

September 7, 2007

BY OVERNIGHT DELIVERY

Mary L. Cottrell, Secretary
Massachusetts Department of Public Utilities
One South Station, 2nd Floor
Boston, MA 02110

RE: 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

Dear Ms. Cottrell:

Enclosed for filing on behalf of the Western Massachusetts Industrial Group (“WMIG”), please find their comments on the above captioned matter.

Please contact me if you have any questions regarding the attached.

Regards,

Donald J. Sipe /s/

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far more practical and effective avenues to assure that demand response and efficiency become an integral part of Massachusetts' energy future. Those alternative avenues include 1) assuring the independent administration and procurement of demand side management programs, 2) adopting appropriate rate designs which, rather than seeking to simply protect utility shareholder interests, accurately reflect the cost of service and thereby send the appropriate price signals to encourage cost efficient demand response in the market, and; 3) focused coordination among all state departments and regulatory agencies to develop a coherent state-wide energy strategy to benefit all Massachusetts customers.

II. EXECUTIVE SUMMARY.

WMIG appreciates this opportunity to comment. WMIG believes that revenue decoupling is likely to be unfair to consumers, and ineffective as a means of removing utility disincentives for demand response. WMIG does not believe that there is evidence that Massachusetts utilities require additional revenue guarantees to act responsibly in the realm of demand response. To the extent the Department or the legislature believes there is cause to find utilities unwilling to act in a socially responsible manner absent such additional revenue guarantees, WMIG would recommend removal of demand response programs from utility oversight altogether, and their administration by an independent agency.

WMIG believes that utility shareholders should not be favored with economic mechanisms which completely insulate them from the shared sacrifice that will be necessary from all Massachusetts businesses if the State is to reach its economic and environmental goals. Ratepayers should not be forced to subsidize such an insurance policy for utility shareholders when they are themselves struggling to meet the new demands that environmental and other challenges pose to the State. WMIG believes that standard rate of return regulation provides fair

and reasonable opportunities for utilities to earn a fair return, and also provides much needed protections to ratepayers to assure that utility rates are just and reasonable and reflective of the cost of service. WMIG believes that a far more proactive and effective approach to encouraging energy efficiency would be to correctly design rates to reflect cost causation principles. In this respect, WMIG notes that the Staff straw proposal, because it is based on a number of customers, is directly contrary to cost causation rate design, and will make matters worse rather than better if adopted. Further, the Strawman, by decoupling revenues and sales will create perverse incentives regarding customer service, maintenance, and the mitigation of losses which additional mechanisms will have to be established to deal with. In order to ensure that utilities are not compensated for acting imprudently or in an unreliable fashion. For all of those reasons, in addition to being ineffective, politically unfair and unnecessary, the WMIG believes that decoupling mechanisms will necessarily be complex, controversial and difficult to administer, or in the alternative, simplistic, unjust and unreasonable, counter-productive, and damaging to both society and the environment.

For these reasons, WMIG will recommend the following four steps to be taken: 1) rejection of revenue decoupling, but if concerns persist about utility incentives, then DSM programs should be administered by an independent office or agency; 2) A comprehensive revenue requirements proceeding to establish accurate cost of service for each jurisdictional utility; 3) a comprehensive and generic rate design investigation for all utilities focusing on the appropriate allocation between demand and energy rate components on a cost of service basis and between classes for all services provided by utilities. This rate design proceeding should include completion of the rate design for cost based stand-by and back-up rates and; 4) the establishment of a task force charged with developing, in consultation with Stakeholders, a

comprehensive energy plan for Massachusetts to assure that all the state's regulatory and administrative efforts are properly coordinated.

III. COMMENTS.

As a general matter, Revenue Decoupling must either be unfair to consumers or ineffective as a means of removing utility disincentives for demand response. Taken literally, if Revenue Decoupling means assuring utilities identical revenues to what they currently earn regardless of usage, then¹ such a program is clearly unfair to consumers and unjust and unreasonable under the Hope-Bluefield standard of assuring just and reasonable rates. Customers should pay for service under cost based rates, not provide income insurance to utilities to prevent them from taking economically, societally and environmentally damaging actions such as intentionally discouraging demand response.

As a threshold matter, WMIG does not believe there is, in fact, reason to suspect Massachusetts's utilities require such payments to act responsibly. The assumption that utilities will not cooperate constructively with legislative or DPU initiated efficiency programs without additional revenue guarantees is a proposition that would be difficult to prove based on past experience with such programs under the current regime. Moreover, if it could be proven, it would have extremely disturbing implications of corporate disregard for the public welfare sufficient to call into question the wisdom of permitting utilities to have any involvement in these programs whatsoever. In such a case it would be far wiser to remove these programs to an independent administrator. However, WMIG hastens to repeat, we do not see evidence of this

¹ Bluefield Water Works and Improvement Co. v. P.S.C., 262 U.S. 679 (1923), and FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944). These cases contain the following guidelines for rate of return decisions:

1. The allowed rate of return should be comparable to that generally being made on investments and other business undertakings which are attended by corresponding risks and uncertainties;
2. The return should be sufficient to enable the utility to maintain its financial integrity; and
3. The return should be sufficient to attract new capital on reasonable terms.

level of social irresponsibility in Massachusetts utilities and therefore question the initial premise that any such scheme is needed.

This is not to say that utilities will be immune from the adjustment pains that will accompany a shift towards a more energy efficient economy. All customers and industries in Massachusetts will have to “share the pain” of adjusting to different and perhaps more costly practices in order to meet the environmental and societal challenges posed by global warming and other threats. Though customers should continue to pay for service received from utilities under the Hope-Bluefield standard, there should not be any “free ride” provided for utility shareholders at consumer expense. Utilities and their shareholders, as all other businesses in Massachusetts, should share some of the burden of meeting the environmental and energy challenges which face the state. Customer costs will inevitably rise as fuel supplies become scarcer, carbon caps take effect, and other necessary legislative and regulatory measures are adopted. Consumers should not be burdened with the added expense of subsidizing utility investors by paying for utility infrastructure which is no longer needed, or which expands less rapidly than those shareholders might wish. Rates based upon the cost of service provided by the utility cannot be maintained under Revenue Decoupling where the amount of service provided by the utility becomes irrelevant. Consumers should not be required to fund a special exemption from the general economic adjustment which all other businesses will need to make, for the purported purpose of preventing utilities from taking socially irresponsible actions. There are far fairer and cheaper alternatives for all involved.

Over time, there may well be a necessary adjustment in the amount of infrastructure provided by utilities that are “used and useful” as we move towards better efficiency and less energy intensive economic practices. These are necessary changes, but they will not necessarily

be painless to anyone. Yet there is no need to resort to inappropriate revenue guarantees to address this concern. Current cost of service regulation is admirably suited to periodically adjusting utility revenues through rate case proceedings to assure utilities continue to receive a fair opportunity to recover all prudent costs. Unlike decoupling mechanisms, however, rate cases provide important consumer protections that assure utilities remain vigilant to find all prudent opportunities to minimize losses. Decoupling, on the other hand will either create perverse incentives by making utilities indifferent to these losses, or will have to incorporate the extensive consumer protection features of Cost of Service regulation to avoid them. This, of course, begs the question of why depart from the current practice at all.

On the other hand, if Revenue Decoupling is not meant to immunize utilities from the long-term effects of declining sales and economic adjustments, it will then be ineffective as a means of removing utility disincentives towards DSM. For certain costs, utilities are already at risk under regulatory lag. But incentives created by those short-term costs pale in comparison with the long term incentives to expand infrastructure, and achieve higher levels of long term rate base upon which shareholders can earn a return. Even with lowered allowed returns, the incentive to continue to expand rate base and service levels will remain. This is because it will be impossible, in the end, not to compensate utilities on a just and reasonable basis for capital prudently invested in rate base. Thus, the long term incentive to have utility infrastructure be the preferred societal option will remain with utilities regardless of Revenue Decoupling. For all of these reasons, WMIG believes Revenue Decoupling will either be unfair to customers, forcing consumers to subsidize utility revenues in an unjust and unreasonable manner or will be ineffective because it will not, in the long run, protect utility revenues from legitimate decreases due to societal shifts away from reliance upon utility services.

Further, it is clear that any form of revenue decoupling that relies upon the Strawman platform will subvert any cost based rationale that may exist in current rate designs. The Strawman's contention that a major driver of utility costs is the number of customers on a utility's system is inaccurate. In fact, number of customers is a relatively minor factor in utility costs, driving only metering and customer costs. In every case, costs related to usage, both demand and energy consumption, are the major drivers of costs on utility systems. The number of customers is largely irrelevant to the overall cost of service to utilities unless one assumes some particular amount of and pattern of usage per customer. Three thousand customers with a demand of 1KW apiece are dwarfed by the expense incurred by the utility to serve the same 3,000 customers at 5KW of demand apiece. An even more important cost driver is the diversity of customer's loads. A group of customers who all place simultaneous demands upon the system costs much more than a group of customers who use the system at different times. These are all well-known cost of service rate design principles, which any mechanism focused upon the number of customers will ignore or incorrectly account for. The result of poor rate design will be inefficient demand response and much less demand response than would be elicited by accurate price signals. Further, the inefficiency of demand response will have societal and environmental consequences because customers will not take meaningful opportunities to reduce because of inaccurate price signals. WMIG believes that the best encouragement of demand response is appropriate rate design which sends accurate cost signals to customers about their usage. Departures from accurate cost of service rate design are counter-productive, and will have environmental and economic costs.

A far more proactive and effective approach to encouraging energy efficiency would be to focus the Department's resources on a comprehensive review of current rate design to assure

that demand related costs are appropriately allocated to coincident peak usage and to eliminate such noncoincident peak devices as poorly designed ratchets that make customers indifferent to the timing of their consumption. The Department should complete its investigation of standby and backup rates in Docket No. 07-6 and adopt a cost based rate that appropriately recognizes the diversity of standby and backup customer demands. Energy efficient distributed generation and cogeneration will never be optimized, even under revenue decoupling, absent the adoption of rates that do not inappropriately penalize these customers for occasional use of the system in non-peak periods. These and other issues are in need of immediate attention and can provide substantial benefits in terms of energy efficiency. By contrast, rate designs focused on number of customers or other non-cost based recovery mechanisms will assure suboptimal Demand Response and inefficient investment in energy efficiency infrastructure.

Decoupling also dilutes customer incentives, under any rate design, to participate in demand response. Demand response is never free. It takes expense, change of habits, change of routines, and often capital investment to make it work. Such costs are not incurred simply to keep ones' bill from the utility the same. Nor should such costs be incurred to simply pass ones' bill on to a neighbor. The Department must bear in mind that it is the public, not utilities, whose attitudes will need adjustment in order to achieve levels of demand response that are optimal. Such an adjustment cannot be made under a regime in which customers incur costs, but save no money in order to participate in demand response, or alternatively, simply push additional costs off onto their neighbors after incurring their own. This is a recipe for customer resentment, not acceptance of the need for Demand Response.

Because all successful and fair decoupling mechanisms must take into account the full cost of service implications of demand reductions, they cannot be simple mechanisms. At best,

they need to be elaborate stranded costs recovery mechanisms which effectively separate out fixed from variable costs of reductions in each customer group and assure the utility a continued level of return upon its fixed capital investment in rate base. These are not easy mechanisms to create or administer. Further, even these mechanisms ignore the effect that shifting usage patterns have on the allocation of costs between customer classes under proper cost of service rate design. If, as seems unfortunate yet probable, manufacturing in Massachusetts continues to decline, and residential loads continue to expand, proper cost of service principles, and effective demand response mandate an adjustment of inter-class revenues to reflect the growing predominance of residential and small commercial cost causation on the system. Freezing inter-class revenue allocation under a decoupling mechanism in order to protect shareholders, will not only be unfair to consumers, but counter-productive from the point of view of demand response. To be effective, a decoupling mechanism therefore would not only need to involve the basics of a complete rate case at each reconciliation, but also a re-evaluation of inter-class revenue requirements for cost allocation purposes.

Further, for the reasons noted above, removing the link between earnings and service presents different incentive problems, notably expanded concerns about customer service, maintenance and reliability. Any decoupling mechanism would have to provide customer service indexes, and other mechanisms to assure the utility's financial lack of concern about the level of service to customers did not translate into inappropriate deferral or neglect of needed maintenance, inadequate response to customer concerns with reliability, or a host of other problems which are generally, though not entirely, minimized by the current regulatory structure which ties utility revenues and earnings to the provision of safe and reliable service.

For all of these reasons, in addition to being ineffective, politically unfair, and unnecessary, the Western Massachusetts Industrial Group believes that any decoupling mechanism will be complex, controversial, and difficult to administer, or, in the alternative, simplistic, unjust and unreasonable, counter-productive and damaging to both society and the environment.

Western Massachusetts Industrial Group believes that there are much simpler, fairer, and practical means of mitigating the effect of any utility disincentive to see effective efficiency and demand response measures implemented. Several states have adopted structures under which demand response and efficiency programs are administered by independent agencies. There is no need for utilities to be directly involved in the delivery or administration of demand response programs. On the other hand, there is every reason to want to have demand response and energy efficiency programs coordinated as part of an overall state strategy among all responsible regulatory, environmental, and administrative agencies to assure the effective and coordinated delivery of these services in accordance with an overall plan of action. For these reasons, Western Massachusetts Industrial Group recommends the establishment of an independent government agency or “office” housed under either the Department of Energy Resources, or the DPU itself to oversee administration of programs and funds. This approach is a far simpler and more effective means (if any, in fact, are needed) of eliminating the influence of utility disincentives from affecting the application of these programs. Further, it has the benefit of allowing closer coordination with other state regulatory and administrative agencies engaged in implementing what will hopefully be a coordinated strategy for the state in meeting the immense challenges before us.

IV. SUMMARY OF RECOMMENDATIONS.

For all of the reasons sated above, WMIG recommends the following:

- 1.** Rejection of Revenue Decoupling but, if concerns about utility incentives persist, then the establishment of an independent office to oversee energy, conservation and demand side response programs;
- 2.** In order to align rates with cost of service, each utility should be required to file a rate case under which the Commission should look at all rates and reset appropriate class revenue requirements based upon latest Cost of Service information.
- 3.** The DPU should establish a generic rate design investigation for all utilities focusing on the appropriate allocation between demand and energy on a cost of service basis for all services provided by utilities. The purpose of any such investigation would be to establish appropriate parameters for inter-class rate design and intra-class charges that appropriately reflect the costs imposed on the system and other customers by demand and energy usage patterns. Proper rate design will automatically provide appropriate pricing to value demand reductions and long-term energy efficiency by allocating costs appropriately.
- 4.** The Western Massachusetts Industrial Group recommends the establishment of a task force charged with identifying all state regulatory and administrative agencies that have an ongoing role in the permitting, siting and construction of

infrastructure, the delivery of gas or electric service to consumers, and environmental oversight. After identifying the appropriate agencies, each agency should appoint a member to the task force with the objective of developing, in consultation with stakeholders, a comprehensive energy plan for Massachusetts.

Dated at Augusta, Maine, this 7th day of September, 2007.

Respectfully Submitted,

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