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## FISCAL IMPACT REPORT

ORIGINAL DATE 2/11/09

SPONSOR Fischmann LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Utility Rate Design Energy Use and Sources SB 319

ANALYST Lucero

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY09	FY10	FY11	3 Year Total Cost	Recurring or Non- Rec	Fund Affected
<b>Total</b>		Indeterminate	Indeterminate	Indeterminate	Recurring	All Funds

(Parenthesis ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Public Regulation Commission (PRC)

Energy, Minerals and Natural Resources Department (EMNRD)

### SUMMARY

#### Synopsis of Bill

Senate Bill 319 enacts a new section of the Efficient Use of Energy Act mandating the Public Regulation Commission (PRC) to discourage the excessive use of energy consumption by dividing consumption levels into block rates. Each block would require a higher price per unit of energy consumed for each succeeding higher block in each billing period. The reshaped rate design shall not result in an increase or decrease to the utility's overall revenue.

The bill also requires rate designs to encourage the promotion of energy efficiency and use of renewable energy sources for new development.

### FISCAL IMPLICATIONS

Rates paid for energy are usually composed of a fixed rate and a commodity rate measured by kilowatt hour (kWh). The application of an increasing block rate design, generally results in some rate-payers paying more per unit of energy as more energy is consumed; however, under the block rate plan, rate-payers may pay a lesser amount as a fixed charge.

It is unclear whether the bill applies only to residential customers or if business and governmental units would be subject to block rate energy pricing. The impact to governmental budgets is indeterminable at this time.

## SIGNIFICANT ISSUES

There are a number of ways to use electricity rates to encourage electricity conservation or a reduction in peak demand. One strategy is to adopt inverted block rates, whereby the price per kilowatt hour (kWh) increases as electricity consumption increases (as proposed in this bill). Two other strategies include time-of-use (TOU) rates that have higher kWh charges during peak demand periods compared to off-peak periods and finally, demand response pricing strategy such as real-time pricing or critical peak pricing.

According to a Western Governors' Association (WGA) Energy Efficiency Task Force report several western states have switched to inverted block rates (also known as tiered rates) for residential customers. Under inverted block or tiered rates, the price per kWh increases as electricity consumption increases. In California, basic residential rates are split into five tiers, with the highest consumption tier being nearly twice as expensive per kWh as the lowest tier.

The PRC notes that increasing block rate designs are already in use, or are under consideration for many PRC-regulated utilities.

The Efficient Use of Energy Act (EUEA) was amended in 2008 with the passage of HB305 to incentivize utilities to pursue cost-effective energy efficiency measures. SB319 seeks to discourage excessive use of, and the use of nonrenewable sources of energy through revenue-neutral utility rate design.

The “New Mexico Energy Efficiency Strategy: Policy Options,” a report done for Energy, Minerals and Natural Resources Department by the Southwest Energy Efficiency Project, recommends that New Mexico adopt decoupling and/or performance-based incentives (see below). SB319 would advance adoption of performance-based incentives, by explicitly penalizing those who use energy less efficiently and charging less to those who do not.

Currently utilities in New Mexico receive dollar-for-dollar cost recovery for their demand side management (DSM) programs through a tariff rider mechanism. A number of states, including California, Idaho, Maryland, Oregon, and Utah have adopted decoupling policies that break the link between electric or natural gas utility sales and recovery of fixed costs. The amount of allowed fixed cost recovery is determined ahead of time in a rate case, and a true-up mechanism is used to ensure the utility received no more (or no less) than the determined amount. This removes the financial incentive that utilities traditionally have of promoting more energy consumption (and ineffective conservation programs) in-between rate cases. It also removes the disincentive that utilities have for supporting adoption of combined heat and power systems by their customers.

In 2006, PNM proposed decoupling for residential and small commercial customers as a way to remove disincentives for implementation of natural gas DSM programs. However, the New Mexico PRC rejected PNM’s request on the grounds that it would insulate PNM from a large variety of business risks, not just reduced sales due to DSM programs, and for other reasons.

Other states including Arizona, Colorado, Connecticut, Massachusetts, Minnesota, and Nevada have adopted performance incentives (also known as shareholder incentives) to reward utilities for implementing effective DSM programs and overcome their historical reluctance for doing so. Various approaches to performance incentives exist, including allowing utilities to earn a higher-than-normal rate of return on some or all DSM expenditures, allowing utilities to earn a bonus if they meet certain energy savings targets, or allowing utilities to keep a portion of the net economic benefits resulting from their DSM programs. The incentive is usually limited to a small fraction of

the net economic benefits produced by the DSM programs. Performance incentives can be relatively easy to implement, and consequently more states have adopted this approach than decoupling, at least for electric utilities.

The amendments to the EUEA adopted by the New Mexico legislature in 2008 direct the PRC to provide utilities an opportunity to earn a profit on their cost-effective DSM programs. The PRC is currently conducting a rulemaking to establish policies to implement this legislation.

### **PERFORMANCE IMPLICATIONS**

SB319 would assist Energy, Minerals and Natural Resources Department (EMNRD) in meeting its strategic goal to promote energy conservation in New Mexico's economy including the residential, commercial, institutional, and industrial sectors. It also would help meet executive order 2007-053, which requires New Mexico to reduce per capita energy consumption 10 percent by 2012 and 20 percent by 2020, relative to 2005 levels.

### **ADMINISTRATIVE IMPLICATIONS**

The PRC could incur additional employee time developing or analyzing new rate designs that would encourage the promotion of energy efficiency and use of renewable energy sources for new development.

### **RELATIONSHIP**

Relates to SB320.

### **TECHNICAL ISSUES**

Section 1, Subsection A(1) of the bill requires that a utility's rate design encourages energy conservation by the use of an increasing block rate design. This subsection of the bill removes the PRC's discretion under existing law to prescribe this rate design in appropriate circumstances, and instead requires an increasing block rate design for all utilities.

Section 1, Subsection A(2) of the bill includes language requiring that a utility's rate design "for new development, discourage the increased use of nonrenewable energy sources while encouraging maximum energy efficiency and the use of renewable energy sources." This language is ambiguous by its use of the phrase "for new development". The Commission currently has the authority to approve rate designs that encourage energy efficiency and use of renewable energy resources and discourage the increased use of nonrenewable energy sources where appropriate.

It is unclear if SB319 would require increasing blocks for all rate class tariffs. The intended benefits of increasing block rates may not be realized for some rate classes, such as street lighting. It is unclear how a particular section of the Efficient Use of Energy Act would apply to cooperatives.

### **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

The application of increasing block rates and other rate designs would remain at the discretion and judgment of the PRC.