# REPORT TO THE COMMISSION ON THE REVENUE DECOUPLING MECHANISM (RDM) COLLABORATIVE

**February 15th, 2011**

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**Appendices**

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## REVENUE DECOUPLING MECHANISM (RDM) COLLABORATIVE

**History of Proceedings**

In its Order issued on November 4, 2010, Case Number U-16191, (Consumers Energy General Rate Case), the Commission directed the Staff to convene a technical conference to be held before January 15, 2011 to discuss pilot revenue decoupling mechanisms (PRDM). The Commission then directed Staff to submit to the Commission a report on the conference, summarizing the positions taken and any consensus that developed with regard to the issues, no later than February 15, 2011.

On January 13, 2011 Staff held the Revenue Decoupling Mechanism (RDM) Collaborative as directed by the Commission. Paul Proudfoot and Robert Ozar from the Electric Reliability division directed the meeting. The Collaborative agenda is attached herein as Appendix A.

**Discussion of Commission-Order Matrix**

Staff commenced the discussion with reference to a matrix which listed particulars of each Commission order in a general rate proceeding which approved a RDM. The matrix facilitated an understanding of the commonalities and differences of each RDM that was approved. Staff opened the discussion up to the group to ensure that the information on the Matrix was correct. The Matrix is attached herein as Appendix B.

**RDM - Efficacy of approved RDM's in Impacting EO Targets**

Staff opened up discussion on whether there is a relationship between the approval of the pilot RDM and the utilities' promotion of their EO programs and in particular whether or not the existence of an approved RDM was a causative factor in exceeding minimum EO targets.

MichCon stated that the EO financial incentive mechanism is more of a driver to exceed targets than the RDM itself. Detroit Edison stated that expanding the EO program was directly related to Commission approval of a decoupling mechanism for the company. DTE further stated that perhaps the RDM did not encourage them to expand their plan but it did ameliorate concerns associated with pursuing more EO programs. Consumers Energy stated that the RDM had a direct impact on their willingness to exceed EO targets. Shortly after CE's RDM was approved they filed an EO plan amendment that was approved by the Commission and resulted in $40 million additional spending on EO programs for the 2011-2014 plan years. SEMCO explained that they did not request a RDM because they proposed a straight fixed-variable rate design and felt that it achieved the objective of decoupling revenues from conservation efforts.

**Types of RDMs Preferred**

Staff explained the four fundamental types of RDMs that were proposed in the various cases before the Commission and then further explained the two mechanisms that the Commission approved. Those two are the Consumption Per Customer Tracker and the EO Lost Sales Tracker. Staff opened up the discussion to hear which mechanism should be in place and what issues could arise. An explanation of the fundamental RDM formulas is attached herein as Appendix C.

**Consumers Energy** stated that the average-use per-customer method (Consumption per Customer Tracker) creates anomalies that were not anticipated. In addition, customer migration between rates and between bundled sales and Retail Open Access (ROA) has a significant impact on margin that is not properly addressed by the average-use per-customer method. CE does not have an ECIM tracker so this is a huge impact for them. Although CE believes the RDM worked as designed for the first reconciliation period, they would prefer to move to a Simple Revenue

Tracker to ensure the company receives their authorized revenue. CE proposed a Simple Revenue Tracker in their pending gas rate case and this would be their preference for both gas as well as electric utilities. CE also believes that decoupling should be symmetrical as allowed by PA 295. Consumers does not support having RDM revenue caps or surcharge caps as they believe it would limit the ability of decoupling to be fully symmetrical. They would also prefer no weather normalization and the use of actual revenues. Currently, CE excludes street lighting rates for the RDM and believes that street lights should continue to be excluded.

**Detroit Edison** is in the midst of a pending rate case and proposed an EO only RDM (EO Tracker). They proposed the EO Tracker because the approved Consumption Per Customer RDM creates aberrations when customers switch rate classes or move to choice during the reconciliation period. Detroit Edison does not believe there should be one decoupling mechanism for all regulated utilities, but not necessarily a different one for each utility. In other words, the variations should be limited. DTE does not prefer to have revenue or surcharge caps and they agree with Consumer's that street lighting customers should be excluded.

**MichCon** is in support of a full revenue true-up (Simple Revenue Tracker). They also believe that the Consumption Per Customer Tracker creates anomalies when customers move unexpectedly from one rate schedule to another, which in turn creates problems. MichCon is interested in a simple method that includes distribution revenues and does not include weather normalization. Customer group exclusions are somewhat dependent upon the mechanism, but some probably could be excluded. MichCon believes that not every utility should have the same mechanism but a few options may be appropriate. MichCon stated that perhaps large gas transportation customers should be excluded.

**MGU** would propose to stick with a Simple Revenue Tracker. They do not believe that weather normalization is appropriate. MGU believes that gas and electric companies should be treated similar. When establishing a particular type of mechanism, the Commission should take into consideration the company size and type of Energy Optimization programs being offered. . MGU stated that depending on the type of mechanism that is adopted, the need for annual rate cases could be eliminated. MGU believes that large general service customers should be excluded from an RDM.

**I & M** states that an EO Tracker is fine for them based on the current cost recovery regulations in Michigan that provide for the filing of projected general rate cases, so long as the utility is able to receive reasonable treatment on projections of load as I & M is able to mitigate the risk of typical load changes within that load projection. I & M stated that the ability to file annual rate cases eliminates all but the need for a limited decoupling mechanism related to EO sales losses. They believe that weather normalization is not appropriate for an RDM because it adds an extra layer of uncertainty. I & M believes that one mechanism for all companies is not appropriate due to the fact that each company has their own business risk and ways to manage those risks. I & M believes that revenue and surcharge caps would be punitive to a utility because there is asymmetry as to how load moves, typically down much quicker than up, and the likelihood of exceeding the caps on the upsides where they would retain those earnings is much more unlikely.

**SEMCO** does not agree with RDMs, but if there were to be one, they would prefer that it be a Simple Revenue Tracker without weather normalization. SEMCO does not believe that revenue and surcharge caps are appropriate and would prefer that the RDM incorporate total revenue (including both distribution and customer charge revenue).  They also do not believe that having one mechanism for all utilities would be appropriate.

**Stakeholders and Interested Parties**

ABATE takes the position that any necessary basis for revenue decoupling has been eliminated by Act 286. ABATE states if the Commission continues to approve revenue decoupling mechanisms despite the revenue recovery advantages bestowed on utilities by Act 286, that the mechanism's scope should be limited to sales losses associated with implementing EO programs.  ABATE also states that gas transport customers should not be subject to any RDMs because they are on their own in terms of acquiring the commodity.

Kroger, from a customer's perspective, opposes adoption of RDMs.  Proposals to go to full revenue trackers subject customers to utility revenue losses that have nothing to do with EO programs.  Kroger stated if they *had* to choose an RDM, they would support targeting EO type activities, although they still do not believe this is the appropriate direction.  They believe that customers who are self-directing their EO programs should be exempt from any revenue decoupling mechanism.

Hemlock Semi-Conductor also does not agree with RDM's regardless of how they are set up and believes it is not in line with traditional ratemaking principles.  They believe that RDM's promote revenue assurance to utilities but do not necessarily promote EO.  HSC does not agree with any RDMs but if they *had* to choose, they would choose an EO Sales Tracker because it attempts to tie revenue losses to a utility's EO program. They also believe that EO self-direct customers should be excluded. HSC further opines that weather normalization should be required. Excluding weather normalization provides utilities a guaranteed level of revenue regardless of what the weather did that year, and this is not fair to ratepayers.  HSC also suggests that the Commission consider revenue and surcharge caps because risk to ratepayers is so substantial that it makes sense to look for some form of protection for them.

Assistant Attorney General Michael Moody also agreed that weather normalization is needed and stated that if an RDM is limited to EO losses there would not be problems with the question of a revenue or surcharge cap.

**Allocating Revenue Variances**

Both Detroit Edison and MichCon raised the important distinction between rate class and rate schedule pointing out that rate schedules with a small number of customers may need to be combined together. Consumers Energy agreed that revenue variances should be allocated by rate class. They do not prefer allocation by rate schedule because of the need to rely on forecasted sales by rate schedule and at such a detailed level, may not reflect a very accurate projection of sales.

Although utilities generally agreed that the lost revenues from each rate class should be allocated back to that rate class, participants to the collaborative were not prepared to address the alternative of allocating the aggregate revenue variance by rate-case revenue requirements. Consumers Energy noted that this method would recognize the change in use of the utility's distribution system from the allocations established in the rate case to the actual distributions. Kroger noted that the fundamental concern is that in a rate case, customers get assigned costs for their particular rate class, and that in a subsequent RDM reconciliation (that allocates revenue deficiencies by rate class), remaining customers are assigned costs after the class characteristics have changed. An example would be if a large customer was lost from one class the remaining customers in that class would pick up the tab because of happenstance. Had that customer loss been known at the time rates were originally calculated, the shortfall would have been allocated to other rate classes.

With respect to accounting treatment, CE makes an accounting adjustment each month to recognize revenue decoupling impact. The revenue loss is not recorded as a regulatory asset until recovery is approved in a Commission Order. Detroit Edison and MichCon also said that revenue losses are recorded in a deferred account until recovery is approved.

**Regulatory Lag**

Detroit Edison and MichCon stated that regulatory lag related to RDM reconciliations could be an issue. The utilities do not want to sit on customer’s money, conversely they do they not want to wait for their money. Despite this concern, utilities agreed that there is not a need for an expedited proceeding.

**Residual Balances**

Commission Staff raised the issue of unrecovered or over-recovered amounts resulting from implementation of RDM reconciliation surcharges/refunds, i.e. reconciliation residuals. Staff inquired as to whether or not the residual balances should be carried forward from year to year. Consumers stated that if a RDM continues into the next period, the residual balance could be rolled into next year’s decoupling reconciliation, and that would be more efficient than dealing with residual balances through additional regulatory filings. Kroger and HTC suggested that another option is to look at where you are in relation to your sales forecast and adjust the surcharge toward that end of the collection/refund period, so you prevent an over or under collection and get as close as possible to a zero balance. ABATE then stated they believe there is no legal basis for a carry forward of residual balances as is done for Act 304 reconciliations.

Assistant Attorney General Moody stated they agree with ABATE that carry-over of residual balances is not legal.

**Self Implementation Months**

Commission Staff asked for thoughts regarding the five Commission Orders stating that very detailed proposals would be required. I & M stated they would have a challenge and that it should be limited to any load from a prior case. Consumers stated they would agree as long as there has been final approval on rates and that new non-fuel rates can be used in the new decoupling mechanism. Consumers then stated that this does require a final order and that self-implemented rates cannot be used for the RDM as they have not been finalized by the Commission and are subject to refund. Commission Staff commented that they would then be collecting a surcharge during the same time period that it is recovered by decoupling. HSC commented that this is an argument of why there should not be an RDM, because when you start comparing protection for utilities and protection for customers it gets complicated. Staff then asked if months with final rates could be different than earlier months and whether previous rate cases are used for revenue in earlier months. DTE stated that if you have good sales forecast and the RDM is a full revenue tracker it should yield zero but in reality forecasts are not always very accurate.

**Collaborative Consensus**

Although no consensus was reached by all parties to the collaborative, issues were clarified as a result of the discussion. In general, utilities desire either a simple revenue tracker or an EO tracker. Customer stakeholders are generally opposed to RDM's, particularly in light of the revenue recovery advantages associated with self-implementation/projected general rate cases. During the collaborative, no party expressed a desire for continuation of the consumption per customer mechanism. The exclusion of gas transportation customers from the RDM had significant support from both utilities and stakeholders. The Commission should note that gas transport class, similar to PA 295, could be subdivided into those customers less than 100,000 Mcf per year and those greater than or equal to 100,000 Mcf. The smaller customers have characteristics similar to the bundled/GCR customers and could remain subject to the RDM with the larger customers excluded.

**Revenue Decoupling Mechanism (RDM) Collaborative**
January 13, 2011, 9:00 - 11:30 a.m.
Hearing Room A – Map to MPSC Offices
Phone-In: 1-877-336-1828, Access Code: 222-0392#

**AGENDA**

1) **Where we are at:** Discussion of Commission Order Matrix.

2) **Success of Pilots thus far in Facilitating Utility Provision of Increased Energy Efficiency Programs.**

3) **Where we want to be:** Discussion of General RDM Approaches
    a. Alternative Mechanisms
    b. Alternative Allocation Methods
    c. One Mechanism for all Utilities vs. Custom Mechanism for Each
    d. Weather Normalization
    e. RDM Revenue Caps or Surcharge Caps
    f. Exclusion of particular Customer Groups

4) **RDM Reconciliation Structure**
    - Accounting/Booking
    - Regulatory Lag Involved in Annual Reconciliations
    - Updating Sales Forecasts on an Annual Basis
    - Whether Balances Should Carry Over from Year to Year
    - Treatment of self-implementation months.
    - Proration of fixed RDM Reconciliation Periods to Reflect Approval of New Final Rates.

5) **Discussion of Reconciliation Issues directly related to Upcoming RDM Filings commencing March 1st, 2011.**

**Customer Order Matrix**
**Revenue Decoupling Mechanisms**

| | Consumers Energy Electric | UPPCo. Electric | Detroit Edison Electric | Consumers Energy Gas | MichCon Gas | MGU Gas | I & M Electric | SEMCO Gas |
|---|---|---|---|---|---|---|---|---|
| Case No. | U-15645 | U-15988 | U-15768 | U-15986 | U-15985 | U-15990 | U-16180 | U-16169 |
| Order Issued | 11/2/2009 | 12/16/2009 | 1/11/2010 | 5/17/2010 | 6/3/2010 | 7/1/2010 | 10/14/2010 | 1/6/2011 |
| Mechanism Type | ∆Consumption Customer | ∆Consumption Customer | ∆Consumption Customer | ∆Consumption Customer | ∆Consumption Customer | ∆Consumption Customer | EO RDM | RDM was not requested |
| Self-implementation Months Excluded | Very detailed proposal required | Very detailed proposal required | Very detailed proposal required | Very detailed proposal required | Very detailed proposal required | YES | Not Addressed | |
| Weather Normalization | NO | NO | NO | Yes - 15 Year | YES - 15 Year | YES - method same as rate case | NO | |
| Fixed Reconciliation Period | December 1 - November 30 | January 1 - December 31 | February 1 - January 31 | June 1 - May 31 | July 1 - June 30 | January 1 - December 31 | January 1 - December 31 | |
| EO/Reliability/Filing Standards | YES | YES | YES | YES | YES | YES - Except EO Conditions | NO | |
| Allocation Method | Determined in Reconciliation | Determined in Reconciliation | Determined in Reconciliation | By Customer Class | By Rate Schedule | By Rate Group | By Customer Class | |
| Rate Class Excluded | None | None | None | None | Large customer rate GS2, Rates ST-XXLT, and all transportation rates addressed in reconciliation period | Large general service | None | |
| Reconciliation Proration Due to New Rates | Not Addressed | Not Addressed | Not Addressed | Not Addressed | Not Addressed | YES - file within 90 days | Not Addressed | |
| Source of Customer Data | Rate Case # of Customers | Rate Case # of Customers | Actual Average Monthly during Reconciliation Period | Actual Average Monthly during Reconciliation Period | Actual Average Monthly during Reconciliation Period | Rate Case # of Customers | Not Applicable | |

# Basic Revenue Decoupling Mechanisms

## Simple Revenue Tracker

$$= \sum_{i-1}^{n} \textbf{[Actual Revenue – Rate Case Revenue]}_{\mathbf{i}}$$

Revenue Input Alternatives

1) Net Distribution Revenue
*(Reflects changes in sales levels) (Promotes Conservation)*
2) Net Distribution Revenue + Customer Charge Revenue
*(Also reflects gains or losses in customers) (Promotes broad based risk reduction)*
3) Net Distribution Revenue + Demand Charge Revenue
*(Also reflects changes in demand charge revenue) (Promotes broad based risk reduction)*
4) Net Distribution Revenue + (Customer Charge + Demand Charge Revenue)
*(Reflects all changes impacting revenues) (Promotes broad based risk reduction)*

## Simple Sales Tracker

$$= \sum_{i=1}^{n} \textbf{[(Actual Sales – Rate Case Sales) * (Net Distribution Revenue / Sales Level)]}$$

## Consumption per Customer Tracker

$$= \sum_{i=1}^{n} \textbf{[ (}\Delta\textbf{ Consumption/Customer) * (Net Distribution Revenue / Sales Level) * Rate Case Number of Customers ]}$$

## EO Lost Sales Tracker

$$= \sum_{i=1}^{n} \textbf{[(Actual EO Sales Loss – Base EO Sales Loss)} \cdot \textbf{(Net Distribution Revenue / Sales Level)]}$$

**EO Sales Loss = *f* (Certified EO Credits)**