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## Second Joint Statement of the American Gas Association and the Natural Resources Defense Council

May 2008

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As the United States confronts the dual challenges of ensuring that Americans have access to affordable, environmentally clean and reliable energy services, while addressing global climate change, the American Gas Association (AGA) and the Natural Resources Defense Council (NRDC) have been working together to accelerate progress toward a clean, energy efficient future. In 2004, AGA and the NRDC issued a joint statement that identified significant regulatory barriers to achieving energy efficiency. AGA and the NRDC encouraged state public utility commissions to consider innovative proposals to promote energy efficiency and conservation in a manner that would benefit both customers and shareholders. The National Association of Regulatory Utility Commissioners encouraged state officials to consider the joint AGA-NRDC recommendations,<sup>1</sup> and the states' initial response has been encouraging.

Today, AGA and the NRDC issue a second joint statement recommending the next steps toward win-win solutions for American consumers and the natural gas utilities that serve them. As we did in 2004, AGA and the NRDC urge state public utility commissions and officials responsible for publicly-owned natural gas distribution systems to consider proposals for implementing cost-effective programs that will increase energy efficiency and reduce the nation's carbon footprint while also balancing shareholder interests.

### **1. Removing Disincentives for Utilities to Promote Energy Efficiency and Reduce Greenhouse Gas Emissions, and Uniting to Achieve Increased Savings Through Programs and Standards.**

It is now almost universally recognized that energy efficiency is a large, underutilized, resource that needs to be expanded significantly to reduce consumer costs, improve energy security and reduce greenhouse gas emissions.<sup>2</sup> Numerous studies and extensive experience in many states and countries have shown that improving energy efficiency can be critical to meeting these goals cost-effectively.<sup>3</sup> Consumer surveys

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<sup>1</sup> *Resolution on Gas and Electric Energy Efficiency*, sponsored by the NARUC Natural Gas Task Force, Committee on Gas, Committee on Consumer Affairs, Committee on Electricity, and Committee on Energy Resources and the Environment. Adopted by the NARUC Board of Directors, July 14, 2004.

<sup>2</sup> See, e.g., *National Action Plan for Energy Efficiency Vision for 2025: Developing a Framework for Change* (November 2007). <http://www.epa.gov/cleanenergy/documents/vision.pdf>.

<sup>3</sup> See, e.g., *Impacts of Energy Efficiency and Renewable Energy on Natural Gas Markets in the Pacific West*, William Prindle, R. Neal Elliott, Ph.D., P.E., Anna Monis Shipley, American Council for an Energy-Efficient Economy, Report Number E062 (January 2006).

show strong support for coordinated government and utility efforts to increase conservation and energy efficiency.<sup>4</sup>

Yet there are a number of barriers blocking the path forward to increased energy efficiency. One significant barrier has been regulatory policies that unintentionally but effectively discourage gas distribution companies from promoting energy efficiency improvements. AGA and the NRDC pointed this out in our July 2004 joint statement:

When customers use less natural gas, utility profitability almost always suffers, because recovery of fixed costs is reduced in proportion to the reduction of sales. Thus, conservation may prevent the utility from recovering its authorized fixed costs and earning its state-allowed rate of return. In this important aspect, traditional rate practices fail to align the interests of utility shareholders with those of utility customers and society as a whole. This need not be the case.<sup>5</sup>

Since the joint statement was issued in 2004, a significant number of gas distribution utilities have been given permission to adopt ratemaking mechanisms that better align the interests of utility shareholders, their customers and society as a whole. Today 26 natural gas distribution utilities in 13 states have implemented revenue decoupling programs that serve 20 million residential customers. The National Action Plan for Energy Efficiency, which was developed by more than 50 diverse stakeholder groups, included as one of its five recommendations the need to “[m]odify policies to align utility incentives with the delivery of cost-effective energy efficiency and modify ratemaking practices to promote energy efficiency investments.”<sup>6</sup> Additionally, Congress passed the Energy Independence and Security Act of 2007, directing each state regulatory authority to consider “separating fixed-cost revenue recovery from the volume of transportation or sales service provided to the customer.”<sup>7</sup> Today, AGA and the NRDC again urge state public utility commissions and officials responsible for publicly-owned natural gas distribution systems to actively support natural gas utilities’ energy efficiency proposals that use automatic rate true-ups to ensure a utility’s opportunity to recover its authorized fixed costs. We also urge state public utility commissions that have adopted such programs on a trial basis to make longer term commitments. Finally, we will assign high priority to mutual advocacy for improved energy efficiency standards at both state and federal levels, and we will seek urgently needed extensions for federal tax incentives for energy efficiency in buildings and equipment. We will work to ensure that these standards and incentives are designed in ways that avoid inappropriately influencing customers’ fuel choices, from both economic and environmental perspectives.

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<sup>4</sup> See, e.g., M. Kubik, *Consumer Views on Transportation and Energy* (Third Edition), National Renewable Energy Laboratory Technical Report, NREL/TP-620-39047 (Jan. 2006), <http://www.osti.gov/bridge>.

<sup>5</sup> Joint Statement of the American Gas Association and the Natural Resources Defense Council (July 2004) at 2.

<sup>6</sup> *National Action Plan for Energy Efficiency – A Plan Developed by More Than 50 Leading Organizations in Pursuit of Energy Savings and Environmental Benefits Through Electric and Natural Gas Energy Efficiency* (July 2006) at 2, 7, 8, and 1-10. See also *Aligning Utility Incentives with Investment in Energy Efficiency – A Resource of the National Action Plan for Energy Efficiency* (Nov. 2007) <http://www.epa.gov/cleanenergy/documents/incentives.pdf>.

<sup>7</sup> See Sec. 532(b)(6), *Energy Independence and Security Act of 2007*, P.L. 110-140, Dec. 19, 2007 (In general, “[t]he rates allowed to be charged by a natural gas utility shall align utility incentives with the deployment of cost-effective energy efficiency.” “[E]ach State regulatory authority and each non-regulated utility shall consider- (i) separating fixed cost revenue recovery from the volume of transportation or sales service provided to the customer; (ii) providing to utilities incentives for the successful management of energy efficiency programs, such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs.”).

## 2. Developing Performance-Based Incentives for Utilities to Promote Energy Efficiency and Reduced Greenhouse Gas Emissions

Simply removing utility disincentives to promote energy efficiency may be adequate if the goal is to achieve relatively modest increases in efficiency. But neutrality is no substitute for committed action. If energy efficiency achievements are to reach the level required by the various climate change bills currently being considered by Congress and under review or adoption in states across the country, then utility commissions need to consider linking such achievements to earnings opportunities for the utilities involved.<sup>8</sup> We agree that such opportunities would yield significant increases in energy efficiency and reductions in customer energy consumption. Despite decades of programs designed to promote energy efficiency, it is widely recognized that these programs remain critically underutilized in the nation's energy portfolio.<sup>9</sup> Without carefully considered incentive programs, it seems unlikely that dramatically improved results will occur in the future.

The National Action Plan for Energy Efficiency discusses three different types of utility performance incentive mechanisms: 1) performance target savings, 2) shared savings incentives, and 3) rate of return incentives.<sup>10</sup> Performance target and shared savings mechanisms have been adopted in a number of states, and while differing in structure and operation, typically seek to allow utilities operating at or above a prescribed minimum performance level to capture some portion of net benefits delivered (usually based on energy savings performance).<sup>11</sup> Rate of return incentives might offer a utility an increased return for energy efficiency investments and/or an even higher return on total equity investment for superior performance.<sup>12</sup> While each option has its advantages and disadvantages, we unite in supporting approaches that link energy-efficiency incentives to independently verified net benefits that utilities deliver to customers through either successful administration of cost-effective efficiency programs and other authorized efficiency programs that serve low-income constituencies, or contributions to enactment of cost-effective efficiency standards and tax incentives.<sup>13</sup> AGA and the NRDC encourage state commissions and officials responsible for publicly-owned natural gas distribution systems to adopt energy efficiency incentive

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<sup>8</sup> Congress recently encouraged state commissions and unregulated utilities to consider such utility energy efficiency earnings opportunities. See Sec. 532(b)(6)(B)(ii), *Energy Independence and Security Act of 2007*, P.L. 110-140, Dec. 19, 2007 (“[E]ach State regulatory authority and each nonregulated utility shall consider- (ii) providing to utilities incentives for the successful management of energy efficiency programs, such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs;”).

<sup>9</sup> See, e.g., *Aligning Utility Incentives with Investment in Energy Efficiency* at ES-1. For years, groups such as the American Council for an Energy Efficient Economy (ACEEE) have produced numerous studies detailing the dramatic results possible if various energy efficiency measures were adopted. See, e.g., *Examining the Potential for Energy Efficiency to Help Address the Natural Gas Crisis in the Midwest*, Martin Kushler, Dan York, and Patti Witte (Jan. 2005, ACEEE Report No. U051) (projecting annual Midwest customer cost savings of \$2 billion on their natural gas bills by 2010); *Potential for Energy Efficiency and Renewable Energy to Meet Florida's Growing Energy Demands*, R. Neal Elliott, Maggie Eldridge, Anna M. Shipley, John “Skip” Laitner, Steven Nadel, Philip Fairey, Robin Vieira, Jeff Sonne, Alison Silverstein, Bruce Hedman and Ken Darrow (June 2007, ACEEE Report No. E072); *Impacts of Energy Efficiency and Renewable Energy on Natural Gas Markets in the Pacific West*, William Prindle, R. Neal Elliott, Anna Monis Shipley (Jan. 2006, ACEEE Report No. E062) (projecting reduced natural gas bills and reduced natural gas consumption if energy efficiency measures were adopted).

<sup>10</sup> *Aligning Utility Incentives with Investment in Energy Efficiency: A Resource of the National Action Plan for Energy Efficiency* (Nov. 2007) at 6-1 (chapter on performance incentives).

<sup>11</sup> *Id.* at 6-3 and 6-4.

<sup>12</sup> *Id.* at 6-11.

<sup>13</sup> Energy efficient incentives do not include rate design mechanisms, such as margin decoupling, which merely reduce utility disincentives. We also agree that consumer education and marketing expenditures are important to the success of many of the energy efficiency programs that this statement references and supports.

mechanisms for natural gas utilities that will reduce consumer costs, reduce greenhouse emissions and align with shareholders' interests.

### **3. Recognizing the Potential Contributions of Efficient Natural Gas Use in Promoting Reduced Greenhouse Gas Emissions**

Among fossil fuels, natural gas applications lead the way in reducing greenhouse gas emissions.<sup>14</sup> Average residential and commercial natural gas consumption is much lower today than in the 1970s, due to improved energy efficiency and conservation. The 64 million households served by natural gas today heat their homes and their water, feed their families and dry their clothing using 1/3 less energy than they did in 1980.

Our paramount joint objective is developing ways to help America extract more economic benefits from the most efficient use of natural gas.<sup>15</sup> There should be continued focus on the environmental benefits of more efficient direct use of natural gas in homes and businesses, which can and should be an important strategy to lower U.S. greenhouse gas emissions.

AGA and the NRDC pledge to continue their efforts to find more ways to use natural gas efficiently, thereby assisting consumers and speeding the transition to a lower carbon future.

**This Joint Statement also has been reviewed and endorsed by:**

**Alliance to Save Energy**



**ALLIANCE TO  
SAVE ENERGY**

*Creating an Energy-Efficient World*

**American Council for an Energy Efficient Economy**



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<sup>14</sup> When burned in power plants of equivalent thermal efficiency, natural gas emits 45 percent less CO<sub>2</sub> than coal and 30 percent less CO<sub>2</sub> than oil on an energy equivalent basis. This advantage can be further increased by integrating combined heat and power applications with end use efficiency improvements.

<sup>15</sup> Along with natural gas, some natural gas utilities have supplemented their supply needs with renewable sources of supply such as biogas, which can help reduce greenhouse gas emissions.