BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Investigation regarding demand side management in Nevada	)))	Docket No. 12-12030

COMMENTS OF THE SIERRA CLUB

The Sierra Club submits these comments in response to the Presiding Officer's Notice of Second Request for Comments regarding analysis and information on alternatives to Nevada's Lost Revenue Recovery Mechanism for DSM programs. For the reasons discussed below, Sierra Club recommends that the Commission move forward to implement a process that will result in full revenue decoupling for NV Energy.

I. THE NEED FOR DECOUPLING

Energy efficiency plays a key role in cost-effectively meeting Nevada ratepayers' energy demands, while also helping to meet Nevada's near-term renewable portfolio standards.[1] However, activities that reduce electricity sales, whether through energy efficiency or distributed generation, reduce utility revenues. This consequence creates a disincentive for the utility to successfully implement efficiency programs, customer installation of solar PV, and other behind-the-meter generation. Without removing this financial disincentive, the Company may be dissuaded from independently implementing comprehensive, meaningful efficiency programs. Customers would therefore be deprived of the lowest-cost resource, and total electricity costs would be significantly higher.

[1] SB 252 provides a schedule by which energy efficiency resources can contribute to the state's renewable portfolio standard (RPS). Currently efficiency can supply up to 25 percent of the RPS, but this amount will gradually be reduced until 2025.

In 2009, the Nevada legislature passed S.B. 358, which directed the Commission to remove such financial disincentives faced by the utilities, and in 2010, the Commission approved a Lost Revenue Adjustment Mechanism (LRAM) for Nevada electric utilities.[2] As a partial decoupling mechanism, the LRAM enables the utilities to recover lost revenues associated with measured and verified savings from energy efficiency programs. While this partial decoupling mechanism addresses a portion of the financial disincentives faced by the utilities, it fails to completely remove them. At the same time, the LRAM imposes significant administrative burden, without producing commensurate benefits for ratepayers.

An alternative to the LRAM is to implement full decoupling in Nevada. Decoupling mechanisms can be designed in many different ways. To ensure that the mechanism aligns both the interests of customers and the interests of utilities, the decoupling mechanism should be accompanied by appropriate consumer protection measures. Considerations for the design of such a mechanism are detailed below.

II. LOST REVENUE RECOVERY MECHANISMS

Nevada's lost revenue recovery mechanism enables the Company to recover revenues that the utility would have earned had the energy efficiency programs not been in place.[3] The lost revenues are recovered via a balancing account, and each year rates are adjusted to account for projected and deferred lost revenues. The lost revenues (exclusive of free-ridership effects) are trued-up through a measurement and verification analysis.

Lost revenue recovery mechanisms suffer from several fundamental flaws. First, the application of LRAM mechanisms can be administratively burdensome and

[2] PUCN Order, Docket No. 09-07016

[3] Energy efficiency program costs are also recovered under the LRAM.

highly contentious, and can actually create a barrier to implementing aggressive, successful energy efficiency programs. The amount of lost revenues can become quite large, especially if the utility begins achieving relatively large amounts of efficiency savings, or if lost revenues are recovered for more than three years. As a result, the large sums of money associated with lost revenues put an inordinate amount of pressure on the measurement and verification process, create increased regulatory burden to review the lost revenues, and create a great deal of contention about how much energy was or was not saved.

The administrative burden due to the LRAM was discussed at length by the Regulatory Operations Staff of the Public Utilities Commission of Nevada in their February 27, 2014 comments. In addition, the Company's earnings related to lost revenues have been subject to much debate in recent dockets, particularly when these earnings exceed the Company's authorized rate of return.[4] To address this issue, the Commission was ultimately compelled to add language to NAC 704.9524 that does not allow the Company to retain the lost revenue recovered if it causes the company to exceed its pre-established rate of return.

Second, a lost revenue recovery mechanism does not eliminate the Company's financial disincentive associated with other important opportunities to reduce demand, such as supporting building codes and efficiency standards, promoting combined heat and power systems, and promoting distributed, behind-the-meter renewable technologies. An LRAM may also not allow utilities to recover lost revenues associated with spillover and market transformation effects, although achieving market transformation for efficient electric and gas end-uses should lead to long-term low-cost savings for all customers and should therefore be a top priority.

[4] See, for example, Docket 13-03003 and Docket 13-04014.

Finally, a lost revenue recovery mechanism is not symmetrical, and therefore does not remove the Company's financial incentive to increase electricity sales through actions outside of the efficiency programs. Moreover, this asymmetry fails to treat ratepayers fairly. Utilities will sometimes experience increases in sales between rate cases that will offset some or all of the revenues lost from energy efficiency savings. An LRAM's failure to account for this situation enables the Company to retain extra revenues from increased sales, while requiring that customers make up for any Company under-earnings from decreased sales.

III. FULL DECOUPLING

Full revenue decoupling does not suffer from the fundamental flaws listed above regarding direct recovery of lost revenues. Full revenue decoupling provides much more comprehensive and better financial incentives with regard to all of the Company's actions that might affect customer sales. Utilities that are allowed revenue decoupling tend to be significantly more supportive of energy efficiency and other demand resources,[5] and the entire regulatory context around efficiency and demand resource planning is substantially less contentious and adversarial. Further, there are ways to design revenue decoupling mechanisms that not only protect consumers but ensure that customers are better off than under traditional ratemaking. Oregon, Washington, Idaho and California have all implemented decoupling.

Under traditional ratemaking, the utility's revenue requirement is determined through a rate case. Prices are then determined by dividing the utility's revenue requirement by sales. These prices are then held constant until the following rate case,

[5] For example, nine of the top ten states in the ACEEE State Energy Efficiency Scorecard have decoupling.

and any change in sales would cause the utility's revenues to increase or decrease proportionally, depending on the direction of the sales.

Decoupling removes this fluctuation in revenues, and instead adjusts prices so that the Company recovers only the revenues it needs to meet its costs. If sales increase due to hot weather or other factors, the utility returns the excess revenues to ratepayers in the next decoupling adjustment. Similarly, if sales decline due to energy efficiency or distributed generation, the utility is permitted to recover the revenues required to cover its costs. In this way, full decoupling actually allows for a utility's revenues to be more closely aligned with costs than under traditional ratemaking.

Because a full decoupling mechanism compensates a utility for sales fluctuations for any reason, it removes the utility's incentive to oppose sales reductions from customer distributed generation as well as energy efficiency and conservation. For this reason, full decoupling better positions the state to meet its solar energy objectives and empowers customers to install cost-effective small-scale renewable generation.

It is a common misconception that by reducing the volatility of utility revenues, risk is shifted from the utility to ratepayers. While the reduction in profit volatility removes risk from utility shareholders, it does not materially increase risk for customers. Rather, it leads to slight annual rate changes, causing utility bills to be slightly lower or higher, that in many instances will be invisible to ratepayers, particularly when compared to the typical month-to-month bill fluctuations due to weather. The volatility that customers will experience from decoupling can be further limited by imposing a cap on decoupling adjustments, as discussed below.

It is also sometimes asserted that decoupling removes a utility's incentive to manage its costs. This is not the case. Under traditional ratemaking, a utility can influence its profits between rate cases in two ways: (1) it can increase sales to gain additional

revenues, or (2) it can reduce its costs. Under decoupling, a utility's revenues are fixed, so it is limited to reducing costs in order to maximize profits. In this way, decoupling actually serves to strengthen the utility's cost control incentives.

IV. DESIGN CONSIDERATIONS FOR DECOUPLING MECHANISMS

There are numerous important design decisions to make when crafting a decoupling mechanism. Decoupling mechanisms should be designed to ensure that they are in the customers' interest. Key factors to consider include:

1) Establishing Appropriate Revenue Targets. Revenue targets should be established only through a full rate case proceeding, with active participation from stakeholders. Between rate cases, the utility's allowed revenues can be adjusted to recover changes in the utility's costs. Revenue targets can be set either on the basis of total revenues or revenue per customer. A revenue-per-customer mechanism allows revenues to increase to reflect the added costs of serving new customers. To adjust for inflation and increases in other costs (e.g., O&M costs) between rate cases, target revenues may be escalated by a pre-determined cost escalation factor. Cost escalation factors are frequently necessary to ensure that the utility is able to recover its future costs, plus a reasonable profit, but should also provide sound financial incentives. Relatively frequent rate cases (e.g., every three years) will enable the Commission to ensure that the utility's revenues remain in line with its actual costs.

2) Decoupling Adjustments Schedule. Decoupling adjustments should be made on a fixed, pre-determined schedule (e.g., annually).

3) Cap on Adjustments. Electricity sales can fluctuate significantly from year-to-year, especially due to weather anomalies. Caps on decoupling adjustments help smooth out such variations and protect ratepayers from significant rate increases from one period to the next. Caps should be tied to total revenue requirements in the relevant period to ensure that the adjustment is reasonable in light of the total customer bill. For example, a cap of one percent of revenues would ensure that customers do not experience a change of more than one percent in their total bill. In periods where the revenue shortfall is greater than the cap, the utility would be permitted to roll the incremental shortfall into the next period for recovery. Revenue shortfalls could be passed from period to period, if necessary, until the next rate case.

4) Return on Equity. The Commission should consider whether to reduce the utility's allowed return on equity to reflect the lower risk that a utility faces as a result of decoupling. The utility's revenues are no longer subject to potential swings due to weather, economic conditions, the implementation of demand resources, or changes in customers or energy technologies. This reduction in volatility is equivalent to a reduction in risk for shareholders, and should therefore be accounted for when a commission sets the utility's rate of return on equity.

5) Require Utility Commitments. In return for reducing revenue volatility risk, it is reasonable to ask utilities to provide commitments related to energy efficiency and distributed generation. For example, utilities could commit to expand energy efficiency activities (e.g., address more measures and

customer types, or serve more participants); support building codes and appliance standards; support energy efficiency RD&D; and facilitate distributed generation integration.

V. CONCLUSIONS AND RECOMMENDATIONS

With appropriate ratepayer protections, full decoupling can serve to better align ratepayer and utility interests with respect to energy efficiency and distributed generation. Sierra Club therefore recommends that the Commission adopt a full decoupling mechanism, and that it adopt the design mechanisms described above so as to be able to promote the implementation of demand-side resources in a way that is in the best interest of both utility shareholders and utility customers. In addition, Sierra Club notes that while full decoupling removes the utility's disincentive regarding energy efficiency investments, it does not create a positive incentive. To address this, the Commission should consider establishing an energy efficiency goal or standard, paired with a performance incentive.

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Respectfully submitted,

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