Session Two

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

Comments of
Maurice Brubaker
Brubaker & Associates, Inc.
What is Revenue Decoupling?

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

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

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

Source: Docket No. UE-950618, Third Supplemental Order, September 21, 1995, pp. 3-5.
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

Source: Docket No. UE-950618, Third Supplemental Order, September 21, 1995, pp. 3-5.
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
- Limit percent increase allowable and amount of accrual
- Minimize number and scope of other adjustment mechanisms that are allowed