

Electric & Gas Utility Revenue Decoupling

The Essentials:

- Energy efficiency may bring benefits such as less cost to consumers, fewer future rate increases, and less environment impact for energy consumption.
- However utilities have a disincentive to invest in energy efficiency measures that reduce sales and therefore profitability.
- A critical step for successful energy efficiency policy is a mechanism that severs the link between utility revenue and total energy sales.
- The Arizona Corporation Commission has pursued such “decoupling” measures in several recent rate cases.

Policy details

Under traditional regulation, electric and gas utilities face incentives that are at odds with increased investment in energy efficiency. The formula below shows a simplified version of how to calculate utility revenues:

$$\text{Total Revenue (\$)} = \text{Total Sales (e.g. kWh)} \times \text{Rate (e.g. \$/kWh)}$$

Thus, one way for a utility company to increase its profitability is to increase its Total Sales. Conversely, the company has a *disincentive* to pursue actions that might lower its Total Sales, such as investments in energy efficiency. This disincentive conflicts with established policies to prioritize energy efficiency over the construction of new power plants (for example, the Energy Efficiency Resource Standard). Revenue decoupling is a mechanism to change the utility incentive structure by modifying the way utility rates are set. Under decoupling, changes in Total Sales that would normally lead to excess or lost revenue are instead offset by automatically adjusting rates to account for the difference.

Opportunities

Aligning Incentives with Energy Efficiency

Revenue decoupling provides an opportunity to strengthen energy efficiency measures by removing the disincentive for energy efficiency that exists as long as revenues are tied to sales. By “decoupling” the link between a utility’s revenue and its sales, revenue decoupling allows utilities to pursue energy efficiency measures without the risk of losing revenue. In this sense, revenue decoupling is a crucial ingredient in establishing effective energy efficiency policies. Energy efficiency in turn provides a variety of long-term benefits. For instance, there are economic and environmental benefits to using less energy. Furthermore, by reducing demand, energy efficiency defers the need to invest in new power plants and can thereby save customers money by warding off future rate increases needed to pay for this equipment.

Challenges

Rate Fluctuations

Revenue decoupling may lead to some short-term fluctuations in rates (including both rate increases and decreases). In cases where utilities make more revenue than their approved requirement, the excess portion may be returned to customers. In cases where utilities make less revenue than their approved requirement, a rate increase may occur. Many proposed and adopted decoupling mechanisms include ways to hedge against large rate increases by placing a cap (e.g. 3% maximum) on the amount of rate increase that is allowed to occur in a given period.

Full vs. Partial Revenue Decoupling

Decoupling can exist in many different forms. Finding agreement on which form is most appropriate for Arizona is a major barrier to be overcome through proceedings in the Arizona Corporation Commission. Most notably, revenue can be either fully decoupled or only partially or from factors that influence sales. These factors include:

1. Weather
2. Economic growth
3. Energy Efficiency measures

A partial decoupling might only consider Energy Efficiency's effect on sales, whereas full decoupling would consider all three. Partial decoupling is also called "Lost Fixed Cost Recovery" or LFCR. Both partial and full revenue decoupling each has its own strengths and weakness.

Read more

- *A.C.C. Policy Statement* -- In December 2010, the Arizona Corporation Commission (A.C.C.) unanimously adopted a policy statement in support of decoupling: <http://images.edocket.azcc.gov/docketpdf/0000121666.pdf>
- *Regulatory Assistance Project report* -- this comprehensive report explains various ways to design utilities rates that include revenue decoupling: www.raponline.org/document/download/id/308

Contact information

Arizona Corporation Commission http://www.azcc.gov/Divisions/Administration/Contact.asp		
Paul Newman	(602) 542-3682	newman-web@azcc.gov
Brenda Burns	(602) 542-0745	burns-web@azcc.gov
Gary Pierce (chair)	(602) 542-3933	pierce-web@azcc.gov
Bob Stump	(602) 542-3935	stump-web@azcc.gov
Sandra D. Kennedy	(602) 542-3625	kennedy-web@azcc.gov
Arizona Corporation Commission Commissioners Wing 1200 West Washington Phoenix, AZ 85007-2996		

Latest developments

Steps to implement utility rate decoupling measures are currently making their way through several rate case proceedings in the Arizona Corporation Commission.

- **Arizona Public Service (APS):** A decoupling mechanism is being negotiated in APS' current rate case. Stakeholders involved in the case were unable to come to a universal settlement agreement and the case will now go before an Administrative Law Judge for review. The judge will propose a Recommended Order that will then be voted on by the Corporation Commission. Proceedings for the APS rate case can be found on the A.C.C. eDocket system: <http://edocket.azcc.gov/Default.aspx?SEARCH=E-01345A-11-0224> . This docket includes a calendar of recent and upcoming events. Important upcoming dates in this case:
 - 5/31/2012 -- Administrative Law Judge issues a Recommended Order
 - 6/25/2012 -- Arizona Corporation Commission votes on the Recommended Order
- **Tucson Electric Power (TEP):** Due to a provision in its last rate case, TEP is not permitted to file for a new rate increase until July 1, 2012. When TEP does eventually file for a rate increase, decoupling will undoubtedly be a major focus.
- **Southwest Gas:** A decoupling mechanism was adopted in the recent Southwest Gas rate case, concluded in January 2012. Proceedings for the Southwest rate case can be found on the Arizona Corporation Commission eDocket system: <http://edocket.azcc.gov/Default.aspx?SEARCH=G-01551A-10-0458>