

Clean Solutions: What's In It For Utilities?

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The Natural Gas Crisis: Finding Clean Solutions

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Incentive Regulation

- All regulation is incentive regulation
- Consider: Energy Star products save energy at a cost of about 1 cent/kWh, a small fraction of the cost of power supply.
- Do you know what incentives utilities have to promote Energy Star?
- Do you really know how utilities make money?



Bottom Line

- Every kWh sold adds to profits
- Every kWh lost to efficiency or customer side distributed resources cuts profits
- AND the numbers are overwhelming
- **If this continues there is little chance of any significant utility investment in these resources**



How the System Works

- **Regulation and utility profits do not work as you might expect!**
- Once case ends prices are all that matter
- Profits = revenue - costs
- Revenue = price * volume
- Costs are mostly unrelated to volume *in the short run* (that is, from rate case to rate case)
- Thus: if efficiency causes volume to decrease, utility profits drop

The Numbers: Typical Vertically Integrated Utility




➤ 1% sales loss yields 5%
cut in profits!




Good News

- It wasn't always this way
- Utility costs have been shifted to consumers or deferred for later recovery
 - Fuel and purchased power
 - AFDC
- Good news: it was not intentional and it can be fixed
- **1989 NARUC Resolution: Reform regulation so that successful implementation of a utility's least-cost plan is its most profitable course of action**

Better Pricing Is Not The Solution

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- Better prices to consumers, revealing the full marginal cost, is a good idea and should be done
 - BUT better prices including TOU prices, inverted block rates, critical on-peak prices, and others do not solve the utility's financial problem and, even worse, create a new set of perverse incentives
 - Example: TOU prices move most utility profits to on-peak sales

Restructuring Does Not Help

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- **Same company divested of generation**
 - **1% sales loss 11% loss of profits**
 - Some states' treatment of stranded costs (e.g., Maine's) actually double the disincentive for energy efficiency



Solutions?

➤ Prices?

- Some utilities have proposed to move all or most revenue to fixed monthly charges
- This would be a mistake for several reasons

➤ Revenues caps

- Revenue or revenue per customer caps are a proven methods for restructured and non-restructured states
- Increasingly used for regulating transmission companies and gas companies in the US and abroad



Learn More

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