

HARVARD ELECTRICITY POLICY GROUP

THIRTY-SEVENTH PLENARY SESSION

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Session Two

Distribution Pricing: Do Revenue Caps Set Appropriate Incentives? Are they Fair to Consumers and Investors?

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What is Revenue Decoupling?

A form of ratemaking that is designed to separate a utility's revenue from its sales.



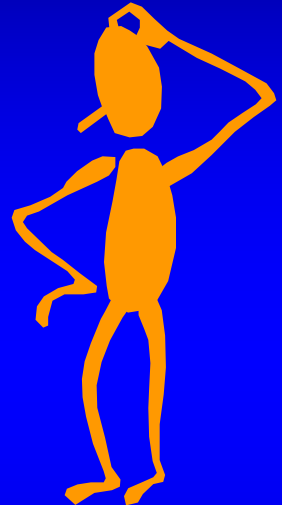
What is Revenue Decoupling?

Why has it been proposed – that is, what problem do its proponents say need to be solved?

- Remove the financial incentive to promote increases in sales
- Remove financial disincentive to promotion of energy efficiency

Major Implementation Problems

- **Utilities became neutral to the impact of sales levels**
 - Economic conditions
 - Weather conditions
 - Customers assume these risks
- **Reduces motivation for utilities to accommodate customer needs**
- **Causes increased rate volatility and uncertainty**
- **Process is complex and expensive to administer and regulate**



Approaches That Have Been Offered to Address These Problems

- **Allowed revenue could be normalized for weather or economic conditions**
- **Incorporate incentives for utility to**
 - **Acquire least-cost resources**
 - **Operate efficiently**
- **Avoid significant rate increases**
 - **Cap amount that can be recovered at any one time**

Where Has it Been Tried and Abandoned?

Maine

- 1991 – Commission adopted a 3-year trial revenue per customer decoupling mechanism for Central Maine Power Company (CMP)
- Shortly after implementation, Maine experienced a recession which resulted in lower sales levels (economic impact)
- Lower sales caused substantial deferrals that CMP was entitled to recover

Source: "Maine PUC Report on Utility Incentive Mechanisms for the Promotion of Energy Efficiency & System Reliability", February 1, 2004, pp. 28-29

Where Has it Been Tried and Abandoned?

Maine (cont'd)

- Majority of the \$52 million deferral was from economic recession
- Decoupling mechanism shielded CMP against impact of recession
- Risk passed to customers
- Late 1993 - program was cancelled

Source: "Maine PUC Report on Utility Incentive Mechanisms for the Promotion of Energy Efficiency & System Reliability", February 1, 2004, pp. 28-29

Where Has it Been Tried and Abandoned?

Washington

- Oct 1991 – Commission adopted PRAM which was a combination decoupling and cost-adjustment mechanism for Puget Power
- Commission granted additional revenue
 - 1st year - \$38 million
 - 2nd year - \$90 million (\$66 million immediate increase, \$24 million deferral)
 - 3rd year - \$36 million and authorized Puget to recover entire \$76 million of PRAM deferrals

Where Has it Been Tried and Abandoned?

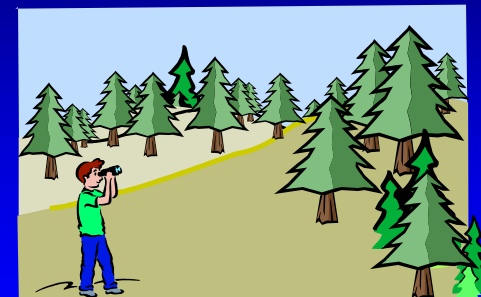
Washington (cont'd)

- 4th year - \$54 million and authorized Puget to recover entire \$85 million of PRAM deferrals
- 5th year - \$59 million and authorized Puget to recover entire \$93 million of PRAM deferrals
- September 1995 - PRAM was cancelled
- Commission viewed that PRAM did not provide incentive for company to manage power costs or conservation and other resource acquisitions at lowest cost

Away from the Trees . . .

See the Forest

- Promoting the efficient use of energy is good policy
- The challenge is how best to do this
- Expecting utilities to simultaneously
 - Sell the use of the product, and
 - Sell the non-use of the same product



CREATES A FUNDAMENTAL CONFLICT

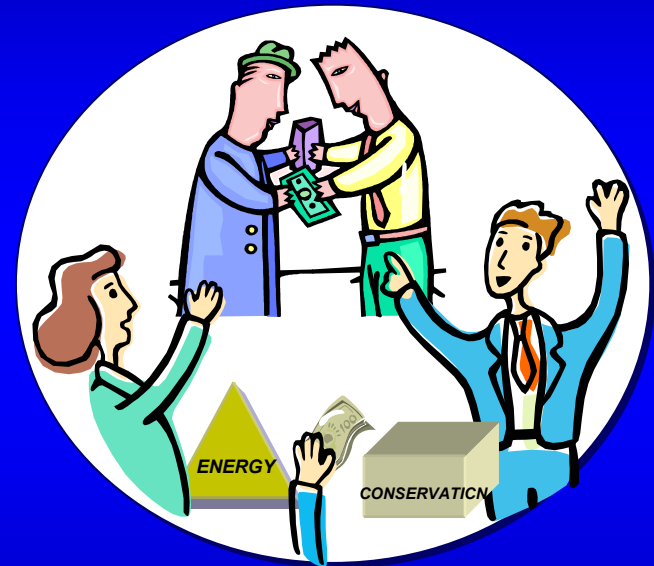
If a utility is tasked to both sell and unsell the same product:

- The Commission must then set up additional oversight to try and regulate the conflicting activities



In An Ideal World

- **Utilities sell energy**
- **Other entities sell conservation programs**



In An Ideal World

- **The competition created makes both entities more proficient and cost-effective**
- **Each profits by excelling in its core business**

AND

In An Ideal World

- The need for regulatory oversight of sales activities is minimized
- There would not be any sales adjustment mechanisms or other rate increase clauses . . . **SO** . . . utilities would have a powerful incentive to reduce their costs
- Economic development activities would not be discouraged

Funding for DSM Programs

- **Could still be consumer funded, if desired**
- **Funding amounts could be set by governmental agency, i.e., the Commission**
- **Implementation by independent parties subject to oversight, with an incentive built into the compensation structure would ensure the most efficient implementation**



The Fundamental Difference

- **Instead of decoupling revenue from sales**
 - **Decouple product sales from the promotion of conservation**
- **Allows everyone to do what they do best**

If Special Mechanisms are Used

- **Do class by class**

- Rate equity
- Does not discourage economic development

Industrial

Residential

Commercial

- **Limit percent increase allowable and amount of accrual**

- **Minimize number and scope of other adjustment mechanisms that are allowed**