

# Bringing Decoupling to Massachusetts



Department of Public Utilities Final Order, Docket 07-50

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## Introduction

The Massachusetts Department of Public Utilities' (DPU) July 16, 2008 Order (MA Decoupling Order) opens the door to a significant expansion in energy efficiency investments in the state by aligning utility and customer incentives. The 89-page decision provides a detailed description of how the Commonwealth will transition to a new set of rate structures for both electric and natural gas utilities that eliminate the economic disincentives to utility investment in energy efficiency and distributed generation.

The MA Decoupling Order works hand-in-hand with the Green Communities Act to create a new paradigm for energy efficiency investment. Under the Act, signed by Governor Patrick on July 2, 2008, electric and natural gas utilities are charged with serving their customers' energy needs by investing in all energy efficiency and demand resources that are cost-effective or cheaper than supply. This should lead to a dramatic increase in efficiency spending—but only if Massachusetts' utilities follow through and make a concerted effort to ramp up their efficiency programs.

The MA Decoupling Order will help ensure that utilities expand their efficiency programs by changing the system of old rate structures in which utilities lost money when their customers cut their energy use through efficiency measures. By substantially revising existing regulatory incentives—breaking the link between utility revenues and energy sales—the order will be an essential tool for achieving the vision of the Green Communities Act.

## Decoupling Basics

Decoupling breaks the link between utility revenues and sales. It is a new way to regulate how utilities get paid, and it changes only the way utilities are compensated for their distribution, or delivery charges. (Energy charges for the electricity or natural gas used by customers do not provide profits for the utility, and are not affected by decoupling.) Under decoupling, delivery charges are not based on sales, but rather on how much it costs to run the company and maintain power-distribution systems. These costs ("target revenues") are determined in a rate proceeding before the DPU. If the utility collects more revenue than predicted in the rate proceeding, customers will get a credit on their bills; if the utility collects less, customers will see a small surcharge. This reconciliation process between target revenues and actual revenues is called a "true up."

## Summary and Analysis of Major Findings

Below are excerpts from the DPU decision followed by brief ENE analysis.

**DPU:** *Full decoupling completely and effectively removes the disincentives that distribution companies currently face regarding expanded deployment of demand resources. Other ratemaking alternatives such as base rate redesign, LBR recovery (or targeted decoupling), partial decoupling, and shareholder incentives do not sufficiently address the issue of disincentives.*

ENE Analysis: The only feasible way to completely break the counterproductive link between utility sales and revenues is through a full decoupling mechanism. The DPU has called for a transition to full decoupling for all gas and electric utilities, ensuring that the financial disincentive for energy efficiency investments will be completely removed by 2012 at the latest. This is a bold step that will allow MA utilities to aggressively invest in cost-effective efficiency while still recovering their allowed revenues.

**DPU: *Annual reconciliations should be collected from customers through distribution energy charges to provide customers with a greater incentive to reduce their energy consumption and, thus further the goal of promoting the deployment of demand resources.***

ENE Analysis: Reconciling the difference between actual and target revenues through small changes to the distribution charge maintains the current price signal to customers that energy is expensive and greater efficiency can significantly reduce their bills. An alternative approach – increasing fixed charges – would reduce the benefits customers would realize from lowering consumption because this approach increases the portion of their bill they would be unable to control through lower consumption.

**DPU: *Factors such as inflation and capital spending requirements may be taken into account when determining the annual revenue that companies will be allowed to recover through their decoupling mechanisms, with a certain amount of flexibility provided to companies to take into account their specific circumstances.***

ENE Analysis: Decoupling removes sales growth as a source of revenue for the company. To ensure that utilities are able to earn enough revenue to provide reliable electric and gas service, this mechanism will allow for adjustments in target or allowed revenues in years that fall between rate proceedings.

**DPU: *Reconciliation of target revenues to actual revenues should occur on a company-wide basis to ensure that customers in one rate class do not see a disproportionate change in rates compared to customers in other rate classes.***

ENE Analysis: The DPU decided to reconcile the difference between allowed (“target”) revenues and actual revenues across all rate classes, rather than conduct segregated, rate class by rate class true-ups. In addition to the administrative simplicity of this approach – making its implementation expeditious and efficient – it prevents disproportionate impacts to customers within different rate classes. This approach avoids the possibility that ratepayers in small, heterogeneous classes would bear significant burdens from the loss of customers or changes in customer usage in their class.

**DPU: *Annual reconciliations, in combination with interim adjustments (as necessary), will best meet the Department’s rate design goals of earnings stability, rate continuity, and efficiency. A company must petition the Department for an interim rate adjustment when the difference between its actual and target revenues exceeds ten percent.***

ENE Analysis: Annual true-ups of actual revenues to allowed revenues make sense. First, they occur frequently enough to reduce the risk of large over- or under-collections. Second, annual reconciliations are administratively efficient, as most utilities are required to make other annual adjustments. As a safety valve to protect against large swings in decoupling surpluses or deficits, the DPU wisely requires utilities to seek an interim rate adjustment if the gap between actual and target revenues is greater than 10%. This will ensure that neither the customer nor the utility will see large fluctuations in credits or surcharges.

**DPU: *Because decoupling is designed to ensure that companies’ revenues are not affected by changes in sales, it should reduce risks to shareholders, all else being equal. However, the***

***quantification of the effect of decoupling on a company's return on equity ("ROE") is subject to a wide range of considerations that are typically evaluated as part of a rate case.***

ENE Analysis: Decoupling, and the risks associated with it, are among the many factors that the DPU should consider when making a determination about a particular company's ROE. This analysis will be completed in a rate case, but ENE anticipates only modest changes to a utility's ROE based on the impacts of decoupling.

***DPU: Implementation of a company's decoupling mechanism requires the Department to (1) investigate issues related to cost allocation, rate design, and cost reconciling mechanisms, and (2) address issues that were not fully explored in this proceeding (e.g., cost drivers, shifting risk profiles). The Department expects that companies will have operational decoupling plans by year-end 2012.***

ENE Analysis: Although ENE analysis and research indicates that Massachusetts consumers will benefit from the implementation of decoupling as quickly as practicable, we recognize that it is important to have an orderly, smooth transition to ensure that decoupling works over the long-term. By setting a 2012 target, the DPU provides sufficient time for all Massachusetts utilities to adopt a decoupling plan without requiring the disruption of current rate plans.

***DPU: To accommodate an orderly transition to the implementation of decoupling, distribution companies will be permitted to recover incremental energy efficiency-related lost base revenues ("LBR") through the term of their initial three-year energy efficiency plans, or until they have implemented decoupling, whichever occurs first. For electric companies, LBR recovery will be based on incremental savings that exceed 2007 savings levels. For gas companies, existing LBR recovery methods will remain unchanged.***

ENE Analysis: LBR denotes a mechanism whereby a utility is compensated for lost sales that are shown to result from utility efficiency programs. As a permanent solution, LBR suffers from several deficiencies: (1) it fails to break the link between sales and revenue; (2) it invites time-consuming, contentious proceedings to determine the source and size of lost revenues; and (3) it could stifle utility support for activities that reduce sales, but are not directly linked to utility efficiency programs, such as increased distributed generation and revisions to building codes or other non-utility energy efficiency efforts. However, LBR can be used as a temporary, transitional tool to encourage increases in utility efficiency spending while utilities prepare to implement decoupling. The DPU wisely restricts the use of LBR to "incremental" efficiency gains to ensure that utilities are compensated only for increases in efficiency and demand resources.

## Other Resources on Massachusetts Energy Policy and Decoupling:

- MA Docket Number 07-50: <http://db.state.ma.us/dpu/qorders/frmDocketList.asp>
- ENE Decoupling Web Page: <http://www.env-ne.org/projects/open/p/id/357/program/Energy>
- ENE Backgrounder on Decoupling: [http://www.env-ne.org/public/resources/pdf/ENE\\_Decoupling\\_Background\\_091807.pdf](http://www.env-ne.org/public/resources/pdf/ENE_Decoupling_Background_091807.pdf)
- ENE Massachusetts Web Page: <http://www.env-ne.org/states/open/p/id/268>
- ENE Summary of 2008 MA Energy Act: [http://www.env-ne.org/public/resources/pdf/ENE\\_MA\\_2008\\_Energy\\_Act\\_Summary\\_062508.pdf](http://www.env-ne.org/public/resources/pdf/ENE_MA_2008_Energy_Act_Summary_062508.pdf)



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