BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of Aligning Electric Distribution Utility Rate Structure With Ohio's Public Policies to Promote Competition, Energy Efficiency, and Distributed Generation.	)))))	Case No. 10-3126-EL-UNC

ENTRY

I. Introduction

In the decade since Amended Substitute Senate Bill No. 3 (S.B. 3) required electric utilities to unbundle generation, transmission and distribution, the basic structure of rate designs for recovering the revenue necessary to distribute electricity has remained unchanged. Through this entry, the Commission is reviewing whether modifications to Ohio's electric distribution utilities' rate structures would better align utility performance with Ohio's desired public policy outcomes; and if so, what modifications should be adopted. To facilitate that review, the Commission establishes through this entry a process to gather additional facts, solicit presentations from diverse viewpoints, and encourage public comment on questions of policy.

II. Background

Ohio's current electric distribution utility rates recover principally fixed costs through volumetric rates. Through this two-part rate design, customers pay a customer charge while the remaining distribution revenue requirement is recovered through a volumetric rate. With this rate design, low-usage customers may pay less than the fixed costs to serve them, while high-volume customers may pay more than their cost of service. When the aggregate electricity used by customers is less than the volume used to calculate a utility's revenue requirement in its most recent rate case, the utility is at risk of recovering less revenue than needed to cover its fixed costs. When customers use more, the utility has the potential to earn revenue in excess of what it needs to meet its fixed costs. This rate design, in essence, may incentivize a utility to encourage its customers to use more power or, alternatively, penalize a utility for encouraging customers to use less power. This "throughput incentive" works counter to Ohio's policy goals of competition, increased energy efficiency, and encouraging distributed generation. Section 4928.02, Revised Code.

Decoupling rate designs break or weaken the link between volume and revenue by "decoupling" revenue from sales. Under a "straight fixed variable" (SFV) rate design, fixed

costs are assigned to fixed charges. With this rate design, a customer pays a single fixed charge for delivery of electricity to cover the utility's fixed distribution costs, while the customer's actual usage of generation may be billed at a volumetric rate. A "decoupling" adjustment utilizes a periodic rate modification to eliminate or reduce any variance between a utility's actual revenue recovery and its authorized revenue recovery. This mechanism would begin with a Commission-calculated, authorized revenue and makes frequent (monthly, semi-annual, annual) comparisons between this figure and what the utility collects. Such comparisons may be made by comparing actual revenue to total authorized revenue, authorized revenue per customer, or a statistical estimate of normal or expected revenue. This method mitigates or eliminates changes in volumetric-based revenues due to consumer activity behind the meter, including energy efficiency and distributed generation. Some decoupling rate designs can also compensate for usage fall-off for any reason, including economic downturn, efficiency gains, or weather. "Lost revenue" adjustments are another rate design tool that can be used to compensate utilities for fixed distribution expenses lost as a result of reduced sales. In these instances, once a utility demonstrates that it successfully implemented energy efficiency programs with documented energy savings, the utility is permitted to recover the "lost" volumetric revenue for each kWh saved by the energy efficiency program. The lost revenue is calculated and recoverable in some future proceeding, usually through a rider or surcharge.

III. Current Ohio Mechanisms to Eliminate or Mitigate the Throughput Incentive.

The Commission has the authority to consider rate designs to eliminate or mitigate the throughput incentive for both electric and natural gas utilities, pursuant to Section 4909.15, Revised Code. For electric utilities, Amended Substitute Senate Bill No. 221 (S.B. 221) establishes a two-part test for the Commission's adoption of a revenue decoupling mechanism. The Commission may approve a revenue decoupling mechanism if it determines both that (1) the company implemented energy efficiency or conservation programs that depressed revenues and (2) the mechanism reasonably aligns the interests of the utility and of its customers in favor of those programs. Section 4928.66(D), Revised Code.

An electric utility may include an application for a revenue decoupling mechanism as part of its proposal to establish, continue, or expand energy efficiency or conservation programs (*id.*). Additionally, pursuant to Section 4928.143(B)(2)(h), Revised Code, an electric utility may include a revenue decoupling mechanism in its Electric Security Plan (ESP). Under this provision, the electric utility must demonstrate that customers' and the electric utility's expectations are aligned and that the electric utility is placing sufficient emphasis on and dedicating sufficient resources to system reliability (*id.*).

For natural gas companies, S.B. 221 defines a "revenue decoupling mechanism" as "a rate design or other cost recovery mechanism that provides recovery of the fixed costs of service and a fair and reasonable rate of return, irrespective of system throughput or volumetric sales." Section 4929.01(O), Revised Code. A natural gas company may propose a revenue decoupling mechanism within an alternative rate plan. Sections 4929.01(A) and 4929.051, Revised Code. Within the past two years, the Commission has considered and adopted a modified SFV rate design for all four major natural gas utilities in Ohio. *In re Duke Energy Ohio*, Case No. 07-589-GA-AIR, Opinion and Order (May 28, 2008) (*Duke Rate Case*); *In re Dominion East Ohio*, Case No. 07-829-GA-AIR, Opinion and Order (October 15, 2008) (*DEO Rate Case*); *In re Columbia Gas of Ohio*, Case No. 08-72-GA-AIR, Opinion and Order (December 3, 2008) (*Columbia Rate Case*); and *In re Vectren Energy Delivery of Ohio*, Case No. 07-1080-GA-AIR, Opinion and Order (January 7, 2009) (*VEDO Rate Case*). In adopting this rate design, the Commission noted that volatile and sustained natural gas price increases were causing customers to conserve gas; that reduced sales under traditional rate design impacts the ability of a utility to recover fixed costs and creates a disincentive to encourage conservation; and that the utilities were engaged in successful conservation programs. The Commission found that the SFV rate design would produce more stable bills for customers, in that they would not be required to pay a higher portion of the fixed costs during the heating season when the commodity portion of their bill was already at its highest, that the bills would be easier to understand and produce a more accurate price signal, and that the SFV rate design would assure a more equitable allocation of distribution system costs to cost-causers. (*Duke Rate Case* at 17-19; *DEO Rate Case* at 22-24; *Columbia Rate Case* at 19-20; *VEDO Rate Case* at 11-14.)

As for the current rate designs for electric utilities, the Commission approved lost revenue mechanisms in ESP cases for each of the seven electric utilities operating in Ohio. Stipulations adopted in five of the electric utilities' cases permitted the utilities to recover "lost revenues" that were created after the utility implemented energy efficiency and peak demand reduction programs. In the case of Duke Energy Ohio, Inc., the adopted stipulation established that Duke could recover lost distribution revenue through its Rider DR-SAW. *In re Duke Energy Ohio, Case No.* 08-920-EL-SSO, Opinion and Order (December 17, 2008) at 19. Duke agreed to sponsor an educational workshop about decoupling and to make an appropriate adjustment to its lost distribution revenue recovery under Rider DR-SAW, if the Commission were to adopt decoupling or an SFV rate design for Duke. *Id.*

The FirstEnergy ESP stipulation adopted in Case No. 08-935-EL-SSO provided that lost distribution revenues from the utilities' energy efficiency and peak demand reduction programs shall be recovered from all customers for a period not to exceed the earlier of the effective date of the Companies' next base rate case or six years from the effective date of the stipulated ESP. *In re FirstEnergy*, Case No. 08-935-EL-SSO, Second Opinion and Order (March 25, 2009) at 14. FirstEnergy's most recent ESP stipulation provides that FirstEnergy

shall be entitled to receive lost distribution revenue for all energy efficiency and peak demand reduction programs approved by the Commission, except for historic mercantile self-directed projects. *In re FirstEnergy*, Case No. 10-388-EL-SSO, Opinion and Order (August 25, 2010) at 14. However, the Commission noted that the stipulation provides that the Commission may institute a "changed revenue neutral distribution rate design" if FirstEnergy concurs (*id.* at 9). DP&L's ESP stipulation specifically notes that recovery of lost revenue does not include lost generation revenue and that lost revenue recovery will be capped at $72 million over a seven-year period. *In re DP&L*, Case No. 08-1094-EL-SSO, Opinion and Order (June 24, 2009) at 9-10.

Finally, the Commission authorized AEP-Ohio to establish an unavoidable Energy Efficiency and Peak Demand Reduction Cost Rider (EE/PDR Rider) to recover the cost of the demand- side management programs as trued-up annually to actual cost. *In re AEP-Ohio*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009) at 41. The Commission then approved a stipulation in the AEP-Ohio energy efficiency portfolio case that authorized recovery of lost revenue through the EE/PDR Rider. *In re AEP-Ohio*, Case Nos. 09-1089-EL-POR and 09-1090-EL-POR, Opinion and Order (May 13, 2010). However, the Commission modified the stipulation's lost revenue provision to authorize it only through January 1, 2011. *Id.* at 26. In issuing this ruling, the Commission noted:

> The Commission believes that it is important to break or weaken the link between sales volume and the recovery of fixed distribution costs... However, in this instance...the record fails to establish what revenue is necessary to provide AEP-Ohio with the opportunity to recover its costs and to earn a fair and reasonable return. Without this information, the Commission cannot determine whether the [proposal for recovery of lost revenue] is reasonable. Given that CSP's last distribution rate case occurred in 1991 and OP's last distribution rate case occurred in 1994, AEP-Ohio's actual costs of service are unknown at this time. Therefore, at this time, the Commission will temporarily grant AEP-Ohio lost revenue recovery through January 1, 2011. During this time, AEP-Ohio is encouraged to propose a mechanism to answer the Commission's concern regarding quantification of fixed costs, as well as a mechanism to achieve revenue decoupling, which may include, but is not limited to, the method proposed in this filing[,] lost distribution revenue recovery, a decoupling rider, or any other method which reduces or eliminates the link between sales volume and recovery of fixed distribution costs.

Id.

IV. Framework for Discussion

a. Commission Objective

We believe that Ohio's unique electric retail environment justifies a generic discussion to consider whether modifications to Ohio's electric utilities' rate structures would better align utility performance with Ohio's desired public policy outcomes; if so, what modifications should be adopted; and finally, if modifications are indicated, what is the process we should use to make them.

In considering these questions, the Commission will be guided by the policy of this state, as expressed in Section 4928.02, Revised Code.

We must also consider each electric utility's responsibility to achieve through efficiency programs energy savings of at least 22 percent by the end of the year 2025 and the obligation of each electric utility to serve 25 percent of its load by the year 2025 from an alternative energy resource, at least half of which must be renewable, including 0.5 percent from solar energy. Sections 4928.64, 4928.66(A), and (B), Revised Code. Finally, we are cognizant of our own obligation to initiate programs that will promote and encourage conservation of energy and a reduction in the growth rate of energy consumption, promote economic efficiencies, and take into account long-run incremental costs. Section 4905.70, Revised Code.

b. Discussion Questions

Through this entry the Commission is soliciting comments to aid the Commission in initially framing the issues that should be considered. To that end, the Commission has included in Appendix A specific questions addressing issues about which we seek input from interested parties. The Commission also finds that the discussion of issues is often better facilitated if there is actual data which represents the context of the issues, such as that included in Appendix B. While the Commission is not, at this time, seeking the actual data contained in Appendix B, the Commission is requesting feedback as to the type of data that should be considered in its review of the various decoupling rate designs. Therefore, the Commission requests written comments by February 11, 2011, responding to the questions posed in Appendix A and as to whether the issues, process, and data delineated in the appendices cover all potential topics and methodologies. This first round of comments is solely for the purpose of having parties aid the Commission in determining the appropriate questions and data necessary to be considered in this review. The Commission, at a later date, will consider and specify additional opportunities for input into this review.

It is, therefore,

ORDERED, That all electric utilities and other interested parties shall observe the requirements set forth in this Entry. It is, further,

ORDERED, That a copy of this Entry be served upon the parties of record in Case Nos. 08-888-EL-ORD and 10-176-EL-ATA.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

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(1) Are there fundamental operational distinctions between natural gas and electric utilities that must be considered in determining whether and how to eliminate or mitigate the throughput incentive in electric distribution rates?

(2) Are there factual or policy considerations that suggest electric distribution rate design should be constructed differently from natural gas?

(3) If the Commission adopts a decoupling rate design, which rate design should it use: SFV, decoupling adjustment, lost revenue recovery adjustment, or some combination of these?

(4) If the Commission adopts a decoupling rate design in electric distribution rates:

(a) Should that rate design be applied only to residential rate classes? What other rate classes should be considered?

(b) How often should the Commission require the utility to update its distribution revenue requirement?

(c) Should the company's return on equity be reduced to reflect a reduced risk to the company?

(5) If the Commission adopts some element of a decoupling rate design:

(a) Should adjustments be made on a total revenue, per customer revenue, or some other basis?

(b) Should adjustments be normalized for weather?

(c) Should the Commission adopt any special features to shield consumers from volatile adjustments (e.g., caps, collars, bands)?

(6) If the Commission determines that a decoupling rate design should be implemented to eliminate or mitigate the throughput incentive in electric distribution rates:

(a) When should this change occur (i.e., in what types of actions before the Commission should this change be implemented)?

(b) Should it be phased in?

(c) Over what period of time?

(7) In order to review the various decoupling rate designs, the Commission will need necessary data such as that included in Appendix B. Is the data contained in Appendix B:

(a) Burdensome?

(b) Appropriate?

(c) A comprehensive list of the necessary data?

(d) Proprietary?

NECESSARY DATA

For each electric utility, please provide the following data for calendar year 2010, or for the most recent 12-month period for which actual data is available.

(1) Average number of customers by class

(2) Number of bills by class

(3) kWhs billed for 12-month period by class

(4) Total "distribution-related" revenues (i.e., including riders) by class

(5) Average distribution-related charges per bill (Line 4 / Line 2) by class

(6) Total "distribution-related" revenues from customer charges and base volumetric charges, excluding riders by class

(7) Average base distribution-related charge per bill (Line 6 / Line 2) by class

(8) Average kWh usage/month (Line 3 / Line 2) by class

(9) Average kWh usage/year (Line 3 / Line 1) by class

(10) At what kWh level, by class, would a customer charge equal to the figure derived on Line 5 be "revenue neutral for a customer?

(11) At what kWh level, by class, would a customer charge equal to the figure derived in Line 7 be "revenue neutral" for a customer?

(12) How many customer bills, by class, are for usage less than the Line 10 usage level?

(13) How many customer bills, by class, are for usage greater than the Line 10 usage level?

(14) How many customer bills, by class, are for usage less than the Line 11 usage level?

(15) How many customer bills, by class, are for usage greater than the Line 11 usage level?