COMMONWEALTH OF PENNSYLVANIA

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August 1, 2011

Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RE: Petition of UGI Utilities Inc. – Electric Division for Approval of its Energy Efficiency and Conservation Plan
Docket No. M-2010-2210316

Dear Secretary Chiavetta:

Enclosed for filing are the Reply Exceptions of Office of Consumer Advocate, in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully Submitted,

Tanya J. McCloskey
Senior Assistant Consumer Advocate
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Enclosures
cc: Honorable Susan D. Colwell

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of UGI Utilities Inc. – Electric Division for Approval of its Energy Efficiency and Conservation Plan	: : :	Docket No. M-2010-2210316

EXCEPTIONS OF THE OFFICE OF CONSUMER ADVOCATE

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Dated: August 1, 2011

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I. INTRODUCTION

In this proceeding, UGI Utilities, Inc. – Electric Division (UGI-Electric or Company) filed for approval of its proposed Energy Efficiency and Conservation Plan (EE&C Plan or Plan). Because UGI-Electric serves fewer than 100,000 customers, it was not required to file an EE&C Plan pursuant to Act 129 of 2008, which specifically exempted electric distribution companies (EDCs) of that size from its requirements. Rather, UGI-Electric's Plan was filed pursuant to a Secretarial Letter issued December 23, 2009 (December 2009 Secretarial Letter) in which the Commission invited, but did not mandate, the smaller EDCs not subject to Act 129 to submit EE&C plans if these EDCs concluded that such measures would be in the public interest. Any such filing would therefore be made voluntarily. In the Secretarial Letter, the Commission prescribed the necessary elements of a voluntary EE&C plan and specified the various provisions of Act 129 that would be required of such plans and which provisions, while not required, should be looked to for guidance by the small EDCs.

It was in response to the December 2009 Secretarial Letter, that UGI-Electric Utilities, Inc. – Electric Division (UGI-Electric or Company) filed, on November 9, 2010, the first (and thus far only) voluntary EE&C plan with the Commission. The Office of Consumer Advocate (OCA) participated fully in this case, filing two rounds of testimony as well as an Initial and a Response Brief.

As the first voluntary plan filed, UGI-Electric raised an issue which the Commission did not face in reviewing the EE&C plans of the larger EDCs. UGI-Electric seeks to recover the revenue it claims will be lost as a result of implementation of its Plan and proposes two methods for doing so. Its preferred method is by way of an automatic adjustment charge pursuant to Section 1307 of the Public Utility Code. 66 Pa.C.S. § 1307. As an alternative, the Company

proposes that lost revenue could be identified, accrued and tracked as a "regulatory asset" until its next base rate case at which point the amount of the regulatory asset would be included in rates. Lost revenue recovery is specifically prohibited by Act 129 for the larger EDC EE&C plans. 66 Pa.C.S. § 2806.1(k)(2) and (3). The OCA opposed the Company's request for lost revenue recovery arguing that it was inconsistent with sound ratemaking principles, impermissible single issue ratemaking and contrary to the policy established by Act 129. The OCA also argued that the mechanism would not result in just and reasonable rates as the claim was not based on a verified measure of revenues lost.

In addition to the lost revenue issue, UGI-Electric's Plan raised an issue concerning the inclusion of fuel-switching as a major component of the Plan. Unlike the larger EDCs, UGI-Electric proposed as a key element of its Plan a residential fuel-switching program. Of particular concern to the OCA was the level of the incentives being offered to customers to switch fuels under the program. For the conversion of an electric water heater or clothes dryer to natural gas or propane, UGI-Electric is offering as an incentive 100% of the incremental cost of making the conversion. For conversions from electric to natural gas or propane-fired heating systems, UGI-Electric is offering an incentive of 75% of the estimated incremental cost of making the conversion. In testimony and briefs, the OCA took the position that the incentive levels were unnecessarily high and should be cut in half. The OCA was also concerned that UGI-Electric's fuel-switching program did not establish as a condition for receiving the incentive payment that the natural gas or propane equipment installed must be high efficiency equipment. The Company's proposal allows the incentive to be paid for standard efficiency equipment. The OCA's position was that high efficiency equipment should be required.

On these two issues – lost revenue recovery and fuel-switching – the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Susan D. Colwell, found against UGI-Electric. The ALJ disallowed lost revenue recovery entirely. The ALJ stated:

> The most convincing arguments are those advanced by the public advocates and large industrial users groups regarding public policy and consistency with traditional rate-making principles: an adjustable mechanism would be "in direct contradiction to what the Legislature and the Commission explicitly prohibited when drafting and implementing Act 129." OTS Stmt. 1 at 10. It would be contrary to the express public policy of the Commonwealth; it results in impermissible single-issue ratemaking; it would produce unjust and unreasonable rates because it is based on speculative estimates of energy savings; it would rely upon a document not intended for ratemaking purposes; its denial would not necessarily lead to an earlier base rate case for the Company; and the revenue reductions for this Company would be offset by revenue increases for UGI affiliates. OCA MB at 17-18.
>
> The revenue recovery mechanism is disallowed. The possible withdrawal of the Plan due to disallowance of this mechanism is preferable to allowing the mechanism. If the Company believes that it is not capable of carrying out the terms of its Plan without the automatic recovery mechanism, then the Plan should be withdrawn until such time that a more affordable Plan can be developed.

R.D. at 31.

With regard to fuel-switching, the ALJ recommended that the incentive levels for customers switching from electric to natural gas or propane should be no more than 50% of the anticipated incremental cost of making the conversion. The ALJ stated:

> The size of the incentives should be brought into line with the other EDCs that offer them. In particular, PPL offers $300 towards a heat pump water heater, and Allegheny offers $225 towards a new water heater. UGI-Electric's $900 is far too high and should be cut by half. Allegheny offers $25 toward a new dryer, and UGI-Electric's rebate of $830 should be cut by half.
>
> Allegheny and PECO will replace a non-functioning furnace for low-income customers while PPL offers $550 for a high-efficiency gas furnace for its Rate Thermal Storage customers only. UGI-Electric's $4,850 is far too high to justify

> charging its customers for the subsidy, and the incentive should be cut to no more than $1,000.[1]

R.D. at 38-39.

The ALJ also recommended that the natural gas or propane equipment purchased to replace electric equipment must be rated high efficiency. On this point the ALJ said:

> It makes little sense from an overall policy standpoint to encourage reduced usage of one form of energy without encouraging the best use of the substituted fuel, especially when funded at the expense of ratepayers.

R.D. at 46.

UGI-Electric filed two Exceptions to the R.D. The Company's first exception contends that the R.D.'s rejection of the lost revenue recovery claim (whether by way of surcharge or regulatory asset) was an error of law and policy. The second Exception contends that the R.D. erred in reducing the fuel-switching incentive payments and in requiring the use of high efficiency equipment.

The OCA now replies to the Company's Exceptions. The OCA submits that the ALJ's R.D. on these points was correct and should be adopted.

II. REPLY EXCEPTIONS

OCA Reply Exception No. 1: The ALJ Properly Rejected UGI-Electric's Claim for Lost Revenue Recovery.

A. The ALJ Correctly Concluded That UGI-Electric's Claim For Lost Revenue Recovery Was Not Supported By The Law.

UGI-Electric sought the recovery of lost revenue associated with the implementation of its EE&C Plan. UGI-Electric's original and preferred proposal for recovering lost revenue is through a Section 1307 automatic adjustment charge. In its Rebuttal Testimony, however, the

[1] Although the ALJ states here that the space heating incentive should be cut to no more than $1,000, the proposed Ordering Paragraphs in the R.D. say that "the incentive level for customers switching from electric heating shall not exceed 50% of the customer's cost incurred in making the switch." R.D. at 60.

Company noted that an alternative to the use of an automatic adjustment charge would be to treat the lost revenues as a regulatory asset, recoverable in its next base rate proceeding.

The OCA opposed the recovery of lost revenue regardless of the method employed to collect it. In Act 129, the General Assembly spoke directly to the issue of lost or "decreased" revenue. Section 2806.1(k) provides:

> (2) Except as set forth in paragraph (3), decreased revenues of an electric distribution company due to reduced energy consumption or changes in energy demand shall not be a recoverable cost under a reconcilable automatic adjustment clause.
> (3) Decreased revenue and reduced energy consumption may be reflected in revenue and sales data used to calculate rates in a distribution-base rate proceeding filed by an electric distribution company under section 1308....

66 Pa.C.S. § 2806.1(k)(2) and (3).

Thus, the Act expressly prohibits the recovery of decreased revenue resulting from reduced energy consumption associated with implementation of energy efficiency and conservation programs through the use of a reconcilable automatic adjustment clause. The Act provides that decreased revenue from reduced consumption, if it is to be recovered, must be reflected in the revenue and sales data used to calculate rates in a future base rate case. In other words, decreased revenues are to be recognized on a prospective basis only by being accounted for in the revenue projections filed in a future rate case. The General Assembly has thus given strong public policy guidance with regard to this issue. Reduced revenue may not be recovered by means of a surcharge, only as part of a base rate case and then only by reflecting that reduction in the prospective revenue and sales data submitted for the purpose of determining the new rates.

UGI-Electric seeks to circumvent the General Assembly's guidance by asserting that because it is a small electric distribution company not covered by Act 129, the provisions of the Act regarding lost revenue recovery do not apply to it. The ALJ correctly rejected the Company's argument as follows:

> Because Act 129 does not require small EDCs to participate, UGI Electric argues that the prohibitions and guidance regarding cost recovery should not apply to small EDCs. This is not persuasive. Obviously, if the legislature had wanted to include small EDCs in Act 129, then it would have done so, and if it had, it would have included specific direction regarding cost recovery. Act 129 does not require small EDCs to file the EE&C plans, and therefore, there was no reason to include a ban on lost revenue recovery mechanisms specific to voluntary plans filed by the smaller companies. It does not follow, however, that the lack of a specific ban makes inclusion of that mechanism a good idea. It is far more logical to expect that, if the smaller EDCs decide to participate in energy conservation programs similar to the large EDCs, they can expect to recover their costs in a manner similar to the large EDCs.

R.D. at 30.

The ALJ also found that allowing lost revenue recovery would "result in impermissible single-issue ratemaking." R.D. at 30. In Pennsylvania Indus. Energy Coalition v. Pennsylvania Pub. Util. Comm'n, 653 A.2d 1336 (Pa. Commw. Ct. 1995)(PIEC), the Commonwealth Court stated that, "Single-issue ratemaking is similar to retroactive ratemaking and, in general, is prohibited if it impacts on a matter that is normally considered in a base rate case." PIEC at 1350. Revenues, sales and usage are the very types of items that are normally considered in a base rate case.

The *Amicus Brief* of the Industrial Customer Groups explains well the rationale for the prohibition and the reason it must be applied in this case. The ALJ cited the *Amicus Brief* with approval. Industrial Customers *Amicus Brief* at 6-7; R.D. at 30. Basically, items of revenue or expense are not to be treated in isolation when setting rates. Rather, all such items must be considered together, including those which work to the benefit of the company as well as those

that benefit consumers. The increases and decreases in all of these items must be accounted for in setting just and reasonable rates. The Industrial Customers Group *Amicus Brief* states:

> Under single-issue ratemaking, the Commission reviews only a limited portion of the overall ratemaking equation and, in effect, assumes that a single variable such as a reduction in sales translates into reduced profits for the utility. If all other elements of the equation remain consistent from the future test year, revenue decoupling essentially *guarantees* the utility an awarded return, rather than just ensuring the *opportunity* to earn an awarded return. UGI-Electric's sales may decrease due to conservation efforts; however, if the Company's cost of borrowing also is reduced, or if its distribution costs decrease commensurate with the reduced sales, then the utility's profit or return is unaffected. Implementing single issue ratemaking schemes such as the Company's CD Rider proposal, or the Company's alternate proposal to bestow regulatory asset treatment upon its lost revenues without further review in a future [b]ase rate proceeding, deprives the Commission of the ability to examine those types of offsets.

Industrial Customers Group *Amicus* brief at 6-7 (emphasis in original); R.D. at 30.

The most appropriate setting in which to examine the impact of energy efficiency programs on revenues is in a base rate case. The wisdom of this assertion has been confirmed in the express declaration of public policy by the General Assembly that lost revenue claims related to EE&C programs under Act 129 are to be addressed on a prospective basis only, in future base rate proceedings under Section 1308 of the Public Utility Code. Therefore, the attempt to single out EE&C-related lost revenue for recovery by way of a surcharge or regulatory asset constitutes prohibited single-issue ratemaking and is inconsistent with sound ratemaking principles.

A second line of argument advanced by UGI-Electric in its Briefs and Exceptions is that since Act 129 does not apply to the EE&C plan of a small EDC, Section 1319 of the Public Utility Code does.[2] UGI-Electric Initial Brief at 19; Response Brief at 3; Exceptions at 3-4. The Company maintains that this section provides all the authority necessary to approve a claim for

[2] 66 Pa.C.S. § 1319. Section 1319 provides that if an electric or natural gas public utility establishes a conservation or load management program which the Commission finds to be prudent and cost-effective, the utility will be allowed to recover "all prudent and reasonable costs associated with the development, management, financing and operation of the program." Notably, there is no reference to lost revenues in Section 1319.

lost revenue recovery as part of a small EDC EE&C plan. As evidence of this, the Company cites the Order of the Commission in Investigation into Demand Side Management By Electric Utilities -- Uniform Cost Recovery Mechanism, 80 Pa. P.U.C. 608 (1993) (1993 DSM Order) in which the Commission permitted electric utilities to treat lost revenues associated with implementation of conservation or load management programs as a regulatory asset, the recovery of which would be deferred until the utility's next base rate case.[3] However, even if allowing treatment of lost revenues as a regulatory asset may have been permitted by the Commission in 1993, prior to the pronouncement of any policy on the subject by the General Assembly, that determination provides no sound basis for such a ruling now. The express policy of the legislature regarding the means of recovery of lost revenue embodied in Act 129 must guide the Commission. The General Assembly, while allowing for recovery of lost revenue in a base rate proceeding (Section 2806.1(k)(3)) via the sales and revenue data used to determine future rates, provides no authorization for the accrual of a regulatory asset in the period leading up to the base rate proceeding. In the face of an express statement of policy to the contrary by the General Assembly, the precedential value of the 1993 DSM Order must be questioned. Further, its value as precedent is questionable because the Order was never actually applied.

In the R.D., the ALJ also rejected UGI Electric's third line of argument that relied on Popowsky v. Pa. Public Utility Commission, 13 A. 3d 583 (Pa. Cmwlth. Ct. 2011) (Popowsky). UGI-Electric argued that Popowsky permits single issue ratemaking of lost revenue recovery through a surcharge under Section 1307 of the Public Utility Code (66 Pa.C.S. § 1307). R.D. at 28-29. The ALJ found UGI-Electric's reliance on Popowsky unpersuasive as the case was easily

[3] It was this Order which gave rise to the PIEC appeal. It is significant to note that before the Commonwealth Court, the issues concerning lost revenue recovery were found to be not ripe for review and were remanded to the Commission. PIEC, 653 A. 2d at 1352-1353. Thus, the Court did not consider this issue. In addition, this was an investigation order and no further cases on the matter were taken up.

distinguishable. The ALJ quoted a passage from Popowsky where the Court noted that Section 1307(a) of the Code and earlier case law established that surcharge recovery of costs is available under 1307(a) where: (1) it is expressly authorized by the General Assembly, or (2) the costs are easily identifiable and are beyond the utility's control. *Id.*, quoting Popowsky at 591. The ALJ determined that UGI-Electric's proposal for recovering lost revenue through a surcharge failed on both counts. The ALJ found that such recovery was not expressly authorized by statute, and that the cost is not easily identifiable and not beyond the Company's control. The ALJ noted that the cost was *within* the Company's control because it is incurred as part of a *voluntary* EE&C plan which is required to prove that the costs are reasonable and prudent before they can be recouped.[4] R.D. at 29.

In its Exceptions, UGI-Electric takes issue with the ALJ's determination on both points. First with regard to whether surcharge recovery is expressly authorized by the General Assembly, the Company argues that in Popowsky the Court expressly recognized that Section 1319 of the Code authorizes a Section 1307(a) surcharge for all prudent and reasonable costs of developing, managing, financing and operating a conservation or load management program. UGI-Electric Exceptions at 6-7. The Company refers specifically to that portion of Popowsky which reviews the Court's earlier holding in PIEC. In that case, however, the Court did not expressly consider whether Section 1319 authorizes 1307(a) recovery for lost revenues. This distinction is critical. While the PIEC Court may have recognized that Section 1319 authorized 1307(a) recovery for program development and operational costs, it never addressed the matter

[4] The "reasonable and prudent" requirement is imposed by the December 2009 Secretarial Letter, which states at p. 2: "The Commission will permit the recovery of all reasonable and prudent costs incurred in implementing and managing a voluntary EE&C plan through a reconcilable adjustment clause under section 1307 of the Public Utility Code."

of whether 1319 authorizes 1307(a) recovery of lost revenues. Thus, no Court has determined that the General Assembly expressly authorized recovery of lost revenues through 1307(a).

Second, with regard to whether lost revenues are easily identifiable and beyond the Company's control, UGI-Electric argues that they are easily identifiable because they are "quantified directly by the 'deemed savings' recorded for each conservation measure implemented." UGI-Electric Exceptions at 8. As for whether they are beyond the utility's control, the Company maintains that "the Commission already decided and in the 1993 DSM Order, and the Commonwealth Court affirmed that holding in PIEC, that costs incurred to implement voluntary conservation programs that arise between rate cases may be recovered outside of the usual base rate recovery regime." *Id.*

The OCA submits that the Company is in error and that the ALJ's analysis of UGI-Electric's lost revenue claim under the standard in Popowsky is correct. As will be discussed below, the use of "deemed savings" does not yield a measure of actual energy consumption reductions and therefore lost revenues are not as easily identifiable as the Company maintains. Further, the ALJ has it exactly right that the lost revenues are not beyond the Company's control. The Company's Plan is *voluntary*. It has the ability to scale its Plan to a level at which lost revenue recovery would not be required. There is no merit to the contention that lost revenues are beyond the Company's control. Moreover, the Company's suggestion that the 1993 DSM Order and the PIEC case established that lost revenues may be recovered outside of a base rate case is clearly wrong since, as discussed above, the PIEC Court never reached the question of recovery of lost revenues.

The OCA submits that the ALJ correctly rejected UGI-Electric's arguments that its lost revenue recovery claim was reasonable and supported by the law. As the ALJ found, UGI-Electric's claim is not consistent with the guidance of Act 129 and is not supported by the cases relied upon by UGI-Electric.

B. UGI-Electric's Reliance on "Deemed Savings" For Its Lost Revenue Claim Will Yield Unjust and Unreasonable Rates.

An additional problem with the Company's lost revenue recovery proposal is that it is highly speculative in nature and therefore particularly ill-suited for the purpose of ratemaking. Lost revenues attributable to the implementation of UGI-Electric's EE&C Plan are not determined on the basis of measurement and verification, but rather on the basis of "deemed savings" from the Commission's Technical Reference Manual (TRM). Plan at 77; UGI-Electric St. No. 3 at 12. The impact of the lost revenues on UGI-Electric's earnings is uncertain at best. The OCA submits that to set rates on this basis cannot produce just and reasonable rates as required by Section 1301. With regard to the use of "deemed savings," the ALJ stated:

> UGI Electric argues that the lost revenue would be quite easy to quantify because the TRM produces an amount for "deemed savings" for measuring electricity savings for conservation programs. UGI Electric MB at 25-26; RB at 12-14. However, "The 'deemed savings' are not the type of empirically verified savings upon which lost revenues should be measured for purposes of determining what customers pay." OCA RB at 8.

R.D. at 29.

OCA witness Crandall spoke specifically to the speculative nature of UGI-Electric's proposal related to lost revenue:

> UGI-Electric is proposing the use of a coarse indicator of a "deemed savings" value that will be developed and modified from time to time for statewide use in Pennsylvania in conjunction with the Technical Reference Manual. The use of statewide "deemed savings" values for purposes of this lost revenue mechanism is not appropriate. The "deemed savings" value to be developed using information from all over the state may be dissimilar to UGI-Electric service territory and

> therefore not transferable. Given the relatively small size of the energy efficiency program that UGI-Electric is proposing and the relatively high costs of developing accurate quantification of any net lost revenues to UGI-Electric revenues (including the necessity to include newly induced central air conditioning by the program) this is not a reasonable or prudent proposal.

OCA St. No. 1 at 22-24.

Indeed, UGI-Electric proposed to calculate the projected revenue reductions using the "deemed savings" for each customer class. UGI-Electric St. No. 3 at 12, 14. For the reasons stated in his testimony, Mr. Crandall argued that the "deemed savings" derived from the TRM are a coarse indicator of the actual energy consumption reductions that may be experienced in UGI-Electric's territory. Mr. Crandall also indicated that the cost of developing a more accurate quantification of UGI-Electric's lost revenues may not be warranted given the size of UGI-Electric's program. Therefore the likelihood of having a more accurate measure to rely upon is small.

In its Exceptions, UGI-Electric takes issue with the characterization of "deemed savings" as a coarse indicator of the actual energy reductions. The Company argues that the "deemed savings" in the TRM is the "gold standard" for measuring the effectiveness of the Pennsylvania's conservation programs and that if the "deemed savings" is appropriate for use in measuring the number of kilowatt hours saved, it is appropriate to use for measuring the lost revenues associated with those saved kilowatt hours. UGI-Electric Exceptions at 19-20. The OCA submits, however, that the "deemed savings" are *not* appropriate for ratemaking purposes in this case. As the ALJ has correctly noted, the "deemed savings" are not the type of empirically verified savings upon which lost revenues should be measured for purposes of determining what customers pay.

In its Exceptions, UGI-Electric also notes that the reason the Commission, in the 1993 DSM Order, opted for allowing lost revenue recovery through regulatory asset treatment rather than through a surcharge was because, at that time, actually calculating the actual amount of revenue lost as a result of a conservation program was difficult. UGI-Electric Exceptions at 13. The Company then asserts that the "'deemed savings' values developed in the TRM to quantify electricity savings for Pennsylvania's conservation programs now provide all the specificity and reliability needed that was lacking at the time the Commission adopted the 1993 DSM Order." *Id.* As discussed above, using the TRM's "deemed savings" is not an accurate or appropriate means for measuring actual energy savings upon which to determine lost revenues for ratemaking purposes. A "deemed savings" approach does not address the verification concerns that existed in 1993.

As further support, the OCA notes that nowhere in the TRM is there any indication that the energy savings it identifies are to be used for ratemaking purposes such as lost revenue recovery. See, *e.g.*, TRM Section 1.1 (Purpose). The TRM is intended as a vehicle to estimate the energy savings from implementation of various energy efficiency measures. The ALJ recognized this point when she stated, "The TRM is not meant to be used for ratemaking purposes, and relying on this measure for use in an automatic adjustment mechanism would result in unjust and unreasonable rates." R.D at 30.

Thus, at pages 29 and 30 of the R.D., the ALJ properly rejects the position of the Company with respect to "deemed savings" and the use of the TRM. For the reasons set forth here, the Commission should affirm the ALJ's determination on these issues.

C. The ALJ Correctly Found That UGI-Electric's Lost Revenue Claim Was Not Supported As A Matter Of Policy.

In its Exceptions, under the heading "Lost Revenue Recovery is Desirable as a Matter of Policy for a Non-Act 129 EDC," UGI-Electric presents arguments intended to rebut several of the findings of the ALJ in the R.D. UGI-Electric Exceptions at 14. These include the ALJ's rejection of the Company's positions regarding: (1) the applicability of Act 129; (2) whether denial of lost revenue recovery will lead to an earlier base rate case for the Company; and (3) whether UGI-Electric's revenue reductions would be offset by revenue increases for other UGI affiliates.

Regarding the applicability of Act 129, the Company's position is that because small EDCs are exempted from the Act, then the limitation on lost revenue recovery set forth in Section 2806.1(k)(2) and (3) does not apply, indicating a legislative intent to allow lost revenue recovery by the small EDCs. UGI-Electric Initial Brief at 19. The ALJ, however, rejected this argument stating:

> Obviously, if the legislature had wanted to include small EDCs in Act 129, then it would have done so, and if it had, it would have included specific direction regarding cost recovery. Act 129 does not require small EDCs to file the EE&C plans and therefore, there was no reason to include a ban on lost revenue recovery mechanisms specific to voluntary plans filed by the smaller companies. It does not follow, however, that the lack of a specific ban makes inclusion of that mechanism a good idea. It is far more logical to expect that, if the smaller EDCs decide to participate in energy conservation programs similar to the large EDC, they can expect to recover their costs in a manner similar to the large EDCs.

R.D. at 30.

The Company finds the ALJ's analysis on this point "perplexing" and states that there is nothing "logical" about the expectation that smaller EDCs should recover their costs in the same manner as the larger EDCs. UGI-Electric Exceptions at 14. The Company responds that logic dictates that a for-profit company will not voluntarily reduce its profits by reducing sales and that

the Commission so recognized this when it determined in the 1993 DSM Order that electric utilities were to be made whole for their lost revenues.

The OCA submits, however, that the following language from the December 2009 Secretarial Letter provides strong support for the ALJ's analysis:

> While these guidelines [related to voluntary EE&C plans filed by small EDCs] were drawn from those established under Act 129 and this Commission's implementation of Act 129, we recognize that the Act 129 program contains complexity and comprehensiveness that may not be appropriate for small EDCs, due to the costs of such programs that must be supported by a smaller customer base. Nevertheless, in evaluating each voluntary EE&C plan, the Commission will be looking to the Act 129 program and applying elements of that program where it is prudent and cost-effective.

December 2009 Secretarial Letter at 2. The ALJ has it right. The Commission's expectation is that although Act 129 is not directly applicable, it will be using and applying the elements of the Act 129 program to evaluate the voluntary plans. There is nothing "perplexing" about the proposition that the policy set forth by the General Assembly will guide the Commission's determinations. The OCA submits that the ALJ's analysis here is the correct one and should be adopted by the Commission.

With regard to whether denial of lost revenue recovery will lead to an earlier base rate case for the Company, UGI-Electric maintains that this is so and relies on it as another reason to support its lost revenue claim. UGI-Electric Initial Brief at 22; Response Brief at 21. The Surrebuttal Testimony of OSBA witness Knecht examines this claim in detail:

> **Q. At page 3 of his rebuttal testimony, Mr. McAllister argues that rejecting the CDR would be bad regulatory policy, as it would push UGI-Electric closer to filing a base rate case. Do you agree with his conclusion?**
>
> A. No, I do not. First, it is not obvious that a rate case for UGI-Electric is imminent, or would become imminent as a result of adopting the proposed EE&C Plan. To my knowledge, UGI-Electric has not filed a base rate case since 1995 (adjudicated in 1996), at Docket No. R-00953534. However, according to its March 31, 2011 Financial Report to the Commission, attached to this testimony as

> Exhibit IEc-S1, the Company's reported return on common equity was 13.08 percent for the 12 months ending December 31, 2010, a value well in excess of recent return on equity awards from this Commission or from other U.S. regulatory authorities. In addition, the $308,000 first year deemed reduction in revenues cited by Mr. McAllister (adjusted for income tax effects) would reduce that equity rate of return by no more than 40 to 50 basis points. Even after three years, the deemed annual revenue reduction of $1.0 million would reduce UGI-Electric's return on equity by about 144 basis points. All other factors being equal, the effects of the EE&C Plan would leave UGI-Electric's return on equity above 11 percent.
>
> Moreover, all other factors are not necessarily equal. Load growth or cost reductions unrelated to the EE&C Plan could produce increases in net income which offset the effect of deemed revenue losses from the EE&C Plan. (Footnote omitted)

OSBA St. No. 3 at 2 (corrected). The ALJ agreed with the OSBA and stated that denial of lost revenue recovery "would not necessarily lead to an earlier base rate case for the Company." R.D. at 31.

With regard to whether UGI-Electric's revenue reductions would be offset by revenue increases for other UGI affiliates, the Company essentially argues that any revenue gains to its affiliates will be *de minimis*. UGI-Electric Exceptions at 16-17. The extent of the revenue gain to the Company's affiliates, however, is not the reason the OCA and other advocates raised the issue nor the reason the ALJ makes the point that the Company's Plan as a whole mitigates any revenue erosion to UGI as corporate entity. OCA witness Crandall addressed this point specifically:

> **Q. Does UGI-Electric have a strategy to mitigate revenue erosion resulting from such a fuel substitution initiative?**
>
> A. Yes, if UGI-Electric receives compensation for lost revenues in a decoupling mechanism as it requested, UGI-Electric will not experience revenue loss resulting from the fuel substitution technologies. The net result would be:
>
> a. UGI-Electric would pay a large (more than likely incremental cost) incentive for customers to switch to natural gas or propane which would be recovered from electric ratepayers.

b. UGI-Electric would receive a lost revenue compensation to make it whole for reduced sales due to fuel switching, again paid for by electric ratepayers.
c. UGI Penn Natural Gas would increase revenues for gas delivery for all natural gas delivered to UGI-Electric customers who switched to natural gas. UGI Penn Natural Gas' earnings are a function of its delivery volumes which would increase.
d. UGI Energy Services [UGI-Electric's affiliated natural gas supplier] and Amerigas would supply at least some of the switched loads. These would be further profit centers resulting from the fuel switching program.
e. UGI's holding company would suffer no loss, and as a result of UGI-Electric's loss revenue compensator plus the earnings of UGI-Electric's affiliates would probably gain.

OCA St. No. 1 at 13. The decreased revenues experienced by UGI-Electric are thus likely to be recouped in some measure through revenue increases to other UGI affiliates. The ALJ properly recognized this potential in the R.D.

D. Conclusion.

In sum, the OCA submits that UGI-Electric's request to recover lost revenues that result from implementing its EE&C Plan must be denied. The request is contrary to the express public policy of the Commonwealth, it is not authorized by Section 1307(a), it would result in impermissible single-issue ratemaking, it would produce unjust and unreasonable rates because it is based on speculative estimates of energy savings, it would rely upon a document not intended for ratemaking purposes, its denial would not necessarily lead to an earlier base rate case for UGI-Electric, and the revenue reductions for UGI-Electric are likely to be offset by revenue increases for other UGI affiliates. For all of these reasons, the ALJ properly determined that the lost revenue recovery request must be rejected.

OCA Reply Exception No. 2: The ALJ Properly Reduced the Size of the Fuel-Switching Incentive Payments and Required the Installation of High Efficiency Replacement Equipment.

A. Introduction.

In its Plan, UGI-Electric includes two fuel switching programs, one targeted to residential customers (Plan at 57) and the other targeted to commercial and industrial customers (Plan at 64). The OCA focused its concerns exclusively on the residential fuel switching program. This program seeks to promote fuel switching for three home-related functions -- water heating, space heating and clothes drying. The program will incentivize a switch from electric appliances for these functions to appliances fueled by either natural gas or propane. Plan at 57. According to the Plan, in order to "make the program affordable to customers," the incentive offered for switching water heaters or dryers is equal to 100% of the anticipated incremental cost to make the switch. Plan at 57. For a space heating fuel-switch, the incentive offered is 75% of the anticipated incremental cost.

In the R.D.'s Ordering Paragraphs, the ALJ makes two recommendations regarding the level of incentives UGI-Electric proposes for the residential fuel-switching program:

> a. The incentive level for customers switching from electric for water heating and clothes drying shall not exceed 50% of the anticipated incremental cost the customer incur in making the fuel switch.
> b. The incentive level for customers switching from electric heating shall not exceed 50% of the customer's incurred cost in making the switch.

R.D. at 60.

In making these recommendations, the ALJ adopted the position advocated by the OCA, that the residential fuel-switching incentives should be reduced. The OCA submits that the ALJ ruled properly and that the recommendations should be adopted by the Commission.

B. The ALJ Correctly Found That The Level of Incentives Proposed By UGI-Electric Was Excessive.

UGI-Electric, in its Exceptions, urges the Commission to retain the incentive levels proposed by the Company. UGI-Electric Exceptions at 25. The Company states that, "Ultimately, there is no way to know precisely what incentive amount is required in order to induce a customer to switch." *Id.* at 29. The Company also states that it wants its Plan to succeed and believes that a successful roll-out of the fuel-switching programs will be particularly important to the Plan's success. *Id.* The Company quotes its witness Mr. Raab as stating, "The best way to ensure early success is by offering large incentives for customers to participate." *Id.* at 40 (quoting UGI-Electric St. No. 2R at 21). The Company then reiterates the point when it says, "The size of the incentive needed to induce a customer to switch is a critical unknown; the only thing we know for sure is that the incentive will need to be very substantial for the program to be successful, at least initially." *Id.*

The ALJ points out the paradoxical nature of the Company's position: "While admitting that its own [incentive levels] are based on conjecture and speculation, the Company criticizes the OCA and OTS witnesses for their opinions that the incentives are too high." R.D. at 37.

OCA witness Crandall testified as to why the UGI-Electric incentive levels were improper:

> Generally speaking, a 100% rebate is not needed in order to induce customers to participate, especially when programs are new and when participation targets are quite low. There is a continuum of customers from those that would have participated without incentives (free riders) to those that will never participate. Offering a lower rebate will adequately incent those customers that are more likely to participate. If the savings goals can be accomplished with the lower rebates, that money can be used to expand other programs to increase the savings levels... UGI-Electric recognizes these facts in the design of its lighting and other programs. Applying those principles to the fuel switching program would make it

a more cost effective program, and therefore the funds could be used to expand other programs.

OCA St. No. 1 at 19-20.

Mr. Crandall also states:

Starting off with high incentives means that the free riders and easily persuaded customers will be paid more than needed to achieve fuel switching participation. It would be more logical to start with lower incentives to capture as many of the free riders and low-hanging fruit at low cost when the fuel switching targets are low and more easily achieved. The incentives could be increased over time as needed to continue to achieve fuel switching targets.

OCA St. No. 1-S at 10.[5]

With respect to ensuring a successful roll-out of the Company's Plan, Mr. Crandall states:

Starting with a high incentive and reducing it if it turns out to be more than necessary increases the cost of the energy saved by the program. From a customer relations standpoint, it is generally more difficult to take away a benefit than it is to increase one. Reducing an existing incentive may adversely impact the long run success of the program, relative to gradual increases in the incentives as necessary.

OCA St. No. 1-S at 11.

Further, evidence of over-incentivizing the space heat fuel-switching component of the program was brought out at the evidentiary hearing. UGI-Electric's proposed incentive for a space heating conversion is $4,850. Plan at 60. The Company arrived at this figure by combining the estimated average cost of installing a gas service line from the street -- $1,500 –

[5] One justification offered by the Company for setting high fuel-switching incentive payments is a desire to minimize the *percentage* of free-riders in the program. UGI-Electric St. No. 2R at 21. Mr. Crandall responded to this by stating:

Mr. Raab's assertion is premised on the notion that the number of free riders is not reduced, but by paying excessively generous incentives (above the incremental cost), participation levels will be so high as to reduce the *percentage* of participants that are free riders. Rather than to design the program to reduce the *number* of free riders, Mr. Raab proposes to provide them an even sweeter deal (the free riders will cost electric ratepayers paying for the incentives more) to increase the participation and reduce the free rider *percentage*. That is inappropriate.

OCA St. No. 1-S at 9-10 (emphasis added).

with the average cost of a standard efficiency natural gas furnace -- $3,350. OCA St. No. 1, Exh. GCC-3; Tr. at 63. While the Company employed its estimate of the average cost of a service line and the average cost of a new gas furnace to determine its incentive level, it also estimated the *maximum* cost for a service line and the *maximum* cost for a gas furnace. According to the Company's estimates, a customer incurring these maximum costs would face an incremental cost of making the conversion of $6,500. UGI-Electric St. No. 2RJ at 9. Whether by coincidence or not, the proposed incentive of $4,850 is exactly 75% of the estimated *maximum* cost of making the conversion. This is important because, as noted above, UGI-Electric's Plan provides that the space heat fuel-switching incentive is to equal 75% of the anticipated incremental cost of making the fuel conversion. Plan at 57. The level of the incentive, therefore, represents the stated target level (75%) of the estimated *maximum* cost to convert. Tr. at 65-66. Logically then, any customer whose cost of making the conversion is less than the estimated maximum is being over-incentivized by the Company's own terms.

Additionally, as the OCA pointed out in its Initial Brief (relying on OCA St. No. 1, Exh. GCC-7), the expected yearly participation levels for all three residential fuel-switching measures are quite low. For the space heating fuel-switch the expected number of customers is 60 per year which represents 0.59% of the Company's electric space heating customers. For the water heating fuel switch the expected number of participants is 550 per year which represents 2.98% of eligible customers, and for the clothes drying fuel-switch the expected number of customers is 100 per year or 0.24% of eligible customers.

If, as the Company states, it is impossible to know precisely the incentive amount that will be required to induce a customer to switch fuels, the OCA questions why the reduced incentive approach suggested by Mr. Crandall and adopted by the ALJ is any less plausible than

the approach that has been proposed by the Company.[6] Moreover, given the very modest expected levels of customer participation in the residential fuel-switching program, it seems that these levels of participation should be able to be achieved without resort to the generous incentive levels proposed by the Company. When compared with the Company's proposal, the OCA's reduced incentive approach has the virtue of attempting to achieve the same results using fewer dollars. This has the potential of increasing the cost-effectiveness of the program while at the same time freeing up funds that could be used to expand other cost-effective elements of the Plan.

The OCA submits that its approach of reducing incentive levels for fuel-switching is the less costly and more rational approach.[7] The ALJ agreed when she stated that, "No incentive financed by the other ratepayers should exceed 50% of the cost of replacement." R.D. at 39. The ALJ's determination should be affirmed by the Commission.

C. The ALJ Correctly Found That High Efficiency Equipment Should Be Required In The Fuel Switching Program.

In this proceeding, the OCA expressed concern that the residential fuel-switching program does not require that the replacement natural gas or propane equipment be high efficiency equipment; that is, that UGI-Electric offers its incentives for standard efficiency replacement equipment. OCA St. No. 1 at 15-17; OCA Initial Brief at 25. OCA witness Crandall testified in favor of establishing as a condition for receiving any fuel-switching

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[6] In Surrebuttal Testimony, Mr. Crandall states flatly, "My core argument, based on over three decades of experience, is that it does not take an incentive equal to 100% of incremental cost to move the market." OCA St. No. 1-S at 5.

[7] As explained in its Initial Brief, the OCA also opposes the portion of the fuel-switching incentives which is intended to compensate customers making the switch for gas service line and other gas-related infrastructure improvements. The OCA submits that this amounts to a benefit to the customer's eventual natural gas supplier at the expense of electric ratepayers. It is also unnecessary in view of the fact that customers converting to natural gas will realize operational savings over the life of the new equipment. OCA Initial Brief at 19.

incentive payments that the customer replace their electric equipment with high efficiency equipment. OCA St. No. 1-S at 13; OCA Initial Brief at 25-26. In the R.D., the ALJ adopted the OCA's position stating that, "For purposes of this Plan and the incentives it provides, appliances which are to be substituted for electric appliances are required to be highly efficient." R.D. at 46. UGI-Electric excepts to this determination of the ALJ. UGI-Electric Exceptions at 30-32.

In its Briefs, the OCA cited the Commission's recent Tentative Order regarding Implementation of Act 129 of 2008- Total Resource Cost (TRC) Test 2011 Revision, Docket No. M-2009-2108601 (May 6, 2011) (2011 TRC Tentative Order).[8] On the topic of the efficiency of appliances involved in a fuel-switching program, the Commission indicated that its proposed resolution of the issue is that new equipment installed to replace electric equipment should be high efficiency equipment. 2011 TRC Tentative Order at 20.

Indeed, the ALJ relied on the 2011 TRC Tentative Order in reaching the decision to require high efficiency replacement equipment. R.D. at 45-46. The Company takes exception to this noting that the 2011 TRC Tentative Order is at this point only a Tentative Order that has not been adopted by the Commission. UGI-Electric Exceptions at 31.

The OCA would note that regardless of whether the Commission has adopted the Tentative 2011 TRC Order, the underlying policy of requiring high efficiency equipment is sound. The ALJ captured this when she stated:

> It makes little sense from an overall policy standpoint to encourage reduced usage of one form of energy without encouraging the best use of the substituted fuel, especially when funded at the expense of ratepayers.

R.D. at 46.

[8] Issued at Docket No. M-2009-2108601, Order entered May 6, 2011.

The OCA submits that the ALJ's determination with respect to requiring high efficiency replacement equipment is in accord with sound public policy and should be adopted by the Commission.

III. CONCLUSION

For the reasons set forth in these Reply Exceptions, the OCA respectfully requests that the Commission reject the Exceptions presented by UGI-Electric and instead adopt the ALJ's recommendations to: (1) deny the Company its request for lost revenue recovery; (2) reduce the level of residential fuel-switching incentives; and (3) require that the natural gas or propane equipment used to replace electric equipment under the fuel-switching program meet high efficiency equipment standards.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

Petition of UGI Utilities Inc. – Electric Division for Approval of its Energy Efficiency and Conservation Plan	: : :	Docket No. M-2010-2210316

I hereby certify that I have this day served a true copy of the foregoing document, the Reply Exceptions of the Office of Consumer Advocate, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code Section 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

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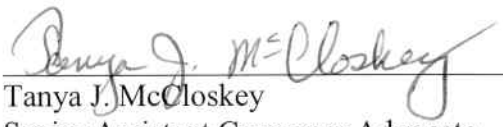

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