Addressing Utility Disincentive to Energy Efficiency

South Dakota PUC
Utility Energy Efficiency Workshop

June 23, 2010

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Iowa Energy Efficiency Mandate

- All gas and electric utilities must provide cost-effective energy efficiency programs
- Energy efficiency plans establish savings, spending, and participation goals based on IOUs' assessments of achievable energy and capacity savings
- Plans must include range of programs tailored to meet needs of all customer classes
- Plans must be implemented in prudent and reasonable manner

Original Legislation - 1990

- Targeted IOU spending levels – 2% of revenues for electric programs and 1.5% of revenues for natural gas
- IOU costs accumulated in deferred accounts, “regulatory assets”; recovery subject to contested case proceedings
- Authorized Iowa Utilities Board to grant IOUs additional incentives to encourage aggressive EE programs – up to 25% of net societal benefits up front
- Rewards and carrying charges were expensive
- IOUs quickly and aggressively developed EE plans, with focus on capturing load management peak savings

Current Iowa IOU Energy Efficiency Requirements Iowa Code § 476.6(16)

- Spending targets eliminated; budgets are guided by IOU assessments of energy and capacity savings potential
- Utilities recover costs through energy efficiency cost recovery factor, which is reconciled annually with actual costs.
- IUB is authorized to conduct prudence reviews of utility energy efficiency plan implementation, with authority to disallow imprudent costs.
- No explicit authority for rewards or returns to IOUs.

IOUs have achieved good results without incentives or prescribed spending targets

- Recent trends in Iowa reported by IOUs:
  - IOUs spending on energy efficiency doubled
    - 2002 – $51 million
    - 2007 - $106 million
  - IOU electricity savings from energy efficiency
    - 2002 – 0.38% of sales
    - 2007 – 0.84% of sales
    - 2009 – 1.2% of sales
  - Annual benefit/cost ratio is consistently 2 to 1
  - Iowa among top ten states for spending and efficiency savings

Iowa Utilities Board Inquiry into the Effect of Reduced Usage on Rate-Regulated Natural Gas Utilities, Docket No. NOI-06-1

Question:

Are alternative regulation mechanisms (decoupling and rate design) needed to address impacts of reduced natural gas usage?

Iowa Utilities Board Inquiry into the Effect of Reduced Usage on Rate-Regulated Natural Gas Utilities, Docket No. NOI-06-1 -- Continued

Answer:

- Tension between energy efficiency & natural gas utilities' opportunity to earn authorized rate of return "does not appear to be a substantial problem in Iowa."
- The data does not show a direct correlation between IOU net operating income and declining customer usage as a result of energy efficiency programs.

Many factors contribute to decline in natural gas use per customer

- Price elasticity
- Non-company sponsored conservation
  - Nonprofit Associations (MEEA, NWEEA, ACEEE)
  - State Energy Offices EE Research Facilities
- Federal appliance efficiency standards
- Turnover of housing stock
- More efficient building codes
- Economic conditions
- Milder winters
- Company-sponsored energy efficiency

OCA Opposed to Decoupling

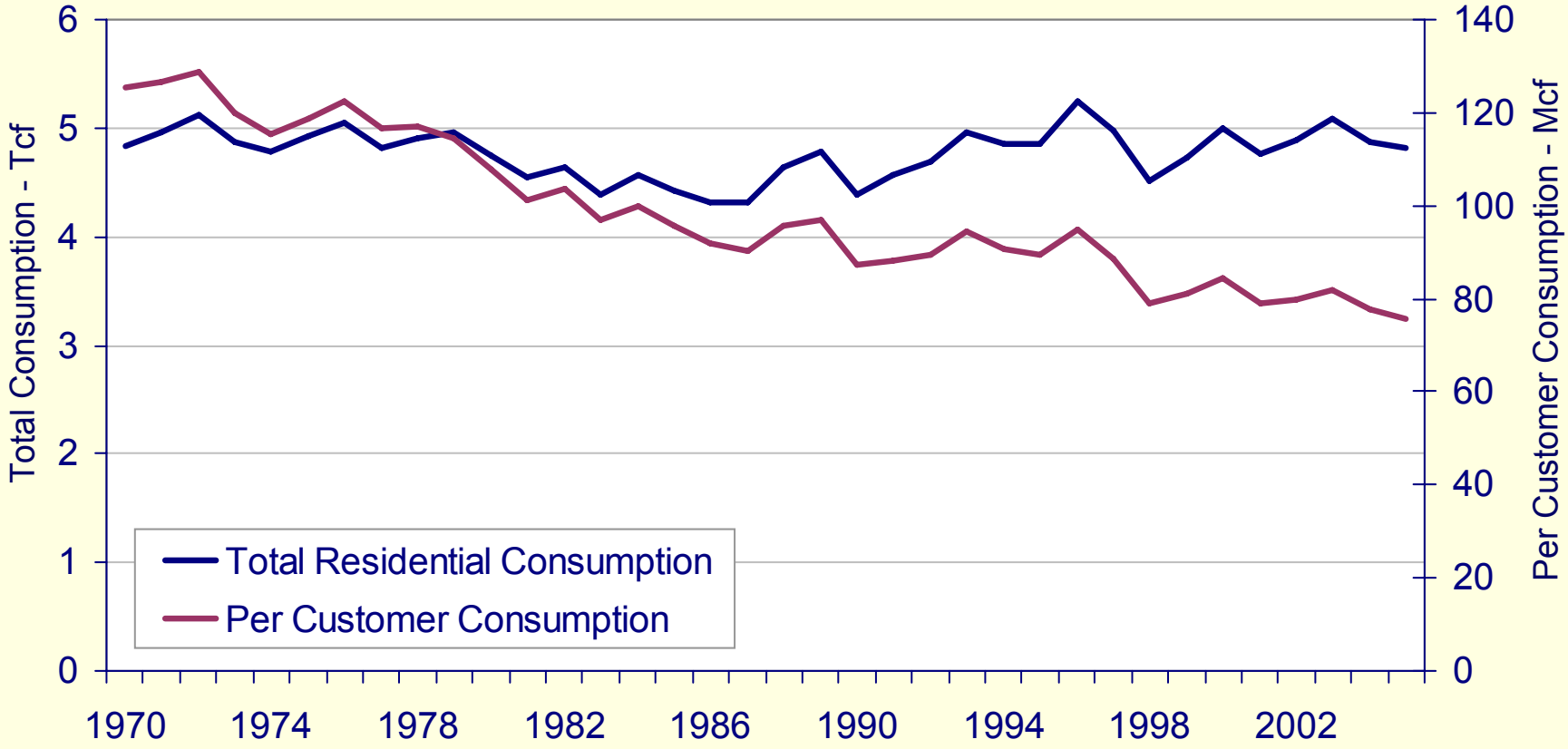
- Significant departure from traditional regulation in which base rates are set in contested case proceedings based on representative test year and rate of return.
  - Representative level of test year revenue and expense — not piecemeal
  - Must prove revenues and expenses in contested case; trackers typically reserved for expenses that are volatile, beyond management control
  - Parties have formal process for discovery, analysis and issue development

OCA Opposed to Decoupling
(Continued)

- Between rate cases:
  - actual rates of return can vary from allowed
  - regulatory lag can provide important incentives
  - it is up to the utility to manage risk associated with sales (revenue) and find opportunities for efficiency (cost). Use of hedging increasing
  - Decoupling shifts revenue risk from utility to consumers

Decoupling is Unnecessary

While overall use per customer is decreasing, overall residential natural gas usage is flat to increasing.



Source: Energy Information Administration, US Department of Energy

Decoupling is not an efficient tool to promote energy efficiency

- The incentive issue is not resolved
- Discourages customers from energy conservation efforts
- Generates controversy
- Don’t discount value of utility’s good-will incentive to get into customers’ homes to present EE ideas, devices and rebates.

Don't just take our word . . .

- "*Idaho Power 'decoupling' regime remains a pilot for now, given uncertain results"* (Platts Electric Utility Week, p. 30 (May 10, 2010). "Evidence suggests that the [decoupling mechanism] may have done little to spur Idaho Power's increased investment . . . ." Energy savings were greater in customer classes that do not have the decoupling measure.

- California experience suggests that EE incentives, if utilized, should be carefully structured and awarded only following clear and convincing demonstration of exceptional results. "*California utilities are taken to task on 2006-2008 efficiency performance*." (Platts Electric Utility Week, p. 31 (May 10, 2010).

3rd Party Administrators

Example: Efficiency Vermont, Energy Trust of Oregon

Pros:

- Removes utilities "disincentive" to promote EE programs.
- Uniform statewide programs.
- Expertise in EE resides in one agency—not fragmented among utilities.
- Promotes most cost-effective programs—financial viability depends on success.
- Reduces controversy over programs adopted.

3rd Party Administrators

Example: Efficiency Vermont, Energy Trust of Oregon (Continued)

Cons:

- System benefits fund could be subject to legislative raid.
- Tension between utilities and 3rd party administrator over access to billing data.
- PUC oversight still required.
- Utilities good-will opportunity lost.

THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

Resolution 2007-01

NASUCA ENERGY CONSERVATION AND DECOUPLING RESOLUTION

Whereas, the provision and promotion of energy efficiency measures are increasingly viewed by state commissions as a necessary component of utility service;

Whereas, many states are now encouraging rate-regulated utilities to adopt energy efficiency programs and other demand-side measures to decrease the number of units of energy each utility's customers purchase from the utility;

Whereas NASUCA has long supported the adoption of effective energy efficiency programs;

Whereas recent proposals by rate-regulated public utilities for the initiation or expansion of energy efficiency measures have featured utility rate incentives or revenue "decoupling" mechanisms that guarantee utilities a predetermined amount of revenues regardless of the number of units of energy sold;

Whereas, the utilities proposing decoupling measures seek guarantees from public utilities commissions that they will receive their allowed level of revenues;

Whereas, these utilities justify this departure from traditional rate-making principles on the theory they are being asked to help their customers purchase fewer energy units from them by promoting energy efficiency measures and other demand-side measures, thereby reducing their revenues and, consequently, their returns to their shareholders, and that decoupling mechanisms compensate utilities for revenues lost due to conservation;

Whereas, these utilities contend that because these measures reduce their revenues, they have a disincentive to encourage programs that aid their customers in purchasing fewer units of energy;

Whereas, historically, rates have been set in periodic rate cases by matching test-year revenues with test-year expenses, adding pro forma adjustments and allowing the utilities an opportunity to earn a reasonable rate of return on their investments in exchange for a state-protected monopoly;

Whereas revenue guarantee mechanisms allow rate adjustments to occur based upon one element that affects a utility's revenue requirement, without supervision or review of other factors that may offset the need for such a rate change;

Whereas, historically, rate-regulated utilities were not guaranteed they would earn the allowed return; rather, earnings depended on capable management operating the utilities in an efficient manner;

Whereas, many utilities proposing revenue decoupling request compensation for revenue lost per customer, implying that sales volumes are declining, when in fact these utilities' total energy sales revenues are stable or increasing;

Whereas, there are a number of factors that may cause a utility to sell fewer units of energy over a period of time, including weather, changing economic conditions, shifts in population, loss of large customers and switches to other types of energy, as well as energy efficiency and other demand-side measures;

Whereas many utilities have been offering cost-effective energy efficiency programs and actively marketing these programs for years without proposing or implementing rate incentives or revenue guarantee mechanisms such as decoupling, and have continued to enjoy financial health;

Whereas past experience has shown that revenue guarantee mechanisms such as decoupling may result in significant rate increases to customers;

Whereas some utilities have referenced the benefit of encouraging energy efficiency programs as a justification for revenue guarantee mechanisms without in fact offering any energy efficiency programs, indicating that the revenue guarantee mechanisms are attractive to utilities for reasons other than their interest in promoting energy conservation;

Whereas past experience has shown that rate increases prompted by revenue guarantee mechanisms such as decoupling are often driven not so much by reduced consumption caused by utility energy efficiency programs, as by reduced consumption due to normal business risks such as changes in weather, price sensitivity, or changes in the state of the economy;

Whereas utilities are better situated than are consumers or state regulators to anticipate, plan for, and respond to changes in revenue prompted by normal business risks, and the shifting of normal business risks away from utilities insulates them from business changes and reduces their incentive to operate efficiently and effectively;

Whereas the traditional ratemaking process has historically compensated utilities for experiencing revenue variations associated with normal business risks;

NOW THEREFORE NASUCA RESOLVES:

To continue its long tradition of support for the adoption of effective energy efficiency programs;

And to oppose decoupling mechanisms that would guarantee utilities the recovery of a predetermined level of revenue without regard to the number of energy units sold and the cause of lost revenue between rate cases;

BE IT FURTHER RESOLVED:

NASUCA urges Public Utilities Commissions to disallow revenue true-ups between rate cases that violate the matching principle, the prohibition against retroactive ratemaking, the prohibition against single-issue ratemaking, or that diminish the incentives to control costs that would otherwise apply between rate cases;

NASUCA urges State legislatures and Public Utilities Commissions to, prior to using decoupling as a means to blunt utility opposition to energy efficiency and other demand-side measures, (1) consider alternative measures that more efficiently promote energy efficiency and other demand side measures; (2) evaluate whether a utility proposing the adoption of a revenue decoupling mechanism has demonstrated a commitment to energy efficiency programs in the recent past; and (3) examine whether a utility proposing the adoption of a revenue decoupling mechanism has a history of prudently and reasonably utilizing alternative ratemaking tools;

If decoupling is allowed by any state commission, NASUCA recommends that the mechanism be structured to (1) prevent over-earning and provide a significant downward adjustment to the utilities' ROE in recognition of the significant reduction in risk associated with the use of a decoupling mechanism, (2) ensure the utility engages in incremental conservation efforts, such as including conservation targets and reduced or withheld recovery should the utility fail to meet those targets, and (3) require utilities to demonstrate that the reduced usage reflected in monthly revenue decoupling adjustments are specifically linked to the utility's promotion of energy efficiency programs.

NASUCA authorizes its Standing Committees to develop specific positions and to take appropriate actions consistent with the terms of this resolution to secure its implementation, with the approval of the Executive Committee of NASUCA. The Standing Committees or the Executive Committee shall notify the membership of any action taken pursuant to this resolution.

Approved by NASUCA:
Denver, Colorado
June 12, 2007

Submitted by:
NASUCA Consumer Protection Committee
June 11, 2007

Opposed:
Ohio
Indiana
Colorado
Wyoming

Abstained:
Massachusetts
California