

# Decoupling Comes to Massachusetts

## Recent DPU Decisions Implement New Policy for Gas and Electric Distribution Companies



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In the fall of 2009, the Massachusetts Department of Public Utilities (“DPU” or “Department”) took another significant step forward for consumers and the environment when it approved revenue decoupling mechanisms for National Grid’s electric utilities and for Bay State Gas Company.<sup>1</sup> In line with ENE’s decoupling advocacy, the approved full decoupling mechanisms will fully sever the counter-productive link between the companies’ energy sales and their revenue, aligning utility incentives with their customers’ interests in reducing bills through energy efficiency measures. As the Department recognized, “[p]romoting the efficient and expeditious deployment of demand resources, as mandated and encouraged by the Green Communities Act, requires the full participation of the distribution companies” including Bay State and National Grid.<sup>2</sup>

The decoupling mechanism approved for National Grid will reconcile the company’s actual revenues in each rate class to an allowed target revenue level, regardless of the cause of the difference between the two. Differences between actual and allowed revenues will be summed and a uniform adjustment will be made to the volumetric distribution rate in each rate class. If total actual revenues exceed the target level, there will be a slight reduction in rates; if the total actual revenues are less than target revenues, there will a slight increase in rates. Similarly, the Department approved a seasonal “revenue-per-customer” mechanism for Bay State Gas in which the actual revenue per customer in each rate class is compared to a target level of revenue per customer.<sup>3</sup> Differences among all Bay State rate classes are summed and will be reconciled through a uniform adjustment to the distribution rate.<sup>4</sup>

Although a comprehensive study of decoupling mechanisms suggests that these decoupling rate adjustments are likely to be low,<sup>5</sup> the Department will cap annual adjustments for both companies at 3% of total utility revenue.<sup>6</sup> In addition, for National Grid, should the company produce earnings that exceed its allowed return on equity (“ROE”), it must flow half of any excess earnings back to customers.<sup>7</sup>

The DPU made several crucial decisions in the design of both Bay State and National Grid’s decoupling mechanisms to ensure that the link between sales and revenue is completely severed. First, holding to its commitment to full decoupling, the Department rejected a proposal to normalize actual revenues for the effects of weather. The DPU found adding a burdensome weather normalization component was unnecessary and would not be in the best interests of the ratepayer.<sup>8</sup> Second, the Department declined to adopt a compounding “dead-band” of 0.4% within which no decoupling adjustments would be made.<sup>9</sup> In particular, the DPU found that the dead-band would add additional complexity, and would effectuate partial decoupling that would cause the company to retain an incentive to maximize its sales within the dead-band range. Third, the Department declined to sunset both Companies’ decoupling mechanisms after three years, finding that such proposals would contribute to regulatory uncertainty and send wrong signals to the market.<sup>10</sup>

The Department concluded that decoupling will reduce utility risks and, thus, the return requirement of their investors. Specifically, the DPU found that the adoption of a revenue decoupling mechanism will result in rate year distribution revenues that will closely reflect the distribution revenue requirement approved in this base rate proceeding and would, thus, reduce variability of the Company’s revenues.<sup>11</sup> In ordering a 10.35% ROE for National Grid (1.25% lower than sought) and a 9.95% ROE for Bay State (2.30% lower than sought), the Department made it clear that decoupling contributed to a lower risk profile and a lower cost of capital.

Finding that the adoption of decoupling would eliminate National Grid’s “potential to collect additional revenue resulting from growth in sales,” the Department approved a capital expenditure rate adjustment.<sup>12</sup> Under this “CapEx” mechanism, National Grid will be allowed to recover up to \$170M in capital costs prudently incurred in the previous year.<sup>13</sup> In addition, it ordered National Grid to work with other stakeholders to develop a capital plan that sets out specific metrics and measures of success.<sup>14</sup> Under Bay State’s approved revenue-per-customer decoupling mechanism, the utility can increase its revenues by adding customers. The Department also approved a mechanism through which Bay State can additionally collect revenue to replace certain aging infrastructure.<sup>15</sup>

In addition to approving revenue decoupling, the Department also approved inclining block rates for some customer classes in order to align distribution rate design with the Commonwealth’s goal of promoting efficient use of electric and gas resources.<sup>16</sup> In these instances, the inclining block rate will encourage customers to reduce their use of electricity and natural gas because they would face higher rates for higher levels of use.

Overall, the decisions to approve decoupling for Massachusetts’ largest electric utility and one of its largest gas utilities represent significant opportunities to increase the Commonwealth’s investment in cost-saving energy efficiency and demand resources. No longer will these utilities be financially penalized for helping their customers use energy more efficiently.

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ENDNOTES

<sup>1</sup> See D.P.U. 09-39, “Petition of Massachusetts Electric Company and Nantucket Electric Company, pursuant to G.L. c. 164, § 94 and 220 C.M.R. § 5.00 et. seq., for a General Increase in Electric Rates and Approval of a Revenue Decoupling Mechanism,” November 30, 2009 at 61-91, D.P.U. 09-30, “Petition of Bay State Gas Company, pursuant to G.L. c. 164, § 94 and 220 C.M.R. § 5.00 et. seq., for a General Increase in Electric Rates and Approval of a Revenue Decoupling Mechanism,” October 30, 2009 at 86-117.

<sup>2</sup> D.P.U. 09-39 Order at 72.

<sup>3</sup> D.P.U. 09-30 Order at 89-91. Revenue-per-customer decoupling mechanisms assign an allowed amount of revenue for each utility customer. As a result, the utility can increase its annual allowed revenues by adding new customers.

<sup>4</sup> See *id.* at 27-31.

<sup>5</sup> See Pamela G. Lesh, “Rate Impacts and Key Design Elements of Gas and Electric Utility Decoupling: A Comprehensive Review,” June 2009, at 4.

<sup>6</sup> D.P.U. 09-39 Order at 86-87; D.P.U. 09-30 Order at 115-117. Adjustments in excess of the 3% cap will be deferred to the next adjustment period.

<sup>7</sup> D.P.U. 09-39 Order at 92. No such earnings sharing mechanism was approved for Bay State.

<sup>8</sup> D.P.U. 09-39 Order at 67-68; D.P.U. 09-30 Order at 110-111.

<sup>9</sup> D.P.U. 09-39 Order at 69-70; D.P.U. 09-30 Order at 113.

<sup>10</sup> D.P.U. 09-39 Order at 90-91; D.P.U. 09-30 Order at 104.

<sup>11</sup> D.P.U. 09-39 Order at 394-95; D.P.U. 09-30 Order at 369-70.

<sup>12</sup> D.P.U. 09-39 Order at 75.

<sup>13</sup> *Id.* at 81-84. The Company may apply to collect any annual expenditures greater than \$170M at the next rate case. The Company had asked for a larger allowance for capital expenditures, including projected capital expenditures. In reducing the scope of CAP-EX adjustments, the Department attempted to strike a balance between the need for safe and reliable service and protecting the ratepayer from over-investment.

<sup>14</sup> *Id.* at 84. By contrast, the DPU declined to adopt a National Grid-proposed inflation adjustment, finding that productivity would likely cover any inflation-related increases.

<sup>15</sup> D.P.U. 09-30 Order at 133-35

<sup>16</sup> D.P.U. 09-39 Order at 423-424; D.P.U. 09-30 Order at 383-404.