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February 23, 2011

VIA OVERNIGHT UNITED PARCEL SERVICE

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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

Dear Secretary Chiavetta:

Enclosed for filing are an original and sixteen (16) copies of Comments of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company (collectively, "the FirstEnergy Companies") in the above-captioned docket. Please date stamp the additional copy and return it to me in the enclosed, postage-prepaid envelope.

Please contact me at the above phone number should you have any questions.

Very truly yours,

Bradley A. Bingaman

d1m
Enclosures

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

COMMENTS OF METROPOLITAN EDISON COMPANY,
PENNSYLVANIA ELECTRIC COMPANY AND
PENNSYLVANIA POWER COMPANY

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Dated: February 23, 2011

Counsel for:
Metropolitan Edison Company,
Pennsylvania Electric Company and
Pennsylvania Power Company

I. INTRODUCTION

On February 17, 2009, President Barack Obama signed the American Recovery and Reinvestment Act (“ARRA” or “Act”) into law. Specifically, Section 410(a) of the ARRA authorizes financial grants to states if certain conditions are met. Among other things, Section 410(a) of the ARRA 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. (Emphasis added.)

As a result of this federal mandate, on March 23, 2009, then-Governor Rendell requested that the Pennsylvania Public Utility Commission (“Commission” or “PUC”) initiate an investigation into whether the State’s existing policies satisfy the requirements set forth in Section 410(a) of the ARRA. The PUC subsequently issued an Order and promptly commenced an investigation at the above-referenced docket on May 6, 2009.

Interested parties were invited to file Comments and Reply Comments in this proceeding, as well as participate in a Technical Conference and subsequent Working Group regarding the issues associated with the State’s compliance with the ARRA. Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”) and Pennsylvania Power Company (“Penn Power”) (collectively, “the FirstEnergy Companies” or “the Companies”) submitted Comments on July 2, 2009 and Reply Comments on August 4, 2009. In addition, Charles V. Fullem, FirstEnergy’s Director, Rates and Regulatory Affairs – Pennsylvania, testified at the

Commission's Technical Conference on November 19, 2009, on behalf of the FirstEnergy Companies. Finally, the FirstEnergy Companies actively participated in the Working Group process.

As a result of the efforts of the Working Group, a report was prepared which discusses existing Commission policies or laws that address the goals outlined in Section 410(a) of the ARRA as well as additional measures that the Commission may consider to address those goals. The Commission entered an Order and issued the Working Group Final Report for comment on January 24, 2011. Interested parties were invited to submit Comments and Reply Comments regarding the contents of the report.

The FirstEnergy Companies appreciate the opportunity to provide the following comments in response to the ARRA Working Group Final Report to assist Pennsylvania's compliance with the goals set forth in Section 410(a) of the ARRA.

II. COMMENTS

At the outset, the Commission should be commended for initiating this investigation and seeking actions and policies to further the federal mandate in Section 410(a) of the ARRA. However, the Companies remain concerned that the existing legal framework and policy in Pennsylvania may be promoting a result that is inconsistent with the mandates set forth in Section 410(a). Specifically, there exists conflicting direction between how electric distribution companies are required to comply with ARRA and the rules established in Act 129 of 2008 ("Act 129"). Therefore, the FirstEnergy Companies respectively submit the following general comments regarding the Working Group Final Report.

A. Recovery of Lost Distribution Revenues

The FirstEnergy Companies agree that the intent of Section 410(a) of the ARRA is to promote energy efficiency and to encourage policies that will nurture that goal. However, Section 410(a) also requires that any conservation policies should be designed to provide the necessary incentives for electric utilities to enact energy conservation plans for customers. Those policies must align utility incentives with these goals by allowing for timely recovery of associated costs and a timely earnings opportunity. If utilities face a reduction in earnings as a result of a conservation plan, then the policy does not appear to align those utility incentives with conservation goals.

The prohibitions regarding the recovery of lost revenues in Act 129 appear to be inconsistent with the standard that is set forth in Section 410(a) of the ARRA and described above. Specifically, Act 129 prohibits the recovery of decreased revenues of an EDC due to reduced energy consumption or changes in energy demand through a reconcilable automatic adjustment clause. *See*, 66 Pa. C.S. §§2806.1(k) and 2807(f)(4)(ii).

For electric distribution companies (“EDCs”), only a small portion of the distribution revenues are fixed while the majority of those revenues, which are composed of measured billing demand and measured energy usage, are tied to volume. As a result of the required reduction in consumption under Act 129, the Companies’ distribution revenues will significantly decrease. That actual amount lost will be dependent upon the successful implementation of energy efficiency and conservation programs. A reasonable assumption is that the Companies could 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 mandate contained in Section 410(a) of the ARRA.

Some 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 EDC'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 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 loss is not consistent with a timely earnings opportunity for electric distribution companies associated with cost effective measurable and verifiable energy efficiency programs.

The Companies believe that Act 129 should be amended in order for the Commonwealth to satisfy the directives set forth in Section 410(a) of the ARRA. The energy efficiency and smart metering sections of the Public Utility Code implemented by Act 129 should 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 automatic adjustable rider pursuant to 66 Pa. C.S. § 1307(e). This would allow Pennsylvania policy to fully compensate utility participation in conservation programs by providing for the recovery of

ongoing costs, including a fair return on invested capital and the recovery of lost revenues in between rate proceedings, on a stand-alone basis.

B. Decoupling

On its face, decoupling may seem like a good idea, but it may result in unintended consequences for customers and utilities. 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. 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.

On the other hand, 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. 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, 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 restock 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. Rather than decoupling as generally understood, the Commission could consider other more beneficial options such as a move to fixed distribution charges, as described above, equal to that dictated by cost of service and minimum billing demand equal to the size of equipment installed to serve customer load. Such a more robust use of utility pricing to appropriately recover fixed distribution costs would likely 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.

C. Other Issues

The FirstEnergy Companies have focused their Comments on two specific issues addressed in the ARRA Working Group Final Report – lost revenues and decoupling. While these two specific issues are of significant concern to the FirstEnergy Companies, the Companies recognize that the Working Group Final Report contained and addressed a wide range of additional topics, policies and actions that are worthy of discussion and consideration. The

FirstEnergy Companies look forward to working with the Commission and interested parties in the future in an effort to further a general policy for Pennsylvania and the Commission that ensures that utility financial incentives are aligned with helping customers use energy more efficiently in accordance with Section 410(a) of ARRA.

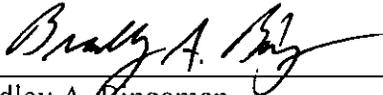
III. CONCLUSION

As illustrated in the Working Group Final Report, there are varying opinions on whether Pennsylvania has done enough to satisfy the compliance requirement of Section 410(a) of the ARRA. The FirstEnergy Companies believe that in order to satisfy the requirement in the ARRA the Commission should enact general policies that ensure that utility financial incentives are aligned with helping their customers use energy more efficiently, and that Act 129 should be amended as described herein by providing for the timely recovery of lost revenues through non-base rate case mechanisms.

The FirstEnergy Companies appreciate the opportunity to offer comments on the ARRA Working Group Final Report, and look forward to continuing to work with the Commission in the future regarding these critical issues.

Respectfully submitted,

Dated: February 23, 2011



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American Recovery and Reinvestment Act :
of 2009 :

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true and correct copy of the foregoing document upon the individuals listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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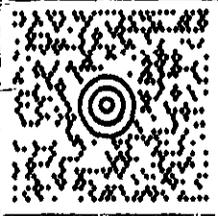
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