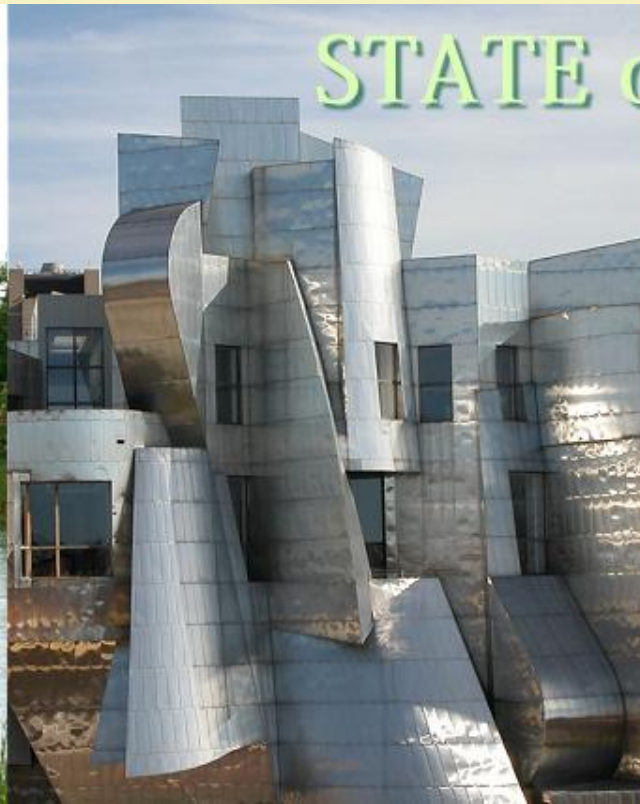


Decoupling and Regulatory Incentives for Energy Efficiency in the Midwest



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Aligning Utility Financial Interest with the Public Interest

- All Regulation is Incentive Regulation.
- Traditionally utility rate structures have been designed to promote the consumption of more energy by customers.
 - Inhibits a company from supporting investment in and use of least-cost energy resources, when they are most efficient.
 - Encourages the company to promote incremental sales, even when they are wasteful.
- Ratemaking policy should align utilities' profit motives with public policy goals of acquiring all cost-effective resources whether supply or demand.

Alternatives to Addressing Utility Profit Loss

- Lost Margin Recovery Mechanisms
- Rate of Return Incentives
- Shared Savings Mechanisms
- Fixed/Variable Rate Design
- Real-Time Pricing
- Moving Efficiency Outside the Utility

Lost Margin Recovery Mechanisms

- Minnesota had a “*Lost Margin Recovery Incentive*” in the 1990’s.
 - All sales reductions resulting from utility-funded EE offset by a surcharge reflecting lost margins
- Because lost-margin recovery was cumulative, utilities began recovering financial incentives that were greater than their actual conservation expenditures.
- This, in effect, doubled the cost of conservation to the ratepayer. By 1998 the lost margins were up to \$40 million a year.
 - Does not remove sales incentive. Utility profits still grow when sales increase.
 - Does not change fundamental financial risk of utility

Shared Savings Incentive

- In 1998, after nearly a year of prolonged negotiations among all the interest groups, a “*Shared-Savings Financial Incentive*” was submitted to the Commission as a settlement.
- Codified in Statute (*Energy Conservation Improvement and Incentive Plan for Energy Conservation*).
 - Conservation investments dropped immediately after Lost Margin Recovery was ceased but soon recovered.
 - Conservation investments have remained stable and appear to be cost-effective.
- The incentive should be structured to increase the incentive for behavior that you want, such as increased energy savings and increased cost-effectiveness.

Shared Savings Incentive-Details

- Utilities are rewarded with a specific percentage of the net benefits created by actual investments in conservation.
- The percentage of net benefits awarded increases as the percentage of energy-savings goal achieved increases.
 - The incentive is calibrated such that at 150% of the energy-savings goal, the utility would receive about 30% of the utility's conservation expenditure budget
 - Utilities are also rewarded for delivering their programs more cost-effectively. This occurs because more net benefits are created when actual costs are lower than projected.

Conservation Spending Requirement (CIP)

- Together with the Shared Saving Incentive (1998), Minnesota established a spending and investment requirement for energy conservation improvements (CIP).
 - For Gas Utility—0.5 % of gross operating revenues.
 - For Electric Utility—1.5% of gross operating revenues
 - For Electric Utility that operates a nuclear-powered plant (Xcel Energy)—2% of gross operating revenues
 - For Coops and Municipals—0.5% of gross operating revenues from sale of gas and 1.5% gross operating revenues from sale of electricity; for Cooperative electric association, 1.5% of gross operating revenues from service provided in the state

Demand Efficiency Program (DEP)

- 2007 Minnesota Energy Efficiency legislation replaces the CIP Program with an “*Energy Efficiency Savings Standard*” called the “*Demand Efficiency Program*” (*DEP*)
 - *DEP* is to achieve energy savings according to a specified schedule.
 - DEP allows utilities to include the costs of Demand Efficiency Programs in their conservation financial incentive plans, and authorizes the Commission to establish, by order, criteria and standards for decoupling of energy sales from revenues, as well as to approve utility decoupling pilot proposals.

Demand Efficiency Program--Details

- Converts Minnesota's Conservation Program (CIP) from *spending* based to realized *savings*.
- Sets an energy savings goal of 1.5 percent of gross retail energy sales annually beginning in 2010.
- It is to be calculated on the most recent 3-year weather normalized average.
 - It is to be accomplished through conservation programs, rate design and “other methods”
 - It requires an inventory of most effective conservation programs and technologies to guide utilities
 - It allows for the award of grants for R&D that identify new energy conservation technologies and strategies

More Details

- Allows for recovery of costs.
- Requires the PUC to review incentive plans associated with CIP and adjust incentives in light of revised energy savings goals.
- Provides that utilities may propose to implement qualifying customer-based programs that achieve one percent savings, and may propose system infrastructure improvements that create additional savings to help achieve the overall state goal.
 - In contrast, the existing CIP program would achieve estimated annual savings of approximately 0.8 percent of retail electric sales

Standards and Criteria for Decoupling

- The 2007 Minnesota Energy Efficiency Legislation requires the Commission to establish criteria and standards for decoupling to mitigate the impact on public utilities of the energy savings goals required under DEP “*without adversely affecting the utility ratepayers*”.
 - Does not mandate Decoupling, but authorized the PUC to approve 3 year decoupling pilot programs proposed by regulated utilities consistent with the criteria and standards established.
 - PUC hired a consultant to facilitate our exploration of this topic who prepared a Report which addressed design criteria, policy options and how to measure the success of any of the pilots approved.

Commission Establishment of Criteria and Standards for Decoupling

- In April 2008, The Commission with the assistance of RAP convened stakeholder workshops to discuss criteria and standards for revenue decoupling.
- In July 2008 the Commission solicited comments on what criteria and standards should be established regarding decoupling.
- In May 2009 the Omnibus Energy Bill was enacted providing procedural options to the Commission for establishing criteria and stands under that Act:
 - *Decoupling criteria. The commission shall, by order, establish criteria and standards for decoupling. The commission may establish these criteria and standards in a separate proceeding or in a general rate case or other proceeding in which it approves a pilot program, and shall design the criteria and standards to mitigate the impact on public utilities on the energy savings goals under section 216B.241 with out adversely affecting utility ratepayers. In designing the criteria, the commission shall consider energy efficiency, weather, and cost of capital, among other factors. (216B.2412 Minn. Laws 2009)*

Commission Action

- All utility decoupling pilot proposals under Minn. Stat. 216B.2412 shall provide the following information in the initial filing:
 - Purpose: All utilities shall state how their proposed decoupling mechanism adheres to the guiding statute.
 - Form: All utilities shall state the form of decoupling proposed and the purpose behind such choice.....
 - Cost of Capital: All utilities shall detail how their proposed mechanism will/will not impact the company's cost of capital...
 - Classes Included: All utilities must identify the rate classes involved in the pilot as well as provide rationale for the inclusion of participating classes and the exclusion, if any, of other classes.
 - Mechanics.: All utilities must provide precise detail on how the decoupling mechanism will operate ...be transparent and easy to follow from a customer perspective

Commission Action, Con't

- Service Quality: All utilities must provide detail on..on how the utility plans to measure and maintain service quality under the pilot program...
- Review: All utility pilot proposals shall be reviewed yearly. If the Commission determines that the pilot is harming ratepayers and/or failing to meet objectives, the Commission may suspend the pilot at any time or recommended modifications....
- Pilot Implementation: ...All utilities shall file a non-binding notice of intent as to their plans for filing a decoupling pilot by June 1, 2010..All pilot proposals shall be filed by December 30, 2011

First Decoupling Pilot Project Approved in Minnesota

- On January 11, 2010, the Commission authorized as a pilot project a partial decoupling plan for CenterPoint Energy.
 - The decoupling plan was a stipulation that modified CenterPoint Energy's decoupling plan which was filed with its rate case.
 - The parties to the stipulation included, CenterPoint Energy, Energy Cents Coalition (a low income ratepayer advocacy group), and the Minnesota Center for Environmental Advocacy/Izaak Walton League (two environmental advocacy groups).

The Decoupling Pilot Specifics

- The Stipulation included a mechanism to recover without filing a rate case, financial losses due to reduced sales resulting from all factors other than abnormally warm weather, including economic conditions, rising gas costs, and increased building code and appliance standards.
- It also included an agreement for an inverted block rate design for gas costs, a rate cap on the annual rate adjustment for four percent upward or downward, and the impact of that program on cost of capital.

Other Provisions in the Stipulation

- The stipulation specified that no adjustment to the Company's authorized cost of capital would be appropriate as a result of the decoupling program
- The stipulating parties supported the company's proposed Residential and Commercial/Industrial rate design and supported a residential monthly basic charge of \$8.00.
- The stipulation provided that the decoupling adjustment on a volumetric basis would be included on the customers bill as part of the delivery charge and not displayed as a separate line item on the customer bill. (*The Commission did not adopt this provision and required CenterPoint to alter the Program so that this adjustment would appear on customer bills as a separate line item.*)
- It required the parties to work cooperatively to identify and implement new conservation programs, modifications to existing programs and new delivery mechanisms..

Commission's Conclusions

- The Commission found that “*the Stipulating Parties’ pilot Decoupling Program, as modified in this Order, fully meets the Legislature’s directive for a decoupling program by separating the Company’s sales from revenues, in order to remove the disincentive for the Company to pursue conservation , while not adversely impacting ratepayers. It will open the door to great conservation and provide not ratepayer benefits.*” (Order in Docket G-008/GR-08-1075, January 11, 2010)
- The Company’s Pilot Decoupling Program will allow the Commission to determine, as the legislature has directed, whether a rate-decoupling strategy achieves energy savings and net ratepayer benefits.

Amending the Regulatory Compact?

- Regulators must be careful in choosing and implementing changes to electric utility rate-making formulas. Proper balance must be found to: Offer large enough incentives to achieve efficiency
- Encourage productive new uses of electricity
- Prevent unnecessarily high rates from undue utility profits
- Avoid undue regulatory discretion
- Eliminate biases from forecast errors, fuel price fluctuations, and weather fluctuations
- Minimize administrative burden
- Ensure public acceptance.

Midwest Governors GHG Accord Energy Efficiency Advisory Group and Roadmap

- Ten Midwestern governors (MN, WI, IL, IN, IA, MI, KS OH, SD) and the Premier of Manitoba signed the Midwestern Regional Greenhouse Gas Reduction Accord.
 - to serve as a regional strategy to achieve energy security and reduce greenhouse gas emissions that cause global warming.
 - central to the MGA Accord was the development of Energy Efficiency Policy Options

MGA Energy Efficiency Advisory Group Recommendations

- MGA State should pursue policies and programs that result in a 2% reduction in energy use from natural gas and electricity per year from a 3 year rolling average base period, if cost effective.
 - The 2% reduction in energy use will come from application of a full suite of policy options
 - Includes building codes, appliance standards government lead by example programs, and aggressive new partnerships to engage all stakeholders in reducing energy use.

Implementation Mechanisms

- State/provinces should commit to implementing all “*cost-effective energy efficiency measures*”
 - is defined to mean all EE measures whose benefits outweigh their costs, where costs are determined via “total resource cost” (TRC) assessments.
 - “Cost” is defined as the sum of EE Program costs and the incremental cost of EE measure compared to standard practice (BAU)

Implementation

- In October, 2009 at MGA Jobs and Energy Summit in Detroit, MI the Roadmap was released and hopefully will be adopted by the participating state governors.

Increasing Energy Efficiency is our Cleanest, Cheapest, Least Risky, and Least Controversial Energy Resource.

- Saves consumers and businesses money on their energy bills
- Reduces dependence on imported fuel sources
- Reduces vulnerability to energy price spikes
- Reduces peak demand and improves the utilization of the electricity system
- Reduces the risk of power shortages
- Stimulates economic development
- Reduces water consumption by power plants
- Reduces GHG and other pollutant emissions by power plants and improves public health