
Making the Legal Case for Good Policy on Standby Rate Design

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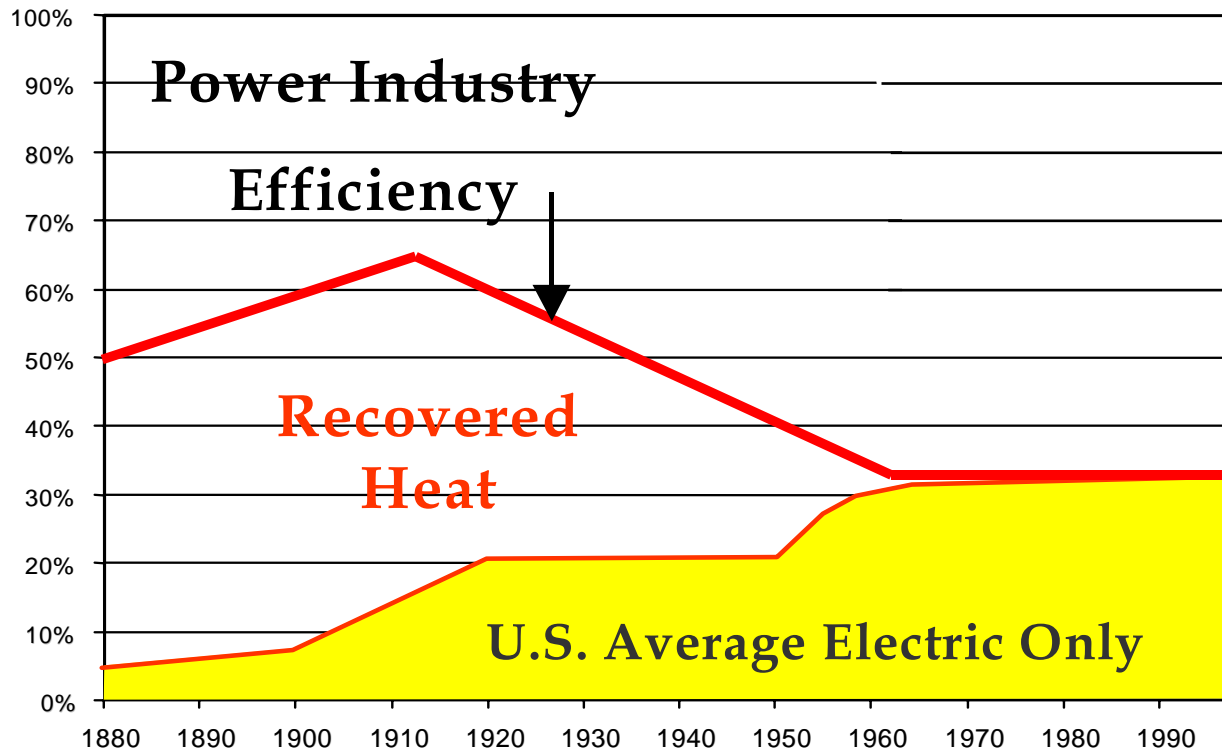




Removing the regulatory barriers to CHP is in the public and consumer interest.

- Privately owned/financed CHP serves ~10% of US power needs
 - Compare to 7% from hydro, 13% from power-only nat gas in 2004
 - Median CHP plant = 2 MW.
 - Only significant generation source that is not underwritten by ratepayers
- Privately deployed CHP is cheaper and cleaner than alternative
 - Unregulated capital budgeting ensures that the only projects that get built are those that are dramatically more energy- and capital-efficient than central paradigm
 - Local siting avoids most expensive component of grid (T&D) and makes it possible to recover waste heat, use opportunity fuels.
- CHP makes big problems smaller.
 - Nat'l security/global warming: More CHP = less fuel use
 - NIMBY problems: Local generation avoids wires & central power
 - Energy costs: greater efficiency = lower gas & electric clearing prices
 - Injects competitive market discipline into electric sector (if allowed!)

The historic efficiency of the US power sector shows the benefits that are created by competition – and the costs when it goes away.



If we were still as efficient as we were in 1910...

- **Would spend ~\$100 billion less on fuel each year.**
- **Would emit ~1 billion fewer tons of CO₂ each year.**

However, these policy arguments don't carry much weight in some of the largest “battlegrounds” for CHP barrier removal.

- Federal and state legislative efforts to remove barriers were proactive, and driven by big-picture policy objectives
 - PURPA most obvious example
 - State legislatures have initiated interconnection standards
 - 1992 EPACT and FERC 888 also driven by macro policy objectives
- Big (and growing) barriers are in utility rates that are decided in PUC proceedings that tend to be reactive, and necessarily take a more narrow, legal approach
 - Standby rates, demand ratchets, certain block-pricing schedules, “cogen rates”, etc.
 - Rate and legal precedent is often at odds with policy objectives



Within a typical PUC, narrow arguments of law & politics tend to trump sweeping arguments of policy.

- Policy argument: “Imposing a standby rate designed to prevent revenue reduction is inherently anti-competitive and will force us to continue our reliance on dirty coal instead of bringing clean DG on-line.”
- Legal argument: “We need a standby rate because otherwise, our revenue will fall and under the terms of our most recent revenue freeze/rate settlement this would compel us to file for a whole new rate case, forcing us to pass recent gas price increases along to all rate payers”
- *Which one carries more weight before your commission?*

With only the utility sector relying on legal arguments the jurisprudential support for standby rates has been perceived as much more absolute than it actually is.

- *Hope* (1944) says that rate-making involves a “balancing of shareholder and consumer interests”, but much testimony to PUCs presumes the two are perfectly aligned:
 - “Cross subsidization” arguments presume that shareholder interests are paramount, since they do not allow for consumers to benefit at shareholder expense.
 - EPRI currently working on a “win/win” model for utility regulation that considers only utility shareholders and DG investors; analytical model fails even to acknowledge actions that benefit utility customers at the expense of their shareholders!
 - Many other examples (and “consumer advocates” are often the worst offenders!)

A more detailed review of relevant jurisprudence calls into question the validity of most existing standby rates.

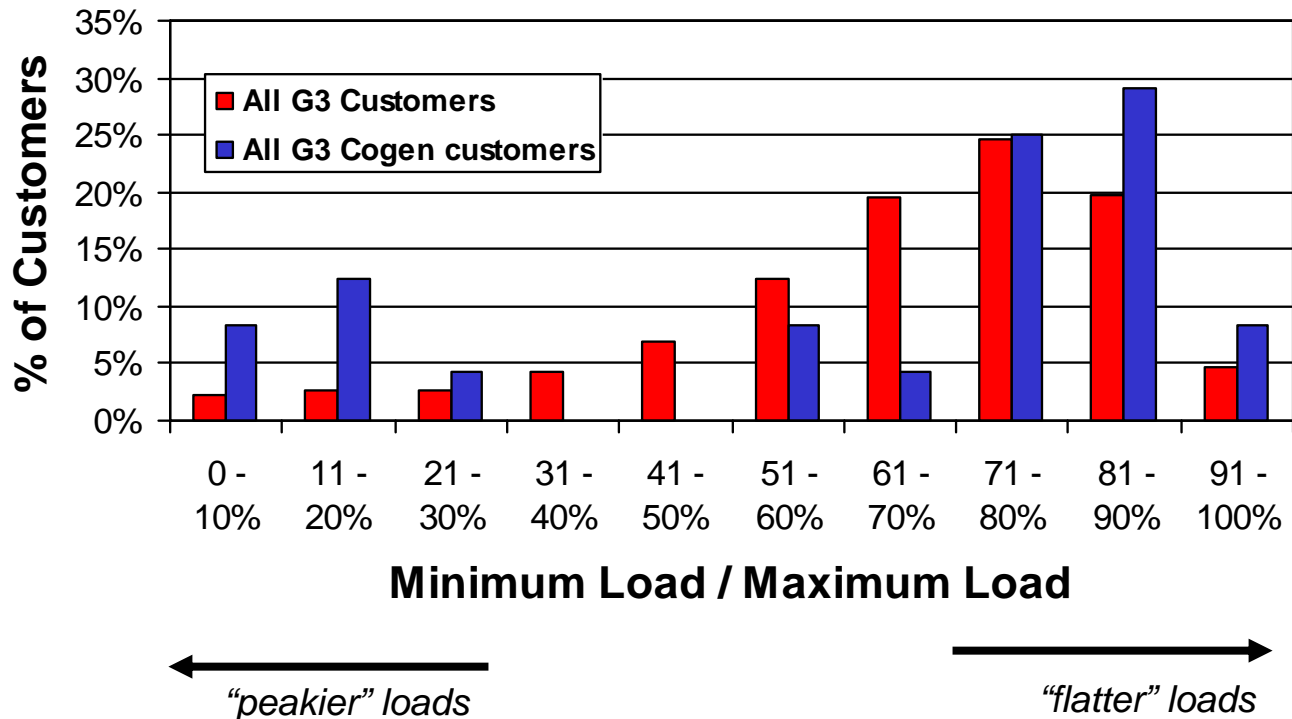
- 1944, *Hope*: The Supreme Court says that rates must “**balance shareholder and consumer interest**” and that neither can be assumed to have primacy. Standby rate arguments that conflate the two are de facto not striking this balance.
- 1945, *Market Street*: SC ruled that rates cannot be imposed to “**restore values that have been lost by the operation of economic forces**”. This is precisely what most standby rates do, by restoring revenue that would otherwise be lost to more cost-effective technologies.
- 1935, *Bluefield*: SC says that utility returns should be commensurate with those of “**other business undertakings which are attended by corresponding risks and uncertainties**“. Since standby rates, demand ratchets and other elements reduce utility exposure to load volatility, does this not imply that they should be accompanied by a reduction in utility ROE?
- 1978, *Public Service Company of Indiana*: The 7th Circuit Court asserted a rate is not **unduly discriminatory** (and therefore not illegal under the Federal Power Act) unless it is contrary to the public (as opposed to consumer) interest. CHP/DG’s impacts on the public interest therefore ought to be THE key consideration in standby rate design.
- 1978, *PSCI* decision also asserted that the ban on undue discrimination may be “**...breached in a case where one customer is afforded, without any factual justification, a contract rate that is significantly lower than the pre-existing rates for all other members of the class.**” Many, if not most standby rates can be shown to be unduly discriminatory based on a rigorous application of this test.



At a minimum, proposed standby rates ought to take the “similarly situated” test required by *PSCI*.

Utility claim: DG reduces fixed cost recovery and must therefore be accompanied by fixed rate elements to “make the utility whole” and prevent cross subsidization

Fact: For this particular utility, customers with Cogen are no peakier than similarly situated customers in the rate class



Perhaps the most egregious failure of most standby rates is a failure to include all relevant facts in the rate calculation.

- *Public Service Company of Indiana*: “[A commission]... must show not only that factual difference justify some rate differences, but also that the factual differences justify the specific rate differences permitted.”
- Standby rates based on unverified utility assertions are invalid under this guidance, as are size- or technology-specific standby rate exemptions!
- The nature of the typical standby rate case is such that many relevant facts are not taken into consideration.
 - Rates created between rate cases tend only to consider the impacts on revenue. Changes in revenue DO NOT equal changes in utility return without a full consideration of the impact on utility capital & operating costs
 - Political bias towards settlements encourages parties to identify the maximum acceptable levels of pain, not underlying facts
 - Facts relating to environmental impacts, congestion relief, job-creation, etc. are rarely if ever considered at any quantitative level.

Recommendations (1/2)

- 1. Do not allow standby rates to be considered as “single issue” rate cases.** Failing to include cost side of ledger excludes precisely those facts which would favor the interests of utility consumers at the expense of utility shareholders.
- 2. Apply the same rigor and analytical tests to standby rates as to other rate elements.** It is logically inconsistent for utilities to require higher revenues when throughput rises AND when throughput falls. Marginal cost causation cannot be unidirectional.
- 3. Include environmental and economic impacts of CHP/DG in rate making considerations, so as to fully include the “public interest” in rate considerations.** Utility dividend disbursement cannot be the only measure of the public interest (*Hope*: “regulation does not assure that the business shall produce net revenues “)

Recommendations (2/2)

4. **Consider long-term impacts of a rate, so as not to direct investments towards paths that don't lead to long-term goals. (Yogi Berra: "If you don't know where you're going, you might not get there.")**
 - A grid that preferentially relies on lower-cost, more efficient, non-rate payer backed capital is in society's best long-term interest.
 - Short-term considerations of revenue maintenance, rate-freezes, "stranded cost recovery", etc. are directly antithetical to long term goals!

5. **Don't exempt DG/CHP from standby rates absent factual analysis. Do reject all standby rates until complete & proper analysis can be done.**
 - Nature of past standby rate deliberations virtually guarantees that existing rates are unjustifiably biased in utility's favor.
 - Since DG/CHP creates public benefits on private investment, a full and complete accounting is virtually guaranteed to lead to a zero or even negative standby rate – but don't take my word for it!