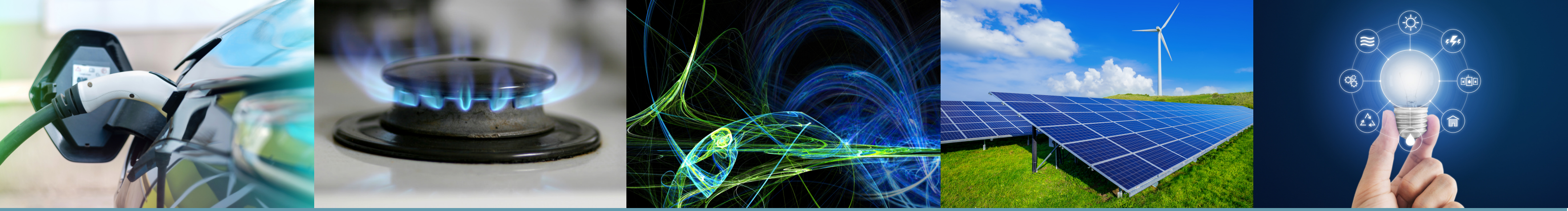

NARUC's Guidance on Fair Utility Cost Allocation

One of the bedrock principles of utility ratemaking is that costs should be allocated as closely as possible to the groups of customers on whose behalf such costs were incurred. This is important as a fundamental matter of fairness and to ensure that even in a regulated industry like public utilities, appropriate price signals can be sent to consumers. This is especially true in states where customers can procure their energy from either a competitive retail supplier or through default service (which is typically provided by the utility).

As part of the electricity and natural gas market restructuring, the introduction of retail choice was accompanied by the concept of default supply service. Many legislatures and regulators in most states determined that the distribution utility would not be entirely removed from the supply market. Rather, the utility would be responsible for procuring energy commodities on behalf of customers who had not selected a competitive retail supplier. What has become clear over time is that certain costs associated with the provision of commodity – costs that should be specifically allocated to those customers served under default supply service – have instead been recovered in whole or in part from the non-bypassable distribution rates paid by all customers.

A Closer Look at the Challenges & Solutions

This inequity persists despite efforts by retail suppliers and customer groups to draw attention to it. It is also not in alignment with the principles and guidelines of the nonpartisan experts in utility rate making - the National Association of Regulatory Utility Commissioners (NARUC).

For example, in Guidelines for Cost Allocations and Affiliate Transactions, one of the key principles highlighted is: "The indirect costs of each business unit, including the allocated costs of shared services, should be spread to the services or products to which they relate using relevant cost allocators."

While this principle is specifically mentioned in the section of the guidelines on managing the costs of regulated and non-regulated services provided by utilities, the concept also applies to the allocation of costs incurred in the provision of default supply service from distribution rates. For example, a utility's legal department provides counsel to the departments dealing with distribution rates and to the staff dedicated to energy commodity procurement. Following this principle, the costs of the utility's legal department should be proportionally allocated between these functions and not to just one of them.

The utilities and other stakeholders concerned about this cost allocation issue often respond that these types of shared service costs are hard to identify and, therefore, more challenging to allocate. But NARUC again offers several approaches to this challenge. For example, Chapter 7 of NARUC's Electric Utility Cost Allocation Manual considers certain hard-to-classify and hard-to-allocate customer-related costs, such as billing and collection, providing service information and advertising and promoting utility services.

There is no dispute that, as Chapter 7 acknowledges, "care must be taken in developing the proper allocators." But it is possible and a fairer approach for the benefit of all customers.

CASE STUDY

There is a success story in Ohio that demonstrates that parties can reach an agreement on unbundling distribution costs. In a 2015 distribution rate case for Dayton Power & Light (now AES Ohio) and a subsequent Standard Service Offer (SSO) proceeding in 2016-17, the parties in the proceeding proposed and the Public Utilities Commission of Ohio (PUCO) approved, an approach to recovering certain costs related to the supply of electricity through a bypassable charge on SSO customers, rather than all distribution customers.

First, the parties agreed AES Ohio could recover the costs of the assessments paid by all utilities to fund the PUCO and the Office of the Ohio Consumer Counsel (OCC) through a bypassable rider. The logic was it would be unfair to effectively charge supplier customers twice by keeping the recovery in distribution rates paid by all customers, as suppliers pay a similar assessment to support the PUCO and OCC. Despite a recommendation by Staff in 2022 to discontinue this approach and return the assessment recovery to distribution rates, the PUCO concluded AES Ohio should continue to employ a bypassable rider mechanism in connection with funding the PUCO and OCC assessments.

Similarly, in the 2015 rate case, the parties agreed to an update to the uncollectible expense for non-payment of customer bills, traditionally done through a non-bypassable charge. Instead, the parties agreed the uncollectible fee associated with the SSO would be recovered through a bypassable component of the SSO rate. In other words, the costs related to customers who had not paid their electric supply charges would be recovered only from other default service supply customers, not from all distribution customers. The uncollectible cost for default service would be allocated appropriately to the default supply costs and not included in the distribution rates. This treatment has been re-affirmed several times by the PUCO, including recently, on August 9, 2023, in the final decision in case number 22-900-EL-SSO.

While the scope of the recovery in the AES Ohio proceedings was limited, a new piece of legislation in Ohio, Senate Bill 102, would address this cost allocation issue. The legislative language proposed states that electric utilities are entitled to full recovery of the "exact costs" associated with providing the SSO, e.g., default supply service, including costs for:

1 - Acquiring energy and capacity;
2 - Costs associated with conducting, administering, and implementing the competitive bidding process;
3 - Costs for independent consultants;
4 - All other direct or indirect costs incurred to support or provide the standard service offer.

Additionally, the bill directs the PUCO to ensure that "any direct costs allocated to the standard service offer rates are not recovered twice from distribution customers. Under this section, the commission may authorize a credit rider to avoid such double recovery."

RESA
Retail Energy Supply Association