Direct Options

Direct Options Executive Market Intelligence **January 2010**

Regulatory Decoupling Removes Financial Barriers to Utility Energy Efficiency Programs

As regulators and utility executives confront expensive capital programs and looming carbon-dioxide reduction goals, efficiency and conservation are gaining more prominence as the low-cost, instantly-available alternative to building new power plants or gas distribution lines.

For too long, utilities have been financially penalized if they helped their customers lower their utility bills by using energy more efficiently. But what is known as "regulatory decoupling" removes institutional disincentives to energy efficiency programs, freeing utilities to achieve meaningful reductions in customer energy use.

Regulatory decoupling will better align financial incentives for utilities, regulators, shareholders, and customers. That means that utility executives can:

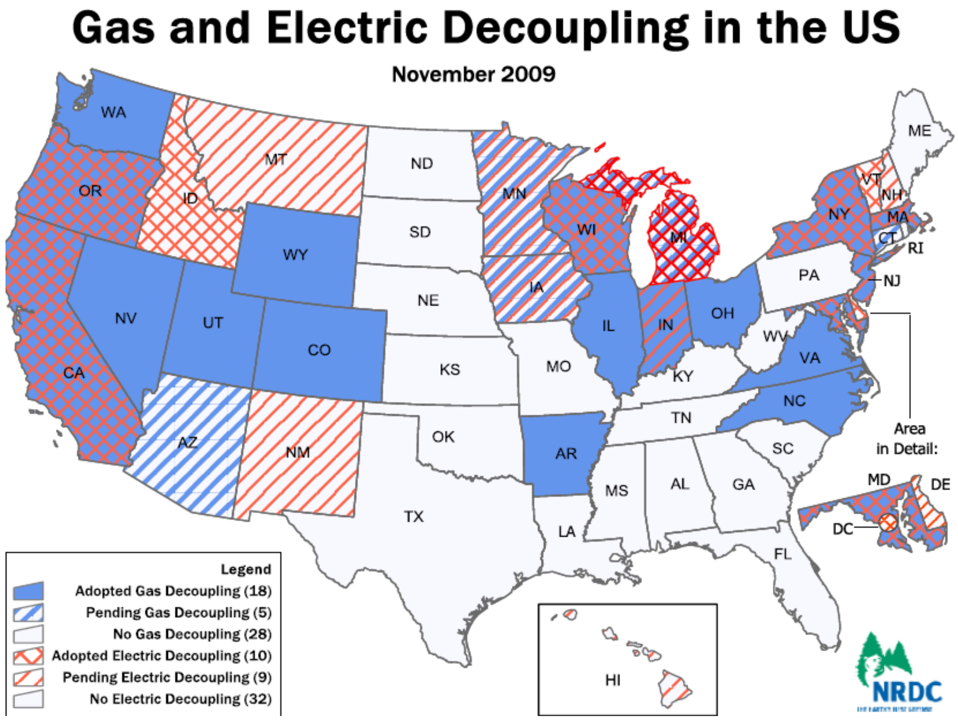
- ✓ preserve existing revenue and margins
- ✓ create opportunities to **increase earnings**
- ✓ meet or exceed regulatory expectations on conservation and efficiency
- ✓ respond to customer requests for help in lowering their energy use
- ✓ maintain and enhance customer satisfaction

Typical utility rates are based on the amount of energy commodities—electricity or natural gas—delivered to customers via the utility's wires or pipes. Customers that succeed in lowering their energy usage generally cause utilities to lose revenue and income. The more successful customers become at using less energy, the greater the toll on the utility's financials.

Regulatory decoupling has eliminated the financial disincentives associated with utilities helping their customers lower their energy use. Ralph Cavanagh, co-director of the national energy program at the Natural Resources Defense Council (NRDC), is a longtime champion of regulatory decoupling. Ralph not only advocates removing longstanding regulatory disincentives to energy efficiency, but also to actually create opportunities to **increase earnings** if utilities effectively implement cost-effective efficiency programs.

"It's good not to lose money automatically when you help your customers save energy, but it's even better from the perspectives of both shareholder and society if management has a financial incentive to succeed," Cavanagh wrote in the Fall 2009 issue of the MIT journal *Innovations*.

Regulatory decoupling has been implemented in about 20 states (see map), and several more state utility commissions are currently considering decoupling measures. About a dozen of those states have included incremental earnings opportunities as part of their decoupling activities.



"A decoupled state regulatory environment that includes an opportunity to create incremental earnings from well-implemented energy efficiency programs, provides a huge benefit to utilities seeking to increase customer participation in efficiency programs," said Jan Moore, president and chief executive at Direct Options.

"In our experience, when utility executives have clear a target, and are given meaningful rewards for exceeding that target, utilities will work hard to exceed that target, which benefits everyone once decoupling is implemented."

Headquartered in Cincinnati, Direct Options has worked with utilities for over 20 years to achieve high enrollment levels in customer energy-efficiency programs. To discuss how Direct Options could boost customer program enrollments, increase customer satisfaction, and support a positive dynamic with your state regulators, contact Harlan Jackson at 513-779-4416 or hjackson@directoptions.com.