



# Revenue Decoupling

A Policy Brief of the Electricity Consumers Resource Council

For over two decades advocates of ratepayer-funded energy efficiency and load reduction programs have recommended that the 'link' between utility's revenues and its sales be 'decoupled' to eliminate a utility's disincentive to sponsor such programs. The argument is that the combination of the utility management's fiduciary duty to shareholders and the use of rates based on a revenue requirement, that includes sales in its calculation, discourages utilities from being competent vendors of energy efficiency and load reduction services.

Revenue decoupling (RD) is generally defined as a ratemaking mechanism designed to eliminate or reduce the dependence of a utility's revenues on sales. It is a significant departure from traditional regulation, which historically provides utilities with ample opportunity to earn a fair return. Under RD, a utility is indifferent to the impact on sales of changing economic conditions, weather, or new technologies.

ELCON members are strong supporters of energy efficiency and are world-class practitioners of innovative technologies that reduce their energy costs to improve their competitiveness and are conscious of their obligation to be responsible energy users. But ELCON strongly opposes RD because it disrupts and distorts the utility core business functions and is not an effective way of promoting energy efficiency. Time and time again RD has been tried in other states, only to be suspended because it unduly interferes with the overall regulatory process. ELCON believes that there are other ways to promote energy efficiency and load reduction services that have proven to be more effective.

- **Decoupling Promotes Mediocrity in the Management of a Utility By Shifting Significant Business Risk from Shareholders to Customers.**

The primary duty of regulated electric utilities is and will always be to efficiently sell and deliver electric energy to customers. For investor-owned utilities, the profit-motive is a legitimate and practical means to incent utility managers to plan and operate their business in a competent and efficient manner. RD mechanisms make the utility whole for earnings losses that go beyond the limited losses caused by energy efficiency and load reduction programs. Customer rates are automatically adjusted to immunize utility earnings from sales fluctuations. This isolates utility management and equity owners from the normal business risk

inherent to the utility industry. In short, an RD mechanism makes retail electric distribution service virtually risk free for utilities. RD does not create any economic incentive to promote greater energy efficiency. At best, it encourages utility indifference to these objectives. At the same time, it undermines customers' efficiency efforts by rewarding customer-initiated conservation with higher future rates, while excessive consumption paradoxically produces bill credits. Thus RD removes any incentive for customers themselves to engage in conservation programs!

- **Decoupling Eliminates a Utility's Financial Incentive to Support Economic Development within Its Franchise Area. This Includes the Incentive to Support the Well Being of Manufacturers and Their Workforce.**

Regulators must not bargain with their utilities from a weak position that assumes that financial incentives in excess of a reasonable return is necessary for ordinary business behavior. For all practical purposes RD mechanisms put utility management on autopilot and this will only encourage them to ignore their core business, the value of economic development in their franchise area, and the broader needs of their customers including commercial and industrial customers.

- **States Have Successfully Used Alternative Entities for Promoting Conservation--Entities Whose Sole Mission is to Promote Energy Efficiency. This Retains the Utility's Responsibility to Efficiently Sell and Deliver Energy.**

There is no inherent inconsistency that a utility would both sell and 'unsell' energy if rates are appropriately designed for the different services. Selling competing products and services is a common business choice and need not be a moral dilemma only for utility executives. There are examples of state ratemaking practices such as shareholder performance incentives that create more explicit economic inducements for promoting energy efficiency and load reduction. These practices avoid the collateral damage created by the 'blunt instrument' nature of RD mechanisms. Alternatively, several states have assigned the administration of energy efficiency programs to independent entities whose sole mission is to promote energy conservation. These entities, which are typically not-for-profit companies, receive their funding from the utilities. ✎