



STATE TECHNICAL FORUM ON EE/RE

Call #8 Summary – May 12, 2005

Decoupling and Other Mechanisms to Encourage Utility Investment in
EE

Participants: 25 state officials from 16 states participated in the call (see the attached participant list)

Key Issues Discussed

- Decoupling approaches
- Lost Revenue Recovery Mechanisms
- Shared Savings Mechanisms
- Return on Equity Bonus Incentives

Summary of Presentations

- A. Overview - David Moskowitz, Regulatory Assistance Project** (See Moskowitz_overview.ppt, Decoupling-_lost revs comparison_RAP.pdf and also Background Decoupling_PQA.doc)
- **Decoupling Utility Revenues from Sales:** Should not be viewed as an incentive, but rather a way to align utility and consumers' choices to consume or conserve energy.
 - **NARUC 1989 Resolution:** "...reform regulation as needed to make least cost planning as profitable as possible..." provided support for decoupling initiatives.
 - **Why adopt decoupling?** Reduction in energy consumption or utility sales via utility-sponsored EE, customer-initiated EE or other factors such as weather or changes in the economy, cause a loss in profits because of the way rates are structured.
 - Vertically Integrated Utilities experience on average a 5% reduction in profits (return on equity) for every 1% drop in Sales
 - Wires Only Company experience on average 11% reduction in profits for every 1% drop in sales.
 - **Better pricing is not the answer** – TOU and marginal cost pricing can actually exacerbate the problem because on-peak sales are the most profitable and marginal cost pricing tends to recover more of the costs through energy sales rather than fixed priced fees like customer charges
 - **Not always been a link between sales and profits.** The advent of purchased power and fuel adjustment clauses and allowance for funds used during construction (AFUDC) shifted more cost recovery responsibility to the energy charges.
 - **Decoupling vs. Lost Revenues** – Difference in these approaches is a difference of scope and degree of measurement and administration. Revenues lost as a result of EE measures is usually much less than the actual cost of the measures.
 - **States with Decoupling** – WA, ME, CA, NY; also used in UK and Australia.

- For more information on overcoming barriers to energy efficiency programs (i.e. decoupling sales volume from rates): The Regulatory Assistance Project – January 2005 Issue Letter – www.raonline.org

B. California – Brian Prusnek, Advisor to Commissioner Kennedy, California PUC (See “Promoting Energy Efficiency in California” PowerPoint presentation)

- **ERAM:** Decoupling mechanism implemented in 1982; eliminated in 1996 when California electric utility industry was restructured. Between 1982 and 1992, established an annual balancing account to true up projected and actual revenue requirements.
- **2000 Energy Crisis** -- the role of EE was heightened, and the need to remove disincentives for utility investment in EE regained attention. Decoupling reinstated through legislative directive (AB29X)
- **2005-06:** Will be the first year of implementation of CA EE targets based on study of potential of EE in the state. Expect EE investment to continue to increase (See slide on CA EE Investment Trends (1976-2012))
- Being implemented through individual utility proceedings; Not all utilities are completely decoupled – See specific information about Southern California Gas, San Diego Gas & Electric, Southern California Edison, Pacific Gas and Electric.
- **Earnings Sharing Mechanism also adopted** – If utility earns more than a benchmark basis points, the additional profits are shared between shareholders and customers.

C. Oregon – Lee Sparling, Director of Utility Programs, OR PUC (See OR_NG decoupling_Sparling.doc)

- **Northwest Natural Gas Company** – Decoupling adopted in 2002; based on revenue requirements per customer formula
- **True-up** allows company to reconcile 90% of revenue requirement/customer
- **Weather adjustments** are addressed separately and only for residential and commercial customers. Tends to smooth out bills, but shifts all risk to customers which has been debated.
- **Design features** developed through a consensus-building process, which contributes to its success
- On-going concern that complete decoupling **will discourage good customer service**, so PUC adopted a service quality mechanism to track “at-fault” customer complaints
- Electricity sales **lost revenues and share savings mechanisms** for PacifiCorp and Portland General Electric were adopted and then abandoned because of lack of support from customer groups and shifting DSM programs implementation to non-utility sector.
- **Lost revenue recovery mechanism** was rejected by NW Natural Gas because it didn’t address lost sales from price elasticity which was their primary concern.

- Decoupling is a blunt instrument that captures changes in economy, weather, and price.
- Staff members concerned that **decoupling reduces utility's risk** and therefore should be accompanied by a lower ROE.
- **Evaluation of benefits** is difficult because there are too many factors at play. PUC will evaluate the effectiveness of NW Natural Gas's decoupling mechanism at the end of the year, based in part on an independent consultant's report.

D. Nevada – Commissioner Carl Linvill, Nevada PUC (See NV DSM Incentives_Linvill.doc)

- **Policy driver** - Utility sponsored DSM went from small to non-existent after restructuring. In 2001, Governor approved a DSM collaborative to resurrect DSM. Recognized that they needed incentives to rebuild the utility DSM infrastructure.
- **Incentive ROE adder adopted** – 5% equity adder to 10.25% base ROE. Company equity adder is based on level of DSM expenditures
- **Successful in reinvigorating DSM.** Companies moved away from stricter Rate Impact Measure (RIM) test to more lenient test to determine which DSM programs to implement.¹
- **Agrees that ROE is a blunt incentive.** No incentive for companies to pursue DSM programs that don't add to rate base or to implement TOU rates.
- NV legislature was considering a EE component of IRP, which would have strengthened incentive for utility-sponsored DSM, but appears that it is not likely to pass.
- **NV PUC has not considered decoupling**, in part because they do not have the authority to implement such a mechanism.²

E. Minnesota – Commissioner Phyllis Reha, MN PUC (See MN DSM Incentives_Reha.ppt, and MNCIPIncentiveHistory.xls)

- **Lost revenue recovery mechanism** adopted in 1982 – met strong customer opposition because there was no cap on the total amount of revenues that could be recovered and allowed for cumulative lost revenue recovery. Therefore lost revenue amounts quickly exceeded the cost of the programs. By 1998, cumulative annual lost revenues had reached \$40 million.

¹ The RIM and TRC tests are methods of evaluating the net benefits of demand side management programs. The RIM test measures what happens to customer bills or rates due to changes in utility revenues and operating costs caused by the program. Rates will go down if the change in revenues from the program is greater than the change in utility costs. The TRC test uses the costs and benefits of the RIM test but adds to it the costs and benefits to the customers who participate in the program. The TRC test can be further expanded to include social costs such as environmental externality costs and benefits. See the California Standard Practice Manual, published in October 2001 by the California Energy Commission for a more complete discussion.

² NV statute appears to limit the use of deferred accounting mechanisms to the recovery of fuel and purchase power expenses (see Nevada Revised Statutes 704.187 at <http://leg.state.nv.us/law1.cfm>). So, to the extent that a decoupling or lost revenue mechanism requires the use of deferred recovery balancing accounts, the PUC's authority is limited. The NV natural gas statute is more broad (see NRS 704.185(3)) and may allow decoupling or lost revenue mechanism that use deferred recovery balancing accounts.

- Attorney General and PUC convened a roundtable to respond to customer complaints. Developed a proposal to **replace lost revenue mechanism with a shared savings financial incentive approach**.
- Incentives designed to encourage utilities to go above and beyond DSM investment required by law. Electric utilities are required to invest from 1.5% to 2.0% of gross operating revenues in EE programs. When companies exceeded 90% of required investment target, incentive payments are based on level of performance.
- **Incentive payment** – based on percentage of the net benefits (costs of programs less value of energy savings) of DSM programs as measured by the utility test. Design of incentive payment scale also rewards cost-effectiveness and lower overall cost of the programs.
- **Program costs** and an allowed carrying charge are recovered through an automatic adjustment clause
- **Success** is based on anecdotal evidence that utilities are willing to support more DSM. No empirical evidence yet. Programs will be evaluated annually.
- Shared Savings is seen as having more benefits for customers than lost revenue approach.

Discussion & Questions

A. Can utility-sponsored programs meet the total EE goals?

- Setting specific savings target for a utility is an important tool, according to CA.
- States could specify that an utilities contract with an independent entity to implement DSM targets to avoid conflict of interest.
- Without decoupling, however, utilities have a major interest AGAINST DSM, including customer DSM investments or policies that promote EE in market like appliance standards.

B. How do you determine what the EE target should be?

- Utilities typically determine which measures/programs to implement using a number of Cost/benefit tests, with varying degrees of direct customer benefits.
 - o Ratepayer Impact Measure test
 - o Societal test
 - o Total Resource Cost test
- CA based goals on studies analyzing the market potential for EE.

C. How do you account for the impacts of the E Star program and other customer-initiated EE investments?

- OH has used Portfolio Manager Software from EPA??/DOE?? To estimate the impact of federal incentives for building EE
- CA developed its own software based on CA's higher building EE standards.