A GOOD FRAMEWORK IS THE FIRST STEP

By Lisa V. Wood, executive director of the Institute for Electric Efficiency.

In March 2007, the Idaho Public Utilities Commission authorized a three-year pilot of Idaho Power Company's (IPC's) fixed-cost adjustment (FCA) mechanism, which "decouples" energy sales from revenue, removing the utility's financial disincentive to invest in demand-side management (DSM). Under the FCA, rates are adjusted up or down each year so that IPC can recover or true-up authorized revenues independently of energy sales, with annual increases capped at 3 percent. Thus, if actual sales are less than predicted due to energy efficiency, IPC can recover its fixed costs.

The commission also authorized a complementary incentive program. The performance-based DSM program provides that when IPC exceeds energy savings targets, it can retain a portion of the financial benefits. Should the utility fall short, it pays a penalty.

Having an appropriate regulatory framework is an important first step for an effective energy efficiency program, but far from the whole story. Market forces and codes and standards play a big role, too.

The Challenges

The FCA pilot applies only to residential and small commercial customers; and the incentive mechanism applies only to the EnergyStar Homes Northwest program, one of many IPC energy efficiency and demand response programs. A successful pilot could lead to expansion of the FCA to other customer groups and a broader application of the incentive mechanisms.

Since the pilot began, the EnergyStar Homes program has seen diminished returns. IPC offers incentives to builders to construct homes 30 percent more energy efficient than those built to state code. The utility measures its success by the number of new home starts that meet its standards and the market share of those starts. In 2006, the program saw 439 new home starts, short of its goal of 465. Best estimates for 2008 put the figure at 257 starts.

Likewise, the program's energy savings declined, from 912 megawatt-hours of peak demand in 2006 to 360 MWH in 2008. Last year, program costs fell from $475,000 to $290,000. In the end, the program shrank due to economic conditions and other factors.

The regulatory mechanisms functioned as intended—because of the combination of the FCA and the performance incentive, IPC was financially indifferent to whether a resource was on the demand or supply side. Also, IPC responded to fewer home starts by shifting focus to market share—the utility's goal now is to capture a percentage of new starts. In 2007, despite the drop in volume, market share increased from 5 percent to 6.5 percent, enough to put the program in the "dead-band" between receiving a payment and paying a penalty.

Fewer home starts accounted for only part of the drop in energy savings and program expenditures. In 2008, Idaho adopted the 2006 International Energy Conservation Code. It meets program standards in several key areas and therefore decreases the incremental energy savings of each EnergyStar home produced. As a result, IPC had to reduce incentives to maintain program cost-effectiveness.

The Takeaways

According to IPC, the first lesson from its experience is that since regulatory frameworks have long-term effects over unforeseeable conditions, the mechanisms must be flexible. A performance-based incentive mechanism that relied solely on achieved savings rather than market share, for example, would have penalized IPC for unavoidable economic conditions over the past two years.

Second, the pilots' failure to stimulate significant energy savings and efficiency investment did not result in a financial setback for the utility or its customers. The IPC program adds to the evidence that a decoupled regulatory structure does not expose customers to risks that outweigh the potential benefits. In this case, new codes and standards resulted in lowering program incentives.

Finally, creating a strong regulatory framework and business model for energy efficiency is a necessary and important step but cannot be the sole focus. Idaho's regulatory structure creates the possibility of a sustainable business model for energy efficiency by ensuring cost recovery, an opportunity to profit from successful performance, and recovery of fixed costs when sales decline. But to capture all cost-effective energy efficiency and demand reduction, programs must respond to market conditions and coordinate with the development of codes and standards. ◆

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MARCH/APRIL 2009

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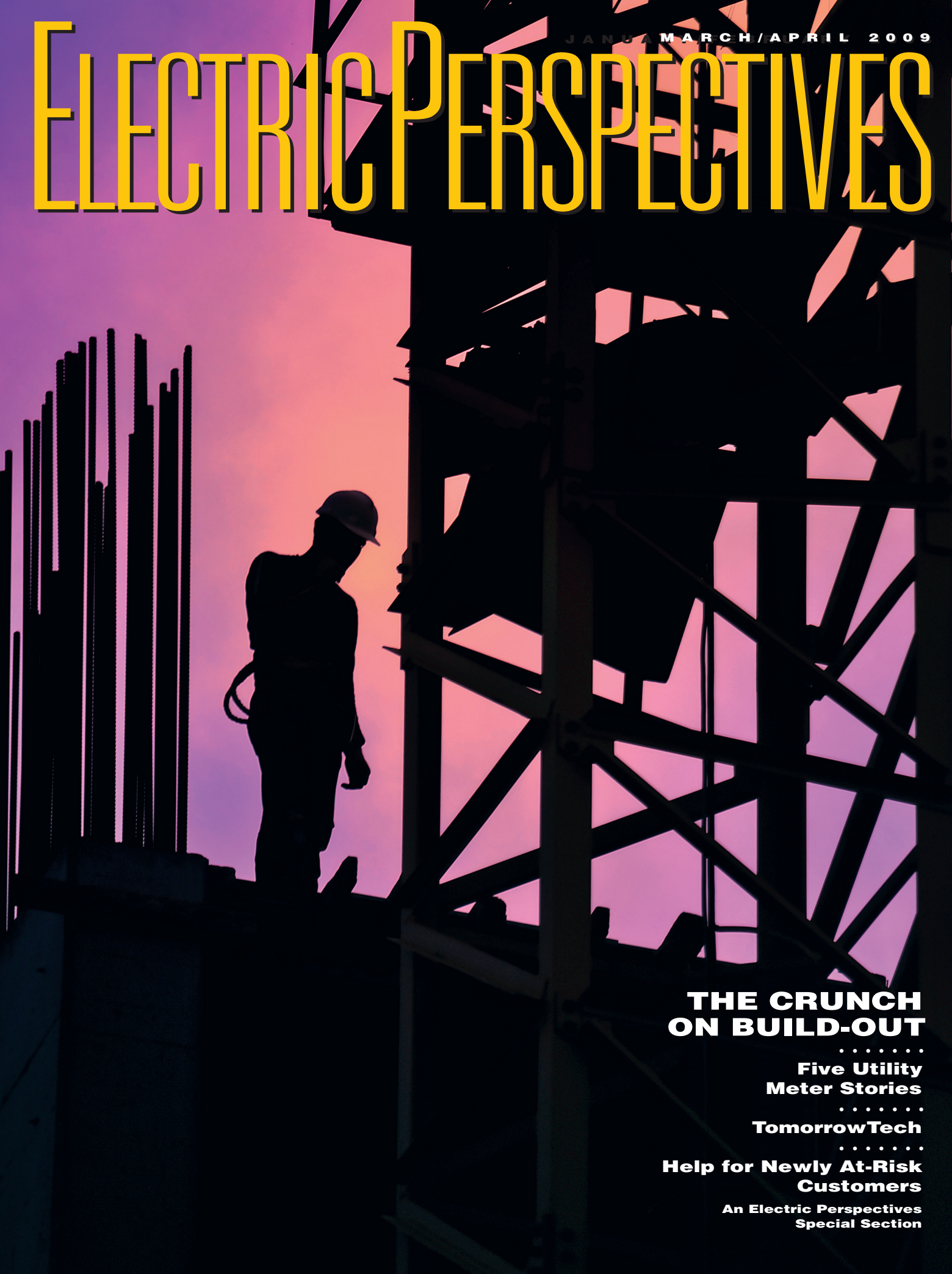

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