residential customer for this purpose is meaningless.
- The average fixed-cost recovery per customer of non-residential customers will be very sensitive to the *composition* of these customers; for example, the opening or closing of a large manufacturing facility would impact such a calculation without at all being representative of utility-sponsored conservation programs.
- Changes in the overall economy are far more likely to influence average fixed-cost recovery per customer for non-residential customers than energy conservation programs. Application of decoupling to these customers would result in undue changes to rates in response to these factors that are unrelated to energy conservation.



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If revenue decoupling is adopted:

- Seattle City Light's target Debt Coverage Ratio used in setting rates should be reduced to reflect the reduction in the utility's risk.
- Utility regulatory commissions in Arizona, Arkansas, the District of Columbia, Hawaii, Illinois, Maryland, Massachusetts, Nevada, New York, Oregon, and Tennessee have ordered reductions in the allowed returns on equity for electric and gas utilities to reflect the reduction in utility risk attributable to decoupling. The analogous adjustment for Seattle City Light would be in the Debt Coverage Ratio.