



**PUBLIC COMMENTS OF  
OF  
AARP UTAH**

**Docket No. 09-035-23**

**In the Matter of the Application of Rocky Mountain Power for Authority to  
Increase its Retail Electric Utility Service Rates in Utah and for Approval of its  
Proposed Electric Service Schedules and Electric Service Regulations**

**April 12, 2010**

AARP submits the following comments regarding the revenue decoupling and rate design proposals made by various parties in the above referenced Rocky Mountain Power (RMP) rate case. AARP is the nation's largest membership organization representing the interests of Americans aged 50 and older and is concerned about the health, safety and financial security of older Americans. There are approximately 220,000 AARP members in Utah, many of whom are customers of RMP and would be directly impacted the outcome of this rate case. AARP also participated in the Rate Design Advisory Group, which resulted from the cost of service stipulation in Docket No. 07-035-93. Several of the concepts under consideration in this proceeding were discussed in the Advisory Group.

Electricity service is crucial to health and personal welfare, especially for older consumers: the ability to have air conditioning during the summer and heat during the winter at affordable rates is necessary to prevent life-threatening conditions. Revenue decoupling and rate design affect both the rates and bills of AARP members and other

customers, as well as influence customer usage of energy. Revenue decoupling guarantees a utility a certain revenue stream, even as energy usage is reduced due to energy efficiency measures or for reasons unrelated to utility-sponsored activities, such as weather, commodity prices, and economic conditions. A related concept is a rate design that recovers most or all fixed costs through a high dollar, flat customer charge. Both revenue decoupling and high customer charges have been proposed in this proceeding. Both revenue decoupling and high customer charges have been controversial at regulatory commissions around the country because of the costs and risks posed to consumers.

### *Decoupling*

Testimony in favor of revenue decoupling cites the number of states that have adopted it for one or more utilities in their state. This testimony fails to mention that in most cases, the adoption of revenue decoupling has been controversial and that it has been rejected by several state commissions. Recent examples of state commissions rejecting decoupling include Arizona, Connecticut and Tennessee. In 2008 the Arizona Corporation Commission rejected a decoupling mechanism proposed by Southwest Gas Company, stating:

[i]t appears that, first and foremost, revenue decoupling is a means of providing the Company with what is effectively a guaranteed method of recovering authorized revenues, thereby shifting a significant portion of the Company's risk to ratepayers. (emphasis added)<sup>1</sup>

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<sup>1</sup> In the Matter of the Application of Southwest Gas Corporation for the Establishment of Just and Reasonable Rates and Charges Designed to Realize a Reasonable Rate of Return on the Fair Value of its

Although Connecticut statutes specifically authorize decoupling, the Connecticut Department of Utility Control nonetheless recently rejected a revenue decoupling mechanism proposed by Connecticut Natural Gas:

Full decoupling compensates the Company for any type of reduction in consumption, such as warmer weather, customer loss, a deteriorating economy as well as permanent and price-induced conservation. Clearly, the very large potential risk of revenue instability is shifted from the Company to customers. If the Company were to purchase an insurance instrument to guarantee [sic] distribution revenues, the insurer would expect compensation and the Company would expect to make payment for the transfer of risk. The Company's decoupling proposal thrusts customers into the role of insurer without proffering compensation. By reviewing the level of compensation customers would require to breakeven under decoupling, the Department concluded that the requisite reduction in ROE needed as compensation would prove too draconian and actually impede the Company's ability to attract capital. The Company's own calculation shows that a 10% change in weather (HDDs) alone translates into a \$4 million change in revenue. Add to this a continuing loss in UPC as predicted by the Company plus the uncertainty of a faltering economy and customers, conservatively, are at risk for \$5 to \$7 million of annual revenue shortfall. It will require a 100 basis point reduction in ROE (approximately a \$3.8 million reduction in revenue) to provide customers with weather-only compensation, without anything additional. While decoupling can be expected, *a priori*, to reduce the frequency of rate applications and associated expense, the Company has not proffered any stay-out proposal. The enlarged conservation expenditures that the Company points to as the decoupling quid pro quo, will be paid for by ratepayers, who will also experience upward pressure on rates as UPC declines further. The Company's decoupling proposal guarantees a revenue stream free of customer compensation while holding open the freedom to file a rate application at will. The Company's decoupling proposal is denied.<sup>2</sup> (emphasis added)

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Properties throughout Arizona, Docket No. G-01551A-07-0504; Decision No. 70665, Arizona Corporation Commission, December 24, 2008.

<sup>2</sup> Application of Connecticut Natural Gas Corporation for a Rate Case; Docket No. 08-06-12, Decision, June 30, 2009.

Earlier this year the Tennessee Regulatory Authority rejected a decoupling mechanism proposed by Piedmont Natural Gas, citing among other factors that decoupling removes important incentives for utility efficiency. On the record, TRA Director Robinson noted that revenue decoupling:

...appears to eliminate or significantly reduce the positive effect of regulatory lag. In theory, regulatory lag provides an incentive for utilities to operate efficiently in order to maximize profits. For a monopoly, this concept is very important, and any new rate design adopted by the Authority should not forgo the benefit of this traditional ratemaking principle.<sup>3</sup>

In the current case the Division of Public Utilities (“Division) proposes, and other parties including RMP support, a three year pilot revenue decoupling mechanism. Arguments in favor of the pilot are that the company is at risk of not recovering its fixed costs due to increased energy efficiency and that decoupling would remove a disincentive to promote energy efficiency measures.

One of the common arguments in favor of revenue decoupling is that it “aligns” the interest of the utility and consumers around energy efficiency. AARP does not agree that energy efficiency programs are dependent on the adoption of revenue decoupling, and in fact the environmental groups participating in this rate case praise RMP’s current commitment to energy efficiency programs. Several states have implemented successful efficiency programs by creating non-utility entities whose sole mission is to improve energy efficiency. In other states utilities provide energy efficiency programs without a revenue decoupling mechanism in place. Furthermore, overemphasis on lost revenues can lead to

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<sup>3</sup> Transcript of Tennessee Regulatory Authority Conference, January 25, 2010, p. 26.

unintended consequences. An example of a misguided approach to revenue recovery is the recent controversy in Ohio over a decoupling mechanism that would have cost ratepayers \$21.45 for each compact fluorescent light bulb distributed by the utility.<sup>4</sup> Decoupling riders, surcharges, and \$21 CFLs serve to erode consumer support for energy efficiency programs that could have been designed to be cost effective and benefit both the consumer and the utility.

The lost revenues associated with energy efficiency programs do not seriously threaten fixed cost recovery. Utilities have always had fixed costs and always recovered the majority of fixed costs through volumetric rates. The potential lost revenue from energy efficiency programs is very small compared with the impact of commodity prices, weather and economic conditions. An increased emphasis on energy efficiency programs does not justify radical changes in rate design.

Proponents also claim that revenue decoupling is necessary in order for regulatory policy to be consistent with federal law. However, claims that the American Recovery and Reinvestment Act requires or prefers revenue decoupling are far off base. In fact, original language proposed for inclusion in the ARRA was changed after the National Association of Regulatory Utility Commissioners (“NARUC”) and consumer

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<sup>4</sup> See for example, PUCO to hear arguments in light-bulb controversy, Oct 15 - McClatchy-Tribune Regional News - Betty Lin-Fisher The Akron Beacon Journal, Ohio

organizations sought to ensure that state regulators had maximum flexibility to adopt a range of cost recovery mechanisms other than decoupling.

***Fixed Cost Recovery Through an Increased Customer Charge***

RMP's testimony states that it prefers a fixed cost recovery mechanism that would recover at least 80% of fixed costs from the monthly customer charge on residential customers. The company calculates that residential distribution fixed costs exceed \$23 per month per account. This type of rate design, sometimes called "straight fixed variable," disproportionately impacts low-use customers and shifts all risk of under-recovery to ratepayers, typically with no recognition of the reduced risk through a reduction in return on equity.

Imposing a hefty customer charge while reducing volumetric rates is contrary to the goals of energy affordability and energy conservation. Indeed, such a rate design discourages conservation, as usage is not tied to cost for the customer, thereby taking away an incentive to conserve. Shifting costs currently recovered on a usage basis to the fixed charge is especially harmful to low usage customers, who are often older households and low income households. Cost recovery through volumetric rates, including tiered rates, ensures that those high usage customers, who are also most able to take advantage of energy efficiency programs, pay their fair share of the system costs. Information provided by SWEEP during the Advisory Group meetings indicated that high use customers drive the majority of the growth in revenue requirement for RMP. High customer charges are especially harmful to low income customers who already struggle

with energy affordability. As AARP/SLCAP witness Dr. Charles Johnson showed in testimony in Docket No. 07-035-93, low income (Schedule 3) customers on average use less than Schedule 1 customers and contribute far less to peak demand.

It is contrary to typical business practice to charge customers a flat fee or access fee meant to recover most or all of a firm's fixed costs. For example in retail sales, customers typically pay no access fees at all, and pay only for goods or services purchased. There is no fee charged for window shopping, although a store owner has certainly incurred fixed costs to operate the business. The same is true of the sale of other goods, services and commodities, such as medical services, delivered heating fuels, legal services, accounting services, and many others.

AARP is also concerned that the adoption of a rate design that could result in a \$20-plus customer charge may cause some customers to lose service altogether. For low-use customers, who typically are also older and/or lower income, a rate design with a high customer charge increase their bills before any energy is consumed. At lower usage levels, the average cost per Mcf is much higher than at the higher usage levels. This could price electricity usage out of the budgets of small users with low- and fixed-incomes, resulting in customers facing disconnection of service over unaffordable bills.

Both decoupling and rate design with high customer charges significantly reduce the utility's risk, and if allowed should be matched by a reduction in the allowed return on equity. If a utility does not risk losing margins if its sales drop between rate cases, it is

virtually guaranteed to full recovery of its revenue requirement. The theory and practice of ratemaking is that rates are set to enable a utility the reasonable *opportunity* to earn its allowed return. Decoupling and high customer charges give a utility the virtual *certainty* that it will earn the allowed rate of return. The risk that the Company will overearn is shifted to the customers (and particularly to the lower-usage customers). With high customer charges recovering all or most fixed costs, customers provide the full revenue requirement, regardless of the Company's performance. Since the Company's risk is lowered significantly if recovery of fixed costs is done through high flat fees, the utility's required return should also be lowered by a meaningful amount to reflect the reduced risk.

### ***Tiered or Inclining Block Rates***

AARP generally supports tiered or inclining block rate designs that maintain an affordable initial block of service and do not impose large monthly fixed charges on low-use customers.

### ***Conclusion***

AARP's concerns about revenue decoupling and high customer charges should not be viewed as opposition to energy efficiency programs or to fair compensation for utilities. Both utilities and consumers have much to gain from the adoption and implementation of effective energy efficiency programs that help consumers lower their monthly energy use and thus reduce their monthly energy bills. Cost recovery and utility incentives should be fair and reasonable and linked to the utility's actual performance in reducing energy use. When considering cost recovery and rate designs, due consideration should be given to

the impact on utility bills, especially lower usage and low income customers. Ratepayers should be able to count on lowering their bills if they consume less energy. That is an outcome that truly aligns the customer and utility interest.