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Energy Efficiency: An Introduction to Revenue Decoupling

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Revenue Decoupling

- 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**

- **Does not incentivize, but should remove the disincentive**
- **Additional performance based incentives may still be employed depending on circumstances**

Source: PACE Center

Impediments to Energy Efficiency

- Traditional Cost of service regulation
 - 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
 - Basic structure creates throughput incentive

Source: PACE Center

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 in the event that decoupling mechanism target revenue on a per customer basis

Source: PACE Center

Revenue Decoupling Mechanism Variations

- Alternative metrics
 - Revenue per Customer
 - Total class revenue
 - Usage per customer
- Alternative Structures
 - Lost Revenue Adjustment Mechanism
 - Straight fixed variable rate design
 - Fully cost-based service (traditional model)

Source: PACE Center

Utility Approach to RDMs

- Issues that regulators need to consider:
 - Type of mechanism (based on rate filing)
 - Service classifications (SC)
 - Should certain SCs be exempt?
 - Treatment of customers switching SCs
 - How to assure data quality & accuracy
 - Forecasting customers and their average usage
 - Reconciling rate mechanisms

Source: PACE Center

RDMs in Practice

- Benefits for more EE achieved
- Customer satisfaction with RDMs
 - JD Power & Associates
 - Reality: most adjustments are small to modest
- Weather and recession normalization?
 - Policy considerations: Should utilities be held harmless no matter the cause?
 - Economic downturn?
 - Weather trends or major storm event?
 - Other?

Rhode Island Revenue Decoupling Policies

- ❑ Revenue Decoupling Act, RIGL §39-1-27.7.1 (the “Act”) mandated revenue decoupling for both gas and electric companies
- ❑ By decoupling a utility’s usage from its revenue, the utility has a greater incentive to aggressively promote energy efficiency programs that are designed to reduce energy consumption
- ❑ Revenue targets are based on the revenue requirement approved in the Company’s most recent base rate case and are compared on an annual basis to actual billed revenue, with any over or under recovery refunded to or collected from customers
- ❑ A revenue decoupling mechanism (“RDM”) does not guarantee that the Company will earn its allowed ROE

- ❑ Electric RDM is based upon the total company revenue requirement approved in Docket No. 4323
- ❑ Annual reconciliation filing submitted May 15, with RDM Factor effective July 1
- ❑ RDM Factor is a uniform per kWh charge applicable to all customers

- ❑ Gas RDM is based on revenue per customer (“RPC”) targets approved in Docket No. 4323
- ❑ The reconciliation between the actual and target RPCs is filed annually on July 1
- ❑ It is applicable to all Residential, Small and Medium Commercial & Industrial firm rate classes
- ❑ Adjustment factor is included in Distribution Adjustment Charge (“DAC”)

QUESTIONS?