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UTAH PUBLIC SERVICE COMMISSION

Memorandum

To: Utah Public Service Commission

From: Committee of Consumer Services
Sandy Mooy, Administrative Secretary
Dan Gimble, Sr. Economist

Re: Comments on DSR Collaborative Report

Date: May 8, 1995

I. Background

Over the past year, the Committee of Consumer Services ("Committee") has actively participated in the Demand Side Resource ("DSR") Cost Recovery Collaborative established by the Utah PSC to examine various DSR issues. The principal mission of the Collaborative was to undertake an "experiment" to see how an agreed upon DSR cost recovery method and a lost revenue formula would perform based on a one year trial period. The filing of the DSR Collaborative Report with the Commission on March 31, 1995 brings to closure the DSR cost recovery and lost revenue experiment that began in early 1994. With the exception of the Committee, all the major parties participating in the cost recovery collaborative have recommended--prior to issuance of the Collaborative Report--adoption of a settlement document which incorporates a cost recovery method and a lost revenue formula closely approximating the method/formula analyzed during the experiment period. The Committee chose neither to support nor oppose the DSR Settlement currently pending before the Commission. After studying DSR issues at some length, the Committee remains unpersuaded that DSR programs either sponsored or solicited by PacifiCorp are in the long-term interests of the ratepayer classes which the Committee expressly represents. The submittal of the DSR Collaborative Report to the Utah Commission affords the Committee occasion to air some of our concerns with DSR.

II. Comments

A. Repercussions of the Existing Divisional Load-Resource Imbalance for Utah DSR Programs

It is the Committee's understanding that PacifiCorp's off-peak transmission bottleneck between the Utah Division and the Pacific Division has resulted in excess resource capacity on the east side of the system. Last year this divisional resource-load imbalance led the Company to offer a prospective Utah cogeneration project an avoided cost price which was 33% below the system avoided cost. If supply side resources sited in the Utah Division are deemed to have a lower value to the system, we believe that the Company needs to perform a study (in the context of RAMPP) to determine whether or not the same is true for DSR. We raised this issue in our formal comments filed with the Utah Commission on the RAMPP III Report, but it has yet to be resolved to our satisfaction. In short, we are troubled by the possibility that the Company may be prematurely acquiring overvalued DSR in Utah during a period of resource abundance.

B. The Conservation is Costly Paradox: Implications for DSR

One of the perplexing conclusions drawn from RAMPP III analysis, which is also a preliminary conclusion echoed in RAMPP IV, is that higher load growth has a negligible affect on customer price levels whereas lower load growth results in higher prices for customers. This conclusion leads the Committee to adduce that there currently must be excess capacity on the PacifiCorp system of a magnitude such that lower load growth fosters rising prices as fixed costs are apportioned over a relatively smaller customer base. While this particular conclusion is subject to a variety of interpretations (e.g., the role that lost revenues plays in obtaining this result), the one that jumps out at us is that investing in DSR in a capacity rich situation amounts to questionable public policy. In any event, we expect that the Company will address the implications of this conclusion in the RAMPP IV Report and fully explain why an <u>inverse</u> relationship between load growth and prices continues to exist.

C. The Role of DSR in a Restructured Electric Industry

The prospect of an increasingly competitive electric industry in the near future gives rise to the issue of stranded investment. In particular, who bears the risk of DSR-related stranded investment costs in the transition to the open access, competitive paradigm is a potentially costly issue for captive ratepayers. It is common knowledge that Utah-specific DSR investment will be primarily limited to customers in the large commercial and industrial classes. These customers may be able to avail themselves of competitive generation options in the future, bypassing the utility's generation while still relying on its transmission and distribution system. The issue relates to the fact that departing commercial and industrial customers take their DSR investments with them--investments that other classes may pay in part for, depending on: (1) how much of DSR costs are recouped via the energy service charge [ESc] from DSR participants; and (2) how DSR costs are ultimately allocated at the class level. While the deployment of the ESc engendered partial unbundling of DSR costs from general rates by making the direct beneficiaries pay a share of program costs, the CCS believes that full unbundling of DSR costs from general rates may be a preferable solution to alleviate the DSR stranded investment problem.

D. DSR: Conservation, Customer Service or Both?

The Committee has always held the view that while DSR may have a tangible conservation aspect, it also has an intangible aspect relating to customer service and establishing goodwill. Specifically, DSR represents a marketing tool that the Company can use to attract new customers, expand the load of existing customers or retain existing customers. In other words, DSR fits in nicely with the Company's overall economic development or business strategy. For example, some of the larger Utah industrial and commercial customers were apparently dissatisfied with the Industrial and Commercial Energy Finanswer DSR programs that were offered by the Company under DSR tariffs. Consequently, the Company developed the Major Accounts DSR program which was tailored to meet the idiosyncratic needs of certain large customers. The salient point is that the intangible dimension of DSR relating to customer service and establishing goodwill may indeed overshadow the conservation dimension of DSR. The Committee feels that this is yet another reason to support the full unbundling of DSR from general rates.

E. The Economics of Supply Side Resources Versus Demand Side Resources: The Hidden Cost of Lost Revenues

Since lost revenues are excluded from the Total Resource Cost ("TRC") test used in the RAMPP IRP forum to perform a cost comparison of demand-side resources with supply side resources, the Committee is concerned that the true cost of DSR to ratepayers may be greatly understated. Conventional wisdom holds that lost revenues are not a cost of production in the true meaning of the term. We have no argument here. However, allowing the Company to recapture estimated lost revenues attributable to the implementation of DSR programs represents an indirect cost that, like direct costs of production, will be recovered from customers in rates. The Committee believes that it makes little sense to ignore lost revenues in the IRP framework when it appears that lost revenues, to some extent, will be reflected in electric rates. If all or some portion of estimated lost revenues are to be recovered from ratepayers, it seems appropriate to include these costs in the DSR cost equations when making economic comparisons, and ultimately resource selections, among competing DSR and supply side alternatives. The Committee maintains that there should be an strong link between planning and ratemaking; a nexus that would be compromised if lost revenues are excluded from the economic comparison of resources at the IRP level.

F. Green Pricing: Panacea or Pipedream?

A somewhat radical departure from conventional utility pricing, that in some fashion complements the ESc concept and has a certain visceral appeal, is to explore "green pricing" as a way to recover the piece of DSR cost outlays which are not covered by ESc revenues generated directly from DSR beneficiaries. In effect, green pricing is a variation on the full unbundling theme.

With the advent of a burgeoning environmental awareness in recent years, there may be a particular segment of the general public that is willing to incur higher electricity bills (i.e., pay green prices) to support or subsidize the proliferation of DSR programs. For instance in Salt Lake City proper, there appears to be a substantial number of households (roughly 10% of total households) willing to pay an extra amount on top of their base garbage collection fee for "blue buckets" to recycle items such as plastic containers, newspapers, magazines, aluminum cans and so forth. Households participating in curbside recycling pay a sunk cost of $7.97 for the blue bucket and a monthly pickup fee of $3.70 for a total first year cost of $52.37. If such households are willing and able to incur a blue bucket "tax" to recycle these items, they may similarly be willing to pay an energy conservation tax through the vehicle of green pricing. Stated differently, despite the absence of economic value in recycling plastic containers for a given household, there appears to be a level of social welfare or psychological value evidenced by the fact that so many households are engaged in recycling activities.

Whether or not there is significant interest in green pricing could be accomplished through the distribution of a customer survey to households and businesses alike. This survey would have to carefully delineate the anticipated costs and benefits attendant to green pricing so that the individual customer could make an informed decision on whether to participate or not. Those customers voluntarily electing to pay green prices would indicate so on the survey. The green price would subsequently be reflected in their monthly bills as an adder to base rates.

III. Conclusion

With the Utah Commission presently undergoing a transition as two new commissioners come aboard, the Committee feels that it is appropriate to indicate the various reasons underlying our position to neither support nor oppose the DSR Settlement currently pending before the Commission. From a public policy standpoint, the Committee is still not convinced that DSR is in the long-term economic interest of Utah Power's residential, small business and irrigation customer classes. In particular, we question the wisdom of investing in DSR when the electric industry is likely to be radically restructured in the near future. While the final form of this reshaping is uncertain, the issue of stranded investment recovery appears to be unavoidable and will invariably be a hotly contested issue among the many stakeholders in Utah. Because DSR investment in Utah will primarily be limited to the large industrial and commercial customer classes (those classes that will initially have competitive choices), we fear that today's DSR investment will be tomorrow's stranded investment with core customers picking up the "stranded investment" check. In a parallel way this is what transpired on Mountain Fuel's system back in the late 1980s, as large industrial and commercial customers switched to interruptible transportation service, procured competitively priced gas supplies on the open market, and left firm service customers saddled with high cost, take-or-pay gas contracts. We hope the Commission will keep this history lesson in mind as it considers the merits of the DSR Settlement against the backdrop of an emerging competitive paradigm in the electric industry.

cc: Douglas C. Borba, Director, Department of Commerce
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