ORDER NO. 02-633

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BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UE 126

In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Proposed Tariffs to Decouple Distribution Revenues from Residential and Small Nonresidential Consumers and their kWh Sales.	)))))))))	ORDER

DISPOSITION: PROPOSED DECOUPLING MECHANISM DENIED

On March 19, 2001, Portland General Electric Company (PGE) filed its proposed Schedule 123, a Distribution Decoupling Adjustment tariff. The Commission found good and sufficient cause to investigate the filing and suspended it for a period of time not to exceed six months.[1] The Commission later suspended the filing for an additional three months through June 30, 2002.[2]

On September 11, 2001, Michael Grant, an Administrative Law Judge (ALJ) for the Commission, held a consolidated prehearing conference in this docket and docket UG 143, an investigation of a decoupling mechanism proposed by Northwest Natural Gas Company (NW Natural). At the conference, the ALJ adopted the same procedural schedule for both dockets, but clarified that the dockets remain separate and would not be consolidated. PGE, NW Natural, the Northwest Industrial Gas Users (NWIGU), the Citizens' Utility Board (CUB), the Natural Resources Defense Council (NRDC), the Northwest Energy Coalition (NW Energy Coalition), the Community Action Directors of Oregon (CADO), the Oregon Office of Energy (OOE), and the Commission's Regulatory Staff (Staff) participated in this docket as parties.

After discovery and the prefiling of testimony, the ALJ conducted an evidentiary hearing on November 15, 2001, to allow cross-examination of witnesses. The parties gave closing presentations to the Commission on December 12, 2001, and later filed opening and reply briefs.

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[1] Order No. 01-751.
[2] Order No. 02-134.

On February 8, 2002, the Commission suspended the procedural schedule in this case pending the review of NW Natural's proposed purchase of PGE in docket UM 1045. Following the termination of docket UM 1045, the parties recommenced settlement discussions for the purpose of resolving the contested issues. To accommodate the discussions in this docket and docket UG 143, PGE agreed to extend the suspension period in this docket until September 16, 2002.[3] The parties were unable to reach settlement on any issue, however, and submitted the matter for Commission resolution.

Based on the record in these proceedings, the Commission enters the following:

FINDINGS AND CONCLUSIONS

Introduction

Decoupling is a regulatory tool designed to break the link between a utility's earnings and the energy consumption of its customers. While such mechanisms take several forms, the basic approach consists of defining a target for revenues and placing over- and under-collections relative to that target in a deferred account for recovery in a later period. Under such mechanisms, a utility cannot increase its earnings by increasing its sales, because additional sales margins are returned to ratepayers.

This Commission first addressed decoupling in the context of least-cost planning. In docket UM 409, the Commission acknowledged the need to change regulatory policy to encourage the efficient use of energy resources:

> We are persuaded that the connection between profits and sales should be severed. As long as the regulatory system provides that increased sales may lead to increased profits, a conflict will exist between the motivation to sell energy and the motivation to promote reduction in energy consumption.[4]

Accordingly, the Commission ordered PacifiCorp and PGE to work with Staff and other parties in a collaborative process to develop decoupling mechanisms. The Commission later adopted the collaborative recommendation and initiated decoupling for PGE during most of 1995 and 1996.[5]

More recently, the Commission adopted a decoupling mechanism for PacifiCorp's distribution related revenues as part of an alternative form of regulation

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[3] Orders No. 02-413 and 02-554.
[4] Order No. 92-1673 at 13.
[5] Order No. 95-322 at 15.

(AFOR) in docket UE 94. The Commission concluded that the mechanism was particularly appropriate as applied to the distribution function, because distribution costs are relatively fixed in the short-term and, consequently, much less sensitive to fluctuations caused by the amount of energy consumed.[6]

Decoupling Proposal

PGE contends that the Commission should continue its decoupling policy and approve its proposal. In its filing, PGE seeks to change the way it recovers distribution costs for a portion of its customer base. As noted above, distribution costs are generally not dependent on the amount of energy consumed, but rather reflect the cost of creating and maintaining the necessary equipment and systems for delivery. Despite the relatively fixed nature of distribution costs, however, PGE—like other utilities—bills its customers for distribution costs based to a large extent on kilowatt-hours (kWh) consumed. In an effort to match revenues to costs, rates are set based on projected energy usage.

Under this volumetric pricing, PGE explains that utilities generally over- or under-recover their distribution costs because actual customer usage rarely equals expected usage. Customer usage can vary considerably due to a variety of circumstances, such as weather, commodity prices, economic conditions, and load growth.

To sever this link between revenues and consumption, PGE proposes a mechanism to recover distribution costs as though they are recovered through fixed charges. In its proposed Schedule 123, PGE would recover its distribution costs from residential and small nonresidential customers based on the actual number of customers served. Schedule 123 would reconcile the differences between actual revenues collected and those that would be collected with a fixed per customer charge of $21.54 per month for residential customers and $34.66 per month for small non-residential customers. PGE determines these fixed per customer charges using the approved distribution revenues and customer counts from its rate case filing in docket UE 115.[7]

Under its proposed mechanism, PGE would assess the difference on a monthly basis and accumulate the calculated amounts in a balancing account for collection or disbursement during a future period. Rates will be adjusted annually to ensure that PGE receives distribution revenues equal to $21.54 per month for each residential customer, and $34.66 per month for each small nonresidential customer.

Positions of the Parties

PGE contends that the decoupling proposal presents a sound approach to the recovery of distribution costs, because it would charge customers based on how costs

[6] Order No. 98-191 at 8.
[7] *See* Order No. 01-777.

actually accrue to the utility. PGE emphasizes that the current regulatory practice, which requires utilities to recover distribution costs through volumetric pricing, introduces unnecessary risk for both utilities and customers. PGE argues that regulated revenues should not fluctuate for reasons beyond the control of the company or its ratepayers.

PGE also claims that its decoupling mechanism eliminates the perverse disincentive to encourage energy conservation or assist customers to reduce usage. By severing the link between its earnings and kWh sales, PGE claims its proposal aligns the company's incentives with the public interest in energy conservation and resource planning, both on the supply side and demand side.

The Joint Parties, comprised of the OOE, CUB, NW Energy Coalition, CADO, and NRDC support PGE's proposed decoupling mechanism. The Joint Parties contend that PGE's proposal is consistent with public policy previously articulated by this Commission and, if adopted, would provide substantial benefits to the customers and environment.

The Joint Parties strongly favor decoupling mechanisms because they align the interests of customers and shareholders in favor of economically and environmentally efficient resource decisions, rather than rewarding utilities primarily for increasing commodity sales. They add that decoupling will help reduce customers' bill volatility and risk due to weather, business cycle, and commodity price variability on a season-to-season and year-to-year basis.

For these reasons, the Joint Parties contend the Commission should approve PGE's proposal, with certain modifications. First, the Joint Parties recommend that the Commission should emphasize service quality standards to ensure that PGE maintains a high level of service quality. Second, the Joint Parties believe that the mechanisms should be structured so that only the Commission would have authority to terminate the plan. This would prevent PGE from canceling the mechanism should conditions occur if the company is consistently refunding overcharges to customers. The Joint Parties also believe that the Commission should have flexibility as to the timing of any surcharge or refund to reduce volatility of customer bills.

Staff opposes PGE's decoupling mechanism for three primary reasons. First, Staff claims that decoupling shifts risks to customers. To reflect this shift in risk, Staff believes that, if the decoupling mechanism is adopted, PGE should compensate ratepayers through either a reduction in cost of capital or cost of debt, a decrease in the amount of debt, or a reduction in rates equal to the price of a weather hedge.

Second, because of the lag in correcting an over- or under-collection of distribution revenues, Staff believes that the decoupling mechanism could increase the month-to-month volatility of customers' bills. Staff believes this lag also introduces unnecessary intergenerational inequities, as it is impossible to match revenues and costs in the period in which they were incurred. In addition, Staff contends that decoupling is inequitable because charges or credits are determined on an aggregate basis. Thus, Staff explains, each customer's decoupling credit or charge is dependant on other customers' actions, not its own actions.

Third, Staff contends that decoupling will reduce the PGE's incentive to provide excellent customer service. Staff explains that, with decoupling, a utility can reduce expenditures for customer service without worrying that its distribution revenues will be adversely affected. Staff is concerned about service deterioration, and adds that service quality measures cannot address every dimension of good customer service—especially those that are hard to measure.

As an alternative to PGE's proposal, Staff suggests other mechanisms to address the company's concerns. For example, Staff proposes that PGE could revise its rate design to recover its fixed distribution costs through a higher customer charge. Staff also suggests that PGE could implement a demand charge for residential and commercial customers or a price elasticity adjustment to adjust for commodity price changes.

Commission Resolution

As discussed above, the Commission first considered decoupling over ten years ago as a means to make regulatory policy more compatible with least-cost planning. Several states, including California, New York, Washington, and Maine adopted various decoupling mechanisms. This Commission joined that list of states by fully decoupling PGE in the mid-1990s and adopting a revenue cap mechanism for PacifiCorp's distribution revenues in 1998.

The popularity of decoupling mechanisms, however, has declined in recent years for a variety of reasons. Uncertainties related to the restructuring of the electric industry caused California to eliminate revenue decoupling in 1998. Concerns that decoupling inappropriately shifted business risk to ratepayers led Maine and Washington to eliminate similar mechanisms. Washington also questioned the effectiveness of decoupling, finding no evidence that its mechanism provided a clear incentive for utilities to manage its acquisition of supply and demand-side resources at least cost. Staff has raised similar concerns with regard to the decoupling mechanisms previously adopted in Oregon. Staff notes that PGE's and PacifiCorp's conservation activities actually decreased significantly while those companies were decoupled.

In addition, the regulatory landscape has changed dramatically since this Commission first embraced decoupling a decade ago. All six regulated energy utilities in Oregon now have some mechanism in place to protect themselves from revenue volatility due to fluctuating power prices. This Commission has also adopted a number of regulatory mechanisms to provide incentives for utility demand-size management (DSM) acquisition. These include investment cost recovery, lost margin recovery, incentive mechanisms such as SAVE, conservation bonding, and various accounting mechanisms to reduce risk associated with the amounts of DSM on utilities' accounting records. The

Oregon Legislature also restructured the electric industry with the passage of Senate Bill 1149, which, among other things, provides funding for energy efficiency, conservation and renewable energy resource programs that are administered by the independent Energy Trust of Oregon. While some jurisdictions are revisiting new forms of revenue cap mechanisms, some question the continued need for decoupling.

Against this backdrop, we view any decoupling proposal cautiously. Before adopting any such mechanism, the Commission must ensure that the proposal benefits the utility, its customers, and the public generally. We made that positive determination with regard to NW Natural's proposed mechanism in UG 143. There, the company entered into a stipulation with CADO and Staff that included a partial decoupling mechanism and price elasticity adjustment. Under the stipulated decoupling mechanism, NW Natural will defer and subsequently amortize 90 percent of the margin differentials in the residential and commercial customer groups.

The stipulated agreement in UG 143 contains numerous features to benefit customers and the environment. To ensure that service quality does not deteriorate under decoupling, NW Natural agrees to adopt a service quality measure that will allow the Commission to monitor the company's performance over the next decade. To enable a full review of the company's cost structure with decoupling, NW Natural also commits to file a general rate filing this November. Moreover, the agreement provides funding for public purpose programs, including enhanced energy efficiency and low-income bill payment assistance. NW Natural also agrees to permanently transfer its energy efficiency programs to an independent entity, such as the Energy Trust of Oregon.

Due to these and other key features of the stipulation, we determined that the proposed decoupling mechanism should be adopted for NW Natural. We found that the stipulation recognizes the interests of all the parties in UG 143, not just those who signed the agreement. Despite the general questions and concerns related to decoupling, we concluded that, as a whole, the stipulation produced a just and reasonable result and should be adopted.

After review, we are unable to reach a similar conclusion in this case for several reasons. First, unlike NW Natural's stipulated proposal, PGE's decoupling mechanism does not weather-normalize customer usages. While we acknowledge PGE's desire to eliminate weather-related risks, the prior decoupling mechanisms adopted in Oregon have not allowed the recovery of margin losses associated with usage deviations caused by weather. Indeed, the previous decoupling mechanisms were designed to address disincentives for least-cost planning, not to reduce weather-related risks.

Second, PGE's proposal relies on customer usage levels from docket UE 115 to establish baseline volumes. Although UE 115 was completed just over a year ago, the reductions since that time to PGE's load caused by the current recession and rate hikes would result in an immediate and potentially significant price increase if the decoupling mechanism were implemented. Moreover, in contrast to NW Natural's stipulated mechanism, PGE's proposal contains no commitment on behalf of the company to file a general rate case in the near future. With no anticipated general rate review, neither the Commission nor the parties will have an opportunity in the near future to review PGE's costs and earnings under decoupling, or to examine whether the company's cost of capital should be adjusted to account for the risk-reducing mechanism.

In addition, the UG 143 stipulated agreement includes a commitment by NW Natural to (1) adopt a service quality measure that includes financial penalties for poor performance and (2) permanently transfer its DSM and energy efficiency programs to an independent entity. Because the Commission currently lacks the authority to require NW Natural to undertake these actions, we concluded that the stipulated agreement offered additional benefits to customers to help offset our concerns about decoupling. Thus, NW Natural's stipulated decoupling mechanism contains benefits that cannot be ascribed to PGE's proposal.

For these reasons, we are unable to conclude that PGE's decoupling proposal is in the public interest and should be adopted. PGE's proposed Schedule 123 should be denied.

ORDER

IT IS ORDERED that Advice No. 01-3, filed by Portland General Electric on March 19, 2001 to Decouple Distribution Revenues from Residential and Small Nonresidential Consumers and their kWh Sales, is permanently suspended.

Made, entered, and effective _____________________________.

______________________________	______________________________
Roy Hemmingway Chairman	**Lee Beyer** Commissioner
	______________________________
	Joan H. Smith Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order to a court pursuant to applicable law.