

# Illinois' Experience With Decoupling and SFV Rate Design

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# Disclaimers

- ▶ The information I present today should not be construed to represent the opinions or viewpoints of the Illinois Commerce Commission or of its staff
- ▶ The information I present today is intended to promote understanding and discussion of the topics presented and may not reflect my professional opinion on a specific issue when testifying as an expert witness

# Overview

- ▶ What problems we are trying to solve with decoupling and SFV rate design?
- ▶ What are decoupling and SFV rate design?
- ▶ Decoupling example - Peoples Gas Light and Coke Company
- ▶ SFV rate design example - Ameren Illinois Company
- ▶ Subsequent cases
- ▶ Some implications for accountants and financial analysts

# What Problems Are We Trying to Solve?

- ▶ Decreasing revenue because of decreasing sales/usage
  - ▶ Sales of electricity, gas, and water are decreasing, generally
  - ▶ A decrease in sales results in lower revenues
  - ▶ Most of a utility's distribution costs are fixed and do not decrease as sales and revenues decrease
  - ▶ Therefore, profits decline due to factors beyond the utilities control
- ▶ Disincentive for utilities to promote conservation
  - ▶ Because lower consumption reduces revenues without reducing fixed costs, utilities have a financial disincentive to promote conservation

# What is Decoupling?

- ▶ Decoupling disconnects sales revenues from sales volume so that over time, as sales volume changes, volumetric charges adjust in order to hold revenues constant

Decoupling Example					
Time Period	Customer	Sales	Volumetric	Volumetric	Total
	Charge			Charge	
	Revenues	Units	Charge	Revenues	Revenues
<b>Test Year</b>	\$1,500.00	<b>10,000</b>	\$0.5000	<b>\$5,000.00</b>	\$6,500.00
Test Year +1	\$1,505.00	<b>9,900</b>	\$0.5000	<b>\$4,950.00</b>	\$6,455.00
		<b>9,850</b>	\$0.0051	<b>\$50.00</b>	Adjustment
<b>Test Year</b>	\$1,500.00	<b>10,000</b>	\$0.5000	<b>\$5,000.00</b>	\$6,500.00
Test Year +2	\$1,495.00	<b>10,050</b>	\$0.5000	<b>\$5,025.00</b>	\$6,520.00
		<b>9750</b>	<b>(\$0.0026)</b>	<b>(\$25.00)</b>	Adjustment

# What is SFV Rate Design?

- ▶ SFV rate design shifts recovery from volumetric charges to monthly fixed charges so that changes in sales volume have less impact on total revenues

SFV Example				
Description	Old Rates		New Rates	
Customers	1,000		1,000	
Customer Charge	\$1.50		\$4.50	
<b>Customer Charge Revenues</b>	<b>\$1,500.00</b>	<b>23.08%</b>	<b>\$4,500.00</b>	<b>69.23%</b>
Sales Units	10,000		10,000	
Volumetric Charge	\$0.50		\$0.20	
<b>Volumetric Charge Revenues</b>	<b>\$5,000.00</b>	<b>76.92%</b>	<b>\$2,000.00</b>	<b>30.77%</b>
<b>Total Revenues</b>	<b>\$6,500.00</b>	<b>100.00%</b>	<b>\$6,500.00</b>	<b>100.00%</b>

# Peoples Gas Light and Coke Company (Docket 07-0242)

- ▶ The ICC's introduction to decoupling mechanisms
- ▶ The company's proposal
  - ▶ Rider VBA (Volume Balancing Adjustment) would adjust residential and small commercial distribution rates to hold constant revenues from usage-based distribution charges
  - ▶ True-up actual revenues from distribution charges to test year revenue from distribution charges in last rate case
  - ▶ Symmetrical true-up - refund excess and collect shortfall

# Peoples Gas Light and Coke Company (Docket 07-0242)

- ▶ Legal concerns
  - ▶ Single-Issue ratemaking
  - ▶ Retroactive ratemaking
  - ▶ Violates test year rules
  - ▶ Response - VBA would operate outside of rate case test year where these issues are a concern

# Peoples Gas Light and Coke Company (Docket 07-0242)

- ▶ Other concerns
  - ▶ Traditional rider criteria
    - ▶ Concern - VBA doesn't fit traditional rider criteria: costs that are volatile, fluctuating, unexpected, and beyond utilities control
    - ▶ Response - Riders are not limited to these circumstances
  - ▶ Conservation
    - ▶ Concern - Ratepayers don't need help from utility in order to conserve
    - ▶ Response - Nevertheless, utilities can promote conservation

# Peoples Gas Light and Coke Company (Docket 07-0242)

## ▶ Other concerns (Continued)

### ▶ Rate impact

- ▶ Concern - Ratepayers could pay more
- ▶ Response - Ratepayers could pay less

### ▶ Business risk

- ▶ Concern - Transfers business risk to ratepayers
- ▶ Response - The rider's symmetry balances the risk

# Peoples Gas Light and Coke Company (Docket 07-0242)

- ▶ Effect on investment risk
  - ▶ Concern - A downward adjustment should be made to the cost of common equity because VBA's revenue stabilization would reduce the company's risk
  - ▶ Response - Some utilities in the ROE proxy sample have revenue stabilization mechanisms, so it is already reflected. Also, VBA's symmetry makes VBA risk neutral

# Peoples Gas Light and Coke Company (Docket 07-0242)

- ▶ The decision
  - ▶ The Commission determined that it did have the legal authority to approve Rider VBA
  - ▶ The Commission approved Rider VBA because it addressed declining customer usage patterns and the resulting impact on utility revenues
  - ▶ The Commission reduced ROE by 10 basis points for reduced investment risk
  - ▶ The Commission approved Rider VBA as a 4-year pilot program

# Peoples Gas Light and Coke Company (Docket 07-0242)

## ▶ The results

- ▶ During the 4-year pilot program, Rider VBA produced both refunds and additional charges to ratepayers

### VBA - Additional Charges/(Refunds)

<u>Year</u>	<u>Annual</u>	<u>Cumulative</u>
2009	(\$4,597,100.43)	(\$4,597,100.43)
2010	\$3,030,087.39	(\$1,567,013.04)
2011	(\$1,057,612.27)	(\$2,624,625.31)
2012	\$3,762,319.98	\$1,137,694.67

- ▶ The Commission made Rider VBA permanent in 2012
- ▶ Rider VBA was upheld by an Appellate Court in 2013
- ▶ Rider VBA was upheld by the Illinois Supreme Court in 2015

# Ameren Illinois Company (Docket 07-0585 et al.)

- ▶ While the Peoples Gas case was still pending, Ameren Illinois Company filed a gas rate case
- ▶ The company's proposal
  - ▶ Ameren proposed a Rider VBA similar to the one Peoples Gas proposed. The Commission was presented with a bundle of arguments similar to those presented in the Peoples Gas case

# Ameren Illinois Company (Docket 07-0585 et al.)

- ▶ The decision
  - ▶ The Commission noted that its decision in the Peoples Gas case was controversial
  - ▶ The Commission also noted that the Rider VBA it approved for Peoples Gas was a pilot
  - ▶ Rather than expand the pilot prematurely, the Commission directed Ameren to increase its monthly customer charge to recover more of its fixed delivery costs through a fixed charge
  - ▶ The Commission directed Ameren to recover 80% of its fixed delivery costs through the customer charge rather than the 43% it was currently recovering through the customer charge
  - ▶ The Commission also determined that the increased fixed cost recovery reduced Ameren's risk and adjusted Ameren's authorized ROE downward by 10 basis points

# Decoupling Mechanisms

## Advantages

- ▶ Actually adjusts usage rates for changes in total usage levels over time
- ▶ Customers retain more control over total bill
- ▶ The symmetry is more transparent
- ▶ Retains more incentive for customer conservation

## Disadvantages

- ▶ Challenging for customers to understand
- ▶ New charge on bill
- ▶ Reconciliations produce more administrative burden
- ▶ Need to coordinate with base rates set in rate case

# Increased Fixed Cost Recovery Through Fixed Charges (SFV)

## Advantages

- ▶ Simpler implementation through base rates
- ▶ Less administrative burden
- ▶ Theoretically matches fixed costs to fixed charges
- ▶ Recognizes the cost of the distribution infrastructure does not vary with short-term changes in usage

## Disadvantages

- ▶ Challenging for customers to understand
- ▶ Mitigates but does not eliminate impact of lower usage
- ▶ Customers have less control over total bill
- ▶ Less incentive for customers to conserve
- ▶ Shifts more cost recovery from high users to low users

# Subsequent Cases

- ▶ The Commission has continued to address decoupling and increased fixed cost recovery
- ▶ More Illinois gas and water companies now have a decoupling rider
- ▶ For some companies, the Commission has increased fixed cost recovery and then subsequently reduced that fixed cost recovery in order to balance various concerns
- ▶ The Commission has also considered the impact of formula rates on revenue stability in relation to the need for decoupling or increased fixed cost recovery

# Implications

- ▶ Annual reconciliation for decoupling riders
  - ▶ How much additional time and resources will the reconciliations require?
  - ▶ Can we identify clearly the rate case revenue amount to which actual revenue should be trued up?
- ▶ ROE adjustment
  - ▶ Does decoupling or increased fixed cost recovery reduce investment risk?
  - ▶ If so, how does one measure this?
- ▶ Less frequent rate cases
  - ▶ Will decoupling or increased fixed cost recovery reduce the frequency of rate cases?
  - ▶ If so, will that affect the amortization of costs between rate cases or the deferral of costs between rate cases?

# Thank You

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