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Energy and Telecommunications Interim Committee
Trevor Graff

FINAL REPORT TO THE 66TH MONTANA LEGISLATURE

**SJ 31 UTILITY DECOUPLING:
MONTANA CONSIDERATIONS
DRAFT**

ENERGY AND TELECOMMUNICATIONS INTERIM COMMITTEE MEMBERS

Before the close of each legislative session, the House and Senate leadership appoint lawmakers to interim committees. The members of the Energy and Telecommunications Interim Committee, like most other interim committees, serve one 20-month term. Members who are reelected to the Legislature, subject to overall term limits and if appointed, may serve again on an interim committee. This information is included in order to comply with 2-15-155, MCA.

Senate Members

Senator Mary McNally, Chair

PO Box 20584
Billings, MT 59104-0584
Ph: (406) 671-1376
Email: Sen.Mary.McNally@mt.gov

Senator Nate McConnell

PO Box 8511
Missoula, MT 59807-8511
Ph: (406) 214-2445
Email: nateforhd89@gmail.com

Senator Tom Richmond

3103 Westfield Dr.
Billings, MT 59106-1402
Ph: (406) 208-5588
Email: tomrichmondmt@gmail.com

Senator Scott Sales

5200 Bostwick Rd.
Bozeman, MT 59715
Ph: (406) 579-7994
Email: Sen.Scott.Sales@mt.gov

House Members

Representative Derek Skees, Vice Chair

PO Box 9134
Kalispell, MT 59904-2134
Ph: (406) 212-5493
Email: Rep.Derek.Skees@mt.gov

Representative Laurie Bishop

211 S Yellowstone St.
Livingston, MT 59047-3018
Ph: (406) 223-1122
Email: Rep.Laurie.Bishop@mt.gov

Representative Zac Perry

PO Box 268
Hungry Horse, MT 59919-0268
Ph: (406) 261-9642
Email: Rep.Zac.Perry@mt.gov

Representative Daniel Zolnikov

PO Box 50403
Billings, MT 59105-0403
Ph: (406) 861-5210
Email: Rep.Daniel.Zolnikov@mt.gov



LEGISLATIVE SERVICES DIVISION

P.O. Box 201706
Helena, MT 59620-1706
Phone: (406) 444-3064
Fax: (406) 444-3971
Website: <http://leg.mt.gov/xxx>

Energy and Telecommunications Interim Committee Staff
Jameson Walker, Attorney | Trevor Graff, Legislative Research Analyst | Sonja Nowakowski,
Legislative Research Analyst | Nadine Spencer, Secretary

This report is a summary of the work of the Energy and

Telecommunications Interim Committee, specific to the Energy and Telecommunications Interim Committee's 2017-2018 natural gas customer choice study as outlined in the Energy and Telecommunications Interim Committee's 2017-18 work plan and House/Senate Joint Resolution 28 (2017). Members received additional information and public testimony on the subject, and this report is an effort to highlight key information and the processes followed by the Energy and Telecommunications Interim Committee in reaching its conclusions. To review additional information, including audio minutes, and exhibits, visit the Energy and Telecommunications Interim Committee website: www.leg.mt.gov/etic.

A full report including links to the documents referenced in this print report is available at the Energy and Telecommunications Interim Committee website: www.leg.mt.gov/etic

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INTRODUCTION

The Energy and Telecommunications Interim Committee (ETIC), guided by Senate Joint Resolution 31 (2017), began its study of utility decoupling by focusing on mechanisms employed by other western states. The committee examined enabling legislation, policy mechanisms and methods for crafting decoupling policies in the west.

ETIC FINDINGS AND RECOMMENDATIONS

Committee members found that most states enact decoupling policy on an individual utility basis at the Public Service Commission level. The committee found the following information helpful in considering future legislative options for decoupling and voted against drafting legislation on the topic.

WHAT IS DECOUPLING?

Decoupling policy separates a regulated utility's profits from its total electric or gas sales so a utility isn't incentivized to sell more electricity or gas. The implementation of decoupling policy is most often discussed by the commissions that regulate utilities and often in terms of ratemaking. The policy is a mechanism to encourage regulated utilities to support energy efficiency, but it is not a tool for increasing energy efficiency. Instead, it is a ratemaking mechanism that removes what can be seen as a utility's incentive to discourage energy efficiency.

Decoupling policy separates profits from total electric or gas sales so a utility is not incentivized to sell more electricity or gas.

A utility collects revenues based on a revenue requirement that is typically determined by a regulatory commission and is typically on a per-customer basis. Regulatory commissions set rates every few years that allow a utility to recover costs and to earn a fair return on investment. The actual revenue earned by a utility, however, varies based on how much energy customers use each month, which results in the utility earning either more or less than the established rate. With decoupling, utility revenue is established based on an amount needed to cover established costs. Rates are then allowed to change with consumption to meet the revenue target. To further simplify, under decoupling, a utility's fixed costs (transmission lines and other infrastructure) are allocated on a per-customer basis for customers. Rates are set by the commission to cover those costs. Then each year, the commission reviews actual costs and the number of customers. Rates are adjusted

Traditional Rates:
 $\text{Revenue} = \text{Fixed Price} \times \text{Sales}$

Decoupled Rates:
 $\text{Price} = \text{Fixed Revenue} / \text{Sales}$

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upward to pay extra costs if the per-customer cost is more than originally estimated. Rates are reduced for the next year if the fixed costs are less than estimated. The utility is then able to recover those costs, regardless of how much electricity or gas a customer uses.

Several methods exist for implementing decoupling policy. For example, some methods implement true-up mechanisms that automatically adjust rates based on consumption or through a balancing account, where excess revenue is stored or makes up for revenue shortfalls. Utilities can also implement full, partial, or limited decoupling.

The table below outlines two common methodologies found in western states.

Decoupling Methodology	Key Elements
Accrual Revenue Per Customer (RPC)	Allowed revenue computed on an RPC basis. One rate adjustment per year.
Accrual Attrition	Allowed revenue determined in periodic general rate cases. Changes based on specified factors determined in annual attrition reviews. Rates adjusted annually.

Regulatory Assistance Project: 2011

WESTERN STATES ELECTRIC DECOUPLING

In the United States, 16 states have implemented electric utility decoupling programs for at least one utility. In the West, California, Colorado, Idaho, New Mexico, Oregon, and Washington currently implement electric revenue decoupling.¹

The utilization of decoupling policy mechanisms varies slightly from state to state. The methods most commonly found in the west are Accrual Rate per Customer or Accrual Attrition. The accrual policies rely on public service commissions to set base allowed revenue figures and reconcile actual revenue with allowed revenue, refunding the surplus or levying surcharges for the deficit using balancing accounts.

The following are three examples of decoupling mechanisms in the West:

¹ Richard Sedano, A Decoupling Foundation: Montana Public Service Commission Workshop on Decoupling, Regulatory Assistance Project

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California

California's decoupling method utilizes the accrual attrition method. The California Public Utilities Commission (CPUC) enacted revenue regulation policies for Pacific Gas & Electric Company (PG&E), Southern California Edison, and San Diego Gas & Electric for the first time in 1982. In 1996, the CPUC suspended revenue regulation with the implementation of utility restructuring.² The California Legislature passed Assembly Bill No. 29 in 2001 to establish energy efficiency programs that sought to reduce energy usage in the state. The bill required the CPUC to reimplement revenue generation.

In the case of PG&E, California implements the accrual attrition method of full decoupling in revenue regulation cases. Revenue requirements are fixed in a rate case and then incrementally adjusted in periodic "attrition cases." The CPUC typically determines utilities' revenue requirements every 3 years in a general rate case. Future cost requirements and sales levels are forecasted in a future test year to determine the revenue requirement. Two methods are available for revenue adjustment. The first, the stair-step method, predetermines revenue requirement adjustments during the general rate case. The second involves changes to the post-test-year revenue requirements.³

During the general rate case, the CPUC also determines post-test-year attrition adjustments. Attrition is defined as the decrease in utility revenues compared with costs between rate cases. Attrition adjustments aim to allow the utility to recover increased costs. Balancing accounts are used to track the difference in billed revenue and authorized revenue on a monthly basis. The total annual surplus or deficit at the end of the year is refunded or collected from ratepayers in the following year through rate adjustments.⁴

Idaho

Idaho utilizes a rate-per-customer method. The Idaho Public Utilities Commission (IPUC) made permanent a 5-year pilot program for the decoupling of Idaho Power Company's revenue in April 2012. The program is based on a fixed cost Adjustment (FCA) mechanism that compares the authorized fixed-cost revenue requirement with weather-normalized sales. The difference is reconciled annually for residential and small business customers. Allowed revenue is determined on a per-customer basis during the general rate case. Total fixed costs are adjusted based on the number of customers.

During general rate cases, the IPUC establishes a revenue requirement based on fixed costs collected through residential and small general service customer rates. The commission also establishes a fixed-cost-per-customer rate and a fixed-cost-per-kWh rate. Fixed costs are defined broadly to include return, taxes and labor expenses.

² Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

³ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

⁴ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

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Revenue adjustment occurs between general rate cases utilizing the FCA mechanism. The adjustment is determined by multiplying the fixed-cost per-customer rate (FCC) by the total number of customers for each customer class to determine the allowed cost recovery amount. The amount is then compared to the fixed costs realized by the company by multiplying the weather-normalized sales for each customer class by the fixed-cost per-kWh rate determined in the general rate case. The difference determines the Fixed Cost Adjustment between general rate cases.

IPUC Fixed Cost Adjustment (FCA) Formula

$$\text{FCA} = (\text{Total Customers} \times \text{Fixed-cost Per Customer}) - (\text{Weather Normalized Sales} \times \text{cost-per-kWh})$$

Idaho reconciles actual revenue with authorized revenue on a monthly basis. The actual fixed-cost recovered amount is determined based on the weather-normalized sales for each customer class multiplied by the fixed-cost per-kWh rate. The methodology used to weather-normalize actual monthly energy used in the FCA is the same as used in the general rate case. The actual fixed-cost recovered is subtracted from the allowed FCA and the difference is recorded as a line item in a monthly Power Cost Adjustment (PCA) report provided to the IPC. The differences are deferred to the end of the year with interest. Each year, the company totals the FCA results, including interest. If a deficit occurs, the amount is recovered the following year. If the company has over collected its fixed-cost revenue, the amount is returned to customers through a credit or surcharge mechanism. The FCA is recovered proportionally from residential and small general service customers. Annual adjustments are capped at three percent and differences beyond that are rolled over until the next period. Adjustments to the rate occur June 1 of the year following the previous 1-year period from January 1 to December 31.⁵

Oregon

Oregon enacted a slightly different rate-per-customer method. The Oregon Public Utility Commission (OPUC) originally approved a decoupling mechanism for Portland General Electric Company (PGE) in 2009.⁶ PGE is the only electric utility using a decoupling mechanism in the state that utilizes the Accrual Revenue Per Customer method.

⁵ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

⁶ Order No. 09-020, Oregon Public Utility Commission

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Oregon's Sales Normalization Adjustment (SNA) mechanism for residential and small business customers sets a fixed charge per customer (FCC) rate. The calculation is made each month based on the difference between allowed revenues toward fixed costs and actual weather-adjusted revenues toward fixed costs.

OUTC Sales Normalization Adjustment (SNA) Formula

$$\text{SNA} = (\text{FCC} \times \text{Customers}) - (\text{Fixed Charge Energy Rate} \times \text{Weather-normalized sales})$$

FCC: Fixed Charge per Customer Rate

Customers: Total number of customers

FCE: Fixed Charge Energy Rate

Sales: Weather-normalized sales

The resulting value is placed in a tracking account called the SNA balancing account. The balancing account records both over collections and under collections. The resulting surplus or deficit is refunded or recovered through a change to electric rates in the following year. Rate increases are capped at 2 percent and rate change are calculated for each tariff schedule.⁷

WESTERN STATES NATURAL GAS DECOUPLING

Natural gas decoupling mechanisms are structured similarly to programs implemented for electricity rates. In the United States, 23 states have decoupled at least one natural gas utility. In the West, Arizona, California, Idaho, Nevada, Oregon, Utah, Washington, and Wyoming implement natural gas decoupling.⁸

Washington

In 2006, Washington voters approve Initiative 937, which resulted in the passage of the Washington Energy Independence Act. That act gave the Washington Utilities and Transportation Commission (WUTC) the authority to implement decoupling policies.

Avista Utilities' natural gas division in Washington implemented an Accrual Revenue Per Customer (RPC) mechanism and provides an example of how decoupling works in the natural gas sector, as well as an example

⁷ Schedule 123 tariff, Portland General Electric Company

⁸ Richard Sedano, A Decoupling Foundation: Montana Public Service Commission Workshop on Decoupling, Regulatory Assistance Project

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of partial decoupling. To calculate the monthly allowed delivery revenue per customer (RPC), the WUTC utilizes a seven-step formula.

1. Determine the Total Normalized Revenue - The Total Normalized Revenue is equal to the final approved base rate revenue approved in the Company's last general rate case.
2. Determine Variable Gas Supply Revenue - The Normalized terms by rate schedule from the last approved general rate case are multiplied by the approved Schedule 150 PGA rates to determine the Variable Gas Supply Revenue.
3. Determine Delivery Revenue – To determine the Delivery Revenue, the mechanism subtracts the Variable Gas Supply Revenue from the Total Normalized Revenue.
4. Remove Basic Charge Revenue – included in the Delivery Revenue is revenue recovered from customers in Basic fixed charges. Because the decoupling mechanism only tracks revenue that varies with customer energy usage, the revenue from Fixed Charges is removed. The number of Customer Bills, multiplied by the applicable Fixed Charges determines the total Fixed Charge revenue by rate schedule.
5. Determine Allowed Decoupled Revenue – Allowed Decoupled Revenue is equal to the Delivery Revenue (Step 3) minus the Basic Charge Revenue (Step 4).
6. Determine the Allowed Decoupled Revenue per Customer – To determine the annual per customer Allowed Decoupled Revenue, divide the Allowed Decoupled Revenue by the Rate Year number of Customers to determine the annual Allowed Decoupled Revenue per Customer (by Rate Group).
7. Determine the Monthly Allowed Decoupled Revenue per Customer - to determine the monthly Allowed Decoupled Revenue per customer, the annual Allowed Decoupled Revenue per customer is shaped based on the monthly therm usage from the rate year.

Once monthly allowed delivery revenue per customer is calculated, Avista recognizes actual revenue with authorized revenue on a monthly basis by multiplying the number of customers by the monthly-allowed decoupled revenue per customer, to find the allowed decoupled revenue for that month. The remaining balance of actual decoupling revenue and allowed decoupled revenue is calculated and deferred to a balancing account. Based on the realized surplus or deficit at the end of the process, Avista Utilities files a request annually with the WUTC to either surcharge or rebate, over the following year, the amount accumulated in the balancing accounts. Rate increases are capped at 3 percent annually.⁹

⁹ Schedule 175, Avista Corporation

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DECOUPLING CONSTRUCTION

The construction of decoupling policies varies nationally among states and further among utilities. Designing a decoupling mechanism requires the consideration of several main policy points in an effort to align the state's, Public Service Commission's and energy stakeholders' policy objectives. The following is a collection of potential policy questions for consideration by policymakers constructing a decoupling policy that fits Montana's energy landscape.

WHY CONSIDER DECOUPLING?

Decoupling policy separates a regulated utility's profits from its total electric or gas sales so a utility isn't incentivized to sell more electricity or gas. The implementation of decoupling policy is most often discussed by the commissions that regulate utilities and often in terms of ratemaking. The policy is a mechanism to encourage regulated utilities to support energy efficiency, but it is not a tool for increasing energy efficiency. Instead, it is a ratemaking mechanism that removes what can be seen as a utility's incentive to discourage energy efficiency.

A utility collects revenues based on a revenue requirement that is typically determined by a regulatory commission and is typically on a per-customer basis. Regulatory commissions set rates every few years that allow a utility to recover costs and to earn a fair return on investment. The actual revenue earned by a utility, however, varies based on how much energy customers use each month, which results in the utility earning either more or less than the established rate. With decoupling, utility revenue is established based on an amount needed to cover established costs. Rates are then allowed to change with consumption to meet the revenue target. To further simplify, under decoupling, a utility's fixed costs (transmission lines and other infrastructure) are allocated on a per-customer basis for customers. Rates are set by the commission to cover those costs. Then each year, the commission reviews actual costs and the number of customers. Rates are adjusted upward to pay extra costs if the per-customer cost is more than originally estimated. Rates are reduced for the next year if the fixed costs are less than estimated. The utility is then able to recover those costs, regardless of how much electricity or gas a customer uses.

The construction of sound decoupling policy usually entails answering the following four policy questions:

1. What entity has the legal authority to enact a decoupling mechanism?
2. What utilities and what utility functions are covered?
3. What method is best to adjust utility revenue under a decoupling mechanism?
4. What method best handles consumer refunds and surcharges?

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1. Regulatory Authority

Historically, decoupling policy is established by a combination of statute and at the regulatory level through the administrative rules at the commission. Several states have enacted decoupling policy at the regulatory level without enabling legislation. The western decoupling states examined in previous meetings implemented policy both by statute and by commission action.

California

California adopted decoupling policy for gas utilities in 1978 and for major electric utilities in 1982. In 1996, decoupling policies were suspended during the era of utility restructuring. In 2001, the California Assembly passed Assembly Bill 29 that directed the California Public Utilities Commission to ensure that errors in estimates of demand did not result in over- or under-collection on the part of the electrical corporations.¹⁰

Idaho

The Idaho Public Utilities Commission began to investigate disincentives to energy efficiency investment in 2004. In 2007, the commission approved a three-year pilot program of a proposed decoupling mechanism. The pilot was extended two years in 2009 and made permanent in 2012.¹¹

Washington

In 2006, Washington voters approved Initiative 937, resulting in the passage of the Washington Energy Independence Act. The legislation gave the Washington Utilities and Transportation Commission the authority to implement decoupling policy.

Montana

Montana regulators most recently considered decoupling policy in 2010 when NorthWestern Energy (NWE) proposed a four-year pilot program that would provide decoupled electric and natural gas rates for residential and small-business customers. The PSC granted the decoupling mechanism as part of NWE's rate case, but the utility filed a motion for reconsideration, which left the docket open and stalled implementation decoupling in Montana.¹²

Lawmakers considering the construction of decoupling policy are faced with the following questions concerning the regulatory authority for decoupling policy construction:

¹⁰ Assem. Bill 29, ch 8, 2001 Cal. Stat. http://www.leginfo.ca.gov/pub/01-02/bill/asm/ab_0001-0050/abx1_29_bill_20010412_chaptered.pdf

¹¹ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

¹² Measuring Montana's Experience with Decoupling, Nowakowski, Sonja, Montana Legislative Services Division

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1. How much authority should be granted to the Public Service Commission? Does the state need legislation in order to propagate decoupling policy?
2. If statute is required, what policies are implicitly included in legislation and what policies should be decided at the Public Service Commission?

2. What is covered?

The second important step in constructing decoupling policy is to decide what utility functions, customer classes, and costs will be included in a decoupling mechanism. Decoupling policy is often crafted at the public service commission level on an individual utility basis during regular rate cases.

Four main points can be considered.

1. Is the utility's generation, distribution, and transmission revenue or a combination of the three included?
2. What customer classes, commercial or residential, are included?
3. What elements of the utility's cost should be included?
4. Which utilities should be included, NorthWestern, Montana Dakota Utilities and the electric co-ops?

Utility Functions

Decoupling can apply to all aspects of transmission, distribution, and generation of a utility or only specific portions of a utility's business. Decoupling policy in the West typically comes in two forms – full or partial decoupling.

Full decoupling

In prior testimony submitted during the Montana Energy and Telecommunications Interim Committee's January 2018 meeting, both Montana Dakota Utilities and NorthWestern Energy officials voiced support for full decoupling. Northwestern officials wrote:

Full Decoupling in its essential, most complete form insulates a utility's revenue collections from any deviation of actual sales from expected sales. The cause of the deviation — e.g., increased investment in energy efficiency, weather variations, and/or changes in economic activity — does not matter. Any and all deviations will result in an adjustment (“true-up”) of collected utility revenues to the allowed level of Decoupling revenues. Full Decoupling can be likened to setting a budget. Currently established ratemaking methods are used to determine a utility's revenue requirement using a historic

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Revenue Adjustment Mechanism (RAM)	Key Elements
No RAM	No adjustment is made to the revenue requirement until a utility files a rate case to increase it; in the meantime, rates are adjusted via periodic true-ups. Some consumer advocates support this out of concern over increasing rates and lack of opportunity to verify the increases.
Stair-Step	Adjustments are pre-determined in a rate case and are usually based on forecasts of projected cost increases. The benefit of this is that it can provide revenue stability based on pre-determined choices that translate into financial benefits for the utility and its customers. The downside is that costs are difficult to forecast accurately.
Indexing	Adjustments are tied to multiple factors, such as general or industry inflation, industry productivity, customer growth, and changes in capital. This is sometimes viewed as a reasonable compromise because it can account for known or likely utility cost changes without necessarily having major rate impacts.
Revenue Per Customer (RPC)	Regulators determine the revenue requirement on a per-customer basis (usually by customer class), and the total system revenue requirement is determined by multiplying the number of customers in each class by the revenue requirement for each customer in that class. This is frequently used for distribution utilities and is among the most popular mechanism; a benefit is that customers do not end up compensating a utility for lost revenues due to lost customers.
Attrition	Periodic reviews are used to adjust base rates for known and measurable changes in rate base and operating expense. More controversial larger changes, such as major plant additions, are left for a full rate case (unless there is an applicable tracker in place, in which case it would not be part of the decoupling mechanism).

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K factor	An adjustment is used to increase or decrease overall growth in revenues between rate cases, if a key assumption (such as increased efficiency or growth in rooftop solar) is likely to vary significantly during the decoupling period. The K factor can vary from year to year but is usually set at a prescribed level in between rate cases. A K factor coupled with an RPC can be convenient, while also addressing the challenge of tracking the effects of these changing cost drivers.
Hybrid	Regulators may use a combination, or hybrid, of regulatory mechanisms. For example, a combination of RPC and K Factor may be used so that the allowed revenue per customer grows (or declines) according to a historical trend factor as the mix of customers changes over time.

test year — i.e., the total revenues it will need in a period (typically, a year) to provide safe, adequate, and reliable service.¹³

Partial Decoupling

Partial decoupling affects only a portion of a utility’s revenue. For instance, a partially decoupled company may only receive a decoupled rate on its transmission and distribution revenue, but not its generation.

Customer Classes

Typically, decoupling is applied to small business and residential customers. The homogeneous nature of that customer class makes it easier to adjust rates and build rate design.

Costs Included

Often, most costs are included in a decoupling mechanism, unless the utility has a separate mechanism to track costs that are recovered on a regular basis.

Decision makers constructing a decoupling policy may consider the following questions:

1. Should all utility functions be included in a decoupling mechanism or should costs be carved out?
2. Is a form of full or partial decoupling the best fit for Montana utilities?

¹³ Northwestern Energy, 2018 Montana Legislative Decoupling Study NorthWestern Energy Response

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3. Revenue Adjustment

Decoupling mechanisms rely on several forms of multi-step formulas called revenue adjustment mechanisms to determine allowed revenue for the utilities. Legislators also must consider how often to implement revenue adjustments. The table below details several revenue adjustment options.

Source: Regulatory Assistance Project, 2016

Western States

In the West, revenue per customer and attrition methods are most common. The accrual policies rely on public service commissions to set base allowed revenue figures and reconcile actual revenue with allowed revenue, refunding the surplus or levying surcharges for the deficit using balancing accounts.

California

In the case of PG&E, California implements the accrual attrition method of full decoupling in revenue regulation cases. Revenue requirements are fixed in a rate case and then incrementally adjusted in periodic “attrition cases.” The California Public Utilities Commission typically determines utilities’ revenue requirements every three years in a general rate case. Future cost requirements and sales levels are forecasted in a future test year to determine the revenue requirement. Two methods are available for revenue adjustment. The first, the stair-step method, predetermines revenue requirement adjustments during the general rate case. The second involves changes to the post-test-year revenue requirements.¹⁴

During the general rate case, the CPUC also determines post-test-year attrition adjustments. Attrition is defined as the decrease in utility revenues compared with costs between rate cases. Attrition adjustments aim to allow the utility to recover increased costs.¹⁵

Idaho

Idaho utilizes a rate-per-customer RAM. The program is based on a fixed cost adjustment (FCA) mechanism that compares the authorized fixed-cost revenue requirement with weather-normalized sales. The difference is reconciled annually for residential and small business customers. Allowed revenue is determined on a per-customer basis during the general rate case. Total fixed costs are adjusted based on the number of customers.

During general rate cases, the Idaho Public Utilities Commission establishes a revenue requirement based on fixed costs collected through residential and small general service customer rates. The commission also

¹⁴ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

¹⁵ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

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establishes a fixed-cost-per-customer rate and a fixed-cost-per-kWh rate. Fixed costs are defined broadly to include return, taxes and labor expenses.

Revenue adjustment occurs between general rate cases utilizing the FCA mechanism. The adjustment is determined by multiplying the fixed-cost per-customer rate by the total number of customers for each customer class to determine the allowed cost recovery amount. The amount is then compared to the fixed costs realized by the company by multiplying the weather-normalized sales for each customer class by the fixed-cost per-kWh rate determined in the general rate case. The difference determines the fixed cost adjustment between general rate cases.

Idaho reconciles actual revenue with authorized revenue on a monthly basis. The actual fixed-cost recovered amount is determined based on the weather-normalized sales for each customer class multiplied by the fixed-cost per-kWh rate. The methodology used to weather-normalize actual monthly energy used in the FCA is the same as used in the general rate case. The actual fixed-cost recovered is subtracted from the allowed FCA and the difference is recorded as a line item in a monthly power cost adjustment report provided to the commission.¹⁶

Oregon

Oregon enacted a rate-per-customer method. PGE is the only electric utility using a decoupling mechanism in the state that utilizes the Accrual Revenue Per Customer method.¹⁷

Washington

Avista Utilities' natural gas division in Washington implemented an accrual revenue per customer mechanism and provides an example of how decoupling works in the natural gas sector, as well as an example of partial decoupling. To calculate the monthly allowed delivery revenue per customer, the Washington Utilities and Transportation Commission utilizes a seven-step formula.

8. Determine the Total Normalized Revenue – The Total Normalized Revenue is equal to the final approved base rate revenue approved in the Company's last general rate case.
9. Determine Variable Gas Supply Revenue – The Normalized therms by rate schedule from the last approved general rate case are multiplied by the approved Schedule 150 PGA rates to determine the Variable Gas Supply Revenue.
10. Determine Delivery Revenue – To determine the Delivery Revenue, the mechanism subtracts the Variable Gas Supply Revenue from the Total Normalized Revenue.
11. Remove Basic Charge Revenue – included in the Delivery Revenue is revenue recovered from customers in Basic fixed charges. Because the decoupling mechanism only tracks revenue that

¹⁶ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

¹⁷ Schedule 123 tariff, Portland General Electric Company

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varies with customer energy usage, the revenue from Fixed Charges is removed. The number of Customer Bills, multiplied by the applicable Fixed Charges determines the total Fixed Charge revenue by rate schedule.

12. Determine Allowed Decoupled Revenue – Allowed Decoupled Revenue is equal to the Delivery Revenue (Step 3) minus the Basic Charge Revenue (Step 4).
13. Determine the Allowed Decoupled Revenue per Customer – To determine the annual per customer Allowed Decoupled Revenue, divide the Allowed Decoupled Revenue by the Rate Year number of Customers to determine the annual Allowed Decoupled Revenue per Customer (by Rate Group).
14. Determine the Monthly Allowed Decoupled Revenue per Customer – to determine the monthly Allowed Decoupled Revenue per customer, the annual Allowed Decoupled Revenue per customer is shaped based on the monthly therm usage from the rate year.¹⁸

Montana

In prior testimony to the Energy and Telecommunications Interim Committee during the January 2018 meeting, both NWE and MDU officials supported a rate-per-customer RAM.

Decision makers constructing a decoupling policy would likely consider the following questions?

1. Which rate adjustment method best fits Montana?
2. How much direction for crafting a RAM should be implicitly written into a bill? How much authority should be granted to the PSC in order to develop such a method?

¹⁸ Schedule 175, Avista Corporation

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4. Refunds and Surcharges

The last step in a decoupling mechanism involves reconciling over- or under-collections of revenue resulting in either customer refunds or possible surcharges charged to future customer bills. To calculate refunds and surcharges the mechanism must consider allocation, the frequency of true-ups, and possible caps in decoupling adjustments.

HANDLING REFUNDS AND SURCHARGES

Decoupling mechanisms offer several choices when constructing refund and surcharge structures.

Allocation

Allocation methods most often include a uniform surcharge or credit per kilowatt-hour (kWh) to all decoupled classes; a uniform percentage surcharge or credit to all rate elements; or “class-by-class” decoupling, in which allowed revenue is computed separately for each class and used to produce a uniform adjustment (either by kWh or percentage) for all customers in that class.¹⁹

Frequency of True-Ups

The typical choices are monthly, quarterly, and annually. Monthly is the low limit because billing is monthly, while annual is the upper limit to avoid excessive divergence between expected and actual revenues. Monthly adjustments tend to be more accurate in matching actual and authorized revenues, while a longer period, such as a year, has the benefit of smoothing out shorter-term volatility and tends to result in smaller adjustments—positive or negative—overall. A weather-only normalization can be used as a form of real-time decoupling adjustment.²⁰

Capping Decoupling Adjustments

While adjustments resulting from a RAM tend to cluster in the -1 to +3 percent range, they can be larger or smaller, as either a surcharge or credit. Many regulators adhere to the principle of gradualism so as to minimize rate shock and make it easier for consumers to adjust to new prices. Not all utilities have caps; some regulators may not be fans of deferrals and may instead prefer to allow the true-up to reflect the full extent of any adjustment, and some have limited surcharges but allowed full flow-through of credits. For those that prefer to limit rate impacts, there are various mechanisms for capping rates, from a cap on the percentage of a permissible rate change, to a cap on total revenue increases (as opposed to rate increases), to setting the cap in

¹⁹ Regulatory Assistance Project: Customizing Revenue Regulation to Your State’s Priorities

²⁰ Regulatory Assistance Project: Customizing Revenue Regulation to Your State’s Priorities

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dollars, not as a percentage. Unrecovered amounts must be considered, usually via the handling of deferral balances and true-ups.²¹

Western States

California

During the general rate case, every three years, the California Public Utilities Commission also determines post-test-year attrition adjustments. Attrition is defined as the decrease in utility revenues compared with costs between rate cases. Attrition adjustments aim to allow the utility to recover increased costs. Balancing accounts are used to track the difference in billed revenue and authorized revenue on a monthly basis. The total annual surplus or deficit at the end of the year is refunded or collected from ratepayers in the following year through rate adjustments.²²

Idaho

Idaho reconciles actual revenue with authorized revenue on a monthly basis. The actual fixed-cost recovered amount is determined based on the weather-normalized sales for each customer class multiplied by the fixed-cost per-kWh rate. The methodology used to weather-normalize actual monthly energy used in the Fixed Cost Adjustment is the same as used in the general rate case. The actual fixed-cost recovered is subtracted from the allowed Fixed Cost Adjustment and the difference is recorded as a line item in a monthly Power Cost Adjustment report provided to the Idaho Public Utilities Commission. The differences are deferred to the end of the year with interest. Each year, the company totals the FCA results, including interest. If a deficit occurs, the amount is recovered the following year. If the company has over collected its fixed-cost revenue, the amount is returned to customers through a credit or surcharge mechanism. The FCA is recovered proportionally from residential and small general service customers. Annual adjustments are capped at 3 percent and differences beyond that are rolled over until the next period. Adjustments to the rate occur June 1 of the year following the previous 1-year period from January 1 to December 31.²³

Oregon

Oregon's Sales Normalization Adjustment (SNA) mechanism for residential and small business customers sets a fixed charge per customer (FCC) rate. The calculation is made each month based on the difference between allowed revenues toward fixed costs and actual weather-adjusted revenues toward fixed costs.

²¹ Regulatory Assistance Project: Customizing Revenue Regulation to Your State's Priorities

²² Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

²³ Decoupling Case Studies: Revenue Regulation Implementation in Six States, Regulatory Assistance Project

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The resulting value is placed in a tracking account called the SNA balancing account. The balancing account records both over collections and under collections. The resulting surplus or deficit is refunded or recovered through a change to electric rates in the following year. Rate increases are capped at 2 percent and rate change are calculated for each tariff schedule.²⁴

Washington

Once monthly allowed delivery revenue per customer is calculated, Avista recognizes actual revenue with authorized revenue on a monthly basis by multiplying the number of customers by the monthly-allowed decoupled revenue per customer, to find the allowed decoupled revenue for that month. The remaining balance of actual decoupling revenue and allowed decoupled revenue is calculated and deferred to a balancing account. Based on the realized surplus or deficit at the end of the process, Avista Utilities files a request annually with the Washington Utilities and Transportation Commission to either surcharge or rebate, over the following year, the amount accumulated in the balancing accounts. Rate increases are capped at 3 percent annually.²⁵

Decision makers constructing a decoupling mechanism should consider the following:

1. What cap, if any, should be placed on the increase or decrease of allowed revenues as a result of a rate adjustment mechanism?
2. How should surcharges and refunds be allocated? Across the board or by customer class?
3. How often should rate true-ups occur in order to ensure the proper surcharges or refunds are being paid?

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²⁴ Schedule 123 tariff, Portland General Electric Company

²⁵ Schedule 175, Avista Corporation