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Committee**

May 31, 2013

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Stan Price
Eugene Wasserman
Co-Chairs, Seattle City Light Review Panel
VIA EMAIL – kim.kinney@seattle.gov & CLRPquestions@seattle.gov

Dear Mr. Price and Mr. Wasserman:

Industrial firms are often the customers that are most motivated to conserve electricity because of their cost incentives to use less. They should be exempted from any plan to decouple rates. The attached position paper explains why. Please let us know if we can answer any questions.

Sincerely,

Dave Gering, Executive Director
Manufacturing Industrial Council & Duwamish TMA

Revenue Decoupling Position Paper

Manufacturing Industrial Council 5/31/2103

The City Light Review Panel consideration of rate setting policy issues will include a discussion of whether revenue decoupling should be incorporated into rates in some way to “remove disincentives to investing in energy efficiency and increasing certainty of recovering the revenue requirement.” This paper examines the policy implications of revenue decoupling and explains the Manufacturing Industrial Council’s opposition to this rate setting mechanism.

What is Revenue Decoupling?

Revenue decoupling is a mechanism designed to reduce the dependence of a utility’s revenue on sales. It establishes an automatic adjustment of customer rates in response to system-wide changes in customer usage. Typically, revenue decoupling targets average usage per customer and establishes different target for residential and non-residential customers.

Under a full revenue decoupling scheme, if average customer usage increases, the kWh charge to customers (that recovers fixed costs) is decreased. Conversely, if average usage per customer decreases for any reason such as energy conservation, weather or economic conditions, the kWh charge to customers 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.

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 only applies 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 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.

Seattle City Light serves the public, not private shareholders. Therefore, 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 setting reflecting the new sales volumes.

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 from utilities 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.

When the appropriateness of a rate or charge that a utility seeks to impose on its customers is considered, the standard practice is to review and consider all relevant factors, rather than just a single factor. 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. For this reason, single-issue ratemaking, absent a compelling public interest, is generally not sound regulatory practice.

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.

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.

Attempting to attribute to utility-sponsored energy conservation projects changes in “average fixed-cost recovery per customer” of non-residential customers is highly problematic and without merit as a ratemaking mechanism.

Given the tremendous diversity among non-residential customers, the concept of an “average” non-residential customer for this purpose is meaningless. Consequently, 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.

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.