BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE INVESTIGATION OF THE PUBLIC SERVICE COMMISSION INTO REVENUE DECOUPLING MECHANISMS FOR POTENTIAL ADOPTION AND IMPLEMENTATION BY ELECTRIC AND NATURAL GAS UTILITIES SUBJECT TO THE JURISDICTION OF THE PUBLIC SERVICE COMMISSION (OPENED MARCH 20, 2007)	)	PSC REGULATION DOCKET NO. 59
IN THE MATTER OF THE FILING BY DELMARVA POWER & LIGHT COMPANY FOR A BLUEPRINT FOR THE FUTURE PLAN FOR DEMAND-SIDE MANAGEMENT, ADVANCED METERING, AND ENERGY EFFICIENCY (FILED MARCH 20, 2007)	)	PSC DOCKET NO. 07-28

ORDER NO. 7420

AND NOW, this 19h day of August, 2008;

WHEREAS, the Commission initiated Regulation Docket No. 59 to consider whether to implement a revenue decoupling mechanism for the electric and natural gas distribution utilities subject to its jurisdiction, consistent with the provisions of the settlement of Delmarva Power & Light Company's ("Delmarva") base rate case approved in PSC Order No. 7152 (Mar. 20, 2007) in which it proposed a Bill Stabilization Adjustment ("BSA"). See PSC Order No. 7153 (Mar. 20, 2007). Simultaneously, the Commission opened Docket No. 07-28 to consider the "Blueprint For the Future Application and Plan" ("Blueprint"), submitted by Delmarva on February 6, 2007, that proposed demand-side management ("DSM"), advanced metering, and energy efficiency plans. See PSC Order No. 7154 (Mar. 20, 2007);

AND WHEREAS, pursuant to 29 Del. C. § 8716, the Division of the Public Advocate intervened in both proceedings to represent the interests of consumers. On April 18, 2007, pursuant to Rule 21 of the Commission's Rules of Practice and Procedure, the Delaware Energy Users Group and the Association of Community Organizations for Reform Now of Delaware each separately intervened in Regulation Docket No. 59. On April 19, 2007, Claymont Steel, Inc. also intervened in Regulation Docket No. 59;

AND WHEREAS, pursuant to the approved procedural schedule in Docket No. 59, the parties convened at a public workshop on May 16, 2007 to receive presentations regarding the policy considerations surrounding the potential implementation of revenue decoupling in Delaware. On June 20, 2006, Professor John Byrne – a member of the Sustainable Energy Utility Task Force – presented an overview of the impact of DSM programs on load growth in Delaware. On July 6, 2007, Chesapeake Utilities Corporation ("Chesapeake") proposed a Revenue Normalization Mechanism ("RNM") as an element of its base rate filing. On August 15, 2007, the parties filed initial comments regarding general policy implications of revenue decoupling and the BSA and RNM proposed by Delmarva and Chesapeake, respectively. On November 19, 2007, the parties filed reply comments;

AND WHEREAS, pursuant to the procedural schedule developed for Docket No. 07-28, Staff held a series of working group meetings with the parties to discuss the various programs proposed by Delmarva in the Blueprint. The first working group meeting was held on May 31, 2007 to establish the procedural timeline for the proceeding. At this meeting, Delmarva presented an overview of the Advanced Metering Infrastructure ("AMI") proposed in the Blueprint and the projected costs associated with its AMI program. On June 6, 2007, the parties convened at a second working group meeting for a presentation regarding the rationale for Delmarva's DSM programs and an overview of the individual DSM programs proposed in the Blueprint. On June 20, 2007, the parties convened for a consensus discussion regarding Delmarva's proposed DSM programs. On August 29, 2007, Delmarva filed its business case for the advanced metering program, which was considered by the parties at a final working group meeting held on September 5, 2007;

AND WHEREAS, in January 2008, Staff raised concerns regarding duplication in the examination of issues in Regulation Docket No. 59 and Docket No. 07-28 (together "the Dockets") in light of the close relationship between DSM proposals and revenue decoupling mechanisms. Specifically, Staff observed that both dockets would be affected by the Delaware General Assembly's promulgation legislation creating the Sustainable Energy Utility ("SEU")[1] to promote the sustainable use of energy in Delaware. Accordingly, Staff recommended that the parties from both dockets convene to discuss common issues and the viability of continuing both dockets. The Hearing Examiner granted this request in an effort to prevent an unnecessary waste of resources, and the parties from both dockets convened at a public workshop on March 17, 2008. On April 1, 2008, the parties to the Dockets submitted comments

[1]Senate Bill No. 18, an Act to Amend Title 29 of the Delaware Code to Create a Sustainable Energy Utility in the State of Delaware, codified at 29 *Del. C.* § 8059 (June 21, 2007).

and recommendations to the Hearing Examiner regarding the path forward in consideration of Delmarva’s Blueprint and revenue decoupling;

AND WHEREAS, after holding a series of public workshops and reviewing written comments from the parties, the Hearing Examiner has now submitted her Findings of Fact, Conclusions of Law and Recommendations to the Commission in which she recommends the Commission approve, with certain modifications, Staff’s proposed policies;

AND WHEREAS, the Commission finds that Staff’s policy recommendations are just and reasonable and that adoption of the Hearing Examiner’s Report is in the public interest.

Now, therefore, **IT IS ORDERED**:

1. That, by and in accordance with the affirmative vote of a majority of the Commissioners, the Commission hereby adopts the Hearing Examiner’s Findings of Fact, Conclusions of Law and Recommendations to the Commission, which are appended to the original hereof as “Attachment A”.

2. That, for the reasons stated in her Findings of Fact, Conclusions of Law and Recommendations to the Commission, the Hearing Examiner’s request to close the dockets titled as <u>In the Matter Of The Investigation of the Public Service Commission Into Revenue Decoupling Mechanisms for Potential Adoption and Implementation by Electric And Natural Gas Utilities Subject to the Jurisdiction of the Public Service Commission</u>, PSC Regulation Docket No. 59 (Opened March 20, 2007)and <u>In the Matter of the Filing by Delmarva Power & Light Company for a Blueprint for the Future Plan for Demand-Side Management,</u>

Advanced Metering, and Energy Efficiency, PSC Docket No. 07-28 (Filed March 20, 2007) is approved.

BY ORDER OF THE COMMISSION:

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Chair

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Commissioner

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Commissioner

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Commissioner

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Commissioner

ATTEST:

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Secretary

A T T A C H M E N T "A"

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE INVESTIGATION OF THE PUBLIC SERVICE COMMISSION INTO REVENUE DECOUPLING MECHANISMS FOR POTENTIAL ADOPTION AND IMPLEMEN-ATION BY ELECTRIC AND NATURAL GAS UTILITIES SUBJECT TO THE JURISDICTION OF THE PUBLIC SERVICE COMMISSION (OPENED MARCH 20, 2007)	)	PSC REGULATION DOCKET NO. 59
IN THE MATTER OF THE FILING BY DELMARVA POWER & LIGHT COMPANY OF A BLUEPRINT FOR THE FUTURE PLAN FOR DEMAND-SIDE MANAGEMENT, ADVANCED METERING, AND ENERGY EFFICIENCY (FILED FEBRUARY 6, 2007)	)	PSC DOCKET NO. 07-28

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

Ruth Ann Price, duly appointed Hearing Examiner in these Dockets pursuant to 26 Del. C. § 502 and 29 Del. C. ch. 101, by Commission Orders Nos. 7153 and 7154, both dated March 20, 2007, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Public Service Commission Staff ("Staff"):

JAMES McC. GEDDES, ESQUIRE, Rate Counsel
BROOKE E. LEACH, ESQUIRE

On behalf of Delmarva Power & Light Company ("Delmarva," "DP&L," or the "Company"):

TODD L. GOODMAN, ESQUIRE

On behalf of Chesapeake Utilities Company ("Chesapeake" or "CUC"):

WILLIAM A. DENMAN, ESQUIRE

On behalf of the Division of the Public Advocate ("DPA"):

JOHN CITROLO, Deputy Public Advocate

ANDREA CRANE, The Columbia Group, Inc.

On behalf of the Delaware Energy Users Group ("DEUG"):

MICHAEL J. QUINAN, ESQUIRE.

On behalf of the Association of Community Organizations for Reform Now of Delaware ("ACORN"):

APRYL WALKER

On behalf of Claymont Steel, Inc.:

PETER J. BRICKFIELD, ESQUIRE
SHAUN C. MOHLER, ESQUIRE

II. PROCEDURAL BACKGROUND

1. By Order No. 7153 (Mar. 20, 2007), the Commission initiated Regulation Docket No. 59 to consider whether to implement a revenue decoupling mechanism for the electric and natural gas distribution utilities subject to its jurisdiction, consistent with the provisions of the settlement of Delmarva's gas base rate case approved in Order No. 7152 (Mar. 20, 2007) in which it proposed a Bill Stabilization Adjustment ("BSA"). Simultaneously, the Commission opened Docket No. 07-28 to consider the "Blueprint For the Future Application and Plan" ("Blueprint"), submitted by Delmarva on February 6, 2007, that proposed demand-side management ("DSM"), advanced metering, revenue decoupling, and energy efficiency plans.

2. Pursuant to 29 Del. C. § 8716, the DPA intervened in both proceedings to represent the interests of consumers. On April 18, 2007, pursuant to Rule 21 of the Commission's Rules of Practice and Procedure, DEUG and ACORN each separately intervened in Regulation

Docket No. 59. On April 19, 2007, Claymont Steel, Inc. also intervened in Regulation Docket No. 59.

3. A procedural schedule was developed for the conduct of Regulation Docket No. 59, pursuant to which the parties convened at a public workshop on May 16, 2007 to receive presentations regarding the policy considerations surrounding the potential implementation of revenue decoupling in Delaware.[2] On June 20, 2007, Professor John Byrne – a member of the Sustainable Energy Utility Task Force – presented an overview of the impact of DSM programs on load growth in Delaware. On July 6, 2007, Chesapeake proposed a Revenue Normalization Mechanism ("RNM") as an element of its base rate filing. On August 15, 2007, the parties filed initial comments regarding general policy implications of revenue decoupling and the BSA and RNM proposed by Delmarva and Chesapeake, respectively.[3] On November 19, 2007, the parties filed reply comments.[4]

4. In May 2007, a procedural schedule was also developed for Docket No. 07-28. Throughout the summer and fall months of 2007, Staff held a series of working group meetings with the parties to discuss the various programs proposed by Delmarva in the Blueprint. The first working group meeting was held on May 31, 2007 to establish the procedural timeline for the proceeding. At this meeting, Delmarva

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[1] At the May 16, 2007 public workshop, the following parties made presentations: Staff, Delmarva, Chesapeake, the Delaware Energy Office, DEUG, the DPA, and ACORN.

[3]Initial comments were filed by Delmarva, Chesapeake, the DPA, Staff, DEUG, and National Resources Defense Council. ACORN did not file any comments following the public workshops.

[4]Reply comments were filed solely by Chesapeake.

presented an overview of the Advanced Metering Infrastructure ("AMI") proposed in the Blueprint and the projected costs associated with its AMI program. On June 6, 2007, the parties convened a second working group meeting for a presentation regarding the rationale for Delmarva's DSM programs and an overview of the individual DSM programs proposed in the Blueprint. On June 20, 2007, the parties convened for a consensus discussion regarding Delmarva's proposed DSM programs. On August 29, 2007, Delmarva filed its business case for the advanced metering program, which was considered by the parties at a final working group meeting held on September 5, 2007.

5. In January 2008, Staff raised a concern regarding duplication in the examination of issues in Regulation Docket No. 59 and Docket No. 07-28 (collectively referred to as "the Dockets") in light of the close relationship between DSM proposals and revenue decoupling mechanisms. Specifically, Staff observed that both dockets would be affected by the Delaware General Assembly's promulgation of legislation creating the Sustainable Energy Utility ("SEU") to promote the sustainable use of energy in Delaware. Accordingly, Staff recommended that the parties from both dockets convene to discuss common issues and the viability of continuing both dockets. I granted Staff's request in an effort to prevent an unnecessary waste of resources, and the parties from both dockets convened at a public workshop on March 17, 2008. On April 1, 2008, the parties to the Dockets submitted comments and recommendations to me regarding the future handling of these matters.

6. I have considered the entire record of this proceeding and, based thereon, I submit for the Commission's consideration these findings of fact, conclusions of law, and recommendations.

III. SUMMARY OF THE FACTS

A. Regulation Docket No. 59

1. Brief Overview of Revenue Decoupling

7. As a result of heightened concern regarding greenhouse gas emissions, volatile gas commodity prices, the cost of electricity and the ability of utilities to meet the growing demand for energy, many jurisdictions - including Delaware - are taking action to mitigate the rising demand for energy through energy efficiency and demand response initiatives.[5] The rate design for recovery of costs related to these emerging energy policies in Delaware is based on traditional rate setting practices that recover only a portion of a utility's fixed costs through customer or demand charges. (NRRI Report at 2). The majority of fixed costs are recovered through variable charges based on volumetric consumption. *Id.* When a utility sells less energy it recovers a smaller portion of its fixed costs. *Id.* This rate structure generally encourages utilities to promote sales between rate cases. *Id.* Through implementation of aggressive Demand Side Management programs, including conservation and demand response programs,[6] one would expect to result in a decline in energy

[5] National Regulatory Research Institute Briefing Paper, "Revenue Decoupling for Natural Gas Utilities," ("NRRI Paper") April 2006 at 2, 6-7.

[6] For purposes of this set of Findings of Fact, Conclusions of Law, and Recommendations, it is important to understand that Demand Side Management (or "DSM") includes programs that are designed to reduce customers'

consumption, and consequently, a decline in revenue for the utility. *Id.* at 6-7. Accordingly, it is believed that traditional rate design, by itself, may not allow a utility to aggressively promote energy efficiency and demand response programs without experiencing an adverse financial impact.

8. Revenue decoupling mechanisms are intended to sever, to a large degree, the direct link between earnings and sales. Most revenue decoupling mechanisms allow a utility to adjust rates to collect its Commission-approved revenues – without filing a formal rate case – whenever sales deviate from their targeted level set in the most recent rate case. *Id.* at 2, 4-6, 14. These mechanisms remove the utility's interest in promoting sales and the corresponding disincentive to promote energy conservation and demand response programs.

9. In the initial set of comments filed August 15, 2007, all the parties agreed that the Commission is authorized to depart from traditional rate base regulation pursuant to 26 Del. C. § 201(d) if such departure is found to promote just and reasonable rates.[7] The Commission has authorized the use of tracking mechanisms for recovery of gas purchasing costs, municipal franchise fees, and environmental

electricity consumption. DSM includes both efficiency/conservation programs and demand response (or "DR") programs. While efficiency/conservation programs are designed to help customers use less energy in general (through programs such as weatherization, compact fluorescent light bulbs, etc.), DR programs are designed to help customers reduce their energy consumption specifically during periods of high demand and high costs. DR programs would include those such as direct load control and smart thermostats.

[7] See Staff Aug. 15, 2007 Comments at 19; DP&L Aug. 15, 2007 Comments at A-1; CUC Aug. 15, 2007 Comments at 3; DPA Aug. 15, 2007 Comments at 9-10. ACORN, DEUG, and NRDC did not comment on the legality of revenue decoupling.

costs.[8] Accordingly, the potential implementation of revenue decoupling is not prohibited by Delaware law.

2. Staff's Position

10. Although Staff recognized that a properly constructed revenue decoupling mechanism carries the benefit of mitigating the utility's conservation and demand response disincentive and reducing the frequency of rate cases, Staff concluded that revenue decoupling, accomplished via surcharges is unacceptable. Staff Apr. 1, 2008 Comments at 6. Staff reasoned that surcharges and tracking mechanisms that protect utilities from revenue erosion associated with conservation distort price signals to both the Company and customers. I*d.* Revenue stabilization results in energy bills that flatten seasonal variation, which mute price signals of higher costs during peak demand periods, inconsistent with economic efficiency. (Staff Aug. 15, 20007 Comments at 6.) Moreover, surcharges and tracking mechanisms reduce the utility's incentive to achieve cost economies and allow utilities to adjust rates for usage changes driven by factors other than sales such as weather and rising commodity costs. *Id.* at 8. Accordingly, Staff determined that the gains in promotion of energy efficiency through the removal of the conservation disincentive do not outweigh the loss of the regulatory incentive to control utility costs. *Id.* at 9.

11. Staff further concluded that implementation of revenue decoupling through a utility's rate design would result in rate

[8]*See, e.g.*, Order No. 7219 (July 3, 2007); Order No. 7119 (Jan. 23, 2007); Order No. 7407 (June 17, 2008).

subsidization and it would not send customers the appropriate economic signal. The DSM programs proposed by both Delmarva and Chesapeake rely heavily on upfront cash incentives and customer education. (Staff Aug. 15, 2007 Comments at 15.) Staff observed that only a minority of utility customers would benefit from utility-based conservation due to market barriers faced by customers such as renters, customers who cannot incur additional debt, low-income customers, and small businesses. (Staff Aug. 15, 2007 Comments at 14.) Absent development of DSM programs that directly respond to market barriers, Staff asserted that most ratepayers will face the risk of rising energy bills from revenue decoupling surcharges, but will not benefit directly from the energy efficiency procured with their dollars and their absorption of the sales reduction risk. (Staff Apr. 1, 2008 Comments at 2.) The utility's relationship to its customers does not remove the presence of market barriers. (Staff Aug. 15, 2007 Comments at 6-7.) Moreover, Staff determined that the implementation of revenue decoupling is not a prerequisite to promoting Delaware's energy efficiency and DSM policy goals in light of the ability of third party vendors such as the Sustainable Energy Utility ("SEU") to supply these programs. *Id.*

12. Despite its recommendation against the adoption of tracking mechanisms and surcharges, Staff supported the concept of revenue decoupling for energy, using alternative rate designs that collect more fixed costs through customer or demand charges as part of a base rate proceeding. As directed by Commissioner Clark, Staff first considered New Jersey's Conservation Incentive Program ("CIP").

(Staff Apr. 1, 2008 Comments at 2). New Jersey's CIP limits the ability of participating utilities to recover their conservation expenses to savings achieved through the reduction in gas supply costs, principally related to interstate pipeline capacity. (Presentation of New Jersey Board of Public Utilities Commissioner Frederick F. Butler at 4). The parties agreed that the CIP would not be appropriate for Delaware because current pipeline capacity assets are well below "demand-day" delivery requirements. (Staff Apr. 1, 2008 Comments at 2-3.)

13. Staff also analyzed implementation of a straight fixed variable ("SFV") rate design utilized by the Federal Energy Regulatory Commission ("FERC") in regulating recovery of interstate pipeline costs. SFV rate design recovers fixed costs through fixed reservation or demand charges and the variable costs, if any, though a volumetric charge. Staff proposed a modified fixed variable method ("MFVM") that would stratify rate classes to mitigate the potential high cost impact on low-income customers resulting from the change in rate design. *Id.* at 5. Staff asserted that the MFVM moves toward a rate design that more appropriately aligns fixed costs with rates that comport to cost causation principles.[9] *Id.* Moreover, Staff observed that the MFVM sends a proper price signal regarding a customer's decision to engage in conservation and reduces customer cross-subsidization. *Id.* at 6.

[9]Staff cautioned that the proposed MFVM would not eliminate the following concerns: (1) approval of revenue decoupling before determining whether energy efficiency has been effective may be premature; and (2) revenue decoupling protects the utility from *all* sources of revenue erosion. (Staff Apr. 1, 2008 Comments at 6.)

14. With regard to disposition of Regulation Docket No. 59, Staff recommended that the Commission order a separate investigation considering implementation of the MFVM for each utility through a base rate case proceeding. *Id.* Staff further recommended that the Commission consider the following factors during such base rate case proceedings:

- Rate gradualism;
- Customer equity;
- Impact on the Company's risk profile;
- Over/under earnings protection; and
- Customer service and reliability protection.

Id. at 6-7. In light of the need to analyze the implications of implementing MFVM for each utility on a case-by-case basis during a rate case, Staff recommended closure of Regulation Docket No. 59. *Id.*

3. Delmarva's Position

15. In PSC Docket No. 06-284, Delmarva proposed the BSA in its gas base rate case in order to achieve conservation, load reduction, and address problems posed by the current volumetric distribution rate design. (DP&L Aug. 15, 2007 Comments at 4.) Delmarva argued that a revenue decoupling mechanism is integral to the DSM programs proposed in its Blueprint to promote energy efficiency by aligning Delmarva's interests with the needs of customers, or at least not working at cross purposes. *Id.* at 5. The BSA is a tracking mechanism that adjusts rates, on a quarterly basis, based on energy usage per customer. *Id.* at 7. Delmarva maintains that if average energy usage

exceeds usage for the test year, the BSA reduces bills for all customers in that class. *Id.* Conversely, Delmarva asserts that if average usage is less than the projected usage for the test year, the BSA increases the delivery portion of a customer's bill up to 10% of the test year average rate for the applicable quarter for each rate class. *Id.*

16. Delmarva asserted two primary arguments in support of its recommendation that the Commission implement revenue decoupling in Delaware. First, Delmarva asserted that revenue decoupling mechanisms provide significant benefits to customers. With respect to impact on a customer's monthly energy bill, Delmarva observed that a revenue decoupling mechanism – such as the BSA – would reduce the severe weather impact in winter and summer months as well as the volatility of the utility's distribution charges. (DP&L Aug. 15, 2007 Comments at 7.) Moreover, Delmarva contended that rate cases would become less frequent and, accordingly, customers would benefit from regulatory cost savings. *Id.* Delmarva highlighted the policy goals of DSM programs that are essential to integrated resource planning. *Id.* at 7-12. For instance, Delmarva observed that DSM reduces monthly energy costs, places downward pressure on energy commodity prices,[10] reduces greenhouse gas emissions, and mitigates future constraints on the PJM transmission system. *Id.* at 10. Delmarva contended that revenue

[10]Delmarva alleged that customers who are unable to participate in DSM programs due to market barriers will benefit from the lower energy prices achieved through the reduction in commodity demand. (DP&L Aug. 15, 2007 Comments at 26). In support of this contention, Delmarva cited the Brattle Group's finding that a reduction in load in MADRI states of less than 2% will likely lower electricity prices by 5-8%. *Id.*

decoupling would permit utilities to aggressively promote and manage DSM programs without acting against the financial interest of the utility. *Id.* at 11.

17. Delmarva suggested that any potential increase in the BSA due to successful DSM programs would be more than offset through customer savings on the supply portion of customer bills, because the supply portion constitutes approximately 75% of the typical bill. Despite the creation of the SEU, Delmarva asserted that utility-managed energy efficiency/conservation programs are appropriate for Delaware. Delmarva reasoned that it has prior experience with DSM, its pre-existing customer relationship facilitates direct marketing efforts, and Delmarva has the ability to realize economies of scale from DSM programs currently administered by both Delmarva and its affiliated utilities in Maryland, New Jersey, and the District of Columbia. *Id.* at 13-19.

18. Second, Delmarva argued that revenue decoupling is a superior rate design for distribution-only utilities. *Id.* at 20. In support of this contention, Delmarva reasoned that traditional rate design creates a problem in matching revenue streams to fixed and variable operating costs. *Id.* at 23-26. According to Delmarva, the mismatch dilemma created by traditional rate design causes customer subsidization and sends inappropriate price signals that encourage customers to consume excess energy when rates are below cost. *Id.* Moreover, Delmarva observed that utilities will under-recover authorized fixed costs under the current volumetric distribution rate design in light of implementation of DSM programs by the SEU,

utilities, or other third party vendors.[11] *Id.* Delmarva asserted that revenue decoupling more accurately aligns revenue with cost by eliminating revenue fluctuations due to weather and changes in customer usage patterns. (DP&L Apr. 1, 2008 Comments at 7.) Accordingly, Delmarva concluded that revenue decoupling mechanisms provide more reliable fixed-cost recovery, lower rates, and equitable treatment of customers.

19. Following the March 17, 2008 public workshop, Delmarva continued to support the BSA and disagreed that surcharges should not be considered by the Commission. (DP&L Apr. 1, 2008 Comments at 6-8.) However, Delmarva expressed flexibility in collaborating with Staff regarding Staff's proposed MFVM rate design in the context of a base rate case proceeding. *Id.* Delmarva agreed with Staff's principles of rate gradualism and customer equity and explained that as long as Staff's proposed MFVM would not result in inequitable treatment of any customer class, it was willing to explore Staff's proposed MFVM. Accordingly, Delmarva supported Staff's recommendation to close Regulation Docket No. 59 and investigate implementation of an MFVM rate design through consideration of rate gradualism, customer equity, changes to the risk profile of the utility, and over/under earnings protection during a base rate case proceeding. *Id.*

[11] Delmarva contended that this revenue deficiency is not offset by the growing customer base in Sussex County due to the high cost of connecting and serving new customers, who will use energy at declining levels similar to other customers on the power system. (DP&L Aug. 15, 2007 Comments at 10.)

4. Chesapeake's Position

20. In PSC Docket No. 07-186,[12] Chesapeake proposed an RNM, applicable to all consumers using less than 100,000 ccf per year, as part of its base rate filing. *See* Direct Testimony of Jeff Householder, PSC Docket No. 07-186, at 2-3. Under Chesapeake's proposed methodology, an annual revenue requirement for each rate class would be established in a rate case proceeding that reflects a forecast of the number of consumers and estimated gas usage levels under normal weather. *Id.* Chesapeake proposed a comparison between this normalized average revenue to the actual revenue accrued each month. *Id.* The RNM would allow Chesapeake to recover any shortfall or credit any surplus to ratepayers on a quarterly basis. *Id.*

21. In its comments, Chesapeake advocated for the implementation of a revenue decoupling mechanism in Delaware to more closely match the recovery of a utility's fixed costs with revenue. (CUC Aug. 15, 2007 Comments at 4.) Chesapeake observed that a utility will over- or under-recover its revenue requirement to the extent consumption varies from forecast levels. *Id.* Revenue decoupling mechanisms apply solely to the delivery service portion of a residential consumer's bill. *Id.* Accordingly, Chesapeake argued that revenue decoupling sends an appropriate price signal because the savings a consumer experiences on the 61% commodity portion of the bill – due to less consumption –

[12] In the Matter of the Application of Delaware Division of Chesapeake Utilities Corporation for a General Increase in Natural as Rates and Charges Throughout Delaware and for Approval of Other Changes to Its Tariff, psc Docket No. 07-186 (filed July 6, 2007).

would outweigh any increase on the delivery service portion resulting from the tracking mechanism's true-up. *Id.* at 10.

22. Under traditional ratemaking practices, the majority of fixed costs are recovered through variable charges based on volumetric consumption, which generally rewards utilities for increased sales between rate cases. Accordingly, Chesapeake asserted that its revenue recovery is negatively affected when gas consumption per customer declines. *Id.* at 4. Chesapeake observed that concern regarding global warming and rising energy demand has prompted Delaware to adopt a policy of promoting energy conservation that will likely reduce gas consumption per customer. *Id.* Chesapeake asserted that it has already experienced a decline in consumption and cited the American Gas Association's study that reported a twenty-five percent (25%) decline in natural gas usage since 1980.[13] *Id.* at 11. Because implementation of revenue decoupling would sever the link tying revenue to consumption, Chesapeake argued that revenue decoupling would create an environment for utilities to play an aggressive role in promoting energy conservation without suffering financial harm. *Id.* at 4. Chesapeake asserted that utilities are an essential function of implementation of DSM programs based on their long-established relationships with customers, developers, retail appliance dealers, and contractors. *Id.* at 12. Chesapeake reasoned that with

[13]Chesapeake argued that declining usage and the associated revenue deficiency are not offset by expansion areas such as Sussex County. (CUC Aug. 15, 2007 Comments at 10-11.) Chesapeake reported that it would need to add 3,655 new customers per year at its proposed expansion revenue level of $440 per customer to recover the $1.6 million shortfall caused by a 25% deficit in consumption. *Id.*

these relationships, utilities could effectively deliver appliance rebates, home energy rating programs, appliance dealer incentives, and educational programs for the real estate development industry. *Id.*

23. In addition to affecting utility-managed conservation efforts, Chesapeake argued that the decline in natural gas consumption will impact Chesapeake's ability to extend natural gas service to new residential developments. (CUC Apr. 1, 2008 Comments at 3.) Chesapeake asserted that natural gas appliances produce significantly less carbon emissions than any other fossil fuel source. *Id.* Accordingly, Chesapeake recommended that the Commission adopt policies, rate designs, or regulatory strategies that encourage prudent expansion of gas distribution systems to serve new customers. I*d.*

24. With respect to Staff's proposed MFVM, Chesapeake generally supported a transition to a properly structured SFV rate design. *Id.* at 5. Chesapeake agreed with Staff's decision to modify the rate design to include class stratification to prevent a disproportionate increase in rates for smaller volume consumers in a rate class. *Id.* at 5-6. Chesapeake opposed Staff's concept of rate gradualism – *i.e.* over the next 2-3 rate cases – because it could take approximately 15 years to accomplish. *Id.* at 6. Regarding the need for over/under-earnings protection, Chesapeake asserted that 26 Del. C. § 310 already addresses the issue by authorizing the Commission to initiate a rate base proceeding to reduce the rates of any utility that is over-earning. *Id.* In light of the likelihood that Regulation Docket No.

59 would conclude prior to its current rate case, Chesapeake requested that the Commission allow Chesapeake the opportunity to initiate a rate design proceeding to implement the policy goals articulated in Regulation Docket No. 59. *Id.* at 7.

5. The DPA's Position

25. The DPA opposed implementation of revenue decoupling in Delaware for several reasons.[14] First, the DPA argued that the Commission should not compensate a utility for a revenue deficiency caused by any factor – such as poor management decisions, economic downturn, population shifts, and weather fluctuation - other than measurable load reduction resulting from conservation efforts. (DPA Aug. 15, 2007 Comments at 5.)[15] The DPA asserted that the success of DSM programs can only be measured where consumers demand less of the commodity at the same price. *Id.* at 6. The DPA concluded that revenue decoupling is not an accurate tool to address a change in demand due to rising prices because this matter is more appropriately addressed in a base rate case proceeding. *Id.* at 6-7. Moreover, the DPA observed that a rate case – not a revenue decoupling mechanism - is the accurate tool to address revenue loss caused by weather fluctuation. *Id.* at 7-8.

26. Second, the DPA argued that new customer growth can easily offset a per customer decline in energy usage. *Id.* at 6. The DPA

[14]The DPA did not file written comments following the March 17, 2008 public workshop.

[15]Notably, the DPA observed that Delaware has not experienced energy conservation to a level of success that requires revenue decoupling to stabilize revenues. (DPA Aug. 15, 2007 Comments at 4.)

observed Delmarva has experienced a thirty percent (30%) increase in electric usage per residential customer from 1995 to 2005.

27. Finally, the DPA concurred with Staff's concern regarding inequity among rate classes. In light of the design of Chesapeake and Delmarva's proposed DSM initiatives that focus on education and rebates, the DPA asserted that renters and low-income consumers have limited access to the market because they do not have the financial resources to weatherize their home, purchase more efficient appliances, or install distributed generation. *Id.* at 13-14. Moreover, the DPA asserted that revenue decoupling does not offer price benefits for consumers because the total monthly allocation of rates – *not* energy price – is changing. *Id.* Notably, the DPA observed that Delmarva currently provides a budget-billing arrangement for customers who prefer to have stable monthly payments. *Id.*

6. DEUG's Position

28. DEUG opposed application of a revenue decoupling mechanism to large commercial and industrial customers. (DEUG Comments at 2.) First, DEUG argued that in light of its purpose of facilitating energy efficiency and load management initiatives, revenue decoupling is inapplicable to the industrial class that is at the forefront of these efforts. *Id.* at 3. DEUG reasoned that industrial customers have the sophistication and resources to manage their energy supply and load efficiently. *Id.* DEUG further reasoned that a utility's distribution charge is already designed as a demand rate for industrial customers. *Id.*

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29. In addition to lack of relevancy to large industrial customers, DEUG argued that revenue decoupling would pose significant risk unique to the industrial class. *Id.* at 4. For instance, DEUG asserted that because of the small number of industrial customers, uncertain or high energy costs discourage future economic development in Delaware. *Id.*

30. With regard to the disposition of Regulation Docket No. 59, DEUG recommended that no formal policies be established or specific recommendations made to the Commission. (DEUG Mar. 31, 2008 Comments at 2.) DEUG recognized the valuable purpose of the docket in educating the participants on the issues, but argued that a formal base rate case would provide a more appropriate opportunity to present evidence and test the positions of the parties. *Id.* Accordingly, DEUG adopted Staff's recommendation to the Commission to address both revenue decoupling and DSM programs in a formal base rate proceeding. *Id.*

7. Natural Resources Defense Council and Clean Air Council

31. The Natural Resources Defense Council ("NRDC") and the Clean Air Council ("CAC") filed one set of joint comments for both dockets that focused on the importance of establishing a regulatory framework that would drive investments in cost-effective energy efficiency. NRDC and CAC supported Delmarva's revenue decoupling because it removes a utility's disincentive to support energy efficiency while still assuring recovery of approved fixed costs, provides better economic benefit to consumers and sends a more appropriate price signal. The NRDC and CAC also agreed with the Staff and Delmarva that

the New Jersey decoupling pilot known as Conservation Incentive Program ("CIP") is not suitable for Delaware and should not be considered. They preferred a regulatory framework with a revenue decoupling mechanism linking utility profits and cost recovery to performance, rather than sales, and energy efficiency programs complementing those managed by the SEU. Additionally, NRDC and CAC supported having utility-managed efficiency/conservation activities and also stated that it is reasonable for a utility to expect direction from the Commission prior to their investment in energy efficiency.

B. PSC Docket No. 07-28

1. Staff's Position

32. Following analysis of Delmarva's business case and the working group series, Staff concluded that surcharges for energy efficiency programs are unacceptable. (Staff Apr. 1, 2008 Comments at 1.) In light of the promulgation of legislation creating the SEU, Staff recommended that the SEU administer efficiency/conservation programs, while Delmarva would manage demand response ("DR") programs. *Id.* With respect to both efficiency/conservation and DR initiatives, Staff proposed that Delmarva, Staff, the DPA, and other interested parties collaborate at a working group meeting to determine if any viable DR programs may be implemented in the near term. *Id.* Finally, Staff observed that proposed DR programs should enable participation in markets administered by PJM such as capacity. *Id.*

33. Staff supported the diffusion of advanced metering technology into the electric distribution network. *Id.* Staff

observed that Delmarva must ensure that development of this technology allows for open access by third parties and provide flexibility to alter the capabilities of the system. *Id.* Moreover, Staff recommended that the AMI proposal be consistent with regional expectations for compatibility requirements. *Id.* With regard to cost recovery for the deployment of AMI, Staff would not oppose Delmarva's establishment of an appropriately valued regulatory asset consistent with the matching principle. *Id.* at 2. To avoid intergenerational inequities, Staff asserted that any proposed regulatory asset should take into account the timing of the AMI investment as well as the potential costs and savings over a medium- or long-term horizon. *Id.*

34. Similar to Regulation Docket No. 59, Staff recommended closure of Docket No. 07-28. Accordingly, Staff urged the Hearing Examiner to recommend that the Commission consider revenue decoupling and load management initiatives, including the potential deployment of AMI, in the context of Delmarva's next base rate case filing. *Id.* at 2.

2. Delmarva's Position

35. The three key components of the Blueprint are: (1) the installation of AMI; (2) the establishment of a range of DSM programs, which consist of both efficiency/conservation programs and DR programs; and (3) the initiation of the BSA. Although it recognized that utilities may not have a primary management role in energy conservation programs following the advent of the SEU, Delmarva explained that it should not be *ipso facto* excluded from engaging in energy conservation programs as long as the programs do not conflict

with the SEU and would be beneficial to Delmarva's customers. Delmarva further advocated approval of AMI and the development of DR programs. (DP&L Apr. 1, 2008 Comments at 2.)

36. Because DR programs require the utility to react on a real-time basis to control usage during periods of high demand, Delmarva argued that only the utility has the proper infrastructure to execute these programs. *Id.* Delmarva reasoned that it operates a control center on a twenty-four hour, seven days a week basis that interfaces directly with PJM and monitors the flow of electricity on a real-time basis in Delaware. *Id.* Delmarva contended that real-time capability is essential to the provision of DR programs in Delaware, such as its proposed smart thermostat system. *Id.* Delmarva observed that the majority of modern DR programs combine elements of AMI and dynamic pricing to give utility operators and homeowners/building operators up-to-date information on energy prices and the technology for remote control of energy. *Id.* at 3.

37. At the March 17, 2008 public workshop, Delmarva indicated its willingness to collaborate with Staff and other parties to develop and implement DR programs within the reasonable short-term future. *Id.* at 5. For instance, Delmarva proposed providing an internet portal to the PJM demand response market to large commercial and industrial customers capable of reducing load by 100kW during a summer weekday afternoon.[16] *Id.* Delmarva reported that the program is

[16]Delmarva asserted that the deployment of AMI will enhance its current Energy for Tomorrow program. Delmarva will offer residential customers with central air conditioning or heat pumps the choice of either an outdoor switch or an indoor smart programmable thermostat. (DP&L Apr. 1, 2008 Comments at 5.)

projected to have the potential to curtail peak load demand by 10MW after three years of operation. *Id.*

38. Delmarva supported establishment of a regulatory asset to ensure recovery of costs associated with the AMI and DSM programs. Delmarva asserted that this asset should include reasonable carrying costs. *Id.* at 7. Delmarva argued that the Hearing Examiner should recommend that the Commission adopt Staff's proposed policies and consider the Blueprint in the context of a base rate case with two caveats. *Id.* at 9. First, Delmarva asserted that the Commission should not preclude the potential use of surcharges at this time. *Id.* at 7. Second, Delmarva recommended that the Commission allow Delmarva to manage conservation programs, in conjunction with the SEU, where customers will benefit. *Id.*

IV. **DISCUSSION**.

39. The Commission has jurisdiction in this matter pursuant to 26 Del. C. § 201(a).

40. The record supports the conclusion that the Dockets should be closed and the Commission should encourage Delaware's energy companies to continue moving forward with its investment in advanced metering technology. In addition, the energy efficiency and demand response programs as proposed in Delmarva's Blueprint For the Future and in Chesapeake's filings should be further explored in the context of a general rate proceeding. The Commission should determine the ratemaking impacts and revenue decoupling rate design issues in the context of a base rate case proceeding.

41. Further, while the SEU was created, in part, to manage efficiency/conservation programs for the State, and Staff's position that efficiency/conservation programs should be the exclusive province of the SEU may have merit, I am not prepared, at this time, to recommend that Delmarva should have no role in efficiency/conservation programs for its customers. The issue of whether and how Delmarva should engage in any efficiency/conservation programs should be further considered in the context of a base rate proceeding.

42. As noted above, a series of working group meetings were held in each docket, in which the parties presented information and identified issues of concern. In Regulation Docket No. 59, the parties submitted initial comments on August 15, 2007 and reply comments on November 19, 2007. Following the March 17, 2008 public workshop that included participants from both Dockets, the parties submitted final comments on April 1, 2008.

43. Accordingly, I recommend that the Commission close Regulation Docket No. 59 and Docket No. 07-28 and that the issue of revenue decoupling and demand-side management be explored in the context of each utility's next base rate case proceeding. While Staff's position that efficiency programs should remain the exclusive province of the SEU appears on its face to have some merit, I recommend that the Commission further consider whether Delmarva should engage in any efficiency/conservation programs in the context of a future base rate case or other proceeding.

V. **RECOMMENDATIONS**

44. Accordingly, I recommend to the Commission that it approve as just and reasonable the following policy recommendations:

(a) The Commission should determine that implementation of surcharges for energy efficiency programs and revenue deficiencies related to conservation efforts are not the preferred approach, but that the Commission not preclude the potential use of surcharges in the future under appropriate conditions;

(b) The Commission should investigate the potential implementation of a revenue decoupling mechanism for each utility in the context of the respective company's next base rate case proceeding;

(c) The Commission should, at an appropriate time in the future, issue an Order approving the diffusion of the advanced metering technology into the electric distribution system network and that the demand response programs proposed in Delmarva's Blueprint for the Future be further explored for implementation. Delmarva should offer its proposal to permit it to establish a regulatory asset to cover recovery of costs associated with the deployment of Advanced Metering Infrastructure and demand response equipment in its next base rate case. The Commission, the Staff, and other parties remain free to challenge the level or any other aspects of the asset's recovery in rates when Delmarva seeks recovery of the regulatory asset in base rates. For ratemaking purposes, the Commission may wish to consider an appropriately valued regulatory asset for advanced metering infrastructure investment consistent with the matching principle giving consideration to both costs and savings in the context of its next base rate case proceeding;

(d) The Commission may want to consider whether Delmarva should engage in any efficiency/conservation programs, to the extent such programs will not conflict with or be unnecessarily duplicative of SEU programs in the context of its next base rate case filing; and

(e) The Commission should direct Delmarva, the Public Advocate, Staff, and any other interested parties to convene at a collaborative workshop to determine the viability of implementing any reasonable demand-side management or demand response programs in the near term.

45. A form of Order implementing the foregoing recommendations is included for the Commission's consideration.

Respectfully submitted,

/s/ Ruth Ann Price_________
Ruth Ann Price
Senior Hearing Examiner

Dated: June 27, 2008