



# ***Regulatory Issues for Consumer Advocates in Rate Design, Incentives & Energy Efficiency***



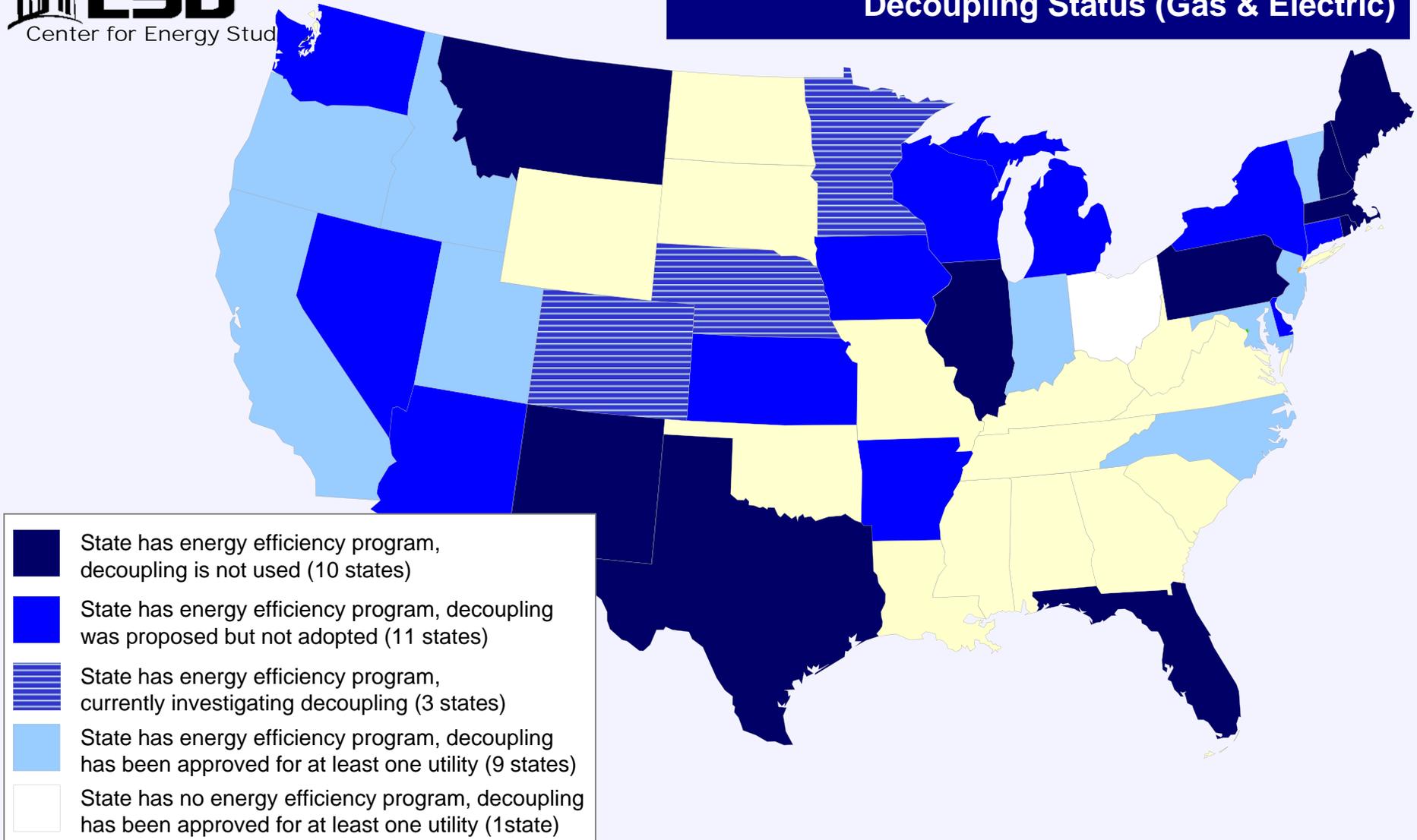
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**National Association of State Utility Consumer Advocates  
(NASUCA)  
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- Aligns utility incentives with energy efficiency.
- Assists utility in earning its authorized rate of return that is challenged by the decreasing use per customer problem (gas).
- Easier for customers to understand and reduces bill volatility.
- Reduces regulatory costs and the need for frequent rate cases.

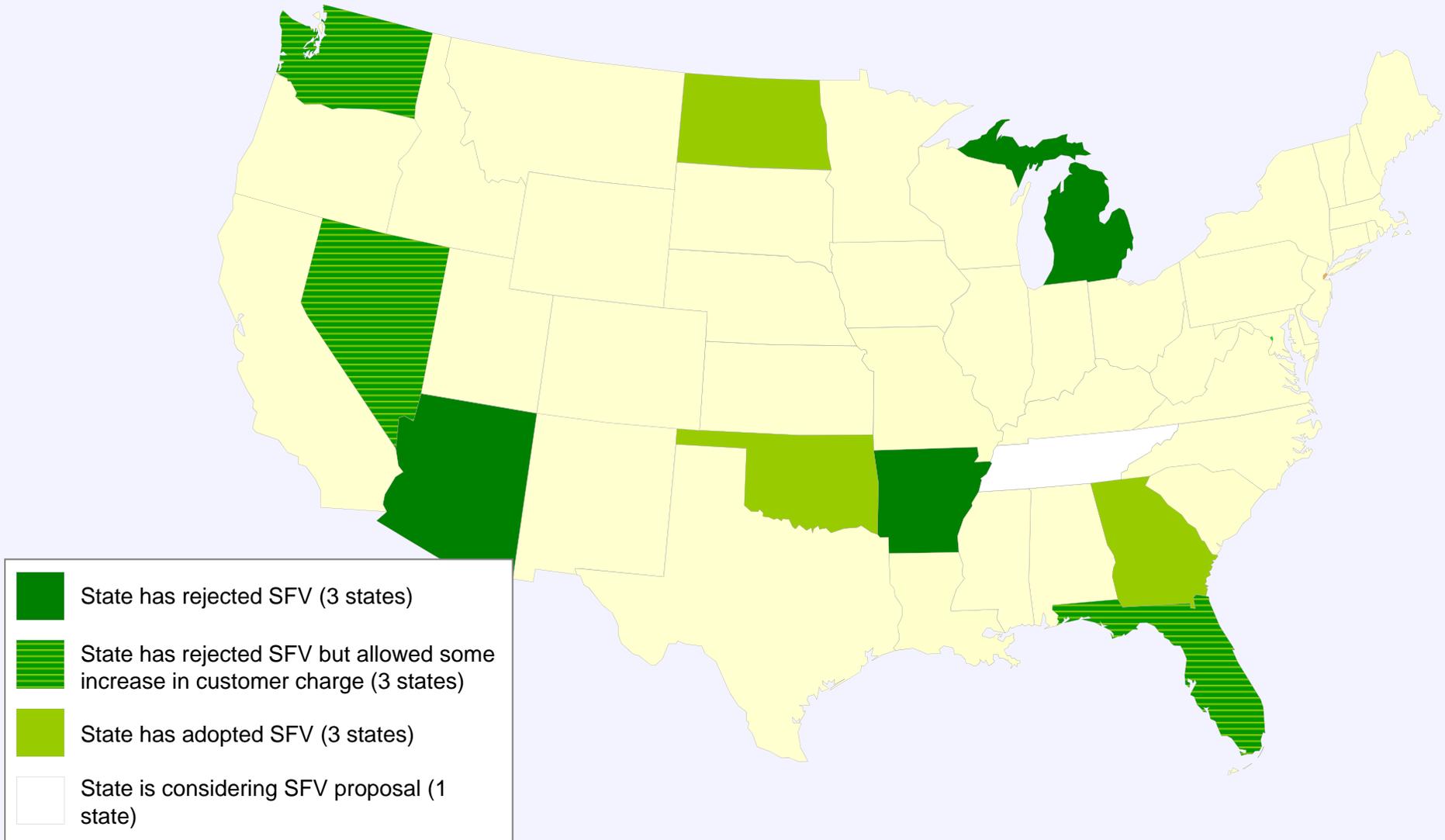
- Straight-Fixed Variable Rate Design: eliminates all variable distribution charges and DNG costs are recovered through a fixed delivery services charge or an increase in the fixed customer charge alone (gas LDCs).
- Sales-Revenue Decoupling: separates revenue recovery from sales (sets annual revenues to a “per-customer” target.) Can be done on a full or partial basis.
- Sales-Margin Decoupling: separates margin recovery from sales (sets margin per customer target). Can also be done on a full or partial basis.

## States with Energy Efficiency Programs – Decoupling Status (Gas & Electric)



Note: In Connecticut, the electric utilities do not have decoupling, but two natural gas LDCs have a partial decoupling mechanism in connection with their energy efficiency programs for low-income customers (a conservation adjustment mechanism). Washington has utilities with decoupling, but rejected the most recent utility proposal (January 2007). In Michigan, revenue decoupling was proposed by the Michigan Staff but opposed by the Michigan AG. The MPSC approved a stipulation that excluded revenue decoupling. In Kansas, revenue decoupling was proposed by Aquila. The parties involved agreed to a stipulation that excluded revenue decoupling while the Commission investigates it further in a general docket.

## States that have Considered SFV



Note: In Michigan, SFV was proposed by SEMCO Energy but opposed by the Michigan AG. The MPSC approved a stipulation that excluded SFV .

- Represents a significant departure from traditional regulation.
- Shifts sales risks from utilities to customers.
- The impact of changes in use per customer for the gas industry are overstated and address the wrong causes on changes in margins. Power industry faces an entirely different set of usage trends.
- At best, the incentive issue is not resolved and never can be with revenue decoupling.
- Current proposals, offered in conjunction with other “regulatory remedies” diminishes the simplicity argument and raises questions about the purpose of proposal.
- Proportionality issue – changing the rate design for all customers based upon programs for which an exceptionally small percentage of the customers will participate.
- Is actually contrary to “sound economic principles” and well-grounded regulatory policies.

# Risks that are Shifted to Ratepayers

**Economy**

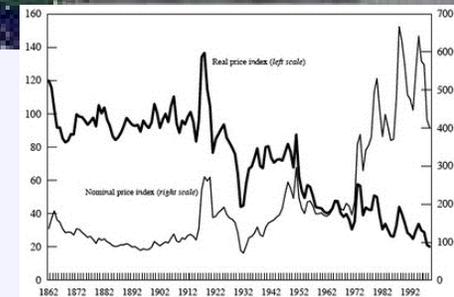


**Weather**

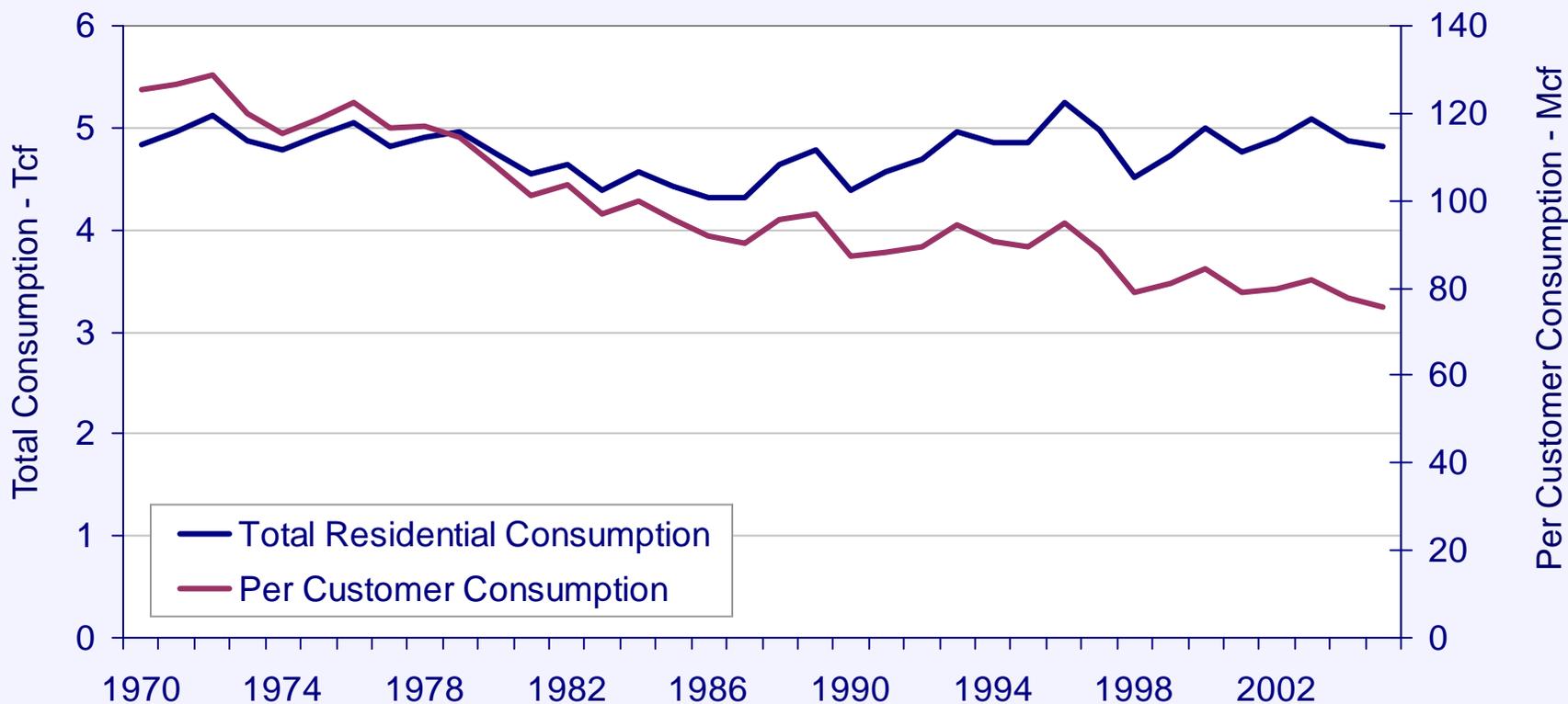


**Commodity Prices**

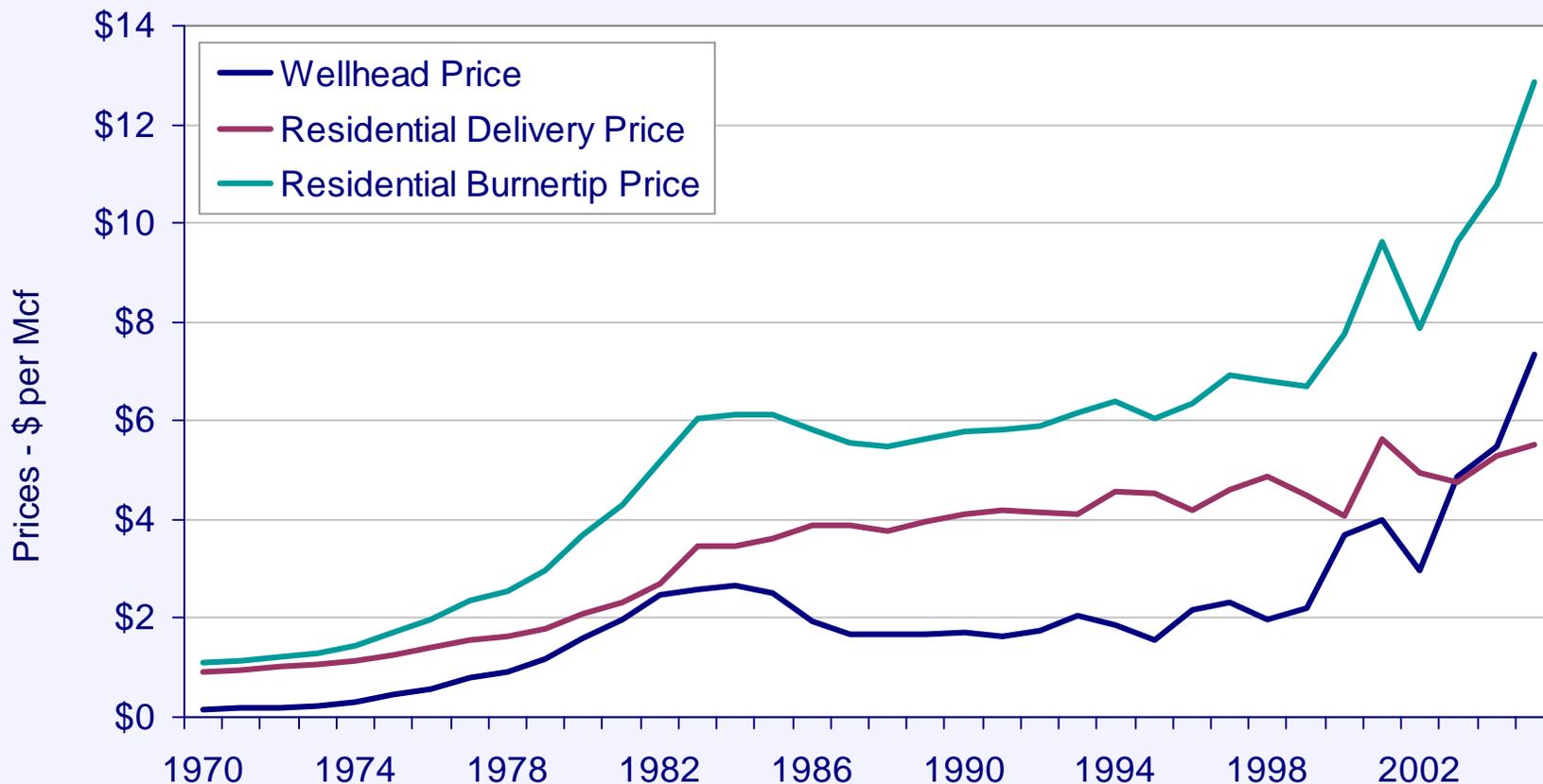
**Other Unanticipated Factors**



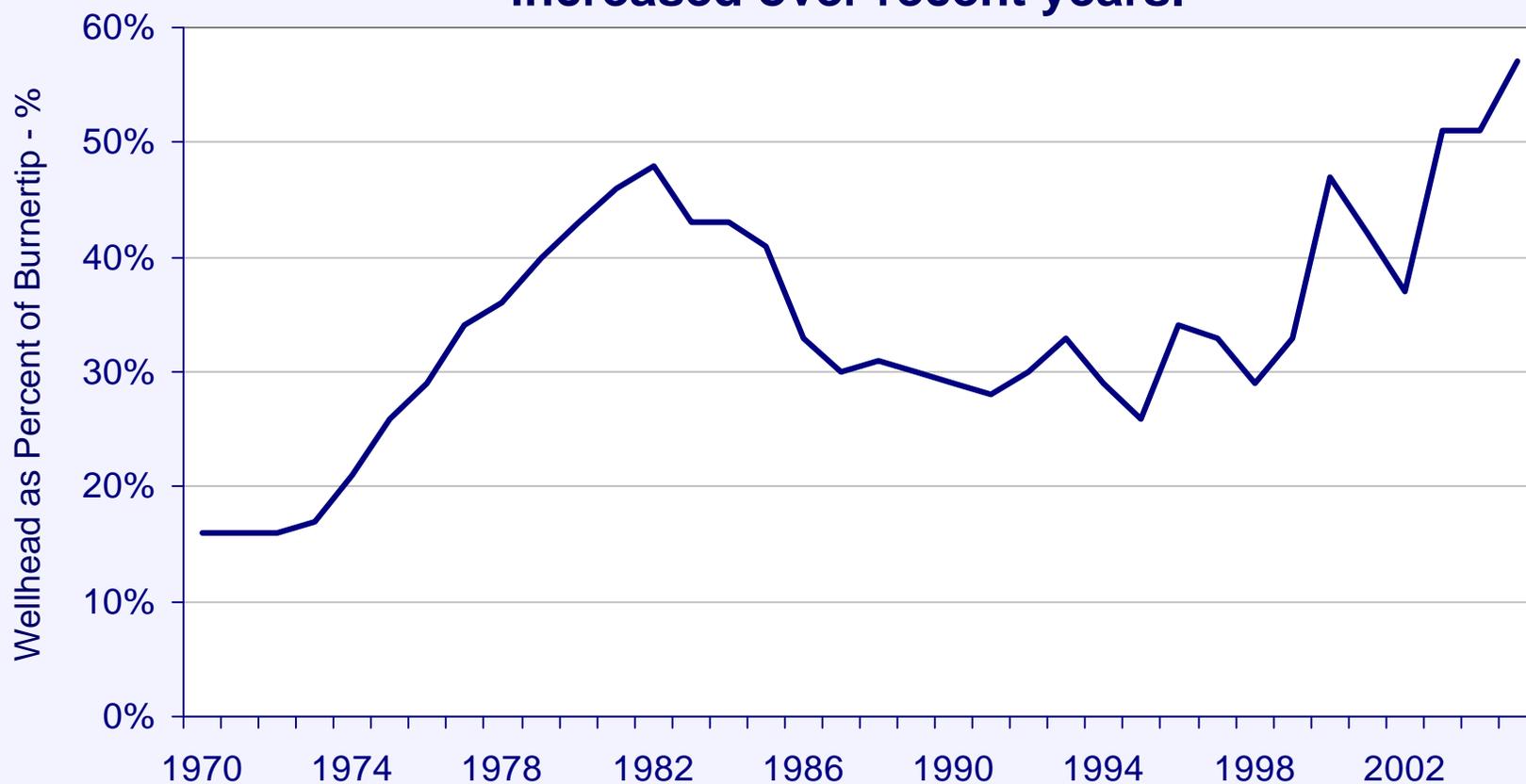
**While overall use per customer is decreasing, overall residential natural gas usage is flat to increasing.**



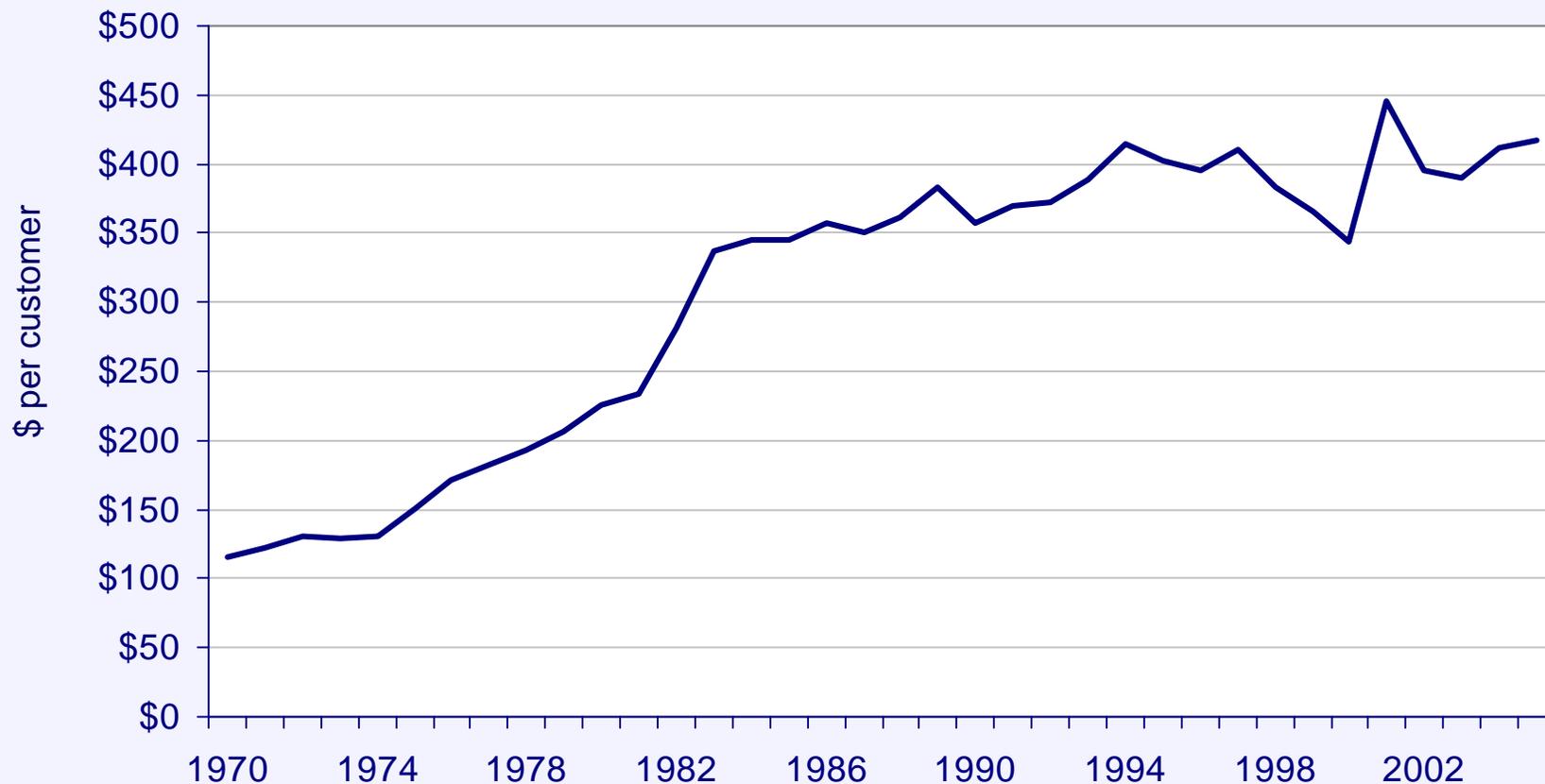
**Retail prices have increased significantly since 2000-2001.**



**The commodity share of overall natural gas rate has increased over recent years.**



**Yet despite high prices, and decreases in use per customer, overall DNG revenues per customer are at close to historic highs.**



Wild West LDC is facing significant growth challenges – ROE impacts of decreases in use per customer pale in comparison to change in rate base and new customer capital expenses.

	2001	2002	2003	2004	2005	2006
<b>Return on Equity</b>						
Allowed ROE	11.00%	11.00%	11.20%	11.20%	11.20%	11.20%
ROE Impact of Change in Use per Customer	0.00%	-0.60%	1.99%	-0.41%	-0.87%	-0.41%
ROE Impact Change in Customers	0.00%	1.04%	1.66%	1.17%	1.51%	1.51%
<b>ROE Impact Change in Expenses Rate Base and Capital Elements</b>	<b>-0.54%</b>	<b>-2.38%</b>	<b>-3.76%</b>	<b>-1.92%</b>	<b>-1.16%</b>	<b>-2.08%</b>
Actual Achieved ROE	10.46%	9.06%	11.09%	10.05%	10.68%	10.22%

Is decoupling a solution to the “use per customer problem” or an “end-run” on a rate case?

**Significant change in rate design for a very small change in overall sales and very limited number of customers.**

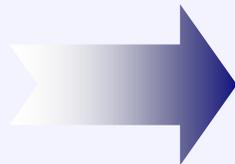
	Program Spending (million \$)	Percent of Retail Revenues (%)	Gas Savings (Mcf/year)	Percent of Gas Sales Saved (%)	Volume saved per million \$ (Mcf/year)	Benefit-Cost Ratio
Aquila	\$ 2.10	1.4%	146,000	0.5%	69,000	-
Centerpoint	\$ 5.60	0.5%	720,000	0.5%	128,600	2.60
Keyspan	\$ 12.00	1.0%	490,000	0.4%	41,000	3.00
Northwest Natural Gas	\$ 4.70	0.7%	85,000	0.1%	18,000	-
NSTAR	\$ 3.90	0.8%	71,500	0.2%	18,000	2.29
PG&E	\$ 13.50	0.4%	2,000,000	0.7%	148,000	2.10
PSE	\$ 3.80	0.4%	311,000	0.5%	82,275	1.93
SoCal Gas	\$ 21.00	0.6%	1,100,000	0.3%	52,000	2.67
Vermont Gas	\$ 1.10	1.6%	57,000	1.0%	52,000	5.60
Xcel Energy (MN)	\$ 4.00	0.7%	663,000	0.9%	166,000	1.56

**Generally, less than one-half of one percent.**

## Incremental Impact of DSM Implementation on Shareholders, Wild West Utility

	Change in Revenue			Income Impact			Shareholders Equity	Impact on ROE
	Use per Customer	DSM	New Customers	Use per Customer	DSM	New Customers		
2007	\$(1,971,361)	\$ (288,537)	\$ 7,052,203	\$(1,221,185)	\$ (178,738)	\$ 4,368,579	\$ 313,071,056	0.95%
2008	\$(2,905,519)	\$ (608,826)	\$ 6,391,367	\$(1,799,862)	\$ (377,145)	\$ 3,959,215	\$ 339,501,229	0.52%
2009	\$(4,485,340)	\$ (943,652)	\$ 6,213,829	\$(2,778,502)	\$ (584,557)	\$ 3,849,237	\$ 363,965,179	0.13%
<b>Total</b>	<b>\$(9,362,220)</b>	<b>\$(1,841,015)</b>	<b>\$ 19,657,399</b>	<b>\$(5,799,549)</b>	<b>\$(1,140,440)</b>	<b>\$ 12,177,031</b>		<b>1.61%</b>
							<b>Net Impact:</b>	<b>\$ 5,237,041.80</b>

### Exaggerated Example

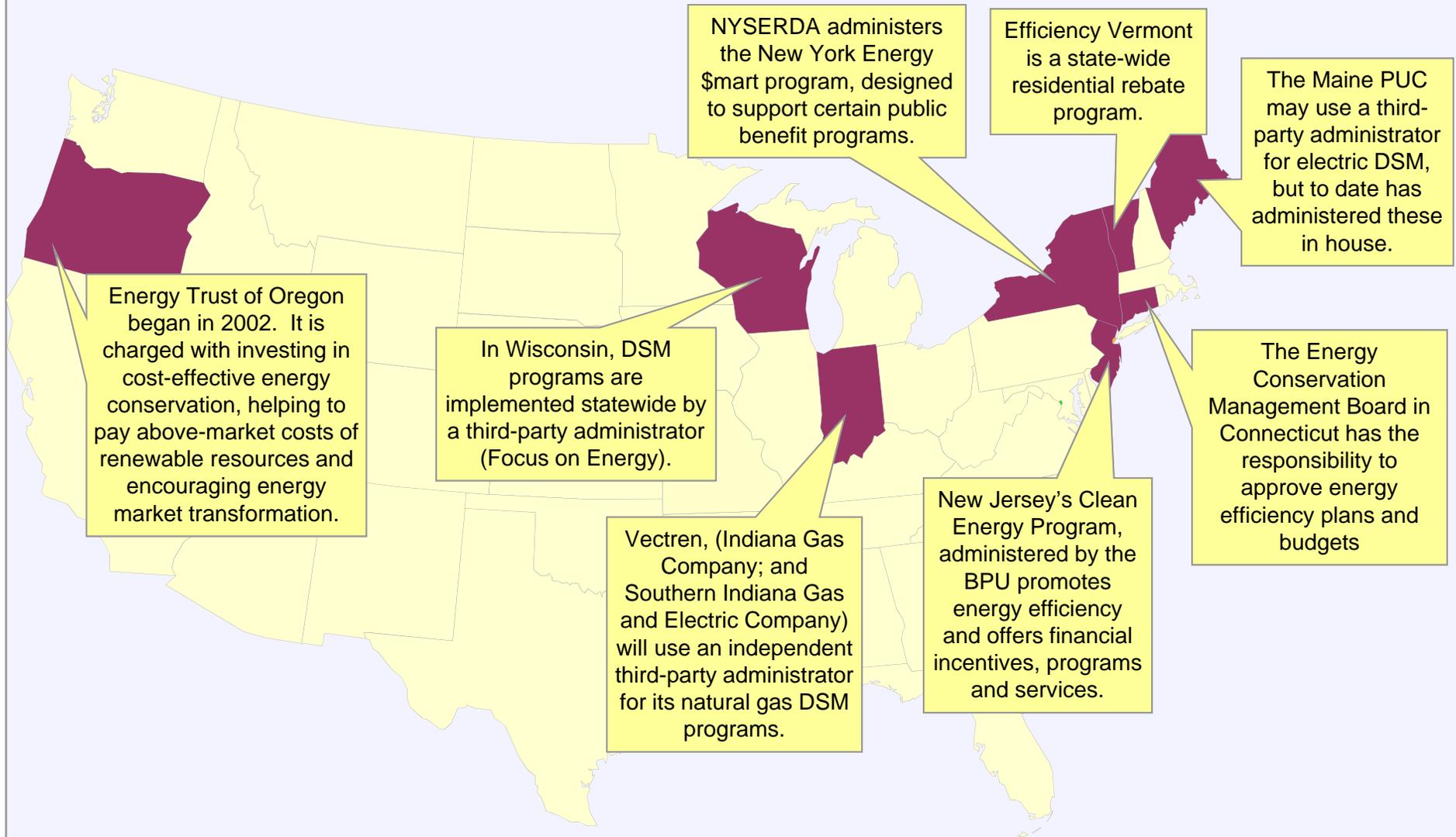


- Reduced revenues/income reduces overall taxes and needs to be considered.
- A one percent per year (3 percent cumulative) reduction is beyond current experience.
- The additional income created by customer growth from the test year is completely ignored (and its corresponding income effects).
- Net impact for a growing LDC is moderate – the net income impact is still positive, not negative.

- Reduces customers' ability to have full control of their energy savings. Reduces, in part, incentive to conserve particularly with SFV.
- If successful in reducing sales incentive, then also reduces incentive to measure sales losses and savings. You have "decoupled" DSM performance to any form of measurement.
- If successful in reducing sales incentive, then reduces incentive to promote efficient natural gas use and economic development.
- Revenues more difficult to estimate than costs, creating revenue certainty reduces incentive to push cost efficiency.

*George A. Schreiber, Jr., SEMCO Company President and Chief Executive Officer, said, "I am very pleased with the Company's results for 2006. We achieved these results, despite warmer-than-normal temperatures and continued customer conservation, which, when combined, adversely impacted 2006 earnings by an estimated \$3.5 million." Schreiber added, **"One way we overcame the impact of the weather and customer conservation was to keep spending under control."***

## States with Third-Party Administrators



- **Projected test years:** forecasts could account for anticipated energy efficiency savings.
- **Cost-effectiveness tests:** screening on RIM-passing measures only.
- **Lost Revenues (*ex post*):** periodic filings on proven, *ex post* lost revenues/sales.
- **Rate design (inclining blocks):** higher rates in upper blocks.
- **Repression adjustments:** usage adjustment to correct of DSM-related reductions in usage.
- **Direct Incentives:** performance-based incentives for programs.
- **Risk Management:** if volatility is an issue, then manage it.
- **More frequent rate cases:** traditional approach at correcting rates that get out of balance.

## Questions, Comments, & Discussion

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