

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Compliance of Commonwealth of** :  
**Pennsylvania with Section 410(a) of the** : **Docket No. I-2009-2099881**  
**American Recovery and Reinvestment Act** :  
**of 2009** :

**Technical Conference  
November 19, 2009**

Remarks of  
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On behalf of  
Metropolitan Edison Company  
Pennsylvania Electric Company and  
Pennsylvania Power Company

**I. INTRODUCTION**

My name is Charles V. Fullem and I am the Director – Rates and Regulatory Affairs – Pennsylvania, for FirstEnergy Service Company. I am participating in the Commission’s Technical Conference today in the above-mentioned proceeding on behalf of Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”) and Pennsylvania Power Company (“Penn Power”) (collectively, “the Companies”).

Immediately following the enactment of the American Recovery and Reinvestment Act of 2009 (“ARRA Act”), the Companies began thoroughly evaluating and exploring opportunities to take advantage of any available federal funds resulting from the ARRA Act in order to develop and improve their infrastructure system. The Companies filed Comments in this proceeding on July 2, 2009. Reply Comments were submitted by the Companies on August 4, 2009. The Companies are committed to working with the Commission and other interested parties to develop policies and initiatives consistent with the intent of Section 410(a) of the ARRA Act and appreciate the opportunity to participate in the Commission’s Technical Conference this afternoon.

Section 410(a) specifically requires the Governor of a State to notify the Secretary of Energy, in writing, that:

The applicable State regulatory authority will seek to implement, in appropriate proceedings for each electric and gas utility, with respect to which the State regulatory authority has ratemaking authority, *a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and that provide timely cost recovery and a timely earnings opportunity for utilities associated with cost effective measurable and verifiable efficiency savings*, in a way that sustains or enhances utility customers' incentives to use energy more efficiently.

American Recovery and Reinvestment Act of 2009, Pub. L. No. 115-1 § 410(a), 123 Stat. 115 (2009) (Emphasis Added).

The Companies commend the Commission's vigilance in seeking actions and policies to further the federal mandate in Section 410(a) of the ARRA Act. However, Pennsylvania's regulatory framework currently does not ensure that utility financial incentives are aligned with helping their customers use energy more efficiently and that provide timely cost recovery and a timely earnings opportunity for utilities associated with cost effective measurable and verifiable efficiency, as required by the ARRA Act. In order to provide the regulatory standards set forth in the ARRA Act, Pennsylvania should reflect the following key attributes in its policy making:

1. Fully compensate utility participation in conservation programs through recovery of ongoing costs, including fair return on invested capital and recovery of lost revenues in between rate proceedings, on a stand-alone basis; and
2. Utilize more robust utility pricing to appropriately recover a greater percentage of fixed distribution costs on a "rental" basis, rather than to recover fixed distribution costs on a "volume" basis.

The Companies believe these attributes will foster increased energy efficiency and allow utilities to fully and timely recover their costs, while not adversely impacting savings opportunities for customers. My remarks today will address two areas for the Commission to consider: 1) the need for the amendment of Act 129; and 2) concerns with decoupling.

## **II. THE COMMISSION SHOULD RECOMMEND AND SUPPORT THE AMENDMENT OF ACT 129 OF 2008 ("Act 129")**

Although electric distribution companies are allowed to recover on a full and current basis all reasonable and prudent costs incurred in the provision and management of energy efficiency and conservation plans implemented pursuant to Act 129, the current law specifically prohibits the recovery of decreased revenues of an electric distribution company due to reduced energy consumption or changes in energy demand resulting from the implementation of energy efficiency and conservation plans. 66 Pa. C.S. § 2806.1(k). In addition, in the smart meter

technology section of Act 129, the recovery of any lost or decreased revenues of an electric distribution company due to reduced electric consumption or shifting energy demand is strictly prohibited. 66 Pa. C.S. § 2807(f)(4)(ii).

For Met-Ed, Penelec and Penn Power, roughly 20% of the Companies' distribution revenues are fixed while the other 80% is tied to volume. The 80% of distribution revenues tied to volume is made up of measured billing demand (20%) and measured energy usage (60%). As a result of the required reduction in consumption of 1% by May 31, 2011, and 3% by May 31, 2013, the Companies' distribution revenues will significantly decrease. The actual amount lost will be dependent upon the successful implementation of energy efficiency and conservation programs; however, it is reasonable to assume that the Companies will lose approximately \$70 million in distribution revenues between 2009 and 2015 if they are to achieve reduced energy consumption and reduced energy demand as required by Act 129. This result, which demonstrates that the utilities are subject to a disincentive, is inconsistent with the ARRA Act mandate.

Some of the other commenting parties have argued that Act 129 provides that any decreased revenues resulting from reduced energy consumption related to energy efficiency and conservation programs may be reflected in the revenue and sales data used to set rates in future distribution rate cases, and that this will, therefore, preserve an electric distribution company's earnings opportunity. It is true that the Companies could file new base rate cases to attempt to recover such losses and meet revenue requirements. However, even if it is assumed that each of the Companies would file a distribution base rate case in early 2011, and again in 2014, absent any post-test period sales adjustments, regulatory lag would occur between the actual loss in revenue and the implementation of new rates. Even if new rates are approved under the earliest possible timetable, this could result in more than \$40 million in lost revenues for the Companies between 2009 and 2015. Such a \$40 million loss is not consistent with a timely earnings opportunity for electric distribution companies associated with cost effective measurable and verifiable energy efficiency programs. These lost distribution revenues are illustrated in Attachment 1.

In order for the Commonwealth to be in compliance with the clear directives set forth in Section 410(a) of the ARRA Act, the Companies believe that Act 129 must be amended. The energy efficiency and smart metering sections of the Public Utility Code implemented by Act 129 must be amended by removing the language that currently prohibits the timely recovery of decreased revenues as a result of reduced consumption or shifting energy demand. New language should be inserted that would expressly allow utilities the opportunity to recover lost or decreased revenues resulting from reduced energy consumption or changes in energy demand through a rider pursuant to 66 Pa. C.S. § 1307(e). The Companies respectfully urge the Commission to recommend and offer its support for these necessary changes to Act 129 to the Administration and Pennsylvania General Assembly.

### **III. DECOUPLING MAY NOT BE THE ANSWER**

The regulatory concept of decoupling means to true-up volume-based rate levels on a regular systematic basis so that they produce a previously established level of revenue

requirement regardless of new volume level. Decoupling has been touted as one way to make sure that the utility investor is not penalized for affirmatively participating in shrinking the level of the utility's business.

Decoupling can provide for the advancement of conservation goals while not financially harming the utility and keeping customer bills relatively stable while offsetting higher rates with lower usage volumes. However, decoupling gives up a very significant benefit of the existing ratemaking structure, and at the same time is potentially confusing to customers. The benefit of continued efficiency gains in service delivery and operations improvements is likely to be diminished under decoupling compared to those that would generally be expected to continue under the existing ratemaking structure.

Fixed rates tend to spur efficiency gains. During periods of fixed distribution rates, utilities are incented to continuously improve their cost structure in order to maintain or increase earnings. The delivery business, at its core, is a fixed cost business. The utility installs plant capacity sufficient to meet customer demands and maintains and operates that plant so it remains operational and capable of providing the delivery service. With decoupling, continuous improvement in cost structure improvement is no longer rewarded because the incentive for the utility to retain any gains is lost since the value of such improvements accrues to rates in a very short time period.

Fixed costs include the costs of materials, e.g., the cost of poles, wires, transformers and related equipment. The costs to install the materials are also fixed costs, e.g. labor, benefits, transportation to the site and warehousing. These installation costs, particularly capitalized labor, often exceed the direct costs of the materials. An additional fixed cost is the cost of having a labor force available to operate and maintain the plant, as well as perform system planning, customer service operations and back-office functions. These costs are generally invariant to the volume of electricity consumption. Rather, the costs are a function of the capacity installed to serve peak loads and to perform the necessary fixed business requirements. For example, the cost to own and operate a pole does not change because a customer uses more or less electricity in a defined period of time.

To the extent that customer demands increase (i.e., the concept of peak period diversified customer load on the system), additional plant capacity is called for and presumably planned for and installed. If the diversified demands decrease, there is little, or even negative, value in uninstalling plant capacity, because the cost of removal is substantive, and the value to reuse the equipment is significantly less than the labor and other costs to remove and re-stock the material. Additionally, since demand reductions have historically been short-lived, replacement of the plant capacity would be necessary in the near future and involve an additional cost.

Inasmuch as the cost structure underlying the electric distribution business is for the most part fixed, it is important, from a rate design perspective, to design distribution rates that are also fixed and that do not have large ranges of variability as energy usage fluctuates. Remember, as I noted earlier, roughly 20% of the Companies' distribution revenues are fixed, while the other 80% is tied to volume (20% measured billing demand and 60% measure energy usage). Likewise, distribution costs are expected to represent roughly 20% of a residential customer's

total bill after the expiration of rate caps. Increasing the percentage of distribution revenue requirement recovered through a “rental type” rate to even 50% of the distribution revenue requirement would result in customer savings equal to 90% of their total average cost for every kWh saved.

The Commission should support a move to customer or fixed distribution charges equal to that dictated by cost of service and minimum billing demand equal to the size of equipment installed to serve customer load. This more robust use of utility pricing to appropriately recover fixed distribution costs would be more successful in aligning utility financial incentives with helping their customers use energy more efficiently, without discouraging customers from achieving energy efficiency and conservation objectives.

#### **IV. CONCLUSION**

In conclusion, reflection of decreased revenue and reduced energy consumption related to Act 129 energy efficiency programs in the revenue and sales data used to set rates in a distribution base rate case, as opposed to allowing full and timely recovery through a recovery mechanism under 66 Pa. C.S. § 1307(e) is inconsistent with a regulatory policy that is to create a timely earnings opportunity for utilities associated with cost effective measurable and verifiable efficiency as mandated by the ARRA Act. Therefore, Act 129 and the Public Utility Code should be amended accordingly.

Additionally, revenue decoupling may discourage continuous improvement in distribution operations, and the goals of decoupling may be better served by changes in rate design through increased customer charges and the increased use of contracted versus measured billing demands. As a result, decoupling may not be the best answer.

The Companies appreciate the opportunity to participate in the Commission’s investigation into this important topic and today’s Technical Conference. The Companies look forward to continuing to work with the Commission in the future on these critical issues. I am available to answer any of your questions. Thank you.

# Lost Distribution Revenues

