COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Investigation by the Department of Public Utilities on its own Motion into Rate Structures that will Promote Efficient Deployment of Demand Resources	)	D.P.U. 07-50

INITIAL COMMENTS OF CONSERVATION LAW FOUNDATION

Conservation Law Foundation (CLF) offers these comments in response to the June 22, 2007 "Vote and Order Opening Investigation" issued by the Department of Public Utilities (DPU) in the above-captioned proceeding.

CLF supports the efforts of the DPU to examine rate structures and revenue mechanisms that can help Massachusetts meet its electrical power needs in the most efficient, cost effective and environmentally sound manner. CLF offers the following initial comments to assist the DPU in this proceeding.

I. Executive Summary

CLF supports rate decoupling as an important step in removing existing disincentives that stand in the way of maximum utilization of clean demand resources. The DPU should move forward expeditiously to implement decoupling, using existing revenue requirements as a starting point except where they are demonstrably unreasonable. Adjustments to the revenue requirement should assiduously avoid being tied to the volume of electricity sold.

To the extent decoupling results in actual changes to a utility's risk profile or access to capital, there should be a corresponding adjustment to the utility's Return on Equity. In addition,

a shared earnings mechanism would help balance the risk and benefits between utilities and customers.

Finally, CLF strongly encourages the DPU to adopt a decoupling mechanism that would operate effectively in tandem with robust Performance Based Ratemaking (PBR) incentives.

II. Introduction

Founded in 1966, CLF is a nonprofit, member-supported organization that works to solve the environmental problems threatening the people, natural resources and communities of New England. CLF's advocates use law, economics and science to design and implement strategies that conserve natural resources, protect public health, and promote vital communities in our region. CLF has a long history of participation in regulatory proceedings relating to energy efficiency and other demand resources. In particular, CLF played a key advocacy role regarding environmental issues in the investigatory dockets and deliberations that led to restructuring of the electric generating industry in the Commonwealth. In the face of the threat of global warming, CLF and its members who reside in Massachusetts have a significant interest in the deployment of demand resources and other solutions that reduce greenhouse gas emissions while increasing energy security and reliability.

The rise in electricity prices in recent years (driven in large part by increasing fuel costs), the challenges of maintaining a stable and reliable power grid, and the imperative to address global warming all call for strong, decisive, effective and timely action that will allow a much greater reliance on cost-effective demand resources. Utility regulation that provides rate structures and mechanisms for collecting revenues that will more closely align utility interests in enhancing profits with the public's interest in lower cost, cleaner and more reliable power can

help meet these challenges. Separating utility profits from the volume of electricity that they sell, or "decoupling," is one means to begin to provide a closer alignment of these interests.

CLF supports decoupling as a step in the right direction. Decoupling alone will neither ensure that all cost effective energy efficiency will be used, nor will it break down all barriers that stand in the way of greater reliance on lower cost demand resources. It simply allows for a greater alignment of interests among utilities, customers and the environment. When effectively implemented, decoupling eliminates a disincentive that a utility has against reducing electricity demand. Given this disincentive, it is rarely in a utility's short-term financial best interests to reduce demand, even though such reductions would cost less and pollute less than building or buying more capacity to meet growing demand. As long as utility profits are linked to utilities selling more electricity, Massachusetts is unlikely to realize the economic and environmental benefits from reducing demand. As a result, consumers will pay more for electricity and suffer more pollution and face greater threats from global warming.

Decoupling is neither the only measure to reduce demand, nor is it a "silver bullet" that alone will transform utility regulation and bring about cleaner and lower cost power for everyone. It is, however, a reasonable and modest first step that provides very real opportunities for utilities, consumers and the environment. At best, decoupling makes a utility neutral to reducing demand. It allows a utility to recover from rates its reasonable costs while not encouraging the utility to sell more power in order to make a higher profit. While decoupling has the potential to provide this benefit, it is important that decoupling is implemented in an effective manner. It should provide an efficient process for setting rates that does not unnecessarily burden any of the parties involved. An effective decoupling mechanism should be

simple, easy and fair to implement in as timely a manner as possible. There will be little benefit from any decoupling structure if it only provides a new way to have an annual rate case.

CLF's comments provide suggestions for how to effectively implement decoupling and allow a fair and relatively simple process for setting rates that will better align utility, consumer and environmental interests.

III. Allowed Revenues per Customer

As with a rate case, the starting point for any decoupling mechanism is determining the appropriate revenue requirement. In an ideal world, the revenue requirement always would be determined based on a new or recent fully litigated rate case. This is not always practical or feasible. Currently in Massachusetts, many utilities are operating under rate agreements. Timely implementation of a decoupling structure tailored to Massachusetts would build on what is in place already. Starting with a new rate case for each utility would take a long time and would likely delay implementation of any decoupling by at least two years, or would delay decoupling until the termination of any existing rate agreement. The current rates for many Massachusetts utilities are based on rate agreements that have been reviewed by the DPU (or its predecessor, the Department of Telecommunications and Energy) and were found to provide for "just and reasonable" rates. To implement a fair decoupling mechanism soon, an alternative that should be considered is to start with the existing revenue requirement and provide an opportunity to reopen and investigate if the existing revenue requirement is not reasonable. This allows decoupling to be implemented expeditiously on a going forward basis, while also providing an immediate opportunity to examine the revenue requirement if necessary. This would simplify the process while ensuring fairness if the existing revenue requirement is not believed to be reasonable.

Changes in the allowed revenues per customer may be appropriate between base rate proceedings, but they should not be based on changes in each rate class' average usage per customer. Changing the revenue requirement based on customer usage perpetuates the existing disincentive against lower cost demand resources. It would continue to link utility revenues and profit to the volume of electricity sold. Instead, any changes in the revenue requirement should be based on clearly justified costs or improved performance as provided under performance based rate incentives.

IV. Annual Reconciliation Calculation

The reconciliation calculations should be done at least annually, and the process for reconciliation should be simpler and less cumbersome than a full rate case. Decoupling can allow for a simpler review of costs that are known and not controversial, and can provide for these to be passed through relatively automatically, as happens now under some performance based rate agreements. More frequent reconciliations can provide a closer connection between the actual costs and the revenues collected. However, any frequency of reconciliation poses challenges. A balance is needed to provide a frequency that is not overly burdensome and avoids possible cross-subsidization (for example, air-conditioning customers paying the revenue in summer and the non-air-conditioning customers getting the credit for an over-collection in the fall). At the same time, delaying all recovery by a year so the seasons "match up" would add unnecessary interest and deferral costs and further separate the customers who are responsible for any increase or decrease from the customers who pay or receive credit for them. Capping and deferring the reconciliation amount, as was done in Maryland, may be attractive and provide some stability. *See In re Potomac Electric Power Company*, Order 81517 at 82-83, Public

Service Comm'n of Maryland (July 19, 2007) (capping Bill Stabilization Adjustment at 10% & deferring any amounts over that). However, as the decoupling experience in Maine in the 1990s suggests, these sorts of deferrals can backfire and either leave excessive costs to be collected from future customers, or leave utilities with insufficient revenue to cover their costs.[1]

Through either reconciliation or base rate adjustments, costs could be separated into a small number of different categories based on the level of control the utility has over the costs. This is a model that was used in Vermont for an alternative regulation plan for Green Mountain Power. *In re Petition of Green Mountain Power Corporation for approval of an alternative-regulation plan*, Final Order at 19-40, Vermont Public Service Board Docket 7176 (Dec. 22, 2006). The different categories could then be subject to somewhat different treatment, both in terms of the frequency and certainty of collection and in terms of a possible range for the cost changes that would determine the amount of sharing between customers and the utility. Similar provisions for adjusting rates exist now in Massachusetts under some PBR plans, and these could be adapted to better align costs and rates to the benefit of the utilities and the customers.

Providing for regular reconciliation should not require normalizing costs for weather or other factors. These would either be considered "exogenous" factors or would be picked up in the next reconciliation. Either way, there would be no risk of either overpayment by customers or under-recovery by utilities. The reasonable costs would be collected and paid for within a reasonable time.

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[1] See C. Harrington, et al, *Regulatory Reform: Removing the Disincentives* 18, Regulatory Assistance Project (June 1994)(decoupling mechanism in Maine used for rate deferral); E. Hirst, *Statistical Recoupling: A New Way to Break the Link Between Electric-Utility Sales and Revenues* 15-16, Oak Ridge National Laboratory (Sept. 1993) (discussion of Maine decoupling experience).

V. Annual Base Rate Adjustment

Any changes required to adjust the recovery of costs should be collected on volumetric rates. As much as feasible, the changes should be reflected in the charges that drive the cost changes. This would provide price signals that more closely align costs with rates. Since both energy and demand charges are volumetric and since both drive costs, both should be adjusted to recover the revenue requirement. The specific implementation would vary depending on the rate design of each utility. As a starting point, however, changes to both energy and demand charges should be used to recover any adjustment.

VI. Submission and Review of Reconciliation Filings

Reconciliation filings should be as simple as possible, but provide sufficient information to justify any changes. They should be provided on the same schedule and frequency as base rate adjustments. If base rate adjustments are done annually, there is no reason to require quarterly reconciliation filings. If adjustments are made more frequently based on costs being in different categories as described above, then concurrent supporting reconciliation filings should be made.

VII. Accounting for Changes in Risk

Adjustments to the Return on Equity (ROE) should be considered based on actual changes in risk. A decoupling structure that includes more certain recovery of reasonable costs, as well as frequent and simpler reconciliations, should reduce the company's risk and a commensurate adjustment to the ROE should be made. A change in risk would also affect the company's access to capital that is reflected in the ROE. In terms of risk and access to capital,

each utility is different. Any adjustment should be based on the individual utility's circumstances.

VIII. Shared Earnings Provision

CLF supports a shared earnings mechanism. Such mechanisms provide a good method to share and balance both the risk and the benefits between utilities and customers. They provide a level of certainty for both the utility and customers and institutionalize, in a simpler form, the sharing that already exists as a result of rate cases or rate settlements. Shared earnings could also provide a basis for specific conservation incentives.

The sharing mechanism should include both a floor and a ceiling for earnings, in order to facilitate operating decisions. The DPU may also consider a sharing band that is asymmetrical rather than equal. If significant costs are passed through to customers and recovery is certain, it may be appropriate for a company to absorb a greater reduction in earnings and share excess earnings at a lower threshold. *See In re Petition of Green Mountain Power Corporation for approval of an alternative-regulation plan*, Final Order at 21, Vermont Public Service Board Docket 7176 (Dec. 22, 2006)(variations within a range of 75 basis points not subject to reconciliation, a 50/50 sharing of earnings shortfalls between 75 and 125 basis points below the target return).

IX. Performance Based Regulation

CLF urges the DPU to adopt a decoupling mechanism that can allow successful Performance Based Ratemaking (PBR) incentives to operate. Decoupling and PBR are different structures and perform different functions. They are not mutually exclusive. Effective PBR

creates good opportunities to enhance both service and efficiency efforts. As noted earlier, at best, decoupling would eliminate a disincentive and make a utility neutral to demand resources. While this is important and should happen as quickly as possible, it should not take the place of PBR incentives. Instead, performance incentives should be allowed and should be used to encourage utilities to perform even better and to financially benefit from better performance. PBR incentives have a distinct role to play to encourage good performance – for service as well as for providing efficiency and clean power. They should be implemented in a manner that ensures they deliver value to both customers and the utilities, and should continue to be tools that are available to enhance regulation and encourage good performance that meets important societal needs.

X. Implementation Schedule

The DPU should move expeditiously to implement decoupling structures for all utilities. As much as possible, the DPU should build on what is already in place and allow decoupling on a going forward basis. Since two utilities serve the bulk of customers in Massachusetts, implementing a decoupling structure for these utilities first would provide the most impact and would provide guidance for future proceedings.

XI. Other Comments

As noted earlier, PBR incentives should be available to complement decoupling. Any performance based shareholder incentives can be factored into the base revenue calculation and be included in any adjustments that would be made to the base revenue on either an annual or more frequent basis.

Respectfully submitted,

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