

Incentive Regulation and Unbundling



NARUC Energy Regulatory Partnership Program

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Overview

- ❖ Unbundling – Accounting and Structural Separation
- ❖ Incentive Regulation
 - Designing the right incentives
- ❖ Programs to Encourage Renewable Energy



Unbundling

- ❖ Vermont Electric and Gas Utilities have generally not unbundled
 - No retail choice
 - Gas utility provides both transportation and distribution
 - Electric utilities responsible for both generation/power supply and distribution



Areas in which unbundling has occurred in Vermont

❖ Electric Transmission

- Separate Company (VELCO) owns and operates transmission system (except limited amount of subtransmission)
- Structurally separate
- Federal government (FERC) regulates rates and financial issues

❖ Two largest Vermont utilities also provide limited transmission service

- Generally, serving small utilities adjacent to their territory



Gas Unbundling

- ❖ Vermont Gas also has unbundling of transmission service
 - Several tariffs provide for transmission service (differences based upon level of commitment of customer to capacity – firm as opposed to interruptible)
 - At least one customer using this service



Separation of Costs in Unbundling

- ❖ With the exception of VELCO, gas and electric utilities that have unbundled are not structurally separate
 - Also no accounting separations
 - Costs of the separate services are accounted for in developing the rates
- ❖ Vermont has much greater experience with unbundling in the context of telecommunications – still not structural separations



Incentive Regulation

- ❖ Regulatory mechanisms that seek to improve on the weak incentives for efficiency in traditional rate of return regulation.



Incentive Regulation

– Statutory Standard

- ❖ (1) establish incentives for least-cost energy service;
- ❖ (2) just and reasonable rates;
- ❖ (3) safe and reliable service;
- ❖ (4) incentives for innovations and improved performance that advance state energy policy such as increasing reliance on Vermont-based renewable energy and decreasing the extent to which the financial success of distribution utilities between rate cases is linked to increased sales to end use customers and may be threatened by decreases in those sales;
- ❖ (5) promote improved quality of service, reliability, and service choices;
- ❖ (6) encourage innovation;
- ❖ (7) reasonably balanced system of risks and rewards that encourages the company to operate as efficiently as possible using sound management practices; and
- ❖ (8) provide a reasonable opportunity to earn a fair rate of return.



Statutory Requirement (continued)

- ❖ For investor-owned utilities, incentive regulation also must
 - not have an adverse impact on the electric company's eligibility for rate-regulated accounting in accordance with generally accepted accounting standards if applicable; and
 - reasonably preserve the availability of equity and debt capital resources to the company on favorable terms and conditions.



Incentive Regulation

- Vermont experience

- ❖ 2 electric, 1 gas utility now under incentive regulation (including 2 largest electric utilities)
 - All 3 plans limited in scope
 - Board has not established specific targets, but has approved plans that lower costs to ratepayers while providing companies incentives to better manage their costs
- ❖ 1 electric cooperative has proposed incentive regulation plan
- ❖ Long history of incentive regulation for largest telecommunications provider



Key Components of Incentive Regulation Plans in Vermont

- ❖ **Purchase Power/Gas Adjustment Clause**
 - Enables utility to more rapidly (quarterly) flow through changes in power or gas costs
 - These costs generally are greater than 60% of utility cost, often much greater
- ❖ **Earnings Sharing**
 - Can retain all earnings above the allowed return on equity up to 75 basis points
 - As a result, utilities have incentive to reduce costs



Other Key Components

❖ Decoupling

- Forecasting of loads and customer levels and calibration of power cost adjustment to load changes
- Reduces exposure of utility earnings to changes in usage
- As a result, utility disincentive to invest in measures that reduce sales is decreased
- Reduces concerns about energy efficiency (although Energy Efficiency Utility has taken over these programs in any case)



Promoting Renewable Energy -- Feed-in Tariffs

- ❖ Commonly used in Europe to promote Renewable Energy Sources
- ❖ Tariff specifies a rate (usually above market prices) at which regulated utility will purchase energy from renewable sources



Promoting Renewable Development

- ❖ US has typically tried to achieve the same result as feed-in tariffs in a different way – Renewable portfolio standards (RPS)
- ❖ RPS's usually require that a certain percentage of a utility's (or the state's) load must be met through renewable resources
- ❖ Company responsible for serving load then has the responsibility for acquiring these resources.
- ❖ Becoming more common in US
- ❖ Requirement may be met by purchase of renewable energy certificates from renewable resources



Renewables – Vermont Experience

- ❖ In 1980's, encouraged small power production by requiring utilities to buy power from these sources at utility's avoided cost
- ❖ Program enabling small power producers to get long-term rate assurances – all at rates that proved to be above-market
- ❖ No new sources since 1991



RPS in Vermont

- ❖ Vermont law now contains an RPS.
- ❖ Takes effect in 2013
- ❖ Requires each Vermont utility to meet its load growth since 2005 with renewable resources
- ❖ Proposed in-state renewable sources still need Board approval for construction.



SPEED Program

- ❖ SPEED (Sustainably Priced Energy Enterprise Development) Program established to encourage utilities to invest in renewable resources without RPS
- ❖ Vermont RPS does not take effect if
 - utilities (collectively) meet load growth since 2005
 - and at least 5% of load is met through new renewable resources (SPEED resources)



SPEED (continued)

- ❖ Last year, legislature added 2 new pricing provisions for SPEED resources
 - For small projects, Board must allow source to sell that power under a long term contract at a specified price determined by the board to be adequate to promote SPEED resource development while remaining consistent with the principles of least-cost energy services under section 218c of this title.
 - For other SPEED sources, encourage long-term contracts, at stable prices. The board shall create a standard contract price, or a set of maximum and minimum provisions, or both, for qualifying SPEED resources over 1 MW of capacity. In setting a standard contract price for a qualifying SPEED resource, the board shall consider the goal of developing qualified SPEED resources, least cost provision of energy service under section 218c of this title, and the impact on electric rates.
 - Board is in the process of meeting these new standards



Renewables

- ❖ In meeting SPEED mandate and other requirements, Board must balance least-cost service with promoting renewables
- ❖ As yet, no specific mandates similar to feed-in tariffs
- ❖ Experience of earlier, small-power program has made Vermont wary of paying above-market prices, even when goal appears desirable (still paying above-market for some projects built about 20 years ago)