Revenue Decoupling Mechanisms

The New York State Experience

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Overview

• Description of RDMs

• History of RDMs in New York State

• Current Status of RDMs in NYS
  – Outstanding issues
Impediments to Energy Efficiency

• Traditional Cost of service regulation
  – \[ R = B^*r + O \]

• Fixed costs (depreciated over time) + commodity costs (recovered as expenses)
  – If sales are not realized, will not recover their fixed costs – lost margin, net loss for the utilities

• Creates throughput incentive
Revenue Decoupling

- Does not incentivize, but should remove the disincentive
- Eliminates the link between volumetric sales and utility revenues/profits
  - Otherwise, lost margins, EE cost recovery for the program, and opportunity costs
  - E.g. 2% reduction in sales can lead to 20% reduction in shareholder earnings
Revenue Decoupling (cont’d)

- Decoupling is achieved by adjusting the rate per unit of commodity sold in proportion to the amount of sales lost by decreased or increased demand.
- Reduces regulatory lag between rate cases.
- Utilities can still increase profits by adding more customers.
Revenue Decoupling Mechanism Variations

- Revenue per Customer
- Sales margin per customer
- Total margin revenue
- Total class revenue
- Usage per customer
Alternatives to RDM and Comparative Advantages

- Lost Revenue Adjustment Mechanism
- Straight fixed variable rate design
- Fully cost-based service
Utility Approach to RDMs

• Issues that utilities have to consider:
  – Type of mechanism (based on rate filing)
  – Service classifications
    • Should certain SCs be exempt?
  – Treatment of customers switching SCs
  – How to assure data quality & accuracy
    • Forecasting customers and their average usage
RDMs in Practice

• Benefits for EE achieved

• Customer satisfaction with RDMs
  – JD Power & Associates

• Weather and recession normalization?
  – Otherwise holding utilities harmless no matter the cause or whether related or not to energy efficiency
Other Regulatory Considerations*

- Balancing/Carrying Accounts
- Revenue Banding
- Rate banding
- Ad hoc adjustments

*Source: NARUC, Decoupling FAQ (2007)
RDM History in New York State

- Originally mandated around 20 years ago, then PSC backed off
- James Gallagher, from the NYC Economic Development Council:
  - RDM “could not be isolated as a factor driving the increase in DSM expenditures”
  - State EE goals + DSM incentives?
  - Other concerns included skewed price signals, large accruals, volatility, reduced development incentives
RDM Implementation Order

• In April 2007, the NY PSC directed all public utilities to
  “develop and implement mechanisms that true-up forecast and actual delivery service revenues and, as a result, significantly reduce or eliminate any disincentive caused by the recovery of utility fixed delivery costs via volumetric rates or marginal consumption blocks.”

• PSC revisited RDM as the best option to sever the throughput incentive
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Progress?

- Consolidated Edison
  - Electric
  - Gas
- National Grid/Keyspan
- National Fuel Gas
- NY PSC actually seems to prefer hybrid approach:
  - RDM for large market customers (residential) +
  - Fully cost-based rates for Industrial/commercial customers
Recurring Problems

• Return on equity (ROE) problems – should ROE be reduced proportionately to the risk reduction?
  – Reduces risk & makes cost of capital cheaper – some advocate reduction of allowed ROE, balanced by improvement in credit rating

• Rate impacts – is volatility unfair for customers?

• Supports poor management?
  – Only interim measure though
Figure: Impact of Revenue Change on Return on Equity (ROE)

Source: SEPA, Decoupling Utility Profits from Sales
Decoupling = Profitability?

- Utilities can still increase profits, even when revenues are trued-up:
  - (1) Adding customers – utilities are familiar
  - (2) Continuing allowed rate of return
  - (3) Improving efficiency lowers cost of service
  - (4) Decreased cost of capital
    - With unchanged ROE, even greater profitability
- In the end, utilities are insulated from most common profit shocks
Issues for Utilities

• Return on equity issues – should be encouraging higher ROE?
  – Weather normalization vs. ROE reduction

• Still does not actively incentivize EE
  – Should utilities be the ones promoting EE?

• Requires investment of resources – opportunity cost issue again

• Better to be discussing true-ups in general rate cases?
Questions?
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