
THE WALL STREET JOURNAL.

SE Energy (A Special Report)
HD **The Bottom Line: Utilities typically have had little incentive to reduce demand for their product; States are trying to change the math**

BY By Matthew Dalton
WC 1,378 words
PD 12 February 2007
SN The Wall Street Journal
SC J
NGC The Wall Street Journal - Print and Online
GC CTGWSJ
PG R4
LA English
CY (Copyright (c) 2007, Dow Jones & Company, Inc.)

LP IN THE POWER business, the more electricity you sell, the more money you make.

Now state officials and **electric** utilities -- backed by environmental groups -- have begun to change that equation. Faced with growing demand for electricity and the environmental consequences of generating it, states and utilities are considering new regulatory regimes that remove the incentive for selling more power -- and give utilities a financial stake in saving energy.

TD The ultimate goal is to eliminate the need for new power plants. Many energy experts predict the U.S. will need hundreds of new plants in coming years to satisfy demand. State and industry officials increasingly believe that by changing the financial incentives for utilities, they can significantly increase the efficiency of the grid and make many of these power plants unnecessary, saving billions of dollars in the process.

Massachusetts, for instance, is considering new incentives for utilities, coupled with tough new efficiency standards. State officials recently proposed a sweeping measure to eliminate all electricity-demand growth through increased spending on energy efficiency. The spending would cover customers that aren't served by competitive suppliers, which is 50% of the state's total electricity load.

"If you could do this universally with all customers, you would theoretically not have to build any more power plants until the existing ones wear out," says David O'Connor, commissioner of the Massachusetts Division of Energy Resources.

States are considering two major regulatory remedies. The first is "decoupling," in which utilities receive a predetermined profit each year -- thereby separating their earnings from the volume of electricity they deliver.

Here's how it works. A **utility** and state regulators hammer out how much profit the company will be allowed to earn. At the end of the year, if the **utility's** actual profit is lower than that amount, the company charges customers to make up the difference. If the actual profit is higher, customers get a rebate.

All of which means a **utility's** profits won't suffer if it decreases the amount of electricity it delivers through increased efficiency. Of course, if extreme weather boosts the delivery of electricity, the **utility** doesn't benefit, either.

Decoupling is currently more popular for natural-**gas** utilities, with about seven programs nationwide. But Washington, Idaho, New Mexico and New York are considering it for their **electric** companies as well. California, the state that has most aggressively advocated energy efficiency, is the only one that has put the mechanism into effect.

"Decoupling is probably the single biggest thing to promote energy efficiency," says Sean Gallagher, director of the energy division at the California Public **Utility** Commission. "Otherwise you're trying to tell the utilities to cut into their profits to make less sales."

Still, decoupling doesn't actually give utilities a financial incentive to cut energy use. That's where the second proposed regulatory change comes in: making efficiency spending as lucrative as infrastructure spending.

Regulators allow utilities to earn a return on their infrastructure spending by raising rates. So, utilities can earn money by investing in power plants, transmission and distribution infrastructure.

But under current rules in most states, utilities can't earn a return on their efficiency spending -- they can only recover the cost. A proposal being considered in California, Texas and several other states would change that.

Under such a system, "the people running the energy-efficiency departments in these utilities will become on a par with those running the transmission and distribution departments," predicts Mr. Gallagher. "There will be more of a corporate focus on energy efficiency."

Texas is considering implementing the new system in conjunction with ambitious new efficiency standards. The state's utilities are now required to account for 10% of annual demand growth through energy efficiency, but the state may increase that figure significantly as part of a regulatory proceeding begun in late January.

"If the utilities are voluntarily achieving more than they're required, what can Texas truly do?" says Theresa Gross, manager of energy-efficiency programs at the Texas Public **Utility** Commission.

In Massachusetts, meanwhile, the administration of newly elected Governor Deval Patrick is eager to consider measures that would encourage utilities to promote energy efficiency, says Ian Bowles, the state's new secretary of energy and environmental affairs.

"We'll be exploring the full-range issue around rate design and decoupling," Mr. Bowles says. "Historically, our rate design doesn't create as many overt incentives for additional efficiency, and that's something we'll be looking at."

Indeed, promoting efficiency will be difficult if the utilities can increase their profits by delivering more power, says Mr. O'Connor of the Massachusetts Division of Energy Resources. "It does require kind of an uphill struggle for utilities to work against their natural interests," he says.

Environmental groups across the country have signed on to these proposed changes. In Texas, for instance, the local Sierra Club plans to lobby the legislature to provide financial incentives for utilities, along with mandating more efficiency spending. The consumer group Public Citizen is also active in the efforts. "We're very interested in coming up with ways for rewarding utilities that run aggressive efficiency programs," says Tom Smith, director of Public Citizen's Texas office.

Utilities have also supported changing financial incentives. In June, more than a dozen of the nation's largest utilities, including Exelon Corp., Duke Energy Corp., Southern Co. and American **Electric** Power Co., signed on to a "National Action Plan For Energy Efficiency," which calls for new regulatory policies to encourage reduced power use.

"Decoupling and [incentives] often lead to increased energy-efficiency investments by utilities, increasing customer and societal benefits," according to the plan. Duke Energy Chief Executive Jim Rogers, who co-chaired the group that wrote the action plan, has advanced the idea that utilities should adjust their business models to become "energy-efficiency providers."

But to do that, he says, utilities must be able to earn a return on the money they spend to make their grids more efficient. Duke has asked state regulators to allow this in North Carolina, where Duke Energy Carolinas has proposed to spend 1% of its annual revenue, or \$50 million, on energy-efficiency programs.

The state is considering this request as part of Duke's plan to add 1,600 megawatts of coal-burning capacity at a plant near the South Carolina border.

These new proposals come amid a nationwide push to increase utilities' spending on energy efficiency. States are realizing that a dollar invested in energy efficiency typically yields a dollar, or often much more, in energy savings.

In many states, utilities put a small charge on customers' bills to finance a hodgepodge of efficiency programs. Often, these involve subsidies to consumers who buy energy-efficient air conditioners and other appliances, upgrade their electrical systems or install "smart meters" that show what they're spending on electricity in real time.

By far the biggest of these programs is in California, where utilities are planning to invest \$2 billion between 2006 and 2008 on improving the grid's efficiency. The state's regulators estimate the plan will reduce peak electricity demand by 1,200 megawatts, about the capacity of three medium-size power plants.

Mr. Gallagher of the California Public **Utility** Commission says the cost of bringing that much new supply to the market through new power-plant construction is about \$4.7 billion -- making energy efficiency one of the cheapest energy resources available.

In all, utilities nationwide spent \$1.6 billion on energy-efficiency programs in 2006, according to Martin Kushler, director of **utility** programs at the American Council for an Energy-Efficient Economy. He says that figure could double in the coming years as state interest increases.

"And there's no engineering or economical reason why you couldn't do much more than that," Mr. Kushler says. "It's a political compromise, not a technical or economic limit."

Mr. Dalton is a staff reporter for Dow Jones Newswires in Jersey City, N.J. He can be reached at matthew.dalton@dowjones.com.

[License this article from Dow Jones Reprint Service](#)

IN i16 : Electricity/Gas Utilities | i16101 : Electric Power Generation | i1 : Energy

NS genv : Environmental News | gpol : Domestic Politics | gvbod : Government Bodies | gcat : Political/General News | gpir : Politics/International Relations | reqren : Editor's Choice - Energy | reqr : Editor's Choice - Industry Trends/Analysis

RE usa : United States | usca : United States - California | usid : United States - Idaho | usma : United States - Massachusetts | usnm : United States - New Mexico | usny : United States - New York | ustx : United States - Texas | uswa : United States - Washington | namz : North American Countries/Regions | use : Northeast U.S. | uss : Southern U.S. | usw : Western U.S.

IPC STE USG NND UTI LMJ SPE

PUB Dow Jones & Company, Inc.

AN Document J000000020070212e32c00005