

Three Steps of Ratemaking

Revenue Requirement: The total amount of money the utility needs to receive from retail ratepayers in order to cover its (allowed) costs. May be supplemented by money the utility receives from other sources—like net wholesale power sales or charges to telecoms companies for allowing attachments to the utility’s poles—to cover some of its costs. (This is essentially the Strategic Plan process.)

Cost of Service/Cost Allocation: Once the utility understands the total amount of money it needs to receive from retail customers, this study calculates the portion each defined group (“customer class”) of retail customers should pay. Based on the utility’s costs to generate or purchase power, to move it through wires to the customer’s premises at a level (voltage) the customer can use to run equipment, and to provide customer bills and answer customer questions. Some costs are easily assigned to one customer class; e.g., the streetlight class is required to pay all the costs the utility incurs to buy new lights or maintain the ones that already exist. Most costs, however, are allocated; e.g., the costs the utility incurs to produce and buy energy are allocated to various types of customers based on how much energy they consume and when they consume it.

Rate Design: “The framework utilities and regulators use to set prices for the reliable provision of electricity and energy services...Prices must reflect the true economic costs of providing energy services, which reflect other market and non-market values, such as environmental performance, resource capabilities, and fluctuations in supply and demand over time.” (Regulatory Assistance Project web page, <https://www.raponline.org/key-issues/pricing-rate-design/>). May include prices for energy, capacity utilization, delivery infrastructure, keeping track of and billing customers, and community benefits or public purposes. General design principles usually followed: collect the revenue requirement, collect it fairly/equitably from customers, and discourage waste while promoting all economically justified types and amounts of use.

