

Decoupling & DSM Performance Incentives

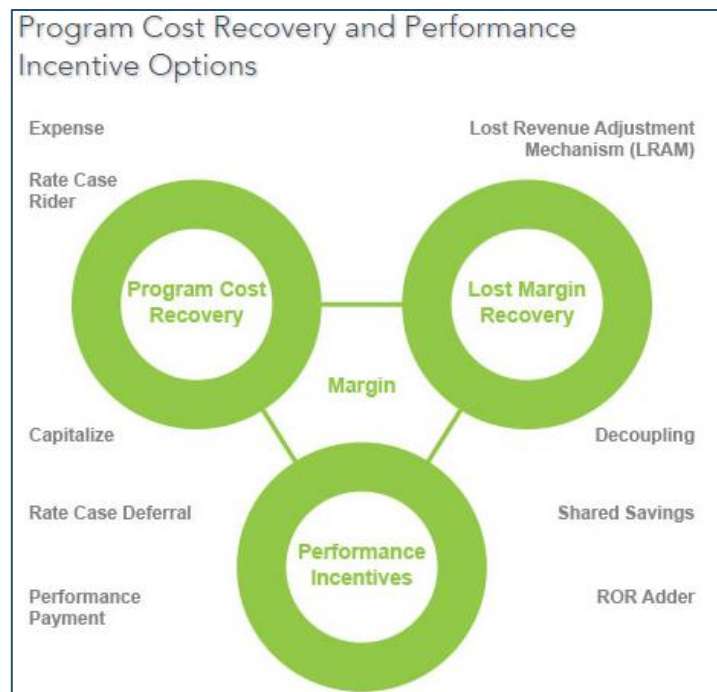
Description:

Decoupling of utility revenue from sales removes a disincentive for utilities to invest in energy efficiency. Broadly, decoupling refers to a process by which a utility commission grants a utility a level of return on equity that is not dependent on volumetric sales.

Discussion of the Policy:

By separating utility revenues from kilowatt hour (kWh) sales, the process of decoupling sets the Rate of Return (RoR) for the utility and adjusts the kWh rate for the customer to ensure the recovery of that return. This rate adjustment mechanism can be moved up or down to achieve the approved utility RoR. In this way, decoupling removes the disincentive for utilities to implement energy efficiency versus generating and selling that energy to customers.

Decoupling is sometimes achieved in the form of a Lost Revenue Adjustment Mechanism (LRAM). With a LRAM, the state utilities commission determines the volume of declining sales attributed to energy efficiency programs and calculates the marginal revenues lost to the utility due to those measures. The utility is then able to collect the lost revenue through an LRAM “rider” on utility bills.

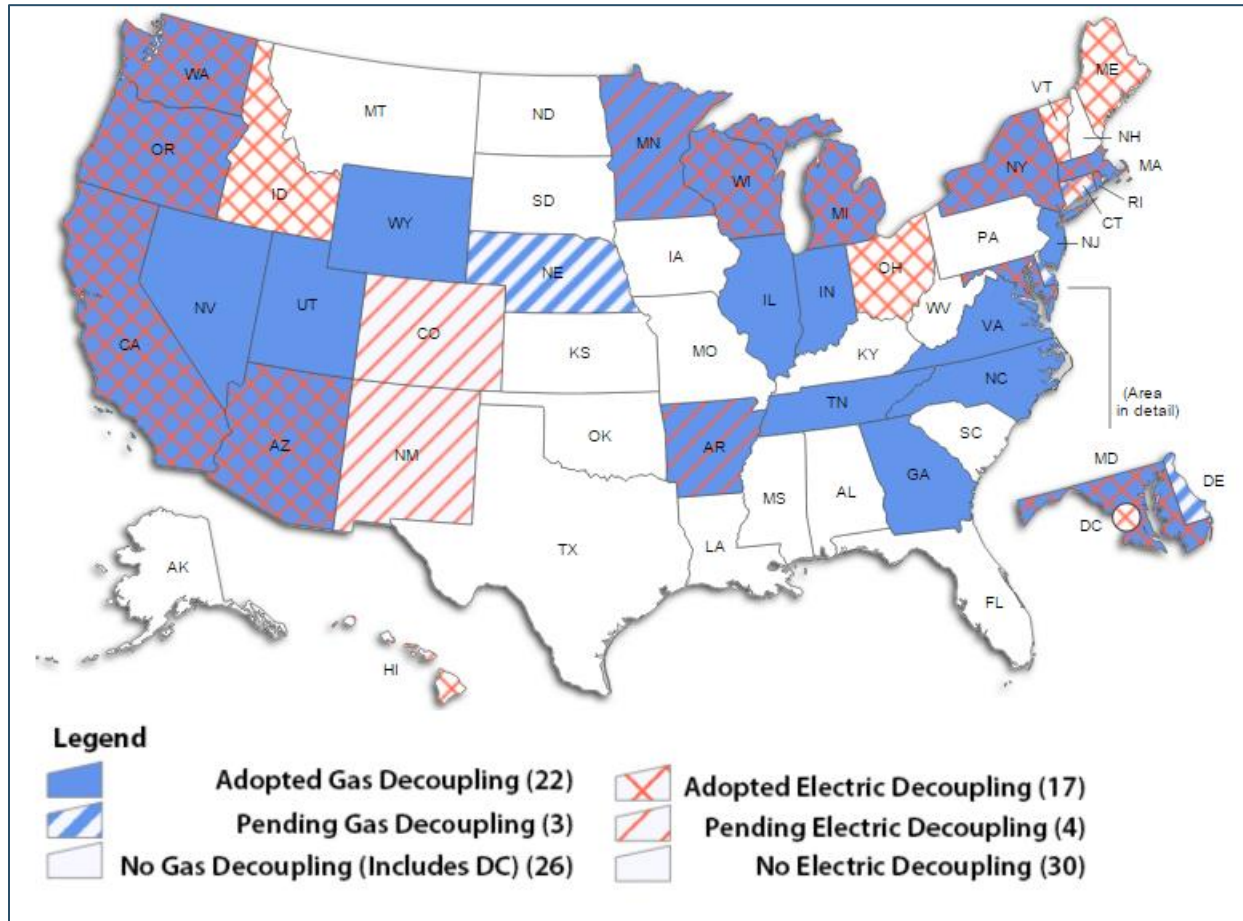


Source: [American Electric Power](http://www.aep.com)

Decoupling is really only one leg of a three-piece policy stool for motivating utilities to invest in energy efficiency (see diagram above). Timely and full recovery for the cost of Demand Side Management (DSM) program administrative and customer incentives is another key piece. The final, and perhaps the most important aspect is some form of incentive for the utilities to invest, or a performance incentive. This performance incentive can take the form of a net economic benefit adder or a percentage bump in a regulated RoR. The important thing to note is that all three legs of the stool need to be in place for successful DSM program implementation.

Example State Programs:

At least 26 states have adopted some form of decoupling for electric utilities, natural gas utilities, or both.



Source: NRDC, <http://www.nrdc.org/energy/decoupling/>

- Hawaii.gov: Decoupling:
<http://cca.hawaii.gov/dca/electric/decoupling/>
- Pacific Gas and Electric:
<http://www.pge.com/en/myhome/saveenergymoney/plans/rateanalysis/howwemakemoney/index.page>

Key Components:

- Program Cost Recovery.
- Lost Revenue Incentive Mechanism.
- Utility Performance Incentive.

More Information:

- NARUC, Decoupling For Electric & Gas Utilities, Frequently Asked Questions:
<http://pubs.naruc.org/pub/536EF203-2354-D714-51DC-D6E578C43238>
- American Council for an Energy-Efficient Economy (ACEEE), Incentivizing Utility-Led Efficiency Programs: Lost Margin Recovery webpage:
<http://www.aceee.org/sector/state-policy/toolkit/utility-programs/lost-margin-recovery>
- Edison Electric Institute, Alternative Regulation for Evolving Utility Challenges paper:
http://www.eei.org/issuesandpolicy/stateregulation/Documents/innovative_regulation_survey.pdf
- Edison Foundation State Electric Efficiency Regulatory Frameworks IEI report:
http://www.edisonfoundation.net/iei/Documents/IEI_stateEEpolicyupdate_1214.pdf
- Regulatory Assistance Project, A Decade of Decoupling for US Energy Utilities: Rate Impacts, Designs, and Observations paper:
<http://www.raponline.org/document/download/id/6356>