Usage-Based System Benefit Charges:  
The New Regulatory Imperative for Avoiding Stranded Benefits

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The nation's utilities generally are concerned that they could soon be plunged into a competitive arena dominated by short-term electric commodity prices. As a result, some utility managers have concluded that any investments that raise those prices -- however slightly -- could result instantly in the loss of customers and revenues. This helps account for utilities' nervousness about long-term investments of all kinds, and their particular concerns about electricity-saving and renewable energy initiatives. The result is large and growing "stranded benefits" from what would have been highly cost-effective investments. [NARUC made these points in a resolution passed unanimously at its November 1994 meeting; a copy is attached.]

The issue today is not whether utilities are right in their concerns about the future; NRDC, for example, continues to press for something much better. But no one can eliminate the threat overnight; it is now clear that the restructuring debate will extend over a period of years. State regulators need a near-term strategy that can sustain utilities' progress on crucial long-term investments while that debate proceeds.

The solution lies in converting cost recovery for energy efficiency, low-income services and R&D to a non-bypassable, usage-based "system benefits charge" on electric distribution services. Cost-effective renewable energy acquisitions should also qualify to the extent that their initial cost streams exceed short-term commodity costs. This would create a cost recovery structure that can accommodate strong performance-based incentives and retain consistency with all plausible restructuring outcomes. Washington's Utilities and Transportation Commission recognized as much recently when it approved Washington Water Power's proposal for a usage-based distribution charge to recover energy-efficiency investments.

The recommended cost-recovery system requires no change in current rates or rate structures. Utilities today typically recover "stranded benefits" charges from all distribution system users based on volume of consumption; they would continue to do so under the new system. The only difference is that state commissions would make explicit that distribution system users cannot bypass their share of contributions to stranded benefits by designating a new supplier of kilowatt-hours over the integrated grid (assuming that states ever decide to permit this). Questions and answers follow regarding implementation issues.
1. **Is this cost recovery approach consistent with the concept of energy-conservation as a least-cost resource for utilities?**

Certainly. Indeed, it is precisely the system-wide resource benefits delivered by cost-effective conservation that help justify its inclusion in a system benefits charge. The proposal is to change the characterization of cost recovery for conservation and other system-benefits investments, not to reconsider the rationales underlying those investments.

2. **Do states have authority to adopt such charges?**

FERC acknowledges state ratemaking authority over distribution services (the boundary between state-regulated distribution and FERC-regulated transmission is blurred, but no one disputes its existence). Retail voltage levels should be irrelevant for this purpose. The "stranded benefits" initiatives themselves, and cost recovery for them, have been mainstays of state utility regulation for more than a decade.

3. **Wouldn't these charges encourage bypass?**

Complete physical bypass of an integrated grid is both rare and costly; shifting the basis of cost recovery for "stranded benefits" certainly won't make it any more attractive than it is now (it just reclassifies costs that already are being recovered). Most talk of "bypass" today involves the retail wheeling variety, which does not involve physical disconnection from the grid and would not prevent collection of usage-based charges.

4. **How big would the charge have to be?**

That is a decision that should be made on the basis of each system's resource and other needs, but on average I would expect outcomes on the order of five percent of current bills. Utilities should invest no more -- and no less -- than is needed to minimize system-wide life-cycle costs of reliable energy services.

5. **Isn't this just a new tax for social programs?**

No -- state commissions are dealing here with cost recovery for investments that are crucial to sustaining high quality electric service. States can and should continue to build in strong performance-based incentives to deliver system value at least cost. In general, non-bypassable charges should be reserved for investments that can be shown to represent potential "stranded benefits" for electrical systems.

6. **Does a system benefits charge require a change in current practice for amortizing conservation costs or assigning them to customer classes?**

No; such an approach can be adapted to either multi-year amortization of costs or year-by-year expensing, and it need not affect current cost allocations.

7. **Does adopting the charge signal a preference for or against retail wheeling?**

No. It signals only a strong preference for avoiding stranded benefits in an era of widespread uncertainty about the electric industry's ultimate structure.
RESOLUTION ON COMPETITION, THE PUBLIC INTEREST, AND POTENTIALLY STRANDED BENEFITS

WHEREAS, state and federal electric utility regulators are exploring the restructuring of the electric utility industry so as to provide lower energy service costs and greater consumer choice through the enhanced use of competition and market mechanisms; and

WHEREAS, the laws and traditions of electric utility regulation have long recognized the electric industry as a critical element of national infrastructure greatly affected with the public interest; and

WHEREAS, the franchise system of regulation has encouraged electric utilities, pursuant to state laws, to secure important public benefits in the provision of utility services, including:
- system reliability and fuel diversity;
- responsible management of the environmental impacts of electric generation;
- the promotion of systematic investments in energy efficiency, thus improving the nation’s energy security and lowering energy costs to the nation’s economy;
- innovative rate designs that have served national and state objectives in such areas as rate stability, equity, economic development, and meeting the specific needs of low-income customers;
- a system of support for research and development for the electric industry; and
- investments in commercialization strategies to speed growth in markets for renewable energy technologies; and

WHEREAS, utility-sponsored energy efficiency programs have become a significant element of the nation’s energy policy (according to the Energy Information Administration, by 1993, cost-effective utility DSM programs provided over 20,000 megawatts of peak load reduction and saved more than 40 million megawatt-hours annually, and such programs were growing at more than 20 percent annually) and utility-sponsored programs were expected to provide a majority of the national goals for energy efficiency savings set out in the 1992 National Energy Strategy; and

WHEREAS, these widespread public benefits could be undermined or lost unless integrated into new proposals which are being developed for a more competitive marketplace; and

WHEREAS, it is the responsibility of state and federal electric utility regulators to assure that these vital public benefits are not "stranded", but are well-served in new electric industry structures and in the transition to them; and

WHEREAS, public utility commissions will generally have the authority and the responsibility to protect these vital interests through (a) new regulatory regimes for assuring that increased competition is both fair and free of major market
imperfections and (b) continued regulation of those sectors of the industry that may remain natural monopolies, such as distribution and transmission activities: now therefore be it

RESOLVED by the National Association of Regulatory Utility Commissioners at its 106th Annual Convention in Reno, Nevada, that a fundamental responsibility of state and federal electric utility regulators in this transition period is to assure that vital public interests and established public benefits will be preserved in any restructuring of the electric utility industry; and be it further

RESOLVED that NARUC shall communicate to the Federal Energy Regulatory Commission, Congress, Department of Energy, and other responsible federal agencies the conviction that any federal actions taken with respect to electric industry competition and restructuring must not foreclose the ability of the states and state regulatory commissions to secure these public benefits within the several states; and be it further

RESOLVED that, in their individual deliberations over the restructuring of the electric industry, state and federal regulators are encouraged to establish the criteria by which alternative proposals are to be judged, and that these criteria should include: reliability and fuel diversity, environmental protection, energy efficiency, equity, economic development, the needs of low-income customers, and research and development; and be it further

RESOLVED that the members of NARUC are committed to promote these criteria in cooperation with federal regulators and state legislatures to further the long-term public interests of both the nation and individual states.

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