WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

UTC INQUIRY ON CONSERVATION INCENTIVES (INCLUDING DECOUPLING)

Report to the State Energy Strategy Advisory Committee

Washington Utilities and Transportation Commission

October 5, 2010

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Recent Commission Activity on Conservation, Renewables

- Inquiry on Conservation Incentives (U-100522)
- Inquiry on Renewables (UE-100849)
- Approval of Conservation Targets under I-937 (UE-100177, UE-100176, UE-100170)
- Smart Grid Report Rule (UE-090222)
- Inquiry on Electric Vehicle Issues (UE-101521)
- Approval of Utility Conservation Tariffs

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Commission Inquiry on Conservation Incentives

Participants engaged in policy development:

Utilities

- Avista Corporation
- Cascade Natural Gas Corporation
- Northwest Natural Gas Company
- PacifiCorp
- Puget Sound Energy

Ratepayer Advocates

- Industrial Customers of NW Utilities
- Northwest Industrial Gas Users
- Public Counsel, Office of the Attorney General

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Commission Inquiry on Conservation Incentives

Participants (cont):

Government

- Northwest Power and Conservation Council
- Staff, Washington State House of Representatives
- Staff, Washington State Senate
- Washington Department of Commerce
- Washington Department of Ecology

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Commission Inquiry on Conservation Incentives

Participants (cont):

Energy and Environmental Community

- Alliances Northwest
- Cost Management Services, Inc.
- Fluid Market Strategics
- Natural Resources Defense Council
- Northwest Energy Coalition
- Northwest Energy Efficiency Alliance
- OPower
- The Energy Project
- The Mountaineers

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Commission Inquiry on Conservation Incentives

PURPOSE:

- Better understand the balance between the recovery of a utility's lost revenue due to conservation and the benefits and costs to rate payers
- Examine possible conservation mechanisms and the pros and cons of each

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Commission Inquiry on Conservation Incentives

SPECIFIC ISSUES:

- The effects of conservation on utility service and revenues
- How “lost margin” may affect utilities’ conservation efforts
- What principles should govern recovery of lost margin
- What impacts recovery of lost margin may have on ratepayers
- What other regulatory incentives should be considered
- What options, other than regulatory incentives, exist for achieving conservation

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Commission Inquiry on Conservation Incentives

Commission Process:

- Initial framing of issues (comments from parties and Commission summary)
- Initial work session (May 4)
- Initial and reply comments
- Second work session (June 29)
- Final statements of positions on four issues:
  1. "Full decoupling"
  2. Recovery of "lost margin" due to conservation
  3. Direct incentives
  4. Independent administrator of conservation programs

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Commission Inquiry on Conservation Incentives

Procedural options for policy:

- Order in rate case or other adjudication
- Rule
- Policy Statement

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Setting of Rates

"In order to control aggregate revenue and set maximum rates, regulatory commissions such as the WUTC commonly use and apply the following equation:

R = O + B(r)

In this equation, R is the utility's allowed revenue requirements;

O is its operating expenses;

B is its rate base; and

r is the rate of return allowed on its rate base."

-- *POWER*, 104 Wn.2d at 808-09.

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Decoupling Background

- In setting rates, the Commission determines the utility's estimated future load.
- Actual load can vary from estimate, either up or down, based on a number of factors, including weather, economic factors, or consumer usage patterns.

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Decoupling Background (cont.)

- Therefore, a utility may sell more or fewer therms or kWH in a given period.
- Uncertainty is reflected in the utility's risk profile, which is taken into account when the Commission sets the utility's rate of return.

Setting of Rates – Fixed and Variable Costs

- A utility has fixed and variable costs.
- Many variable costs are covered by “tracker” mechanisms, such as the purchased gas adjustment (PGA) mechanism or an electric utility power cost adjustment mechanism (PCAs or ERMs).

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Setting of Rates – "Lost Margin"

- Utilities impose both a per customer (fixed) charge and a volumetric (variable) charge based on the amount of energy consumed.
- However, a utility does not cover all of its fixed costs with its per customer charges. For example, Northwest Natural Gas Company charges a per customer charge of $7.00, but its per customer fixed costs are closer to $22.

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Setting of Rates – "Lost Margin"

- The volumetric rate, which is based on the amount of energy consumed, includes a portion of the total fixed costs.

- If total usage equals the expected levels, the rate design allows for revenue sufficient to recover all costs and earn the authorized rate of return.

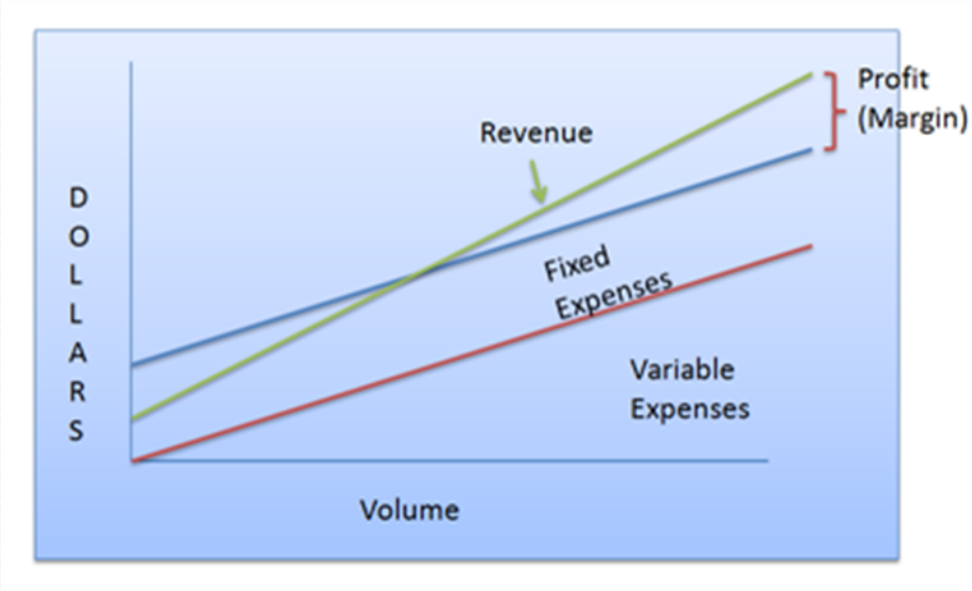
WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Setting of Rates – "Lost Margin" (cont.)

- If usage decreases:
  - the utility may not recover its full expected revenues, thus experiencing an erosion of its expected earnings.
  - Earnings erosion may result in not earning its authorized "rate of return." This is "lost margin."

Setting of Rates – "Lost Margin" (cont.)

- Lost Margin and Fixed costs: Revenues must be reduced to the point of "breakeven" before fixed costs are not recovered.



WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Setting of Rates – "Lost Margin" (cont.)

- Just as "lost margin" reduces a company's earnings, there are factors that generally increase a company's earnings between rate cases (sometimes termed "found margin").
- Examples include growth in customer base, increased plug load, or other increases in customer usage.

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Setting of Rates – "Lost Margin" (cont.)

- If usage increases:
  - the utility will recover its full expected revenues, plus it will experience increased earnings.
  - Greater earnings may result in earning more than its authorized "rate of return."

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Previous UTC Approved Decoupling Programs

- Avista
  - Allows recovery for Avista's programmatic and educational programs
  - Replaces pilot program
- Cascade
  - Pilot program to be evaluated in September 2010
- PSE PRAM (approved in 1991; terminated in 1996)

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Policy Options

Options considered:

1. "Full decoupling"
2. Recover "lost margin" due to conservation
3. Direct incentives
4. Independent administrator of conservation programs

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Decoupling Issues

Issues raised in Inquiry:

1. Offsets ("found margin")
2. Measurement (EM & V)
3. Impact on rate of return
4. Need in light of requirement to meet conservation goals
5. Earnings test
6. Other mechanisms to compensate for lost margin
   a. Incentive rate of return
   b. Pro forma adjustment to reflect future decrease in load

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Conservation Incentives

Threshold issues raised by stakeholders:

- Are direct incentives different from decoupling or lost margin recovery? Can they substitute for decoupling?
- Need for incentives if there is a mandate to acquire all “cost-effective” conservation?

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Conservation Incentives

Examples:

- PSE incentive mechanism
- Put conservation expenditures in rate base

Elements of UTC Policy Statement

Four topics:

1. Partial decoupling
2. Full decoupling (electric or gas utilities)
3. Direct incentives
4. Other

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Partial Decoupling

- Applicable to gas utilities only
- Reconciles only a percentage of the difference between expected and actual revenues (*i.e.* a utility might be allowed to recover 90 percent of revenue shortfall from decreased sales)
- Only the portion of decreased sales directly attributable to programmatic and non-programmatic conservation is eligible for recovery ("limited decoupling")
- "Found Margin"
- Earnings Test
- Impact on ROR

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Full Decoupling

- Applicable to both electric and gas utilities
- Reconciles any difference between expected and actual revenues regardless of the underlying cause of the difference
- “Found Margin”
- Earnings Test
- Impact on ROR

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Full Decoupling

- At this time, 12 states and the District of Columbia have adopted some form of full decoupling for electric utilities.
- Some state commissions have adjusted utilities' ROE to reflect reduced risk resulting from decoupling.
- Other commissions are considering adjustments to ROE in future rate cases.

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Direct Incentives

- I-937 requires utilities to set conservation targets every two years and to meet those targets within the following two year period.
- Commission receptive to proposals establishing incentives to utilities to acquire additional cost-effective conservation at levels exceeding these targets.

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Other

- Nothing in policy statement limits utilities ability to make other specific proposals.

WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

QUESTIONS?