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Decoupling for Energy Conservation

by

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Developing a sound energy policy that moves the nation towards achieving greater energy independence involves multiple actions, not all or nothing solutions. Foremost, a rational energy policy should recognize it is in the nation's interest to increase domestic energy production from various sources, including clean-burning fuels, while, at the same time, increasing energy efficiency and conservation.

A rational energy policy should also recognize that unreasonable barriers to the transport and storage of energy should be minimized, while taking care to protect public safety. To meet our growing energy needs in our offices and at home, not every proposed new transmission line or storage tank site can be allowed to become a project-killing cause célèbre for the NIMBY (not-in-my-backyard)-minded.

And a rational energy policy should take care not to pick winners and losers by directing government subsidies of one sort or another to the government's latest favored pet energy projects. Remember Jimmy Carter's ill-fated government-run Synfuels Corporation that "invested" millions in promoting new synthetic fuels, with nothing much to show for this expenditure of taxpayer's money before the corporation was shut down? Markets generally allocate resources far better than politicians responding to pork-barrel spending pressures.

Some of the needed changes in law or policy, such as allowing more off-shore drilling for domestic oil and gas, require action at the federal level. And they have been subject to controversy for years. But others can be accomplished by the states acting as partners with the federal government in developing an overall sound energy policy.

Here's one idea that should be non-controversial, and which can make a contribution in promoting conservation. It's called "decoupling" in the lingo of the utility regulators and

the utilities. In essence, decoupling involves a ratemaking change that removes a disincentive that discourages utilities, such as power and natural gas companies, from promoting energy conservation.

Under traditional ratemaking principles, utilities generally are allowed to recover all of the reasonable costs incurred in providing services to their customers and to earn a reasonable return in their investment in plant and facilities. A significant portion of the utilities' costs of delivering energy are fixed. In many jurisdictions, regulators traditionally have tied the utilities' revenue recovery associated with the fixed distribution costs to the amount of their customers' usage of energy. In other words, the greater the energy usage, the greater the revenues the utility would realize.

Obviously, under this ratemaking regime, utilities have little financial incentive to promote energy conservation on behalf of their customers. In fact, the incentive runs in the opposite direction. What "decoupling" ratemaking mechanisms do is to allow utilities to recover their fixed distribution costs independent of the amount of energy consumed. Revenue recovery associated with the fixed costs of delivering energy is uncoupled from customer consumption. The costs directly associated with customers' energy consumption would continue to be recovered on a usage-sensitive basis.

In November 2005, the National Association of Regulatory Utility Commissioners adopted a resolution encouraging state utility regulators to implement new rate designs to encourage energy conservation. NARUC's resolution specifically identified as a promising reform Washington Gas Light Company's decoupling tariff --one of the first in the country--approved in October 2005 by the Maryland Public Service Commission.

And just last month, the Maryland PSC approved implementation of decoupling for electric utilities, Pepco and Delmarva Power. The commission explained that in the absence of decoupling, "utilities face a disincentive to encourage conservation, because if conservation efforts are successful, their revenues from distribution charges will drop and they risk not covering their fixed distribution costs." And it pointed out that decoupling is an energy conservation approach that has been endorsed by environmental groups, such as the National Resources Defense Council, as well as the utilities.

Washington Gas has decoupling proposals pending before the utility regulators in the District of Columbia and Virginia. These local jurisdictions should follow Maryland in approving decoupling tariffs. Virginia has long been an advocate for weather normalization, and, along with the District, should now also be considering decoupling. Then, the company no longer will lack incentives to promote conservation through messages to customers or through other means. Because less usage of natural gas generally exerts a downward pressure on prices as the market adjusts, customers benefit from the utilities' conservation-promoting efforts.

A sound energy policy that best serves the interests of the nation and its consumers consists of many components. Some of these components stir considerable public controversy. But implementing decoupling mechanisms as a means of achieving

conservation and efficiency gains —thereby fostering our nation’s energy independence—ought to be an objective on which consumers, utilities, and public policymakers can make common cause.

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