

# GMAC MEETING BACKGROUND: ELECTRICITY DISTRIBUTION COST RECOVERY



**JANUARY 2025**

## ELECTRIC DISTRIBUTION COMPANIES

Electric distribution companies (EDCs) build, maintain, and operate the electric grid. EDCs are regulated monopolies, meaning customers cannot choose which company delivers their electricity, and therefore the prices that EDCs charge for electricity are set by the Department of Public Utilities (the Department). The Department’s mission is to ensure that customers are protected, and that utility companies are providing the most reliable service at the lowest possible cost.

## TYPES OF COSTS INCLUDED IN ELECTRICITY RATES

### ENERGY SUPPLY COSTS

Supply costs include the costs of generating electricity. EDCs do not own or operate power plants. Instead, EDCs purchase electricity from competitive suppliers on behalf of their customers and pass on the costs directly to customers. EDCs do not make a return or profit on energy supply costs.

*Energy supply costs currently represent roughly 54% of electricity rates.*

### TRANSMISSION COSTS

Transmission costs reflect the cost of building, operating and maintaining the regional transmission system, which carries electricity over long distances at high voltage levels.

*Transmission costs currently represent roughly 15% of electricity rates.*

### DISTRIBUTION COSTS

Distribution costs reflect costs associated with building, operating, and maintaining the local distribution system such as the costs for electrical substations, transformers, poles, metering, billing, and connections to all homes and businesses. Distribution costs also include public benefit initiatives, such as energy efficiency programs. Grid modernization costs fall within this category.

*Distribution costs currently represent roughly 31% of electricity rates.*

## RECOVERY OF DISTRIBUTION COSTS

Distribution costs are recovered through several bill charges, including a “base” distribution rate, and through a variety of program- and policy-specific reconciling cost recovery factors.

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## DISTRIBUTION RATES

Base distribution rates are set based on the actual costs incurred by the EDC in a recent “test year.” This provides the EDC with an incentive to maintain future costs at a level consistent with historical costs. A key distinction of base rates from reconciling cost recovery factors is that they do not allow the EDC to recover exactly the amount of money spent.

In recent years, base distribution rates have been set using performance-based ratemaking (PBR), which is intended to incentivize the EDCs to operate efficiently.

PBR includes a formula allowing EDCs to increase costs recovered between rate cases to account for inflation and other projected increases, but also intends to build in certain ratepayer protections.

### Rate Cases

Rate cases allow for a detailed regulatory review an EDC’s distribution costs and rates. The Department reviews all proposed costs to ensure that they are prudent, reasonable, used, and useful.

Rate cases are also used to ensure that costs are allocated equitably across customer classes, rates are designed to be equitable and to promote efficient consumption levels, and that rates are overall just and reasonable.

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## RECONCILING COST RECOVERY FACTORS

Some costs related to electricity distribution are recovered through reconciling factors instead of base rates. There are several reasons for recovering some costs through reconciling factors, including:

- The costs are volatile and can change significantly between rate cases.
- The costs are somewhat outside of the EDCs’ control.
- The costs are incurred to achieve specific policy goals.
- The costs are expected to change significantly relative to the costs included in the test year.

Reconciling factors are often used to recover costs associated with particular programs, such as the Energy Efficiency Reconciliation Factor used to recover the costs of energy efficiency programs.

Each factor is typically determined at the beginning of a year based on forecasted costs. At the end of the year any differences between actual and forecast costs are reconciled allowing the EDCs to pass through to ratepayers the amount of funds that they spend.

Some factors and associated costs are subject to significant stakeholder and regulatory oversight prior to being put into rates. For example, the energy efficiency programs are developed with input and review from the Energy Efficiency Advisory Council and are also reviewed by the Department.

## GRID MODERNIZATION COST RECOVERY

The Electric Sector Modernization Plans include two types of costs: conventional distribution costs (i.e., non-ESMP costs) and incremental grid modernization costs (i.e., ESMP costs). Non-ESMP costs will be reviewed in rate cases and recovered through distribution rates. The options for review and recovery of these costs are currently under investigation in Phase II of DPU Dockets 24-10/11/12.

### ADDITIONAL RESOURCES

- [MA recent electric rate cases](#)
- [Current MA electric rates and tariffs](#)
- [Eversource: Electric Delivery Charge and Supply Cost](#)
- [What is in an Electric Rate?](#)