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David R. Eichenlaub
Assistant Director, Division of Economics and Finance
VA State Corporation Commission
Richmond, VA 23218-1197

Re: Additional Comments in PUE-2007-00049

Dear Mr. Eichenlaub:

Given the issues being considered by the SCC working group and the various subgroups which have been established, MeadWestvaco (MWV) wanted to include in the record additional comments reflecting our point of view with regard to two issues: cost competitiveness for demand side management programs and electric utility revenue decoupling. These comments complement those we filed on July 13th which reflect a concern about the future cost of purchased power for large consumers in the Commonwealth of Virginia. The ELCON policy brief on revenue decoupling is also attached for the record as it reflects the consensus position on this issue prepared by large US industrial consumers of energy. There are some ELCON members who have significant operations in the Commonwealth.

1. Comments on Cost Effectiveness of Demand Side Management Programs

Demand Side Management (DSM) refers to non-traditional utility activities that are designed to reduce or reshape load. Traditionally, electric utilities have matched supply and demand by increasing supply whenever necessary. It may be less expensive, though, to reduce demand. DSM is an alternative to supply-side additions. Our experience in other states has shown that use of the total resource test in the early 1990s for has been extremely costly to the program non-participant. Therefore, contrary to the recommendations in the SCC Staff Report in Case No. PUE900070, MWV believes that DSM programs should pass the rate impact measurement (RIM) test as a prerequisite for implementation. Only the RIM test will avoid upward pressure on electricity rates. DSM programs that fail the RIM test would result in higher rates for all consumers. Moreover, because electricity is priced on the amount of energy consumed, the vast majority of the cost of these programs would be borne by customers that either chooses not to participate or who have already invested their own capital in DSM programs. Participating customers pay only a small fraction of the cost of DSM programs that fail the RIM test. This result

is unfair. Further, because DSM is not a natural monopoly, allowing participants to pay only a fraction of the cost will diminish competition and increase the cost of DSM.

If demand-side options result in lower costs and lower rates than supply-side additions, they are worthwhile. Problems can arise, however, because the apparent effect is the opposite of new supply. With a new generation plant, the utility invests money to sell the electricity demanded by its customers. These sales pay for at least part of the cost of the new facility. With DSM, the utility invests money and *reduces* sales. New supply can be used to serve all customers—residential, commercial, industrial or street lighting. A DSM investment, however, provides service *only* to a specific customer.

The Rate Impact Measure (RIM) cost-effectiveness test looks at the costs of an energy efficiency program from the customers' perspective, and provides information on whether rates will need to be adjusted if a DSM program is implemented. In the RIM benefit/cost test, the benefits of each DSM program include the capacity and energy costs the utility avoids when the demand-side measure is in place. These benefits are weighed against the costs incurred by the utility to acquire the demand-side resource, including the costs associated with the loss of revenue (i.e., reduced sales). A DSM program with a RIM benefit/cost ratio greater than one means that rates will be lower with the program than with an alternative resource option. Thus, all customers would benefit. Consideration of rate impacts in the evaluation of DSM programs helps to minimize both rates and costs for ratepayers.

There are implications associated with requiring electric utilities to implement DSM programs that fail the RIM test. First, as a threshold matter, electric utilities charge for services through rates based on the amount of electricity sold to customers. Because DSM reduces electricity sales, the customers that participate in DSM programs will pay only a fraction of the additional cost even though they are clearly receiving a benefit from the DSM service. This means that non-participating customers will not only pay the remaining costs not recovered from participating customers, but their rates will also be higher.

An example showing how customers participating in DSM programs would pay only a small fraction of the actual cost would be helpful to illustrate the point that aggressively pursuing DSM programs that fail the RIM test will lead to higher costs for the majority of non-participants. This example is in the attached table. In the Base Case there are three customers, each using 100 kW. The cost of existing resources is assumed to be $100/kW. In Case 2, Customer C increases usage by 100 kW. The utility must add 100 kW of new resources. Let’s assume that the cost of the new 100 kW of supply is $180/kW. Therefore, the plant addition will increase rates from $100 to $120 per kW. Customer C, whose usage increases, would pay $14,000 for the additional 100 kW of usage or 78% of the added cost to the system. Under the assumption that the incremental supply costs more than the average existing supply, other customers would pay somewhat more, too, as a consequence of the rate increase.

Assume that the utility were to invest in equipment at Customer C's premises (conservation devices or different equipment) that would allow Customer C to increase output while maintaining the existing level of usage (Case 3). In effect, Customer C would receive the *equivalent* of 100 kW of service, though in a different form. If the utility were to simply add the cost of this DSM service to its rates, the rates would increase from $100 to $150 per kW. The rates with DSM would be significantly higher than with new supply (Case 2), because, in Case 3, more cost must be recovered from the existing sales base. This outcome occurs because with DSM there would not be incremental energy sales and corresponding revenues to defray the incremental cost. In other words, it would fail the RIM test. Customer C, who received the "kW substitute" through the DSM program, would pay only $5,000 or one-third of the cost. Two-thirds of the DSM cost would be borne by other Customers A and B. This result would be especially unfair to those customers that have already invested their own capital in load reducing/energy efficient equipment.

Case 4 of this example illustrates what happens if DSM were less costly than existing resources. As can be seen, the non-participants (Customers A and B) would still experience higher costs than if a more expensive supply side resource were added. In other words, the DSM measure would still fail the RIM test. Customer C, though, would still pay only one-third of the actual cost of the DSM program.

The illustration demonstrates that DSM programs that fail the RIM test will cause rates to be higher for non-participating customers than would be the case if the utility had chosen supply-side, rather than demand-side measures. This result is unfair. If the demand-side measures were chosen instead because they were less costly than adding new supply, then the impact of DSM on *all* customers should be lower than if new supply had been added. This inequity can be avoided by using the RIM test to ensure that only those DSM programs that provide downward pressure on rates are implemented.

Prior experience with implementing DSM programs that failed the RIM test was pointed out by a Georgia Power witness, Mr. Burleson during recent hearings to implementation of DSM.

“The kinds of programs we had back in the early ‘90s, the residential energy efficiency programs that were based on the total resource cost test or societal cost test, we spent about $90 million and we got about 40 MW of load reduction out of those programs. So far, the power credit program which does pass the RIM test, we’ve spent about $5 million on that program and we’ve gotten about 40 MW of load reduction capability out of that. So that’s kind of the difference between the RIM test and the societal or total resource cost test. You can spend $90 million and get 40 MW or you can spend the $5 million with RIM and get the same 40 MW of load reduction.” (Tr. P. 331, lines 12-24)

Illustration of the Impact of Purchased DSM

Base Case

	Customer A	Customer B	Customer C	Total	
Usage kW	100	100	100	300	Existing resources have cost of $100/kW
Cost/kW	$ 100	$ 100	$ 100	$ 100	
Cost	$10,000	$10,000	$10,000	$30,000	

Case 2: With Growth at $180/kW
Extra Cost = $18,000

	Customer A	Customer B	Customer C	Total	
Usage kW	100	100	200	400	Adding $180/kW resources to meet
Cost/kW	$ 120	$ 120	$ 120	$ 120	greater usage causes all customers to pay
Cost	$12,000	$12,000	$24,000	$48,000	more

Case 3: With DSM at $150/kW
Extra Cost = $15,000

	Customer A	Customer B	Customer C	Total	
Usage kW	100	100	100	300	A and B pay more for $150/kW DSM
Cost/kW	$ 150	$ 150	$ 150	$ 150	than if $180/kW resources had been
Cost	$15,000	$15,000	$15,000	$45,000	added

Case 4: With DSM at $90/kW
Extra Cost = $9,000

	Customer A	Customer B	Customer C	Total	
Usage kW	100	100	100	300	A and B still pay more than Case 2 –
Cost/kW	$ 130	$ 130	$ 130	$ 130	even though new supply is cheaper than
Cost	$13,000	$13,000	$13,000	$39,000	existing

*100 kW of actual plus 100 kW of imputed usage

2. Comments on Electric Utility Revenue Decoupling

Utility "revenue decoupling" is a radical departure from traditional electricity rate setting where costs, revenues and profits are analyzed together as a whole. Decoupling eliminates such thoughtful regulatory analysis, guaranteeing a utility a revenue stream paid by consumers regardless of how much power they use. This effectively guarantees a utility's profits and eliminates business risks because customer rates are adjusted automatically to hold utility earnings harmless from fluctuations in customer consumption.

Traditionally electric utilities have the opportunity for a fair return, not guaranteed revenue. Under existing law, a fair revenue stream and return are provided in rates set by regulators after a detailed showing of costs, revenues, and efficient management. Revenue decoupling requires customers to pay without a detailed showing that the guaranteed rates are justified. Aside from this fundamental unfairness, decoupling is a bad idea for other reasons.

First, right now when homeowners or businesses conserve electricity their electricity bill goes down because less power is purchased. The customer's delivery costs are also reduced since delivery costs are related to power used. With revenue decoupling, increased conservation reduces the fuel cost associated with energy for consumers, because less is used. But all the fixed costs including delivery costs will not go down under decoupling and may even go up because the utility is receiving fixed payments from consumers regardless of the amount of power used in order to guarantee a level of revenues per customer. This certainly diminishes a consumer's incentive to conserve. The utility is effectively getting paid from the customer's savings from conservation.

Second, revenue decoupling eliminates a utility's incentive to control its costs and perform efficiently for its customers. Because decoupling immunizes a utility's revenues from sales fluctuation, a utility's motivation to be more efficient and improve service evaporates. This in turn could have profoundly negative impacts on reliability, necessary system expansion and maintenance, and customer service. Decoupling can also reduce or eliminate a utility's desire to support economic growth or to advance development of infrastructure to support such growth.

The driving force for revenue decoupling today is a notion it would advance energy conservation. As the theory goes, the current system pays utilities for selling electricity while energy conservation reduces utility revenues. Therefore by guaranteeing revenues utilities will somehow become allies in reducing power consumption. It is striking that when individuals and businesses are coping with high energy costs and emerging climate change impacts - thinking differently, changing behaviors, and spending money to conserve - decoupling exempts utilities from shared sacrifice. Utilities would be paid to do their share while consumers foot the bill. Utilities and their shareholders, as all other businesses in the Commonwealth of Virginia should share some of the burden of meeting the environmental and energy challenges which face the state.

The idea that utilities don't encourage energy efficiency programs, because less power used cuts into their revenues and decoupling solves this problem, is wrong. Utilities in many states conduct extensive efficiency programs using money collected from

consumers. They gain customer loyalty and revenues from such programs. There is no conflict between sales and conservation. If these programs are deficient or need enhancement, the answer isn't to guarantee utility revenues; it's to make those programs more useable, targeted, more widely known, and more efficient.

Even assuming that conservation is a reason to decouple, decoupling is a blunt instrument because it's very difficult to specifically identify reasons for lowered utility revenues. There are always multiple variables present and interacting on each other. If for example, a utility has less revenue because of an unseasonably warm winter – a risk every utility has and a leading cause of utility revenue swings - under revenue decoupling that business risk is eliminated and guaranteed consumer payments continue. Such a reduction in revenue has nothing to do with conservation, but decoupling is blind to what causes utility revenue reductions. In other words, conservation may be an argument for decoupling, but the results can very well have nothing to do with conservation. Shortcutting the normal rate setting process is fraught with unintended consequences and potentially high costs. There are better ways to encourage energy conservation and efficient use of electricity.

Decoupling is a bad idea for many reasons. Highlighting a number of these reasons, the National Association of State Utility Consumer Advocates recently passed a resolution opposing "…decoupling mechanisms that would guarantee utilities the recovery of a predetermined level of revenue without regard to the number of energy units sold and the cause of lost revenue …." June 12, 2007. .

Utilities are entitled to recover their costs and a fair profit as well. When utility revenues decline because of a reduction in sales for any reason including energy conservation or when there are increased expenses due to operating requirements, a utility has the right to file a rate case that examines what happened, what a fair return is, and what new rates should be adopted. A utility's cost increases and offsetting cost reductions to the extent allowed by law are considered together in traditional rate proceedings, and appropriate customer-class cost allocations (using long standing cost causation principles) are determined.

This balanced, thoughtful approach is more equitable for utilities, homeowners, and businesses. It can respond to reduced revenues from energy conservation, it can encourage efficient utility management, and it can provide the correct price signals for consumers.

Very truly yours,

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