

**NASUCA**  
**CONSUMER PROTECTION COMMITTEE**  
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***Recent Developments Regarding Utility  
Efforts to Increase Customer Charges***

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# Issues:

## Recent Developments Regarding Utility Efforts to Increase Customer Charges

- National trends in Residential customer charges.
- Cost-based customer charges.
- Issues concerning direct customer cost determination.

## The Utility Push To Increase Customer Charge: What's Wrong With It and How To Respond To It (2015 Presentation to NASUCA)

- Are high customer charges being used (or should they be used) as a substitute for revenue decoupling?
- Are high customer charges contrary to energy efficiency policy and do they encourage increased use?
- Is the push to “recover fixed costs through fixed charges” consistent with efficient competitive pricing principles?
- Should increased customer charges be counter-balanced with ROE reductions?
- Do increased customer charges interact with tiered volumetric rates?
- What impact does the customer charge have on low volume and low income customers?

# National Trends In Residential Customer Charges

The trends in increasing customer charges vary across the Country.

- Frankly, the pricing of customer charges is generally a matter of Commission policy.
  - Some States have adhered to maintaining minimal customer charges citing:
    - Affordability
    - Low income customer concerns
    - Proper price signals promoting conservation and efficient usage
    - Customer's ability to control total utility bill
    - Customer rate structure preferences
  - Other States have accepted utilities arguments and have substantially increased fixed monthly charges:
    - Fixed costs should be recovered from fixed charges
    - Revenue decoupling
    - Straight-Fixed Variable rate structure
- At least one State (Connecticut) has been successful in legislatively codifying how customer charges shall be determined.

*The Public Utilities Regulatory Authority shall adjust each electric distribution company's residential fixed charge upon such company's filing with the authority an amendment of rate schedules pursuant to section 16-19 to recover only the fixed costs and operation and maintenance expenses directly related to metering, billing, service connections and the provision of customer service. §16-243bb (2)*

# Cost-Based Customer Charges

- Utilities often argue that customer charges should include all “direct” customer-related costs as well as a portion of other distribution and overhead costs.
  - Direct costs generally include metering, service lines, and customer accounts.
  - Other distribution costs may include capital costs associated with poles, conductors, and transformers (electric) or mains (gas and water).
  - Overhead costs may include a portion of Common and General Plant, Administrative & General expenses, Advertising, Sales expenses, Uncollectibles, etc.
- Most Consumer Advocates (including myself) are of the opinion that customer charges should only include the direct costs required to “connect and maintain a customer’s account” including:
  - Service lines, meters, meter reading and metering expenses, customer accounting and customer records expenses.
  - Generally use revenue requirement approach wherein capital costs include depreciation, return, and income taxes.

# Issues Concerning Direct Customer Cost Determination

- Individual utility accounting practices vary.
  - It is sometimes argued that the identified accounts relating to services, metering, and customer accounting do not accurately reflect all “direct” costs.
    - Accounting for computer billing system and software are sometimes included within Intangible or General Plant
    - Employee pensions and benefit accounting is not uniform across utilities. Sometimes these costs are embedded within individual FERC Accounts, other companies book these costs to Account 926 (Employee Pensions & Benefits).
    - For large utilities (primarily with affiliates or part of a holding company), some customer accounting and billing costs may be booked under Account 923 (Outside Services) provided by an affiliate.
  - The required rate of return for services and meters investment should be lower than the overall rate of return due to the lower risk associated with guaranteed revenue recovery.
  - Consideration should be given to Contributions In Aid of Construction and/or connection fee revenues as an offset to customer costs.
  - With regard to Smart Metering, the entire capital cost of smart meters investment should not be included in the direct customer cost as a large portion of this investment is energy/demand-related; i.e., not entirely customer-related.
- Some customer accounting, customer service, and informational expenses are controversial including:
  - collection activities should be excluded from total Account 903 (Customer Records & Collections) if possible.
  - At most, only a small portion of uncollectible accounts (associated with customer charge portion) should be considered within direct customer costs.
  - Customer Service, Informational, and Customer Assistance expenses should not be included in direct customer costs.
  - Demonstrating and Selling expenses should not be included in direct customer cost analyses.
  - Administrative & General expenses should not be reflected in direct customer costs.

# NASUCA 2015 MID-YEAR MEETING

*The Utility Push To Increase Customer Charge:  
What's Wrong With It and How To Respond To It.*

## Are High Customer Charges Being Used (Or Should They Be Used) As A Substitute for Revenue Decoupling?

**If most (or all) base rate revenue is collected from fixed monthly customer charges, revenue is guaranteed and therefore is “decoupled” by definition.**

**If a regulatory agency adopts a decoupling policy, volumetric-based mechanisms are far more equitable and are more consistent with energy conservation policies.**

# Are High Customer Charges Contrary To Energy Efficiency Policy and Do They Encourage Increased Use?

**Short answer --- Yes.**

- **Price Signals**
- **Price Elasticity**



# Is The Push To “Recover Fixed Costs Through Fixed Charges” Consistent With Efficient Competitive Pricing Principles?

**Short answer --- No.**

- **Fixed costs are more appropriately termed “sunk” costs.**
- **Public Utilities are “businesses.”**
- **Competitive business activity provides the greatest benefit to consumers and results in the most efficient utilization of resources.**
- **Regulation should serve as a surrogate for competition.**
- **The notion that fixed costs should be recovered through fixed charges is at odds with accepted economic theory, as well as business practices in competitive markets.**

- **From an academic perspective, economic theory tells us that in competitive markets, prices are equal to marginal costs.**
  - **marginal cost is defined as: the incremental change in cost as a result of an incremental change in output.**
  - **Because marginal costs measure the changes in costs with output, short-run “fixed” costs are irrelevant in efficient pricing. This is because “fixed” costs are reflected within a firm’s production function.**
  - **In summary, utility marginal costs are volumetric in nature, with the exception of those costs required to connect and maintain an individual customer’s account.**
- **In practice, competitively-based prices are almost universally volumetrically priced.**
  - **many industries are faced with high “fixed costs.”**
  - **industries that were once regulated are now price volumetrically.**
    - **airlines**
    - **railroads**
    - **motor carriers**
    - **products pipelines**
- **Arguments that fixed costs should be recovered from fixed charges have not been supported with a single shred of academic support.**
  - **this recent argument (over the last 8 or 10 years) stems from the FERC’s use of “Straight-Fixed Variable” pricing for natural gas interstate transmission service.**

- **SFV pricing was established in FERC Order 636. However, SFV pricing was implemented not as a matter of efficiency or conservation, but rather, the opposite. SFV pricing was a result of national policy to encourage the increased use of domestic natural gas and reduce our Nation's dependence on foreign oil. Specifically, FERC Order 636 states:**

*The Commission's intent is to further facilitate the unimpeded operation of market forces to stimulate the production of natural gas . . . [and thereby] contribute to reducing our Nation's dependence upon imported oil . . .*

*Moreover, the Commission's adoption of SFV should maximize pipeline throughput over time by allowing gas to compete with alternative fuels on a timely basis as the prices of alternate fuels change. The Commission believes it is beyond doubt that it is in the national interest to promote the use of clean and abundant gas over alternate fuels such as foreign oil. SFV is the best method for doing that.*

# Should Increased Customer Charges Be Counter-Balanced With ROE Reductions?

- Concept of Risk and Return
  - *Fixed charges = guaranteed revenue = lower risk*
  - Differential class rates of return

# Do Increased Customer Charges Interact With Tiered Volumetric Rates?

- **Depends on the rate structure**
- **Policy**
- **Higher customer charge with Inverted-Block rates**
- **Lower customer charge with Declining-Block rates**
- **“Essential Service”**
- **Minimum bill rate structure**

# What Impact Does The Customer Charge Have On Low Volume And Low Income Customers?

## Intra-class Cross Subsidization

- this argument is tied to the misguided belief that small volume customers do not contribute their fair share towards the recovery of the utility's fixed costs.
  - remember the concepts of marginal cost, as well as cost causation.
  - load factors
  - tail wagging the dog
  - seasonality

# CONCLUSION

- Matter of Regulatory Policy
- Reasonable Fixed Charges