

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Compliance of Commonwealth with :
Section 410(a) of the American Recovery : **Docket No. I-2009-209881**
and Reinvestment Act of 2009 :

**REMARKS OF PECO ENERGY COMPANY
AT THE COMMISSION'S TECHNICAL CONFERENCE
November 19, 2009**

PECO appreciates the opportunity to participate in this Technical Conference. PECO has long supported energy conservation and efficiency programs because they are good public policy and good for our customers. Such programs – whether utility programs providing direct customer incentives or savings enabled by smart-meter technology and time-of-use rates -- reduce energy costs and help the environment. In particular, we support the economic-development and energy-conservation goals of American Recovery and Reinvestment Act (“ARRA”) and Act 129 and appreciate the Commission’s effort to maximize Pennsylvania’s funding through ARRA.

The Challenge – Aligning Utility Financial Incentives with Helping Customers Use Energy More Efficiently

Every form of ratemaking rewards some behavior or results and deters others. Under traditional base rate ratemaking – under which rates are reset only intermittently and customers are charged largely on a volumetric basis – utility returns on fixed costs increase as sales increase (and as expenses are managed downwards). This approach discourages utilities from inducing customers to use less of their service; as sales decline, company returns decline. In addition, as utilities escalate spending on conservation programs, their returns decline further. The ARRA recognizes this dilemma and urges state commissions to adopt policies that **“ensure that utility financial incentives are aligned with helping their customers use energy more efficiently and that provide timely cost recovery and timely earnings opportunity for utilities associated with cost-effective measurable and verifiable efficiency savings[.]”**

Solutions – Several Mechanisms Are Available to Align Utility and Customer Interests in Promoting Conservation

A number of mechanisms can be implemented to remove existing disincentives to promote conservation and align utility and customer interests. These include:

- Designing rates that favor fixed charges as opposed to charges that vary by volume
- Providing full and current (surcharge) recovery of conservation program costs (something that Act 129 expressly provides and that the Commission has approved for electric-company conservation programs)

- Providing “lost-revenue” surcharge recovery associated directly with conservation programs (something that Act 129 prohibits for electric programs)
- Reflecting lost revenues associated with conservation programs on a forward-looking basis when establishing rates in base-rate cases (something that Act 129 expressly provides)
- Adopting revenue-decoupling mechanisms
- Implementing positive incentive mechanisms that provide enhanced utility financial returns for promoting conservation

Decoupling

Much attention has been paid lately to decoupling, a concept that has been around for some time. Simply put, decoupling de-links utility revenues from sales volume. Under a decoupling mechanism, the utility’s rates are adjusted on a regular basis (annually or quarterly, for example) to reflect actual sales.

Decoupling, as typically constructed, adjusts rates to reflect sales changes from all causes, including weather and the economy as well as revenue reductions resulting from conservation initiatives and programs. Lost-revenue recovery mechanisms, in contrast, are more narrowly tailored to adjust rates to reflect only those sales losses attributable to utility-sponsored conservation programs. It should be noted that decoupling removes utility disincentives to promote conservation and thus make utilities neutral. Decoupling, however, provides no positive incentive for utilities to embrace aggressive conservation program promotion.

Decoupling carries some collateral implications. One is that it removes incentives for utilities to promote state and local economic development, by making utilities indifferent to sales volume. However, we need utilities and government pulling together to promote economic development and job growth - an especially pressing imperative given the depressed state of the economy. Promoting such growth is not at odds with a conservation focus. We should grow, but in a fashion that encourages the efficient use of power.

Another collateral implication is that revenue decoupling drives more frequent base rate cases. Under traditional ratemaking, increasing revenues offset increasing expenses (for example, to pay escalating pension or health-care costs), thus forestalling the need for rate increases). Under decoupling, during a time when the economy and expenses are growing, increased sales will result in decreased rates under a decoupling mechanism, and increased revenues will not be available to offset increased costs, thus requiring more frequent rate filings to reflect increasing costs.

An Annual Interim Rate Adjustment Mechanism Would Properly Align Incentives

An efficient way to align customer and utility interests is through periodic base rate cases coupled with an annual rate adjustment mechanism. Under this method, a utility files a base rate case at specified intervals, say every 3-5 years. In between base rate cases, all costs as well as all revenues are trued up through an annual adjustment mechanism, with some cap

on the permitted annual increase (perhaps tied to inflation). Thus, this mechanism addresses the cost side as well as the revenue side of the rate equation. This method removes disincentives to aggressively promoting conservation, provides for timely recovery of costs (including increased costs from conservation and smart-meter programs), allows for symmetry in ratemaking, smoothes rate adjustments, and provides for complete review of utility cost and operations, thereby fully aligning customer and utility interests.¹

The Commission Should Consider Mechanisms that Provide Positive Incentives

The Commission should adopt mechanisms that provide affirmative, positive incentives to utilities to promote conservation. As noted above, a number of mechanisms simply remove disincentives and thereby make the utility neutral. However, positive incentives will drive the most aggressive promotion of conservation and achieve the strongest results. Act 129 and ARRA clearly contemplate encouraging utilities and customers to conserve energy over and above mandated levels.² Such incentives can include a rate-of-return adder, performance-target incentives, shared-savings mechanisms and accelerated depreciation.

The Commission Should Remain Open and Flexible

As noted, rate mechanisms to align customer and utility incentives can take many forms, with multiple permutations and variations. The commission should encourage Pennsylvania electric and gas distribution companies to propose mechanisms tailored to their particular circumstances and customer characteristics and should remain flexible in considering the variety of ways in which alignment can be achieved.

¹ The Commission has the authority to approve an annual interim rate adjustment mechanism. *See* 66 PA.C.S. § 501, 1308, 2806(i).

² *See* 55 Pa.C.S. § 2806.1(a)(6); ARRA § 410(a)(1)