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Decoupled Rates Support Transition to New Energy Age

Delaware is moving into an age of greater energy efficiency and environmental protection. After working together for more than two years with public input, Delmarva Power, the Delaware Public Service Commission Staff, the Division of the Public Advocate and other stakeholders reached agreement on a new rate structure to support the transition to a cleaner Delaware. The new approach is called “rate decoupling.”

The traditional utility rate structure, a “volumetric rate design,” has led to ever increasing energy use. Under a volumetric rate design, the more energy a utility sells, the more revenue it generates. But rate decoupling will break the traditional link between electric sales volume and utility revenue and enable Delmarva Power to partner with customers and the state in reducing energy use.

This new decoupled rate structure stems from a key fact: Delmarva Power owns and operates not power plants but only the poles, wires and other equipment that distributes electricity to customers’ homes and businesses. These costs represent about 25 percent of a typical customer’s bill and are reflected on the “delivery” portion of the bill. They are, primarily, fixed costs which are comparatively steady, even though, historically, the rate structure used to recover them was based largely upon customer usage, which can vary considerably.

The actual electricity Delmarva Power delivers is provided by competitive generation companies who bid to provide the power. Delmarva Power passes these particular costs through to customers. These costs are shown on the bill as “electricity supply” and constitute approximately 75 percent of the total annual customer bill.

The Delaware Public Service Commission has the role of evaluating and authorizing the amount of revenue the utility can collect from its customers. In the past, when the level of revenue was approved, the utility would collect it through a variable charge based upon the amount of energy used. If customers used more energy because of hot summers or inefficient equipment, then the company would receive more revenue than was actually approved by the Commission. If the summer was cool or customers made more efficient use of energy, then the company would receive less. This approach put the company at odds with customers’ desire to reduce energy use.

But the landscape is changing. Both the nation and the State of Delaware are pursuing greater environmental protection and energy independence. Delmarva Power would rather have a business model that aligns with customers’ desire to reduce energy use, not increase it.

Rate decoupling is a solution that has proven experience in other parts of our country. Delmarva Power has agreed with the Delaware Public Service Commission Staff, the Division of the Public Advocate and other parties on a new decoupled rate structure. Delmarva Power also is working with regulators on a decoupling plan for its natural gas distribution rates.

There are various ways to decouple rates, all with the same result of separating revenue from sales volume. Under this proposal, the regulators continue to determine the amount of revenue needed by the company to maintain the electric system. And, just as before, regulators determine the amount that constitutes a fair return on the utility's investment.

Under the proposal, Delmarva Power's revenue will be collected through a fixed charge based on how much of the electric distribution system each customer uses during peak summer times instead of a variable amount based simply on the volume of electricity the customer uses. The electric distribution system is designed and built to meet summer peak usage. Linking the delivery portion of each customer's bill to their peak usage assures that they contribute a fair share toward the costs associated with their demand on the system.

As in the past, when the revenue amount is set, Delmarva Power will have to manage within that limit. There is no guarantee of a profit. Reducing the variability in revenue lowers the company's risk and, as a result, Delmarva Power will receive a lower rate of return. This translates into slightly lower rates for our customers compared to the old rate structure. Moreover, the decoupled rate structure also assures that Delmarva Power cannot earn more than the amount of revenue approved by regulators, regardless of how much energy is sold.

The new rate structure will result in some portions of the bill being higher, and others being lower. The customer charge on the monthly bill will increase from \$7 to \$12 for a typical customer. The customer charge covers many of the costs of service such as billing, call center operations and meter reading, which are equal for all customers regardless of the amount of energy used. The old "variable charge" for our distribution services, a charge that covered the cost of our system and for maintaining the system, will actually decrease, however, from roughly \$20 to about \$14 for this same average customer.

Although the numbers above are true for the average customer, not every customer will see the same impact. In general, during the conversion to the new rate structure, low-usage customers will see a slight increase on this portion of the bill, and high-volume customers will see a slight decrease. Remember that the costs to distribute electricity are, primarily, fixed, regardless of customer usage, and that decoupling rates will not change the amount of revenue the company receives. The impact of this new rate structure on most customers will be minimal. To prevent any individual customers from feeling a big impact from the change, the proposed settlement includes caps that will buffer customers from dramatic adjustments.

The proposal preserves the incentive for customers to reduce their usage because the fixed charge covering the 25 percent of the bill for delivery still can be reduced over time if customers use less energy during peak summer days. In addition, the other 75 percent of the bill, which applies to actual electricity usage, remains variable, subject to fuel prices and other

factors in the market. So it remains true that the more electricity a customer uses, the more the total bill and a customer still can lower the bill by using less.

The proposal -- which still must be approved by the Delaware Public Service Commission -- is significant and forward-thinking in that it aligns the company's interest with those of its customers and with the goals of the state to reduce the overall cost of energy.

Delmarva Power is taking many steps to help Delaware move into a new age of energy independence. We're installing new smart meters, for example, and supporting the development of wind and solar power. Developing new rate structures is an important step in helping the state make the transition to this new age with a focus on more efficient use of energy.

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