

Governor's Energy Policy Council

Staff Research Brief

Alternative Utility Regulation

What is Alternative Utility Regulation?

Alternative utility regulation, sometimes called “decoupling,” refers to a range of regulatory practices designed to better align utility investment incentives with the state’s strategic goals of increasing energy efficiency and ensuring reliable and affordable energy with the smallest possible environmental impact.

Traditional ratemaking procedures link a utility’s health to the volume of electricity or gas it sells. Alternative regulation allows utilities to consider energy efficiency options by reducing the dependence of utility revenues (and shareholder profits) on unit sales. By fixing revenues to other criteria, such as the number of customers, utilities receive fixed revenues and can increase profits by operating more efficiently and/or reducing their costs. This enables options that pass the Total Resource Cost¹ test and benefit the state as a whole to also benefit the utility and its shareholders.

Three classes of regulatory practices could be considered:

1) Reduce the Throughput Incentive

Link revenue to customers rather than sales

During each rate case, the Public Service Commission would establish a revenue cap per customer, with a mechanism to adjust for the addition or departure of customers. Under this paradigm, the utility’s revenues do not fluctuate with sales, and the fixed revenue cap allows utilities to increase profits by operating more efficiently (i.e. reducing costs).

2) Provide Funding for Energy Efficiency Programs

Efficiency as Qualified Resource

During the Integrated Resource Planning process, regulators can set clear expectations that efficiency is a resource to be procured like any supply-side option, and “prudent” costs are recovered in the rate base.

Efficiency Spending Budget

Regulators can determine a percentage of utility revenues to invest in energy efficiency programs.

3) Provide Incentives for Energy Efficiency

Capitalize Energy Efficiency Expenses

Treating energy efficiency investments as capital investments allows costs to be recovered over longer periods of time. This may slightly increase the overall costs of the measures, but it

¹ In its 2004 Integrated Resource filing, Georgia Power described Total Resource Cost as determining “whether all ratepayers, in the aggregate, are better off with the measure. A measure would pass the TRC if it benefits participants more than it costs non-participants.” (2-8)

significantly reduces the rate impact. This process could also increase the number of energy efficiency measures that pass cost effectiveness tests used by regulatory bodies to analyze resource acquisition options.

Bonus-Return, Shared Savings

Regulators can authorize a slightly higher return on investment (ROI) for energy efficiency investments when compared with other capital investments. An alternative is to share the value of the energy savings with the utility. Both of these incentives are linked to actual performance of the programs.

Why is it relevant to State Energy Strategy for Georgia?

The State Energy Strategy emphasizes the value of improving energy efficiency in Georgia. Utilities are key partners in the delivery of energy efficiency programs and services but currently have little or no incentive to deliver them to their customers. Creating appropriate incentives for the utilities to offer energy efficiency services can improve the deployment of energy efficiency throughout Georgia.

How is it implemented?

For investor owned utilities, the Public Service Commission would examine different alternative regulatory practices to determine which make sense for Georgia's circumstances.

What is the potential?

The *Assessment of Energy Efficiency Potential in Georgia* estimated that cost effective energy efficiency could reduce Georgians' energy consumption by approximately 6-8%. Comparable studies from other states and regions of the country identify even greater ranges of energy efficiency potential. Utilities with appropriate incentives could achieve this potential. Since alternative utility regulation would affect only the investor owned utility in Georgia, the actual kWh savings and demand reduction would be approximately two-thirds the number listed in the report (since Georgia Power's energy sales account for approximately 60% of the retail sales in the state). This new environment could help to reduce the size and number of new conventional generation plants required and thereby reduce their demands on air, land and water resources.

How is this issue perceived by stakeholders in the State?

The Georgia Public Service Commission submitted comments to the State Energy Strategy indicating that they had examined alternative deregulation practices in 1994 and that stakeholders suggested regulatory changes were not needed. Investor owned utilities do not favor any changes in the regulatory environment. Electric membership cooperatives and municipal gas and electric utilities oppose any regulatory direction from entities other than their boards or local governments. Proponents of energy efficiency programs suggest that utilities have a financial disincentive to offer these programs and continue to favor supply side options as a result of signals provided by the regulatory structure.

What are other states doing in this regard?

Five states have a decoupling mechanism in place for one or more utility types (natural gas and electric): Maryland, Vermont, New Mexico, California and Oregon.

- **New Mexico's** Efficient Use of Energy Act of 2005 states: "It serves the public interest to support public utility investments in cost-effective energy efficiency and load management by removing any regulatory disincentives that might exist and allowing recovery of costs for reasonable and prudently incurred expenses of energy efficiency and load management programs."
- In **Maryland**, Baltimore Gas and Electric has operated with decoupling for more than seven years, using a revenue cap per customer with a monthly true-up to adjust for new and departing customers.
- **Oregon** and **Vermont** allow capitalization of energy efficiency investments.

Several other states offer incentives for energy efficiency programs:

- **Connecticut** provides utilities with "performance management fees" based upon the actual impact of energy efficiency programs.
- **Nevada** offers a higher return on investment (+5%) for energy efficiency programs than for supply side investments.

Are there relevant federal and/or regional policies or projects that impact this issue?

The U.S. Environmental Protection Agency recently coordinated the *National Plan for Energy Efficiency* with the stated purpose of "creat[ing] a sustainable aggressive national commitment to energy efficiency through gas and electric utilities, utility regulators and partner organizations." Southern Company was among the 50 participants and signatories to the plan that is being used within many states as the framework for increasing the delivery of energy efficiency to utility customers. The National Action Plan closely examines alternative utility regulation.