

ALTERNATIVE RATEMAKING: FOUR WAYS TO MOVE FORWARD

Alternative ratemaking has become the norm in many U.S. states. As costs increase, consumers use energy differently, and zero-carbon production continues to gain ground, utilities have had to embrace alternative ratemaking. Gradually, regulators are starting to embrace alternative rate proposals, and even states that were reluctant to modify the regulatory landscape are now considering alternative measures.

In this discussion paper, the first in a series, we provide a sample of recent alternative rate developments across the country.

MCR's experience and research show that four types of alternative rate plans are used throughout the industry. All of them streamline the regulatory process by avoiding rate case proceedings and enabling utilities to file less frequently.



**Regulatory Rate
Mechanisms**



Formula Rates



**Annual Rate
Adjustments**



**Rate Stabilization
Mechanisms**

- » **Regulatory rate mechanisms** allow utilities to recover costs through adders, riders, clauses, and rate adjustments outside of a rate case. These enable the utility to recover specific costs more quickly and efficiently than through base rates, bypassing common regulatory lag issues but retaining regulatory review and oversight. As part of PROJECT*pipes*, a 40-year accelerated pipeline replacement program in Washington, D.C., Washington Gas can recover capital expenditures and earn a return on the installed assets through its Accelerated Pipeline Replacement Plan Adjustment.¹
- » **Formula rates** are familiar to utilities with electric transmission. In all 48 contiguous U.S. states, utilities seek rate recovery under FERC formula transmission rates. In addition, a growing number of state jurisdictions are now considering formula rates at the retail level. Retail formula rates are defined as rates that are periodically adjusted based on a predetermined formula without the need for full base rate proceedings. Retail formula rates make the case more about ensuring correct calculations, rather than arguing over costs and rates of return.² Entergy Mississippi's Formula Rate

¹ <https://www.washingtongas.com/-/media/d7dc128b90bc4b5cada9f12092ef174a.pdf#page=123>

² Pennsylvania HB 1782.

Plan allows annual adjustments to its base rates based on a historical test year and has a deadband of plus or minus 50 basis points on its rate of return.³

- » **Annual rate adjustments** or multi-year rate plans allow utilities to file rate cases less frequently. Intervening parties benefit by avoiding regulatory intervention and not having to develop testimony or prepare for hearings. Approved plans provide for changes to the revenue requirement and base rates over several years. Baltimore Gas and Electric has used a version of this mechanism for several years. The first adjustment, approved in December 2020, authorized electric rate increases in 2021 of \$59 million, followed by \$39 million in 2022 and \$42 million in 2023, while avoiding the regulatory lag associated with filing and settling rate cases.⁴
- » **Rate stabilization mechanisms** enable a utility to recover its costs and return on capital in a less volatile manner than traditional ratemaking. A common mechanism of this type is revenue decoupling, a rate adjustment that helps the utility recover its exact revenue requirement, regardless of the amount of energy used in a given year. Idaho Power's Fixed Cost Adjustment ensures that its fixed costs, adjusted according to the number of customers, are recovered fully each year through an additional energy charge or credit based on actual recovery from the prior year.⁵

Each of these alternative methods adds certainty and predictability to the ratemaking process, which can lessen perceived risk for utility investors. This, in turn, can help lower the cost of capital for investments, which ultimately benefits customers as well.

We will continue this series throughout the year, diving deeper into each of these four alternative ratemaking options, explaining their benefits and pitfalls, and giving further real-world examples of how utilities are using them today.

MCR's Experts Can Help

MCR uses a collaborative approach to help our clients develop specific proactive alternative rate mechanisms that ensure rates reflect their company's operational and financial requirements.

³ https://www.entergy-mississippi.com/userfiles/content/price/tariffs/eml_frp.pdf

⁴ <https://www.psc.state.md.us/wp-content/uploads/Order-No.-89678-Case-No.-9645-BGE-Multi-Year-Rate-Plan-Order-1.pdf>

⁵ <https://docs.idahopower.com/pdfs/aboutus/ratesregulatory/tariffs/286.pdf>



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