COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF PUBLIC UTILITIES

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

INITIAL COMMENTS OF BLACKSTONE GAS COMPANY

I. Overview

On June 22, 2007, the Department of Public Utilities (the "Department") issued a notice of inquiry opening an investigation into rate structures and revenue recovery mechanisms that may reduce disincentives to the efficient deployment of demand resources in Massachusetts (the "NOI"). NOI at 1. The Department's proposal to implement a revenue-decoupling mechanism recognizes that, under current ratemaking practice, electric and gas companies have a strong incentive to take actions to maintain or increase sales in order to ensure an adequate flow of revenues between base rate proceedings. Id. at 2. The Department's NOI also recognizes that there is an inherent conflict between the incentive to increase sales and the existence of important state, regional and national goals to increase end-use efficiency and minimize the environmental impacts of energy production and consumption. Id. 2-3. Accordingly, the Department's NOI finds that this inherent conflict "must be addressed expeditiously" through the implementation of a revenue-collection mechanism that renders utility revenue levels immune to changes in sales volumes between rate proceedings, in order to eliminate barriers to the deployment of cost effective demand resources. Id. at 3. To facilitate the implementation of revenue decoupling, the Department presented a "straw proposal" for a base revenue adjustment mechanism, which would "render electric and gas companies' revenue levels immune to changes in sales between rate proceedings." Id. at 3. According to the Department, the objective of the base revenue adjustment mechanism is to "eliminate the current financial disincentive that electric and gas companies face regarding the deployment of customer-sited, cost-effective demand resources in their service territories." Id. at 11. As delineated in the NOI, there are two principal elements of the Department's straw proposal, which are (1) the conduct of future base rate proceedings to set "just and reasonable" per customer revenue targets for each rate class; and (2) the implementation of an annual reconciliation methodology to ensure recovery of the revenue target set in that proceeding. Id. at 4-5. Blackstone Gas Company ("Blackstone" or the "Company") will not address the theory or precedent for revenue-decoupling, but will leave that initially to the larger distribution companies reserving its rights to file reply comments later in the proceeding. Blackstone will respond to the Department's questions in the NOI below.

II. Responses to Department's Questions

In its NOI, the Department set out 12 questions for specific comment. Blackstone's responds to those questions as follows:

> **DPU-1-1**: The Department's proposal that a company's allowed revenues per customer be determined through a subsequent base rate proceeding is intended to ensure that the allowed revenue levels, which serve as the basis for the base revenue adjustment mechanism are closely aligned with the company's costs.

> Under what, if any, circumstances should the Department permit a company's allowed revenues per customer to be determined through some manner other than a base rate proceeding?

If the Department wants to implement revenue decoupling on an expedited basis it should allow an annual revenue target per customer to be determined based on existing approved distribution rates. Blackstone is in the fourth year of a five year Settlement Agreement which includes an annual performance based ("PBR") adjustment with productivity off-set and an earnings sharing mechanism originally approved in *Blackstone Gas Company,* D.T.E. 04-79 based on a 2002 allocated cost of service study. The 2002 test year billing units, costs and rates adjusted for the PBR and earnings sharing adjustments could be calculated and used as the initial customer revenue target. The annual revenue target for each rate class must be adjusted for the approved PBR and earnings sharing adjustments for the remaining term of the Settlement Agreement to avoid revenue erosion and confiscation. For Blackstone it is imperative that it not be required to prepare a costly base rate case to implement revenue decoupling and that it be allowed in the future to establish a PBR Plan with an earnings sharing mechanism in a cost-effective manner to avoid an undue cost burden on its customers with or without a revenue decoupling mechanism.[1]

It is not necessary or desirable to terminate or curtail existing approved rate plans and embark on a very costly and time-consuming process of developing new rates and prices through litigated rate cases to establish a different level of target revenues. To embark on such an unnecessary process would result in an inordinate delay in promoting

[1] Blackstone is currently investigating whether it would need to divide its Residential Heating rate into two sub-classes with separate revenue targets, to reflect the increased size and consumption of new homes being constructed in its service territory in the last few years which far exceed the size and consumption of older heating customers.

energy efficiency investments, which can be accomplished simply by implementing an annual revenue reconciliation mechanism.

> **DPU-1-2**: The Department's proposal uses an approach in which a company's allowed revenues per customer for each rate class does not change between base rate proceedings. An alternative approach would be to adjust the allowed revenues per customer values periodically, based on changes in each rate class' average usage per customer. Please discuss the merits of each approach.

The important issue associated with the Department's "straw proposal" is the proposal to fix the "allowed revenues per customer" between rate cases (because costs do not remain fixed) and not the proposal to fix the average usage per customer within a rate class.

If a decoupling mechanism is put in place that does not provide for recovery of volatile costs outside the utility's control, PBR or PBR-like rate components, utility's will experience revenue erosion between rate cases as a result of O&M inflationary pressures and capital funding requirements, which will not be addressed by the decoupling mechanism and that will drive the need for frequent rate cases. .

> **DPU-1-3:** The Department's proposal that a company's actual versus allowed revenues be reconciled annually is intended to balance three objectives: rate stability, rate continuity, and administrative efficiency. Do annual reconciliations strike an appropriate balance among these three objectives or would alternate reconciliation periods (e.g., quarterly or semi-annually better do so?

Annual reconciliation will, in all but the most volatile of circumstances, strike the appropriate balance among rate stability, rate continuity and administrative efficiency. For a very small company like Blackstone, any reconciliation more frequent than annual will be costly and these costs must be passed on to customers.

> **DPU-1-4**: The Department's proposal to determine a company's actual revenue based on billed revenues is consistent with the base rate treatment applied to distribution-related bad debt costs. An alternative approach would be to determine actual revenues based on payments received. Please discuss the merits of each approach.

In a base-rate proceeding, the Department's policy is to include an allowance for bad debt in the cost-of-service and resulting revenue requirement. Thus, the "allowed revenues" inherently anticipate the recovery of "uncollectible" revenues. If the Department were to include bad-debt expense in base rates and then also to implement a decoupling mechanism that reconciles actual receipts (rather than billed receipts) to target revenues based on those rates, bad-debt expense would be double counted. Therefore, the approach taken in the Department's straw proposal to determine actual revenues based on billed revenues is appropriate.[2]

> **DPU-1-5:** The Department's proposal for determining billed revenues is based on actual consumption. An alternate approach would be to determine billed revenues based on consumption normalized for weather and/or other factors.
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> (a) Please discuss the merits of determining billed revenues using actual versus weather-normalized consumption.
>
> (b) Should consumption be normalized for other factors (e.g., economic conditions)? If so, identify those factors and describe how the normalization for such factors could be done.

The use of billed revenues rather than weather adjusted revenues will better achieve the Department's goals of rate stability, rate continuity, and administrative efficiency. For example in a warm summer, the unadjusted usage would mean a reduction in price for customers, mitigating high summer bills. This mitigation also helps the Department's goal of continuity. The current Blackstone PBR Plan and earnings

[2] The Department may want to establish a reconciliation factor for uncollectible costs included in base rates with actual non-gas bad debts. If so, the Company would have to determine the amount of bad-debt expense included in each rate class.

sharing mechanism is based on billed revenues and not weather normalized revenues for these very reasons. In addition, the administrative costs involved in determining the impacts of factors on each customer group would be significant since experts would need to be involved. Instead, the Department can easily monitor the balance of revenues and costs through its annual earnings sharing review.

> **DPU-1-6**: the Department's proposal to recover the difference between a company's target and projected revenues through adjustments to its base energy charges is intended to send appropriate price signals to consumers. An alternate approach would be to adjust both base energy and demand charges (where applicable) to recover this difference. Please discuss the merits of each approach.

As the Department's "straw proposal" assumes that costs are incurred on a per customer basis, this would seem to indicate that any reconciliation up or down should also be implement on a per customer basis and not on an energy basis.

> **DPU-1-7:** The Department's proposal to require a company to submit quarterly filings identifying actual and allowed revenues is intended to ensure that changes in rates are made in a predictable and gradual manner.
>
> (a) Under what circumstances should the Department allow an adjustment in base charges during a reconciliation period?
>
> (b) Under what circumstances should the Department initiate a review of a company's base revenue adjustment mechanism?

Please see the response to DPU-1-3. The Department should provide for an annual reconciliation and adjustment in base charges. The Department may find it necessary to review the operation of a company's base revenue adjustment mechanism if (1) repeated and significant under or over recoveries are occurring; or (2) a company's ROE indicates that something is out of line. In practice, it is unlikely that there will be a need to "review" the base revenue adjustment mechanism once it is designed and implemented because it should operate fairly transparently.

> **DPU-1-8**: What standards should the Department use to measure the performance of a company's base revenue adjustment mechanism over time?

In terms of measuring the "performance" of a company's base-revenue adjustment mechanism, the Department should consider whether:

- There is no positive or negative incentive for the utility to maintain or increase sales;
- There is an ability to recover the "allowed revenue requirement," without a the need for repeated and frequent base rate cases;
- There is an opportunity to earn a fair return; and
- There is an incentive to maintain the investment level necessary to ensure safety, reliability and efficiency of the distribution system.

In practice, the Department's proposal to require annual earning sharing calculations will ensure that a company is not unacceptably under-earning or over-earning and that the utility is able to recover its allowed revenue requirement without consideration of sales volumes.

> **DPU-1-9**: How will the implementation of a base revenue adjustment mechanism affect a company's risk and how should such considerations be reflected in a company's capital structure and ROE?

Since costs increase annually, a plan that sets allowed revenues per customer on a historical basis (and removes load growth as an option for mitigating cost increases) is likely to raise substantial concerns regarding the ability to achieve allowed ROEs on a consistent basis.

> **DPU-1-10**: The Department's proposal to include a shared earnings provision in the base revenue adjustment mechanism is intended to strike an appropriate balance between the risks borne by customers and shareholders associated with company earnings. Please comment on the merits of such a provision. Also comment on the design of the proposed earnings sharing provision.

The Department's proposal to include a shared earnings provision is critical to the implementation of the mechanism. This approach will allow for monitoring and evaluation of the decoupling mechanism and enable the Department to implement decoupling with existing rate plans in place.

> **DPU-1-11**: Please comment on the merits of implementing a base rate adjustment mechanism with and without the individual elements of a PBR plan (e.g., fixed term, inflation, productivity, performance standards, exogenous factors.

A base rate adjustment mechanism is appropriate to adjust declines in sales as a result of conservation or other impacts. Inflation in costs is totally separate and containing those costs inflations is a sound goal for rate setting policy. The goal of adjusting rates at a rate lower than the expected increase in costs is that the customer benefits (this is the PBR with an offset to the inflation factor). To the extent that the utility can contain costs to a level below the allowed level, the shareholders as well as the customers can benefit from these cost controls.

The inclusion of exogenous costs in a PBR mechanism is necessary to avoid significant costs or gains that arise from unexpected external or exogenous events.

The Department's base-revenue adjustment mechanism is appropriate to adjust for declining consumption and to ensure that utilities have no incentive to maintain or increase sales. However, the Department's proposed mechanism is not sufficient, if applied in isolation of approved cost-recovery mechanisms, to ensure that utilities will be able to recover their revenue requirement between rate cases. In particular, PBR is designed to provide the utility with incentives to control costs and provides the utility with the ability to share in the benefits of long-term investments that achieve this goal, but require substantial investment by the utility. Moreover, the Department's NOI indicates that the Department intends to maintain its service quality performance requirements, which was designed to work in coordination with a PBR plan that would provide the utility with the incentive to make service quality investments. For all these reasons, the Department should implement decoupling along with PBR and other cost recovery mechanisms adopted by the Department in the past 15 years to meet public policy goals apart from the desire to promote conservation.

> **DPU-1-12**: Please comment on how the Department should schedule the implementation of a base revenue adjustment mechanism for each gas and electric company in light of the need to move expeditiously, the resources required to implement such changes, and the specific circumstances of each company. How should the Department determine the order of individual base rate proceedings?

Blackstone would request that any schedule of implementation reflect the available resources of the company to make the requested filing. Thus, Blackstone should only be required to file after the larger companies have filed their mechanisms and they have been approved by the Department.