

**Aligning Utility Interests with
Energy Efficiency Objectives:
A Review of Recent Efforts at
Decoupling and Performance Incentives**

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Table 1. Regulatory Mechanisms for Cost Recovery, Performance Incentives, and Decoupling

State	Cost Recovery	Direct Lost Revenues Recovery	Performance Incentives	Decoupling
Arizona	Yes—Electric rate cases	No	Yes—Capped at 10% of Arizona Public Service's electric energy efficiency program budget. APS's electric EE Plan not yet finalized. Under development	No
California	Yes—Electric and natural gas "system benefits" or "public goods" charge plus additional funding through rates. Yes—Electric rate cases Yes—Electric system benefits charge (SBC)	No		Yes—Natural gas and electric
Colorado		No	No	No
Connecticut		No—Electric distribution companies are only allowed recovery of lost revenues if their earnings are below their allowed rate of return for six months. In addition, in certain regions in Connecticut, the DPUC has introduced a type of lost-revenue recovery mechanism for new CL&M electric load response and distributed generation initiatives.	Yes	No—Electric Partial—Natural gas In CT DPUC Docket 05-05-09, the DPUC rejected enacting any changes to existing rate-making approaches for electric and natural gas utilities. (Electric has no decoupling but two natural gas local distribution companies have a partial decoupling mechanism in connection with their energy efficiency programs for low-income customers—a "conservation adjustment mechanism".)
Florida	Yes—Electric rate or tariff rider/ surcharge	No	No	No
Idaho	Yes—Electric rate or tariff rider/ surcharge	No	No	Investigating—Electric

State	Cost Recovery	Direct Lost Revenues Recovery	Performance Incentives	Decoupling
Illinois	Yes—Small-scale electric energy efficiency programs supported by an assessment on electric utilities.	No	N/A—The electric and natural gas energy efficiency programs are administered by the Department of Commerce and Economic Opportunity (DCEO), a state agency.	No
Iowa	Yes	No	No	No
Maine	Yes—Public benefits assessment	No	N/A—Efficiency Maine, a division of the Maine Public Utilities Commission, administers the electric energy efficiency programs.	No
Massachusetts	Yes—Electric SBC	No	Yes—5% (of electric EE expenditures) shareholder incentive for meeting goals	No
Minnesota	Yes—Electric and natural gas cases (based on legislative mandate)	No	Yes—Electric and natural gas	No
Montana	Yes—Electric SBC Yes—Natural gas general rate cases	No	No	No
Nevada	Yes—Electric rate cases	No	Yes—Electric	No
New Jersey	Yes—Electric SBC	No	N/A (NJ is moving to state administration)	No
New Hampshire	Yes—Electric SBC	No	Yes—Electric	No
New Mexico	Not applicable yet; just enacted law that requires utility DSM; cost recovery to be via rate cases.	No	No	No—However a new statute (dealing with both electric and natural gas) calls for removal of disincentives—nothing proposed or in place.
New York	Yes—Electric SBC	No	NA—Electric (NYSEEDA administers the electric energy efficiency programs)	Investigating—open docket

State	Cost Recovery	Direct Lost Revenues Recovery	Performance Incentives	Decoupling
Ohio	Yes—Electric rate rider	No	NA—Electric (The Ohio Department of Development administers the electric energy efficiency programs.)	No—Electric Issue is being examined for natural gas utilities.
Oregon	Yes—Electric and natural gas SBC	No	N/A—Electric (The Energy Trust of Oregon administers the electric and natural gas energy efficiency programs.)	No—Electric. Yes—mechanisms in place for the two biggest natural gas utilities.
Rhode Island	Yes—Electric SBC	No	No—Natural gas.	No
Texas	Yes	No	Yes	No
Utah	Yes—Electric rate or tariff rider/surcharge	No	No	No
Vermont	Yes—Electric SBC	No	Yes (non-utility)—Electric (A nonprofit, EVT, administers the programs. EVT can obtain an incentive for program performance.)	No (A proposal was submitted in one current rate case—settlement is pending.)
Washington	Yes—Electric rate or tariff rider/surcharge	No	No	Investigating—Electric
Wisconsin	Yes—Electric SBC, plus additional funding through rates is possible, if utilities request and PSCW approves.	No	Generally N/A—Electric (Currently the state of WI, Dept. of Administration administers the majority of the programs but utilities have the option to administer.) One exception, Alliant Energy is allowed to earn its rate-of-return on one C/I "shared savings" energy efficiency program.	No—Electric (A proposal was submitted in one current rate case.)

APPENDIX B: STATE SUMMARIES OF DECOUPLING MECHANISMS

States with Decoupling Mechanisms in Place or Proposed

Over the past two decades, a number of states across the U.S. have experimented with some form of utility revenue decoupling. In this section we examine both historical and recent experiences with decoupling, including a series of state-by-state summaries of these experiences.

The renewed interest in decoupling is occurring in parallel with renewed interest in the "resource" aspect of energy efficiency. This renewed interest seems to stem from a number of factors, including rising "supply-side" costs, growing demand for energy resources, and heightened environmental concerns. Support for decoupling comes from a broad spectrum of industry stakeholders—environmental groups, consumer advocates, utilities, and trade associations. For an example of the latter, the American Gas Association is strongly in favor of decoupling—not necessarily just for its benefits related to energy efficiency investments, but probably more to provide more secure and stable revenue streams in an industry increasingly concerned about fixed-cost recovery.¹⁵

"Decoupling" has re-emerged as a mechanism of interest to address lost revenues and to remove the disincentive for utilities to pursue energy efficiency programs. There are a growing number of jurisdictions that have enacted or are actively considering enacting decoupling. Below we provide brief profiles and summaries of leading states that have enacted or have seriously investigated and considered implementation of decoupling.

California

Overall Energy Efficiency Program Approach and Structure

California's investor-owned utilities administer energy efficiency programs with CPUC oversight. These programs are funded both by a public goods charge and via rates as a result of recent CPUC decisions to aggressively pursue acquisition of energy efficiency resources as part of the state's energy plan. The CPUC approves the utilities' plans for efficiency programs and oversees the program planning, market assessment, and program evaluation of the efficiency programs. In addition to the utility programs, there also are programs administered and implemented by "third-party providers" as a way to encourage innovation and ensure coverage of markets that utility programs may be missing.

California's structure and funding for energy efficiency programs are undergoing major changes as a result of recent legislative and regulatory decisions. The state has a "public goods" wires charge in place that had become the primary funding mechanism for utility energy (and some non-utility) energy efficiency programs. This charge is assessed as a separate line item on customers' monthly electric bills and as a small charge per therm on

¹⁵ Many gas utilities are facing stagnant or declining sales levels in response to high natural gas prices. This has led to a growing interest in decoupling mechanisms.

natural gas bills. Utilities also have been authorized to raise additional program dollars in the utility procurement process as determined in general rate cases.

In September 2005, the CPUC embraced an aggressive resource procurement plan for energy efficiency, on top of its base of public goods charge program funding. Between the two sources, the regulated utilities will spend a total of \$2 billion over the 3-year period of 2006–2008. Cost recovery for the resource procurement portion of the energy efficiency will presumably occur through regulatory casework.

Performance Incentives

The utilities used to be able attain shareholder incentives based on the success of their programs. Performance incentives, however, have been eliminated. In Decision 02-03-056 delivered in March 21, 2002, the California Public Utilities Commission stated:

In the past, the Commission has offered shareholder incentives to large IOUs for successful program delivery, in lieu of a profit margin. The Commission will no longer make a special provision for shareholder earnings. Both utility and non-utility entities are free to propose program budgets they feel are necessary for their organizations to complete the program delivery successfully.

While there are no performance incentives presently in place, the CPUC has kept the door open for enactment of such mechanisms in individual utility rate cases. The CPUC is currently undergoing extensive efforts to establish a common performance basis for energy efficiency programs that will capture cost-effective energy savings that defer more costly supply-side investments and costs. Once these foundations and frameworks are established, the CPUC will work on establishing performance incentives for energy efficiency programs.

Decoupling and Lost Revenue Recovery

California was one of the first states to enact decoupling mechanisms for its regulated electric utilities. In 1982 the CPUC adopted an “electric rate adjustment mechanism” (ERAM) to achieve two key objectives: (1) decouple utility revenues from sales; and (2) remove disincentives for utility investment in energy efficiency and conservation. This mechanism was implemented in conjunction with the state’s integrated resource planning requirements. ERAM required utilities to track the difference between actual and forecasted base rate revenues. Overcollections would then be refunded to ratepayers and undercollections would be recovered by subsequent rate adjustments. ERAM allowed the utilities to recover their revenue requirements independent of actual energy sales.

California’s experience with ERAM was generally positive. It was largely successful in reducing rate increase risk to customers and revenue recovery risks to the utilities. Despite that positive track record, however, other industry developments led to the elimination of ERAM in the mid-1990s. Specifically in conjunction with restructuring its electric utility

industry, the CPUC ruled that ERAM would no longer be appropriate. In Order D.96-12-077 the CPUC concluded:

Introduction of competition for generation will render ineffective the CPUC's past approach of supporting demand-side management by using ERAM to counter the utility's economic incentive to increase sales.

As it turned out, California's restructured electricity markets failed to function effectively, leading to the infamous "crisis" of 2001. As a result, California enacted another set of sweeping changes to its electricity markets—re-introducing regulatory control over utilities and placing the responsibility for "resource portfolio management" back with the utilities. The legislation that was enacted in 2001, AB29X, also included regulatory provisions for ratemaking. One of these specifically addressed decoupling requirements:

The Commission shall ensure that errors in estimates of demand elasticity or sales do not result in material over or undercollections of the electrical corporations. (Public Utilities Code Section 739.10).

This rather tersely worded statutory language essentially requires revenue decoupling. This statute rules out any ratemaking approach that ties earnings to sales fluctuations and also provides regulated utilities with assurance of cost recovery for authorized revenue requirements. From 2002–2005, California's investor-owned utilities developed and implemented decoupling mechanisms as required by this statute. Each utility's mechanism arose out of general rate cases before the CPUC. While specific details of the mechanisms vary, they share a common approach, which is to use balancing accounts for annual true-ups. This protects utilities from fluctuations in revenues stemming from fluctuations in sales for any of many possible reasons (energy efficiency and conservation are just two of these—weather and economic activity are other prominent reasons). Through individual rate cases, the CPUC determines initial revenue requirements and then takes one of two specific approaches to adjusting revenue requirements between rate cases:

- Using attrition mechanisms that escalate revenue requirements by inflation minus a productivity offset every year—and adding a factor to account for customer growth; or
- Using an inflation adjustment (consumer price index) to escalate the revenue requirement each year with boundaries set for a minimum and maximum allowable escalation.

The changes in rate-making approaches for California's utilities have occurred during a period of significant changes overall with California's approach to energy efficiency. In September 2005, the CPUC embraced an aggressive resource procurement plan for energy efficiency, on top of its base of public goods charge program funding. The CPUC adopted an "Energy Action Plan" (CPUC 2005) that places energy efficiency as the first resource in utility loading order—meaning that the first dollars spent by California's utilities are to be on cost-effective energy efficiency. This policy in turn is translating to unprecedented levels of investment in new energy efficiency resource in California. Over the next three years, 2006–

2008, California plans to invest a total of \$2 billion in energy efficiency through programs offered by utilities and other organizations. These investments are to achieve aggressive targets for energy efficiency savings impacts—by the year 2013, reducing peak demand by nearly 5,000 MW and reducing energy use by over 23,000 GWh and 400 million therms.

California's decoupling initiatives are thus one element of a much larger energy policy—a policy that requires utilities to commit large amounts of resources to fund and implement energy efficiency programs. We found no efforts to date that attempt to evaluate the impacts of just the decoupling mechanisms on the utilities' investment and related actions toward energy efficiency programs. Given these tremendous additional changes with CPUC targets and approved budgets for energy efficiency programs, we believe it will be difficult to isolate the specific policy impacts of decoupling. However, we also observe that establishing such mechanisms is a valuable complement to achieve the overall policy objective. It's part of a "complete package" to align utility financial interests with public policy interests towards greater levels of energy efficiency.

References

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- [CPUC] California Public Utilities Commission. Various years. Decisions:
- Decision 04-07-022. *Opinion on Base Rate Revenue Requirement and Other Phase 1 Issues. Application of Southern California Edison Company for Authority to, Among Other Things, Increase Its Authorized Revenues for Electric Service in 2003, and to Reflect That Increase in Rates*. July 16, 2004.
 - Decision 04-05-055. *Opinion: Phase 1 Issues. Application of Pacific Gas and Electric Company for Authority, Among Other Things, to Increase Revenue Requirements for Electric and Gas Service and to Increase Rates and Charges for Gas Service Effective on January 1, 2003*. May 27, 2004.
 - Decision 05-03-023. *Decision on Southern California Gas Company and San Diego Gas & Electric Company's Phase 2 Post-Test Year 2004 Ratemaking, Earnings Sharing, Incentive Proposals, and 2004 Incentive Proposals*. March 17, 2005.
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- Southern California Edison Company, San Diego Gas and Electric Company, Southern California Gas Company, and Pacific Gas and Electric Company. 2006. "Decoupling Mechanisms—Energy Efficiency Policy Impacts and Regulatory Implementation." In *Proceedings of the 2006 ACEEE Summer Study on Energy Efficiency in Buildings*. Washington, D.C.: American Council for an Energy-Efficient Economy.

Idaho

Overall Energy Efficiency Program Approach and Structure

The state's vertically integrated, regulated utilities administer energy efficiency programs. Cost recovery is by individual rate cases and rate design. Generally the approach taken by the Idaho Public Utilities Commission is using rate design to reduce energy rates (variable costs) and use more fixed costs to recover revenue requirement.

Rate riders (surcharges) are also used. Both Pacificorp and Idaho Power have 1.5% surcharges collected as an adder on customer bills to fund energy efficiency programs. The final order for a Pacificorp rate case has not been issued yet, which may change this surcharge slightly.

Performance Incentives

None in place. PUC staff are interested in moving toward some type of performance-based ratemaking, but nothing is proposed or in-process.

Decoupling and Lost Revenue Recovery

There is no mechanism for lost revenue recovery.

Decoupling is being actively proposed and investigated. In May 2004, in a general rate case for Idaho Power Company (Case No. IPC-E-03-13, Order No. 29505), the Idaho Public Utilities Commission (IPUC) determined that a separate proceeding was called for to "assess financial disincentives inherent in Company-sponsored conservation programs." The Commission directed the parties to propose a workshop schedule and initiate a proceeding. On June 18, 2004, the parties formally requested that a proceeding be initiated, and on August 10, 2004 the IPUC established Case No. IPC-E-04-15 for an "investigation of financial disincentives to investment in energy efficiency" by Idaho Power Company.

A series of workshops were held and a final report filed by the parties on February 14, 2005 ("Final Report on Workshop Proceedings"). The parties all agreed that "material financial disincentives to the implementation of DSM programs do exist" (p. 6), but not all participants agreed that restoration of lost fixed-cost revenues alone would directly result in additional or more effective investment in DSM programs by Idaho Power. However, the parties did all agree on a set of principles, or "criteria," to use to evaluate possible approaches to address the lost fixed-cost revenues problem. Those criteria are:

1. Stakeholders are better off than they would be without the mechanism.
2. Minimizes cross subsidies across customer classes.
3. Removes financial disincentives.
4. Optimizes the acquisition of all cost-effective DSM.
5. Promotes rate stability.
6. Simple mechanism.

7. Administrative costs and impacts of the mechanism are known, manageable, and not subject to unexpected fluctuation.
8. Monitors short and long-term effects to customers and company.
9. Avoids perverse incentives.
10. Closes link between mechanism and desired DSM outcomes. (p. 7)

The parties also agreed on two recommendations:

1. That Idaho Power would conduct a simulation analysis to examine what might have occurred if a decoupling or true-up mechanism had been implemented for Idaho Power at the time of the last general rate case and share those results with the parties.
2. That Idaho Power would develop and file an application with the Commission to implement a pilot energy efficiency program that would incorporate both performance incentives and "lost revenue" adjustments. (pp. 10-11)

On January 27, 2006, Idaho Power filed an application in Case No. IPC-E-04-15 requesting authority to implement a rate adjustment mechanism that would adjust the Company's rates upward or downward to recover the Company's fixed costs independent from the volume of the Company's energy sales. This type of ratemaking mechanism is commonly referred to as a "decoupling mechanism." However, Idaho Power believes that a more accurate description of what the Company is proposing is a "true-up mechanism." The true-up mechanism it is proposing, entitled "Fixed-Cost Adjustment," would be applicable only to Residential Service and Small General Service customers. This case is currently in process.

The Idaho Public Utility Commission has not yet reached a decision in the present Idaho Power rate application that would decouple revenues from utility earnings.

References

Idaho Public Utilities Commission. Various Years. Decisions and Orders in Dockets:

- Case No. IPC-E-04-15 on January 27, 2006, "In the Matter of the Investigation of Financial Disincentives to Investment in Energy Efficiency by Idaho Power Company."
- Case No. IPC-E-04-15. "Investigation of Financial Disincentives to Investment in Energy Efficiency by Idaho Power Company. Final Report on Workshop Proceedings." February 14, 2005.
- Case No. IPC-E-03-13, Order No. 29505. May 2004. Idaho Power Company General Rate Case.

New York

Overall Energy Efficiency Program Approach and Structure

New York established a state-wide systems benefits energy program administered by the New York State Energy Research and Development Authority (NYSERDA). Two public power authorities—the New York Power Authority and the Long Island Power Authority—

offer similar programs. Customers of regulated distribution utilities pay a non-bypassable system benefits charge as a separate line item.

Performance Incentives

Not applicable to the state-administered program.

Decoupling and Lost Revenue Recovery

New York is once again considering decoupling. On May 2, 2003, the NYPSC issued an order (Case 03-E-640) that instituted a proceeding “[T]o investigate potential electric delivery rate disincentives against the promotion of energy efficiency, renewable technologies and distributed generation.” In its order, the NYPSC directed the administrative law judge to request, at a minimum:

- detailed “typical” bill analyses of possible impacts of alternative rate structures,
- comments on the degree to which current rate designs discourage electric delivery utilities from promoting energy efficiency, renewable technologies, and distributed generation,
- an indication of each of the electric delivery utilities of the feasibility of, and their interest in, making cost-based electric delivery rate design modifications for each service classification that remove such disincentives, and
- other recommendations to remedy any identified rate design disincentives against the promotion of energy efficiency, renewable technologies, and distributed generation.

The NYPSC defines decoupling this way in this docket:

Revenue decoupling is defined as a rate making mechanism that is designed to eliminate or reduce the dependence of a utility’s revenues on system throughput, adopted for the purpose of removing utility opposition to customer efforts to reduce energy consumption and demand or to install generation to displace electricity delivered by the utility’s distribution and transmission system.

A technical conference was held to initiate the proceedings, after which time the NYPSC invited parties to submit comments on the issues identified at the conference and within the scope of the investigation. NYPSC staff did not submit comments, but did summarize comments received and provided its recommendations in a staff report issued July 9, 2004. Below are key findings given by NYPSC staff in this report:

- Staff’s previous experience with comprehensive “revenue decoupling mechanisms” (RDMS) is that they tend to generate large revenue accruals, nearly all caused by weather.
- To the degree that unit prices are considered “too high” due to rate design measures such as volumetric rates, those rates create a strong incentive for customers to consider energy conservation, distributed generation or alternative energy sources.

While the proponents of RDMs argue that current rates provide a disincentive to utilities to promote energy conservation or distributed generation, the same rates provide a strong counter-balancing incentive to customers to engage in those practices. [emphasis added]

- While there may continue to be a financial disincentive in utility rate structures, in staff's view it is not enough to warrant implementation of RDMs.
- Rather than implementation of RDMs, staff recommends the continued development of better rate designs and, where appropriate, targeted mechanisms and performance incentives should be pursued.
- The application of focused performance incentives should be further explored, most appropriately within individual utility rate proceedings.

Based on these findings and analysis of the issues raised in the proceeding, staff issued the following recommendations in this report:

- While theoretically imposition of an RDM could resolve some of the conflicts [between utility revenues and profits to the throughput of the utilities' systems] as the proponents of the RDM concept argue, there are serious concerns with such an approach, such as the difficulty that would be involved in developing an appropriate mechanism and the risk of rate instability that might result.
- Further, other approaches, such as improved rate designs, targeted rate incentives, and performance incentives, may be just as effective as or even better than such a broad-based incentive ratemaking approach.
- Indeed, the various program initiatives identified above have achieved success without the need for a broad-based RDM, and other incentive approaches should be explored in the various utility rate proceedings as needed.
- *Accordingly, staff recommends that an RDM not be required at this time* [emphasis added].

A final decision in this investigation is still pending. The NYPSC has not issued an Order or other decision.

References

State of New York Public Service Commission. Various years. Case documents:

- Case 03-E-0640. "Staff Report: Proceeding on Motion of the Commission to Investigate Potential Electric Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation." July 9, 2004.
- Case 96-E-0898. "In the Matter of Rochester Gas and Electric Corporation's Plans for Electric Rate/Restructuring Pursuant to Opinion No. 96-12" Settlement Agreement.
- Case 96-E-0897. "In the Matter of Consolidated Edison Company of New York, Inc.'s Plans for (1) Electric Rate/Restructuring Pursuant to Opinion No. 96-12; and (2) the Formation of a Holding Company Pursuant PSL, Sections 70, 108 and 110, and Certain Related Transactions."
- Opinion 88-20, issued July 26, 1988.

Oregon

Overall Energy Efficiency Program Approach and Structure

The Energy Trust of Oregon, a nonprofit set up by the Oregon Public Utility Commission, is the administrator of the energy efficiency and renewable energy programs. A state agency, the Oregon Housing and Community Services, administers the low-income programs. The Education Service Districts administer the public purpose funding for the schools.

PacifiCorp and PGE collect 3% of billed revenues from ratepayers (with the exception of certain large customers who are allowed to invest the conservation and/or renewable portions of the public purpose charges in their own facilities). Distributions of fund allocations to program administrators occur monthly net of uncollectibles and administrative costs of both the utilities and the Oregon Public Utility Commission. Funding amounts are reported to the Commission. Public purpose funding sunsets for all programs in 2012 unless the Oregon Legislature renews it.

Oregon has established a statewide public benefits program for electricity and natural gas energy efficiency. The state's restructuring legislation (SB 1149) established a 3% "public purpose charge" on customer utility bills.

Performance Incentives

None is in place or proposed.

Decoupling and Lost Revenue Recovery

In the 1990s, Oregon established and used various mechanisms to remove utility disincentives toward energy efficiency investments, including lost revenue adjustments, shared savings, and decoupling. But none of these prior mechanisms are in effect because of the change in program administration and implementation.

While electric utilities were no longer expected to administer or implement programs, in 2002 Oregon implemented a decoupling mechanism for one of its large natural gas utilities, Northwest Natural. On September 12, 2002, the PUC issued an order (No.02-634) adopting a stipulation agreement allowing Northwest Natural Gas Company (NWN) to implement a Distribution Margin Normalization mechanism. (This was included in a package deal along with a very substantial funding mechanism [over 3% of total revenues] for "public purpose programs" to support low-income bill payment assistance, low-income weatherization assistance, and enhanced energy efficiency programs. The revenues for energy efficiency are provided to the Energy Trust of Oregon for administration.)

Oregon has since enacted decoupling for another of its natural gas utilities. A recent decoupling proposal by Cascade Natural Gas (Docket UG 167) was approved in early April 2006 (Order No. 06-191 entered 4/19/06) by the Public Utility Commission of Oregon.

Cascade's application for approval of its "Conservation Alliance Plan" (CAP) includes a decoupling mechanism consisting of two deferral accounts:

- One deferral account tracks changes in margin due to variations in weather-normalized usage, and
- The other deferral account tracks changes in margin due to weather that varies from normal.

The PUC also had considered a decoupling proposal for Portland General Electric, but rejected the proposal. We provide details of these cases in Appendix A because Oregon is the state with the greatest recent experience with decoupling.

References

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Public Utility Commission of Oregon. Various years. Decision and Orders in dockets:

- Order No. 06-191, Docket UG 167. *In the Matter of Cascade Natural Gas Corporation Request for Authorization to Establish a Decoupling Mechanism and Approval of Tariff Sheets No. 30 and No. 30-A*. April 19, 2006
- Order No. 05-934, Docket UG 163. *NWN Joint Stipulation to Extend the Existing Decoupling Mechanism for Another Four Years*. August 25, 2005.
- Order No. 02-634, Docket No. UG 143. *In the Matter of Northwest Natural Gas Company Application for Public Purpose Funding and Distribution Margin Normalization*. September 12, 2002.
- Order 02-633, Docket UE 126. *In the Matter of Portland General Electric's Proposed Tariffs to Decouple Distribution Revenues from Residential and Small Nonresidential Consumers and their kWh Sales*. September 12, 2002.
- Order No. 98-191. *In the Matter of the Revised Tariff Schedules in Oregon Filed by PacifiCorp, dba Pacific Power and Light Company*. 1998.
- Order 95-322. *In the Matter of the Revised Tariff Schedules for Electric Service in Oregon filed by Portland General Electric Company*. 1995.

Washington

Overall Energy Efficiency Program Approach and Structure

Washington is a non-restructured state. Utilities carry out DSM programs with regulatory oversight by the state's regulatory body, the Utilities and Transportation Commission. Utilities get cost recovery of energy efficiency programs through tariff riders. Program costs are expensed and trued up annually.

Performance Incentives

No performance incentive is in place or proposed. The Utilities and Transportation Commission (UTC) has established penalties for non-performance for Puget Sound Energy for not achieving energy savings targets.

Decoupling and Lost Revenue Recovery

In 1991, Washington Utilities and Transportation Commission adopted a revenue cap mechanism for Puget Sound Power Energy in order to decouple company revenues from energy sales. This "experimental rate design" was enacted in Docket Numbers UE-901183-T and UE-019184-P. In addition to the revenue caps, the WUTC established a "periodic rate adjustment mechanism" (PRAM). The WUTC explained its reasoning for taking this action, including a note about not instead using some type of "lost revenue adjustment" in the following excerpt:

[T]he revenue per customer mechanism does not insulate the company from fluctuations in economic conditions, because a robust economy would create additional customers and hence, additional revenue. Furthermore, the Commission believes that a mechanism that attempts to identify and correct only for sales reductions associated with company-sponsored conservation programs may be unduly difficult to implement and monitor. The company would have an incentive to artificially inflate estimates of sales reductions while actually achieving little conservation.

Implementation of this decoupling mechanism played a critical part in changing the role of energy efficiency and conservation programs within Puget Sound Energy. In the first two years following enactment of decoupling, there were dramatic improvements in energy efficiency program performance. In an order (11th Supplemental Order, Sept 21, 1993), the WUTC observed:

PRAM has achieved its primary goal—the removal of disincentives to conservation investment. Puget has developed a distinguished reputation because of its conservation programs and is now considered a national leader in this area.

This supplemental order extended PRAM another 3 years. In 1995, the WUTC approved a request from Puget and several other parties to terminate a set of rate adjustment mechanisms, including the revenue-per-customer cap, as part of a litigation settlement. The WUTC approved the request adopting an alternative set of rate proposals, which ended decoupling for Puget Sound Energy. However, the proposal itself brought before the WUTC expressly reserved the right of all parties to bring forth in the future "other rate adjustment mechanisms, including decoupling mechanisms, lost revenue calculations [and] similar methods for removing or reducing utility disincentives to acquire conservation resources."

Decoupling is once again being actively investigated and proposed in Washington. The Washington Utilities and Transportation Commission has considered (or is considering) decoupling both in a rulemaking docket and in individual utility rate cases. On March 31, 2005, the WUTC began its rulemaking inquiry into decoupling when it issued CR-101, "Preproposal Statement of Inquiry Concerning the Possible Issuance of Administrative Rules for Natural Gas Companies Pertaining to Rate and Accounting Methods to Separate or 'Decouple' Utility Recovery of Fixed Costs from the Volume of its Commodity Sales." This commenced WUTC Docket No. UG-050369, "Natural Gas Decoupling Rulemaking."

In May 2005 the WUTC held a workshop that was "intended as a forum for open discussion of alternative approaches to natural gas decoupling, as well as an opportunity for parties to identify potential issues or concerns associated with use of various types of decoupling methodologies." Following the workshop, the WUTC issues a Notice of Opportunity to File Written Comments. Numerous parties filed written comments. On Oct 17, 2005, the WUTC withdrew its rulemaking on decoupling and closed the docket. The UTC noted in its decision:

The comments provide a wide spectrum of views on decoupling and highlighted a number of issues that require more detailed thought.....The Commission believes that the wide variety of alternative approaches to decoupling make it more efficient to address these issues in the context of specific utility proposals included in general rate case filings rather than through a generic rulemaking.

The Commission's decision is not intended as a comment on the viability of any specific decoupling proposal that has been discussed and considered in this docket. (Docket UG-050369)

In its ruling, "Summary, Analysis of Comments and Decision to Close Docket without Action," the WUTC identified key issues with enacting decoupling, namely:

- a) *Scope of events covered by decoupling?* Weather impacts? All-inclusive (all impacts including energy efficiency/conservation)?
- b) *Scope of customer classes included?* Residential only? Small commercial? All commercial/industrial? All classes? Cost allocation accordingly?
- c) *Scope of the measurement and subsequent rate impacts?* Decoupling applied to individual customers? Across all customers in a class? If cost reductions achieved are spread out over entire rate class, does this encourage and/or provide correct incentives for such actions? Equity?
- d) *Timing of adjustments: deferral with annual true-up vs. monthly adjustments?* Administrative efficiency versus more timely feedback to customers from actions?
- e) *New customer impacts?* How to account for growth in number of customers? Impacts on fixed cost recovery?
- f) *Rate of return implications?* Does decoupling materially reduce the risk associated with investment in a gas utility?
- g) *Low-income customer considerations?* Since low-income customers tend already to be low volume customers, do decoupling mechanisms affect them adversely and disproportionately?

- h) *Pilot project implementation approach?* Should a pilot program be tried first?
- i) *Basic charge increase alternative?* Should the Commission be open to covering all fixed costs through a uniformly applied customer charge?
- j) *Earnings cap or other mechanism to avoid windfalls?* Should measures be built in to protect against windfall recoveries caused by operation of the mechanism?
- k) *Need to set fixed cost level in general rate case?* How much data does the Commission need to make an informed decision on any decoupling proposal?
- l) *Proper way to measure weather impacts?* Best way of measuring deviations from normal weather for rate adjustment purposes?

In this Summary, the WUTC only identified the above issues. It did not describe possible approaches to address the issues and did not offer recommendations on any such approaches. As noted earlier, the WUTC concluded that decoupling was more appropriately addressed in the context of specific utility rate cases rather than a general rulemaking docket. Such individual cases have arisen, as we describe next.

PacifiCorp proposed a decoupling mechanism in a recent general rate case before the WUTC (Docket No. UE—50684). The decoupling proposal in this case was a response to an earlier Docket (UE-032065), in which WUTC ordered, “PacifiCorp may propose a true-up mechanism, or some other approach to reducing or eliminating any financial disincentives to DSM investment. This could be in connection with a general rate proceedings such as the Company suggests will be filed sometime in 2005.”

In its recent rate case, concluded April 17, 2006 (Docket No. UE-050684), PacifiCorp (Pacific Power) sought to establish three “key regulatory mechanisms” to support “continued reliable operations.” One of these three goals is to develop and adopt a decoupling mechanism to support implementation of energy conservation programs. The Natural Resources Defense Council submitted a “Joint Proposal” with PacifiCorp for a 3-year pilot test of a true-up (decoupling) mechanism.

The WUTC denied the request by Pacific Power for the rate increase, which included the proposal for a pilot decoupling mechanism. The case involved a “long standing dispute over how to allocate costs in the utility’s six-state territory.” According to a WUTC press release on its decision:

In rejecting the allocation formula, the UTC found that the company failed to carry the burden it alone bears to prove that resources in its eastern service territories, remote from Washington, provide tangible and quantifiable benefits to customers in this state.

Rejection of this proposal does not close the door to future consideration of decoupling. As noted in a WUTC press release (WUTC 2006), “In its order, the commission said that while it would support a well-designed decoupling program, it could not approve a proposal for PacifiCorp until it determined the proper allocation of the utility’s costs to Washington.”

The WUTC is presently considering another decoupling proposal in a different general rate case. Cascade Natural Gas Corporation has sought to establish a decoupling mechanism in its recent general rate case (UG-060256). The Company filed its application on February 14, 2006.

References

- [WUTC] Washington Utilities and Transportation Commission. Various years: Decisions, Orders, Filings and Proceedings:
- Docket No. UG-060256. *Cascade Natural Gas Corporation, 2006 General Rate Case Application.*
 - Docket No. UE-050684. *PacifiCorp (Pacific Power). General Rate Case Application.* Final Order issued April 17, 2006.
 - Docket No. UG-050369. *Rulemaking to Review Natural Gas Decoupling, Notice of Withdrawal of Rulemaking and Summary, Analysis of Comments and Decision to Close Docket without Action.* October 17, 2005;
 - Docket No. UG-051651. *Application for an Order Authorizing the Establishment of a Decoupling Mechanism and Deferred Accounting Treatment for Changes in Margin Due to Conservation and Due to Variances from Normal Weather Decoupling Mechanism Proposal.* December 2005.
 - Docket UE-920433. *11th Supplemental Order.* Sept. 21, 1993.
 - Docket Numbers UE-901183-T and UE-019184-P. *Puget Sound Power Energy General Rate Case Application.* 1991.

Other Examples

There are a few other jurisdictions that either have decoupling in place or are actively considering proposals to enact decoupling. In this section, we present short summaries of a few of these other cases.

Maryland

Maryland has had a decoupling mechanism for Baltimore Gas & Electric (BG&E) since 1998 and just recently enacted the same mechanism for its other principal gas utility, Washington Gas. The decoupling mechanism consists of three parts: (1) base revenues are set based on weather-normalized patterns of consumption, (2) monthly revenue adjustments are accrued based on actual revenues, and (3) monthly adjustments to rates are made based on the accrued adjustments. The intent of this mechanism is to decouple weather and energy efficiency impacts from the revenue ultimately recovered by gas companies. Another main objective is to provide revenue stability to the companies.

The energy efficiency impacts on revenues are only those achieved by customers without the support or funding provided by utility or other types of utility-sector energy efficiency programs. BG&E and Washington Gas do not fund or provide energy efficiency programs, and Maryland has no statewide "public benefits" program in place. The only exception is that the utilities do fund and administer programs for low-income residential customers.

These cases in Maryland provide concrete examples that decoupling mechanisms alone are not sufficient to lead to significant investments by utilities in energy efficiency. Other mechanisms, policies, and regulatory requirements are required.

New Jersey

On October 12, 2006, the New Jersey Board of Public Utilities approved two pilot programs for natural gas conservation for the South Jersey Gas and New Jersey Natural Gas companies. These pilot programs include provisions for decoupling so that gas cost savings (through improved energy efficiency) will not be offset by costs related to reduced usage. Details of this mechanism and other aspects of this decision were not available as this report went to press. It is noteworthy that these decoupling mechanisms were part of a package that includes plans to promote greater energy efficiency and to provide incentives (via decoupling—not “performance incentives” as described in this report) to the gas companies to promote energy conservation.

North Carolina

Piedmont Natural Gas Company

In October 2005, the North Carolina Utilities Commission issued “Order Approving Partial Rate Increase and Requiring Conservation Initiative” in Docket No. G-9, Sub 499; Docket No. G-21, Sub 461; and Docket G-44, Sub 15. In this order, the Commission approved an experimental conservation tariff, called the “customer utilization tracker” (CUT) in order to align the interests of company shareholders with those of customers regarding conservation initiatives. This tariff is effective for the 3-year period, November 1, 2005 to November 1, 2008. During the life of the CUT, Piedmont is also to contribute \$500,000 per year toward conservation programs. The company is to work with attorney general and utilities commission staff to “develop appropriate and effective conservation programs to be submitted to the Commission for approval and annual review.”

The status of this mechanism is unclear at the present time. The North Carolina Attorney General has filed a notice of appeal challenging the North Carolina Utilities Commission’s legal authority to approve the CUT.

While the ultimate resolution of this issue is not known, this case provides a good illustration of the desirable tactic of tying decoupling to other provisions or requirements for specific funding of energy efficiency programs.

References

North Carolina Utilities Commission. 2005. *Order Approving Partial Rate Increase and Requiring Conservation Initiative*. Docket No. G-9, Sub 499; Docket No. G-21, Sub 461; and Docket G-44, Sub 15. October.

New Mexico

In the Energy Efficiency Act of 2005, the New Mexico Legislature recently passed enabling legislation for utility DSM, and this legislation calls for removal of financial disincentives towards energy efficiency. Nothing is yet in place.

Utah

The Public Service Commission of Utah approved a decoupling mechanism for the Questar Gas Company on October 5, 2006 in Docket No. 05-057-T01. This mechanism establishes a "Conservation Enabling Tariff (CET)" Pilot Program for a 3-year period. CET is to address the issue of declining usage per customer while removing the disincentives for Questar Gas to implement demand-side management programs, which Questar Gas committed to undertake in the settlement in this docket. The basic approach of this tariff is to determine "non-gas revenue" per customer and use a balancing account with periodic true-ups to meet established utility revenue requirements.

The Conservation Enabling Tariff methodology consists of three steps:

1. The allowed GS-1 distribution non-gas revenue (DNG) per customer per month is calculated. The revenue requirement and the year-end customers are allocated to the calendar months based on historical patterns. The monthly revenue requirement is then divided by the monthly number of customers to arrive at the allowed revenue per customer per month. The proposed revenue per customer will be based on projected year-end 2005 customers and the revenue collected from these customers using the rates proposed to be effective on January 1, 2006.
2. On a monthly basis, the allowed DNG revenue per customer each month is multiplied by the actual number of GS-1 customers. The product is compared to the actual GS-1 DNG revenue and any difference, higher or lower, is booked into a balancing account.
3. On a schedule of not less than twice per year, the Company will file for a percentage adjustment to the GS-1 DNG block rates in an amount to amortize the balancing account over the projected sales for the upcoming 12 months.

References

- Public Service Commission of Utah. 2006. *Order Approving Settlement Stipulation: In the Matter of the Approval of the Conservation Enabling Tariff Adjustment Option and Accounting Orders*. Issued October 5.
- Questar Gas Company. 2005. *Joint Application of Questar Gas Company, the Division of Public Utilities, and Utah Clean Energy, for the Approval of the Conservation Enabling Tariff Adjustment Option and Accounting Orders*. Docket No. 05-057-T01. December 16.