RATE DECOUPLING

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Informational Update

RATE DECOUPLING
OVERVIEW

- Rate Decoupling = adoption of adjustable rate mechanism to recover revenue requirements from ratepayers → breaks link between energy sold and revenue collected to recover fixed costs of providing service.
  - Can be used for electric and/or gas.
  - Adoption is result of flattening energy sales from improvements in energy efficiency and adoption of distributed energy resources (DERs), e.g. residential solar.
  - Part of broader "smart rate design" movement, which also includes TOU, minimum billing, and location & attribute pricing.

By breaking the link between sales & revenue, decoupling lessens utility opposition to energy efficiency and DER programs & policies by mitigating financial risks.

RATE DECOUPLING

HOW IT WORKS

Traditional System

Revenue = Rate Set by Regulator x Energy Sales

Decoupled System

Price = Set Target Revenue ÷ Energy Sales

- A decoupling recovery factor is applied periodically to adjust rate to meet revenue targets.
  - Rate per kWh is adjusted *up or down* depending on sales.
    - Higher than forecasted sales = lower rate.
    - Lower than forecasted sales = higher rate.
- Recovery factors are typically updated annually, but some are monthly.
  - Adjustments to residential typically between -2% & +3%, while commercial adjustments fall between -4% & +3%.
  - Research shows rates are adjusted up ~60% of time and down ~40%.

RATE DECOUPLING

VARIATION IN DECOUPLING

- Decoupling can be implemented fully, partially, or on a limited basis.

Full Decoupling	Truly breaks the link between revenue and sales, e.g. if $1M shortfall is created because of lower sales, rate adjustment would recoup the full $1M from ratepayers.
Limited Decoupling	Protects only a portion of revenue requirements, e.g. if $1M shortfall, may only recoup 50% leaving utility with $500,000 shortfall.
Partial Decoupling	Applied to specific programs, e.g. recouping lost sales from weather variations or adoption of energy efficiency program.

- There can be separate revenue targets & recovery factors for different groups, e.g., residential & commercial/industrial.

RATE DECOUPLING
PROS AND CONS

Pros

- Reduces need to sell energy to meet revenue requirements → encourages adoption of energy efficiency/DER efforts by utility.
- Provides financial certainty & reduces financial risks to utility from external factors.
- Reduces frequency of rate cases.
- May reduce customer bill volatility during times of higher than forecasted sales.
  - Hotter than anticipated summer → a lower rate after adjustment.
- May result in less of a negative impact to low-usage ratepayers while still retaining traditional kWh based recovery that allocates costs based on system usage.
  - Could be less "rate shock" for low-usage customers through decoupling than higher fixed charges, i.e. rate fluctuating by 2-3% up or down may be better than increase in fixed charge.

Cons

- Does not send appropriate price signaling → rates are higher when *less* energy is used than forecasted.
  - Individual customer who engages in energy efficiency actions may not see a lower bill because of their efforts. Requires education on how individual usage impacts bill.
- Does not create any bill certainty which allows customers to be able to plan and budget.
  - While a hotter summer than forecasted may reduce a bill, an economic downturn that reduces demand may increase rate when customers are more vulnerable.
- May encourage adoption of DER/energy efficiency programs, but makes all customers cover lost revenue, which has a higher impact on low-income customers that do not have means to invest in DERs/energy efficient homes or products and do not meet program requirements.
- May decrease industry's focus on mitigating sales risks and may shift risks to customers.
- May create imbalances, e.g. partial decoupling leads to recovering of lost sales for energy efficiency program while utility also gets higher than anticipated sales from weather.
- Likely requires adoption of complimentary programs/policies to lessen negative impacts.

RATE DECOUPLING

SPECIFIC CPS ENERGY CONSIDERATIONS

- Rate decoupling is primarily aimed at for-profit utilities. CPS Energy, as an MOU, is not for-profit and does not structure rates to achieve a profit.

- CPS Energy, through STEP, already has the largest energy efficiency program in Texas.

- Only applies to non-fuel revenue → fuel adjustment charge and regulatory adjustment would not be decoupled.

RATE DECOUPLING
TAKE AWAY

- The effectiveness and success of decoupling depends on what kind of decoupling is adopted and how it is implemented.

- May be good at encouraging adoption of DER/energy efficiency programs, but minimum billing or a higher fixed charge is likely better at addressing lost revenue from adoption of DERs/energy homes and products.
  - Decoupling should be analyzed for its ability to meet the utility's rate design goals.

RATE DECOUPLING

LEGAL CONSIDERATIONS IN TEXAS

- In Texas, rates must primarily be based on providing cost of service to each customer class, and rates must cover costs of providing service.
  - Rates must be “just and reasonable” and cannot be “unreasonably preferential, prejudicial, or discriminatory” and must be “sufficient, equitable, and consistent in application to each class of consumer. ”

- There is currently no decoupling in Texas.
  - A form of decoupling exists in approximately 2/3 of states.

- In response to 2015 legislation, PUCT filed report with Legislature on alternative ratemaking mechanisms. The report concluded that decoupling is an artifact of regulation, relatively difficult to maintain, and allows continuation of cross subsidies.
  - Legislature has not specifically authorized decoupling.