

Utility-Sponsored Renewable & Efficiency Program Ratemaking

Introduction

Today, energy efficiency programs for new and existing buildings (including industrial equipment) are often operated or funded by utilities, as mandated by legislation, their utility commissions, or public utility governing bodies. Successful comprehensive efficiency programs involve significant costs that must somehow be recovered through rates, whether the utility itself operates the program or funds an independent entity to do so. The manner in which the costs are recovered can affect the adequacy of funding. The following sections provide the principles the Club supports in evaluating ratemaking proposals. They are generally phrased as if the utility were operating the programs itself but the ratemaking principles would generally apply if the utility were funding a separate agency.

There are current examples of extremely successful programs operated by public utilities, investor-owned utilities, and independent agencies with utility or other funding. Whatever approach is used, the programs must be governed properly, employ high standards of quality and cost-effectiveness, and be evaluated for results. Similar considerations apply to cost recovery for utility programs encouraging renewable energy, large-scale or community-scale.

The Sierra Club has no national position on whether utilities or independent agencies are preferred for efficiency program operation, or in favor of public or investor-owned utilities. Utility attitude and the quality of utility governance or regulation can vary widely from locality to locality and state to state. It is, however, an important priority for the Club that effective, comprehensive energy efficiency and renewable energy programs be in place as soon as possible, and that ratemaking decisions should not inhibit full development of efficiency and renewables. It is clear that the power system must move quickly to replace fossil fuel generation with energy efficiency and clean renewables. Clean energy advocates do not always agree on the exact necessary speed for this necessary transformation, but none are worried that it will happen too quickly.

The Sierra Club supports the following principles:

Efficiency Programs

(1) Utilities should be encouraged to operate (or fund independent agencies to operate) effective programs to improve the performance of buildings and equipment. Such utilities must be able to recover their net costs and earn an appropriate rate of return on their investments. Utility programs should cover all end-users and all end-uses, including commercial, industrial, and residential customers; both new and existing buildings; and industrial equipment.

(2) Funds collected from rates to operate these programs and recover their costs are in the nature of a public trust. Sizable investments (perhaps on the order of 5% of utility

revenues) will need to be made for a number of decades. In order to maintain public confidence, programs should be subject to regular, professional evaluation and audit, and cost-recovery mechanisms should be transparent and predictable. A rate approach employing direct reimbursement of approved costs is preferable to a complex mechanism that may disguise windfall returns for the utility.

(3) The cost-recovery mechanism should encourage utilities to make all investments up to a defined cost-effectiveness limit. Partial investments can in some cases create a setback, by making a full investment at some later time too expensive to justify. The mechanism for recovering utility cost or rewarding utility performance, while allowing for incremental choice of efficiency measures by customers, should not encourage utilities or agencies to offer to fund only the cheapest measures ("cream-skimming"). Performance incentives, if employed, should reward utilities for meeting or exceeding aggressive annual goals for energy savings, rather than for minimizing costs.

(4) Regulatory oversight should establish cost-effectiveness limits that are high enough to achieve the goals of an aggressive climate stabilization program. The goal of regulation should be providing energy services in the most efficient, long-term manner, including direct, social and environmental costs.

(5) Other disincentives for utility investment (such as linking profits to increased sales) should be eliminated through effective decoupling or similar mechanisms.

(6) Where appropriate because they control costs or provide environmental benefits such as reducing climate impacts or pollution, efficiency programs which reduce peak electrical power use are also encouraged.

(7) Utilities will also need to recover net costs for supply-side efficiency investments, although the money flows are different in that the utility has new electricity to sell as a result.

Green Power and Small-Scale Renewable Energy Programs

(1) Utilities should be encouraged to operate effective programs that recruit customers to maximize their use of renewable energy, as supplied either by the utility from verifiably dedicated RE sources, or by the customer via small-scale installations of solar photovoltaic arrays, wind turbines, or other genuinely renewable technologies as defined in applicable Sierra Club energy policy; for the purposes of this policy, "small-scale" is defined as less than or equal to 40 kilowatts, a common upper bound for existing state net metering policies. Utilities must be able to recover the net costs of green power programs – including the cost of effective publicity and marketing, which should be extensive – and earn an appropriate rate of return on their investments. Such programs should be made available to all end-users, including commercial, industrial, and residential customers, for both new and existing buildings and industrial equipment. Utility-financed and administered small-scale RE programs should be designed to dovetail with any existing state incentive or rebate programs; they should offer meaningful incentives to

customers interested in installing renewable technologies, and where the utility will take ownership of renewable energy credits, transparently fair compensation must be offered, to the extent that a reasonable near-term value can be calculated. Programs should effectively target residential and small commercial and industrial customers, and must be well-publicized. Ratepayers should not be burdened with unreasonable "add-on" charges: for example, while requiring a homeowner to install, at his or her expense, a new "smart meter" before allowing interconnection of a home PV array may be legitimate, the utility should not be allowed to charge more than the actual cost of the meter plus any related administrative expense, since the long-term benefit of the smart technology will accrue at least as much to the utility as to the homeowner.

(2) Customers should be made aware when utilities sell Renewable Energy Certificates that transfer the environmental benefits of their renewable energy to a buyer through a third party broker.

(3) To maintain public confidence, programs should be subject to regular, professional evaluation, and cost-recovery mechanisms and any formula for enhancing the utility's bottom line should be transparent and predictable.

(4) The rate of return on a utility green power program should be comparable to the rate of return the utility would earn on an alternate investment in generation, plus an increment sufficient to provide a meaningful incentive to continue and expand the program. Outsize, windfall returns for the utility from supply-side RE programs are not acceptable, although some latitude in revenue enhancement may be extended to the utility in a given case. For example, in assessing what constitutes a fair or an excessive rate for green power, it will be necessary to note whether – and to what extent – higher rates are offset for green power customers by exemption from fuel cost adjustments and/or other surcharges. A green power per-kWh rate that is as much as one-third higher than the rate for conventional power might still prove acceptable if the utility has demonstrated serious commitment to (and investment in) RE, and to recruiting customers to extensive use of renewables, and if a large percentage of the increase is offset by a ratepayer's exemption from the fuel cost adjustment that would otherwise appear on the monthly bill.

Board of Directors, March 20, 2010