

POLICY BRIEF

Transparency in Local Utility Rate Making

In Alabama, utility rate making is a public issue with very limited public access and decisions routinely made behind closed doors. With no regulated, judicious process for assessing and changing utility rates, consumers are left without any verifiable reasons for a rate change. Additionally, rate-makers deny themselves the benefits of an active consumer base, which can help drive innovation and identify new engagement opportunities. Transparency in the local utility rate making process is crucial to mending the utility-consumer relationship and spurring the growth of, and participation in, new energy technologies.

Specifically, Energy Alabama supports City Council action to create and implement an open, evidence-backed utility ratemaking process.

Background |

Utility rate making is the process public utilities must go through, by law, to set the rates or prices they charge their customers. In the United States, any business that is formally classified as a public utility must participate in a public ratemaking process to determine the regulated service charges for natural gas and electricity generation and distribution. Public utilities must follow the ratemaking process to ensure that rates are fair and just for all customers. The process is also intended to encourage natural monopolies due to the costly and wasteful alternative of having multiple grids, one for each company.

Ratemaking for investor owned utilities in Alabama is carried out by the Alabama Public Service Commission in an administrative function. At the federal level, the Federal Energy Regulatory Commission oversees matters or intrastate wholesale sales of electric power. If a municipal utility is present, ratemaking authority usually lies with a City Council or a local utility board of directors. In the case of electric membership cooperatives (EMCs),

the members of the cooperative are also its owners and participate in the ratemaking process through an elected board of directors.

Goals of ratemaking:¹

- Capital attraction: government regulators must ensure that revenue is available so utilities can borrow money and invest in energy opportunities
- Reasonable energy pricing: regulatory body and process helps make energy more affordable
- Incentive to be transparent: strong processes allow utilities to understand the rates they can charge and the process for changing them
- Energy efficiency and demand response: using the power of the market to achieve larger public policy goals such as efficient use of the shared infrastructure and reduced use of limited natural resources.
- Eliminating income transfer: proper ratemaking helps to eliminate cost shifting between classes of customers

The regulator's chief task is to make sure the ratemaking process results in the best rates for customers while also keeping the utility financially stable (competitive/conflicting interests).

In 1978, the Public Utility Regulatory Policies Act (PURPA) was signed into law. It was the only federal law that required utility industry competition and encouraged renewables.² PURPA encouraged the following:

- creating a market for power from non-utility power producers;
- increased efficiency by making use of cogeneration;
- ending promotional rate structures;
- encouraging the development of hydroelectric power; and
- the conservation of electric energy and natural gas.

While the Act was definite in its language concerning the regulation of public utilities, PURPA's implementation was left to the states because needs varied across the country. This led to a significant variability in the transparency of the utility rate making process, which ultimately resulted in less access and recourse for consumers than originally intended.

¹ <https://www.electricchoice.com/blog/how-utilities-determine-generation-and-distribution-rates-ratemaking/>

² <https://energy.gov/oe/services/electricity-policy-coordination-and-implementation/other-regulatory-efforts/public>

How are Rates Determined? |

Rates are divided by residential and commercial buildings.³

- Electric: customers are billed a fixed availability charge that corresponds to the customer class (residential, commercial, industrial etc.) and a variable usage charge based on meter readings collected each month. The electric rates change periodically based on fuel costs associated with TVA's cost of operating the generation plants on the system. All of the electric rates used in billing Huntsville Utilities' customers have been reviewed and approved by the Electric Board before going to the Huntsville City Council for final approval
- Water: Water rates are driven by the costs associated with testing, analysis, purification and distribution. Water customers are billed a fixed availability charge that corresponds to the size of the water meter and variable usage charges based on meter readings collected each month. All of the water rates used in billing Huntsville Utilities' customers have been reviewed and approved by the Gas/Water Board before going to the Huntsville City Council for final approval.
- Gas: Natural gas is a commodity, and as such, the rates fluctuate according to market variables. Gas customers are billed consumption charges based on monthly meter readings in addition to a fixed availability charge.

³ <https://www.hsvutil.org/learning-center/rates/>

Process Model: The Rate Case Process |

The Rate Case Process is a process model cited by PURPA that includes several steps that must happen before a utility receives a rate change.⁴ These steps provide a general outline, and can vary by state.

1. Utility files rate request with the Public Utility Commission or related regulatory office.
2. Several decisions and offices review the request. The request can also be reviewed by other organizations who act as mediators. These parties can file testimony with the Public Utility Commission, which helps everyone involved to better understand the case.
3. Public Witness Days are set to allow individuals and consumers to state their opinions on the case.
4. Like any standard hearing, attorneys cross-examine witnesses. After the information is presented, the Public Utility Commission will consider and then make a final ruling.

Overall, the Public Utility Commission tries to make its final ruling based on the following three questions:

- Based on the services customers receive – are the rates reasonable?
- What is the quality of service?
- For the shareholders who dedicate capital to the utility – is the return on investment fair?

Since utility customers need to pay for their energy services, they have the right to several things related to the ratemaking process.⁵ These include:

- The right to be informed about the process.
- The right to receive explanation regarding their utility bill.
- The right to have any complaints or concerns dealt with quickly and fairly.
- The right to the utility service when payment obligations are met.

⁴ <https://energy.gov/oe/services/electricity-policy-coordination-and-implementation/other-regulatory-efforts/public>

⁵ <https://www.electricchoice.com/blog/how-utilities-determine-generation-and-distribution-rates-ratemaking/>

Benefits to Municipalities |

Numerous states around the U.S. now require public utilities to engage in a transparent and open ratemaking process. The benefits include:

- Builds consensus
- Engages stakeholders within the community and ensures all sides are heard
- Produces an identifiable path forward that can be supported with verifiable, publicly heard evidence
- Ensures a judicious, thorough ratemaking process

Legislative and Regulatory Obstacles |

There are very few tangible obstacles at the municipal level of government other than that a ratemaking process does not currently exist, and thus would need to be created, passed by the city government, and implemented. Additionally, there is a possibility the city code would need to be amended to include the approved process.

Other Considerations |

The biggest challenge in enacting a transparent and open utility ratemaking process is both the public and the government's mindset. Accepting and adhering to the status quo is consistently the easier, more sure-fire way to get things done. Huntsville Utilities is so small, both the public and utility believe their processes do not really matter in the grand scheme of state energy policy. This lack of malleability makes change extremely difficult to enact, especially when it comes to opening up a process to make it more public.

Additionally, officials tend to believe PURPA is too broad and therefore inapplicable to them; it is meant only for larger public utilities. Energy Alabama's response to these arguments is to ask for only PURPA's basic provisions to be enacted, and only key issues determined. We want a consumer-directed, open and transparent, evidence-backed utility ratemaking process.

Distributed energy technologies make consumers more active in the utility process, which in turn encourages market signals that bolster efficiency and create new opportunities for public utilities to serve their customers. As a public utility, Huntsville Utilities has a duty to serve all its customers fairly and equitably. Huntsville Utilities and local governments, when applicable, should provide meaningful opportunities for members of the public to participate in utility rate making and other actions that require approval from the Huntsville City Council.