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To: Honorable Bob Smith, Chairman
Senate Environment and Energy Committee

From: Stefanie A. Brand, Director
New Jersey Division of Rate Counsel

Re: Decoupling Work Group

Date: June 18, 2014

Thank you for the opportunity to participate in the Decoupling Work Group. Rate Counsel appreciates the important dialogue regarding how our state will move toward a more efficient and less carbon-producing energy portfolio while maintaining safe and reliable electric service at just and reasonable rates. While the group was not able to reach a clear consensus, Rate Counsel believes the dialogue is useful. We write here to explain our opposition to decoupling and our thoughts on fair and cost-effective methods of encouraging utility participation in energy efficiency (EE) and renewable energy (RE).

It has been said that in order to increase energy efficiency and renewable energy, utilities must be given incentives to sponsor and participate in such programs. There are many ways of providing such incentives. One way is "decoupling," which is a term often used for the concept of separating how a utility gets paid from how much energy it sells. Decoupling is merely one form of available incentive. There are also many forms of decoupling.

New Jersey does have some experience in providing incentives for utilities to participate in energy efficiency and renewable energy programs. Two of New Jersey's gas companies (South Jersey Gas and New Jersey Natural Gas) have BPU-approved Conservation Incentive Programs (CIPs). Under these programs, the companies' shareholders pay for conservation programs that reduce the amount of gas the company needs to serve its customers. The company may then demonstrate that it has achieved savings in the gas supply costs that it passes through to customers through its BGSS rate, such as by restructuring the company's contracts with the interstate gas pipelines to avoid paying for transportation and storage capacity it does not need due to the reduced usage. If it makes an adequate showing, shareholders then are allowed to impose a surcharge to recover their lost revenues, up to the amount of the BGSS savings. These programs are small but work well, as they are designed to provide an incentive for the companies to promote energy efficiency and conservation, but ensure that they are only rewarded for the benefits their programs provide. However, these programs would be difficult to translate to electric companies for a variety of reasons (*e.g.*, they don't have capacity contracts that can be restructured, it is hard to normalize for weather, there are differences between the BGS and BGSS mechanisms, etc.).

Several years ago, legislation was introduced that would have allowed for decoupling for New Jersey's electric and gas utilities. That bill was opposed by the BPU and a broad coalition of business and consumer representatives. The bill was not passed. However, shortly after, in 2008, the Legislature did pass N.J.S.A. 48:3-98.1 (commonly called "Section 13 of RGGI") which, for the first time since deregulation, allowed gas and electric utilities to invest in renewable energy and energy efficiency programs. The statute does allow alternative revenue mechanisms for EE and RE programs if approved by the Board. While Rate Counsel opposed Section 13 of RGGI at the time, it has turned out that some utilities have invested significantly in RE and EE programs through Section 13. The cost recovery mechanism that has been utilized for these programs provides for a tracker which allows contemporaneous recovery at either the Weighted Average Cost of Capital (WACC) approved in the companies' last rate case, or a WACC updated to reflect the current cost of debt. Through Section 13 programs, PSE&G has or will be investing over $1 billion in solar programs and $300 million in energy efficiency programs. In addition to their CIP programs, New Jersey Natural Gas has invested over $100 million in energy efficiency programs and South Jersey Gas has also spent almost $50 million on EE programs. Other companies have also invested in EE and RE both through Section 13 of RGGI and through unregulated affiliates.

These programs represent a significant ratepayer-funded investment by the utilities in EE and RE. These investments are in addition to ratepayer investment through the Societal Benefits Charge, which funds the Office of Clean Energy's (OCE) programs each year. While the annual budget for OCE programs varies each year, the FY 2015 budget calls for new ratepayer funding of almost $250 million. These funds are also in addition to ratepayer funding through renewable energy credits (RECS). While the exact amount spent by ratepayers for RECS is not known (because it is incorporated into proprietary bids by BGS bidders) ratepayer exposure for solar RECS alone through 2028 is over $6 billion.

Despite these substantial investments already committed by ratepayers to encourage EE and RE, Rate Counsel has not opposed finding ways to incentivize further investment. Rate Counsel does believe that ratepayer investment in renewable resources should be limited in time and should only be used to help "jump start" new technologies and industries. Ratepayer investment should not become the norm for the solar industry or other renewable industries. Once "jump started" those industries must find ways to stay in business with little or no ratepayer contributions. Rate Counsel is more supportive of ratepayer investment in energy efficiency, as greater efficiency may reduce prices overall and may reduce the need to pay for new generation or transmission. However, ratepayer funding for EE must be cost-effective, fair and transparent.

Rate Counsel does not believe that "decoupling" is the best way to provide incentives for utilities to invest in EE and RE. Rate Counsel also does not believe that decoupling proposals generally are either fair or transparent. For this reason Rate Counsel generally does not support "decoupling" as a means of encouraging greater energy efficiency or renewable energy programs.

At the outset, it is important to understand that traditional utility ratemaking is designed to ensure that utilities operate efficiently. In a rate case, a utility's rate is set by looking at the company's costs and spending in a test year. Once the rate is set, there is a strong incentive for the utility to operate efficiently because if it keeps its costs low, it earns more under the approved rate. If the utility's earnings are no longer tied to the cost of providing service, then some of these incentives to operate efficiently will be lost. Moreover, the return the utility earns on its rates is intended to reward it for assuming the risk of revenue and sales differences from the test year. Any decoupling mechanism that guarantees a level of recovery and insulates the utility from the risks associated with providing service must be accompanied by a reduction in the utility's return. Otherwise, the decoupling mechanism is not only inconsistent with some of the major goals of regulating utilities; it is fundamentally unfair in that it rewards the utility for risks that would now be assumed by ratepayers.

In addition, the traditional ratemaking process ensures that if usage goes down for reasons unrelated to the utility, such as weather or a downturn in the economy, the utilities are not unfairly rewarded. Consumers should be allowed to use less energy because they are struggling to afford electricity or natural gas without having to shoulder an additional burden of making utility shareholders whole. In fact, decoupling could have the perverse result of reducing the incentive for ratepayers to conserve, as it may erode the bill reductions they hope to see from energy efficiency. Moreover, it is not clear that utilities will necessarily see reductions in sales as we move forward. While energy efficiency may reduce sales, increased use of electronics and initiatives such as electric vehicles may actually result in increases in energy use that will simply be offset to some extent by efficiency. Utilities should not be guaranteed an increase in sales and should not be compensated simply because their growth may be slowed due to greater energy efficiency.

As noted, decoupling can take various forms. Some of the proposals still require traditional rate cases, but also provide for earnings reviews between rate cases to ensure that a utility is earning their authorized return. Under these proposals, if a utility is over or under earning, its rates would be adjusted between rate cases to allow it to earn its authorized return despite lower sales. If such reviews were designed so that they did not violate the prohibition against single-issue ratemaking, then they might be acceptable from a ratepayer perspective. Many costs and expenses of a utility will increase or decrease between rate cases. For example, a company may add or reduce the number of employees between cases, or their pension costs may go up or down with losses or gains for their pension funds in the stock market. The prohibition against single-issue ratemaking provides that you may not consider such costs in isolation, but must consider the whole in setting rates. This prohibition serves to ensure that any increases are thus kept as low as possible. If the reviews that occur between rate cases were to consider all changes in costs over the relevant time period, rather than simply lost revenues, the process would be fairer and more transparent. It would also assist in ensuring that the utilities are not rewarded for decreased sales that occur due to factors other than their EE programs. The utilities are not likely to support such a process, however, because the proceedings between rate cases would then be much more extensive.

In sum, while some parties advocate for decoupling as an incentive to get utilities to invest in energy efficiency and renewable energy, there are certain pitfalls that go along with separating a utility's earnings from its cost of service. Rate Counsel does not believe that there has been a demonstration that decoupling would be more effective at encouraging New Jersey's utilities to invest in energy efficiency than simply paying them to do so, which is what the Section 13 tracker mechanism does. While Rate Counsel does have concerns about placing too many costs in tracker mechanisms, because they, too, implicate single-issue ratemaking, at least the Section 13 process allows for a more comprehensive review and greater transparency than most decoupling mechanisms. Trackers also must come with an "umbilical cord" to a rate case, so that regular full-blown reviews of utility rates are preserved.

Again, Rate Counsel very much appreciates being part of the dialogue on this important subject. We would be happy to answer any questions you or others may have regarding our position.

Respectfully Submitted,

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NEW JERSEY DIVISION OF RATE COUNSEL

Stefanie A. Brand

Dated: June 20, 2014

Stefanie A. Brand, Director

cc: members of the Decoupling Work Group