

Connecticut Adopts Decoupling for United Illuminating Co.



Summary

The Connecticut Department of Public Utility Control (DPUC) approved a full decoupling mechanism for The United Illuminating Company (UI) on February 4, 2009 based on a 2007 statute which mandated decoupling using one of several approaches. This is a significant advance over an earlier decision in January 2008 concerning The Connecticut Light and Power Company, which adopted only minor increases in customer charges in an effort to comply with the statute. DPUC decisions prior to 2007 had declined to approve decoupling in any form.

The UI Decision in Docket No. 08-07-04 approved a revenue adjustment mechanism which trues up actual revenues to those approved in the rate decision. It does not contain any component for adjusting the approved revenues over time. The mechanism will be reviewed at the end of 2010 to determine if it should be adjusted in some manner or terminated. The following excerpts from the UI Decision (pp. 117 – 126) indicate an appreciation of the need to align utility incentives with the interests of customers and society in reducing energy consumption.

Excerpts from DPU Decision Docket No. 08-07-04

“The reason to examine decoupling extends beyond whether UI is willing to implement cost-effective efficiency programs. This examination must consider the current regulatory landscape and the present and future impact of the multiple policies and initiatives that have been created to target energy use in the state. In addition, it is necessary to consider the impact that recent changes in society’s overall attitude toward energy and energy-related issues may generally affect UI....”

Significant among the reasons cited to move forward with decoupling in Docket No. 05-06-04 was the Department’s determination that traditional approaches to ratemaking have linked UI’s financial health to the volume of electricity sold resulting in a strong incentive to maintain or increase the sale of energy. The Department found that the effect of this linkage is exacerbated in the case of distribution-only utilities, since the profit impact of electricity sales reduction is disproportionately larger for utilities without generation resources. In some cases, a 1% loss in sales can result in a 5% or greater reduction in profit. This concern remains valid today....

As discussed in the Decoupling Decision, a full revenue adjustment clause is easier to administer than a CAM because it unnecessary to determine the cause of lower sales. The full revenue adjustment clause also provides relief and credit at appropriate times because the distribution company receives revenue when sales decline and it provides bill credits to customers when sales are higher than forecasted. In addition to removing the impact of weather, a full revenue adjustment mechanism removes variation due to demand elasticity and economic activity. A revenue adjustment mechanism can also provide benefits to both ratepayers and shareholders. For instance, a full revenue adjustment clause lowers earnings volatility which reduces risk to shareholders. In turn, reduced risk results in a lower cost of capital to the utility which can reduce rates. Decoupling Decision, pp. 17-19.....

The Decoupling Decision noted that in 1991 the Department felt it was inappropriate to implement a sales adjustment clause because doing so would shelter electric utilities from the

business risk associated with revenue recovery. In addition, the Department expressed concern with this type of clause because it removes the incentive for an electric distribution company to encourage economic development. However, the electric industry and regulatory landscape have changed dramatically since the early 1990s and ratemaking standards must evolve to accommodate these changes. Id.

Further, driven by global events as well as significant and sustained increases in energy costs Connecticut's energy policies have rapidly evolved over the last five years. The result has been a myriad number of programs and policy initiatives designed to reduce energy consumption, control peak demand and increase awareness about energy in general....

In addition to the ongoing impact from conservation programs and potential future declines associated with energy-related policies, a downturn in the economy is occurring and will further depress sales over the rate period. The magnitude of sales that may be lost to this downturn is difficult to forecast. Therefore UP's revenue recovery is even more tenuous in 2009 and 2010. The sales/revenue adjustment clause proposed by UI would assure that UI recovers its allowed revenue requirement, no more, no less. Therefore, the risk of fluctuations in revenues associate with the changes in the volume of UP's sales would be eliminated. ...

The determination as to whether to implement a full sales/revenue decoupling mechanism involves much more than UP's willingness to promote the C&LM programs. This issue must be reviewed in the context of the energy environment described herein. The environment for traditional ratemaking did not include worldwide concerns and related publicity regarding climate change and related issues. Nor did traditional ratemaking include the energy-related policies and programs noted herein. As stated, traditional ratemaking principles have linked UP's financial health to the volume of electricity sold. Based on Connecticut's current and future energy environment the Department believes that maintaining this link is contrary to fulfilling Connecticut's energy policy goals. Therefore, this link must be severed.....

Success in achieving Connecticut's energy policy goals requires that the Department take advantage of this relationship to promote the energy-related programs and policies that have been recently set in place. UI will play a key role in aggressively targeting energy consumption in the future and the Department must consider this role as regulatory standards evolve. Approval of UI's proposal provides an opportunity for UI to work aggressively with its customers to reduce their energy consumption and lower their costs. This in turn will enhance its role as the trusted source of energy-related information for its customers. For example, with full decoupling in place UI should be indifferent as to whether a customer uses electricity, natural gas, propane or solar thermal energy to fulfill domestic hot water needs. As a result, UI should become the conduit for providing information pertaining to the most efficient use of our resources.

UI will be assured of its revenue recovery. As a result, UI should be indifferent as to whether its revenues are collected through fixed charges, energy-based charges or a combination of these rates. UP's proposal relies on a kWh-based decoupling mechanism instead of increases to fixed costs. This allows UI to maintain higher kWh charges which will provide customers with energy-based price signals. The Department prefers this approach to continuing to advance decoupling through increases to fixed charges. Therefore, the Department finds that an energy-based decoupling mechanism is appropriate because approval of UI's plan allows the Department to reduce the emphasis on increasing fixed distribution charges to achieve decoupling. This in turn eliminates the Department's concern regarding the bill impacts

associated with fixed cost recovery on low use customers. This also addresses the objections raised by the OCC and Environment Northeast as to the anti-conservation potential associated with fixed cost recovery of distribution revenues.”

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Environment Northeast is a nonprofit organization that researches and advocates innovative policies that tackle our environmental challenges while promoting sustainable economic development. ENE is at the forefront of state and regional efforts to combat global warming with solutions that promote clean energy, clean air and healthy forests.