Michigan Public Service Commission
Report on
<u>Electric and Gas Revenue Decoupling in Michigan</u>

Section 97(4) of 2008 PA 295 required the Michigan Public Service Commission (Commission) to report to the Legislature regarding the status of revenue decoupling for regulated utilities in Michigan. Specifically, the act required the following:

> (4) Not later than 1 year after the effective date of this act, the commission shall submit a report on the potential rate impacts on all classes of customers if the electric providers whose rates are regulated by the commission decouple rates. The report shall be submitted to the standing committees of the senate and house of representatives with primary responsibility for energy and environmental issues. The commission's report shall review whether decoupling would be cost-effective and would reduce the overall consumption of fossil fuels in this state.

To accomplish this goal the Commission issued an order on October 1, 2008 requesting all interested parties to file comments regarding the issue of revenue decoupling.

> The Commission finds that all interested parties should have an opportunity to comment on the analysis and content of the decoupling report. All recommendations should be consistent with the provisions of Section 97(4) of Act 295. Any person may submit written or electronic comments regarding the decoupling report required by Act 295. The comments must be filed with the Commission and must be received no later than 5:00 p.m. on March 13, 2009. Written comments should be sent to: Executive Secretary, Michigan Public Service Commission, P.O. Box 30221, Lansing, MI 48909. Electronic comments may be e-mailed to mpscedockets@michigan.gov. All comments should reference Case No. U-15898. All information submitted to the Commission in this matter will become public information available on the Commission's website and subject to disclosure.

Comments filed in response to the Commission order can be viewed in the docket file for Case No. U-15898. Subsequent to this action various cases were filed at the Commission containing revenue decoupling discussion. A number of these cases currently remain open, in various stages of the administrative hearing process. The following cases have issues pending which concern decoupling: *Case No. U-15645* - Consumers Energy Company's electric rate case; *Case No. U-15768* - The Detroit Edison Company's electric rate case; *Case No. U-15986* - Consumers Energy Company's gas rate case; *Case No. U-15985* - Michigan Consolidated Gas

Company's gas rate case; *Case No. U-15988* - Upper Peninsula Power Company's electric rate case; and *Case No. U-15990* - Michigan Gas Utilities Corporation's gas rate case.

Because the Commission is legally and ethically unable to provide comments regarding the issues surrounding decoupling in the above-described pending rate cases, the Commission has delegated the responsibility of providing the Legislature with the required status report to its staff. The following comments are the result of this delegation.

MPSC Staff Comments Regarding Decoupling

Revenue decoupling is a regulatory mechanism that removes the link between energy sales and utility revenues and profits. Revenue differences are trued-up on a periodic basis as a surcharge or credit to customers so that the utility's revenues match the allowed revenue requirement as established in the utility's last general rate case. Revenue decoupling removes the utility's disincentive to promote energy efficiency by eliminating the negative financial impact on a utility's earnings resulting from the reduction of energy sales due to the implementation of energy efficiency programs.

A decoupling mechanism will break the link between actual revenues and utility energy sales. Decoupling means that changes in revenues resulting from changes in consumption will no longer contribute to the determination of need for a rate case. Instead, rate case filings will be driven by a change in underlying costs sufficient to warrant a filing by the utility. Thus, a decoupling mechanism will remove the energy optimization disincentive and may reduce the frequency of rate case filings.

Decoupling mechanisms should reconcile actual non-fuel and non-purchase power revenue to the revenue requirement authorized in the utility's last rate case so the utility will receive no more nor less than the total fixed cost revenue requirement last approved in a rate case. The periodic decoupling true-ups should be conducted as administratively efficiently as possible.

Each utility has unique circumstances because of variances in its businesses and service territories, which require that each has the opportunity to design, with Commission approval, the specific components of any potential decoupling mechanism.

Decoupling is not expected to increase the cost of utility service. Customers pay no more and no less than the fixed costs the Commission find necessary and prudent to provide them utility service. What decoupling does facilitate is cost savings to customers, through the reduced bills energy efficiency makes possible. Because these savings reflect both fixed and variable costs of energy consumption, they are generally lower than the fixed cost true-up decoupling generates.

The exact rate impact of the various decoupling proposals is tied to each individual proposal, however the on-going long-term rate impact of implementing a decoupling mechanism should compare favorably with the rate determination mechanism mandated by 2008 PA 286, which set a 12-month limit for each case and allowed the utility to self-implement six months after filing. Most decoupling mechanisms could be expected to establish rates at a similar level in a similar time frame because of their annual nature. Decoupling mechanisms, because of their symmetrical nature will provide rate reductions due to increased utility sales on a faster time frame than the current rate case process.

With the adoption of Public Act 295 in 2008, Michigan instituted an energy efficiency portfolio standard for all Michigan-based gas and electric utilities. It is generally a more efficient use of resources if utilities save every unit of energy that is less expensive to capture than it is to generate or purchase. Utility energy efficiency programs are projected to save electricity for less than one-third of the average cost of generation. Traditional rate regulation rewards utilities for selling more energy, and punishes utilities for selling less, thereby pitting the interests of the utility's investors against the interests of the utility customers.

The utility incentive to increase sales applies to a utility's fixed costs, which are the costs that do not vary directly with customer usage, such as some operations and maintenance expenses and the depreciation and return on rate base. Since utilities recover most of their authorized fixed costs through revenues based on volumetric sales, a utility can collect more revenue for fixed costs than the amount authorized if sales are above the levels predicted when rates are set. If sales dip below projected levels, the utility may not collect enough revenue to support its fixed costs. Absent decoupling, utilities will continue to seek ways to increase sales to counteract the impact of the energy efficiency programs on revenue.

The adoption of an effective decoupling mechanism is expected to reduce energy costs in the long run through the promotion of cost effective energy efficiency measures. The reduction in overall energy usage driven by strong energy efficiency program and supported by an effective decoupling mechanism will likely reduce the over all consumption of fossil fuels in the future.

Parties seeking additional information and the view points of the various parties can review the comments filed in Case No. U-15898 and specific testimony related to decoupling in pending rate cases.