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**POSITION STATEMENT ON DECOUPLING AND FORMULA RATES**  
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INDIEC supports retaining the current ratemaking structure for utilities. The traditional ratemaking structure under which the Utility Regulatory Commission (IURC) sets rates in a rate case, properly balances utility needs and consumer protection. INDIEC is opposed to efforts to change the ratemaking formula through decoupling or formula rates for the reasons outlined below.

**Traditional Ratemaking Structure**

Unlike most other business, utilities are monopolies operating in a service territory provided by the IURC. For monopolies, regulation is the surrogate for competition. Currently in Indiana, and in many other state jurisdictions, a utility chooses when to seek a change in rates and charges through filing a rate case at the IURC. The utility presents what its actual revenues and expenses were during its selected twelve month test year and may propose adjustments for items which are fixed, known and measurable and which occur within 12 months after the end of the test year. Unlike other businesses which risk incurring losses if their business is not successful, utilities go through a ratemaking process during which the Commission determines a reasonable rate of return for the utility to earn on the investments it has made in its utility system ("ratebase"). The utility must manage its costs in-between rate cases in order to have the opportunity to earn the return authorized in a rate case, but may choose to file a new rate case if its returns are too low.

**Decoupling and Formula Rates**

Decoupling and formula rates are trackers which change the traditional ratemaking structure and allow utilities to recover differences between actual financial results and rate case authorized amounts in-between rate cases. Decoupling mechanisms seek to recover the difference between the per customer margins resulting from the utility's last rate case, whereas formula rates track the differences between the return on equity determined in a rate case and the utility's actual return on equity. In both mechanisms, the utility's rates are automatically adjusted without examination of the factors which have caused the change. Under decoupling or formula rates, it does not matter whether the utility's financial results deviate from the rate case because of factors within the utility's control (management of costs) or outside of its control (weather, economy).

Consider a decoupled or formula rate structure in the context of buying a hot dog from a vendor at a baseball game. The hot dog would normally sell for \$2 dollars, allowing the vendor to recover his costs and a profit. But if the vendor had formula rates, the price of a hot dog might go up to \$10 dollars when the game has low attendance or gets called short for rain because the vendor has not sold enough hot dogs. The customer might choose not to buy the hot dog, but electricity is an essential service available only from the customer's monopoly service provider.

**Problems with Decoupling and Formula Rates**

Decoupling and formula rates serve as a mega-tracker. Unlike most trackers, a decoupling or formula rate mechanism is not limited to a particular type of cost; the mega-tracker allows the utility rates to be adjusted for any reason. These non-traditional mechanisms also distort the utility incentive to manage costs in-between rate cases. The mechanisms also dull a utility's sense of reflecting the conditions in its service territory. If households and businesses are cutting costs to adjust to economic conditions, utilities should feel pressures to do the same, rather than have

mechanisms that guarantee the utility will earn its authorized return. Decoupling and formula rates also send signals that are counter to innovation and productivity, because a utility will no longer be financially rewarded for its efficiency. Accordingly, the changes represented by decoupling and formula rates are significant and substantial deviations from the traditional ratemaking formula.

A utility's rate of return includes a component for its cost of capital. Decoupling and formula rate mechanisms lower a utility's business risk and accordingly its cost of capital. If a utility is authorized to set rates through a non-traditional rate mechanism, the utility's cost of capital and resulting overall rate of return must be lowered to recognize the reduced financial risks.

Regulatory lag, or the time required to conduct a rate case, is frequently used as a justification for decoupling or formula rates. The IURC also has rules developed through a stakeholder processes under which a utility can receive a rate order between 10 months and 1 year after the date of filing. The last 3 months of this period is devoted to the Commission's preparation of a final order. The utility can also seek expedited relief in the case of a true emergency. Accordingly, processes already exist for prompt resolution of utility rate cases, and Indiana's favorable environment to utilities has historically been recognized by the financial sector. Rate cases which have not been resolved around the 1 year mark are ones where the utility has gone for a substantial period (10 years or more) in-between rate cases or the utility is requesting unique or unusual relief.

Decoupling and formula rates take the worst from both regulated and deregulated structures. The non-traditional rate mechanisms create the appearance that utility rates have been reviewed and determined reasonable by the IURC, when in reality the rates have not, while exposing the utility to none of the pressures that an open market might otherwise provide.

Aligning utility objectives with energy efficiency efforts is another justification provided in support of decoupling or formula rates, however, this argument is flawed. If a utility's business risk has not increased from offering energy efficiency programs, the traditional regulatory bargain should not be changed. If energy efficiency programs cause a utility to lose any fixed cost recovery that it cannot otherwise manage in-between rate cases, those issues should be addressed when implementing the energy efficiency program. Good rate design is a much better solution to any such problems than the blunt instruments of decoupling and formula rates.

Furthermore, the IURC has already considered and rejected a decoupling mechanism for a vertically integrated investor owned electric utility. The IURC found that decoupling mechanisms are rarely utilized in other states for vertically integrated investor owned utilities such as exist in Indiana. A vertically integrated electric utility has not only distribution assets, but also generation and transmission functions which would complicate use of non-traditional ratemaking formulas.

## **Conclusion**

It is critical to maintain the current environment of regulation ratemaking in Indiana to ensure both the utilities' financial health and consumer concerns are met equitably. Introducing decoupling or formula rates would shift risks unduly to the customer and remove natural incentives to effective management of utility costs.