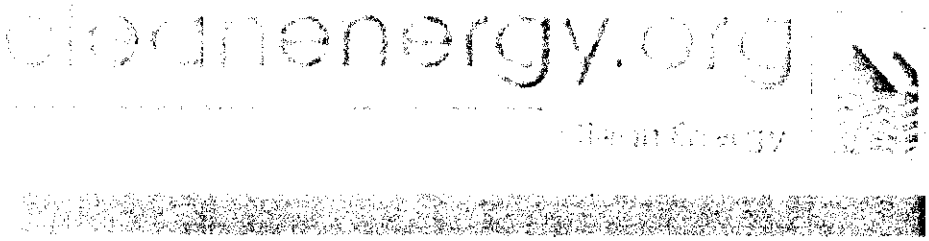

August 7, 2008

Ms. Karen Webb
Florida Public Service Commission
2540 Shumard Oak Blvd
Tallahassee, FL 32399

**RE: Southern Alliance for Clean Energy's Comments on August 7, 2008 Revenue Decoupling Workshop**

Dear Ms. Webb:

Please accept the following comments by Southern Alliance for Clean Energy for the Florida Public Service Commission revenue decoupling workshop on August 7, 2008.

Southern Alliance for Clean Energy (SACE) wishes to thank Governor Crist, the Florida Legislature, and the Florida Public Service Commission for their commitment to expand the use of energy efficiency in Florida. HB 7135 is an important step forward in securing the state's energy security, increasing energy-related investment in Florida and reducing the state's greenhouse gas emissions. The fastest and most cost-effective method of achieving those goals is through increased implementation of all cost-effective energy efficiency resources.

Florida is rich in untapped energy efficiency and demand side renewable energy resources. Currently, however, regulatory barriers, poor market structures, and a lack of information prevent our state from reaping the benefits of these resources. The Florida Legislature recognized barriers to greater efficiency in HB 7135 when it tasked the Commission to " analyze utility revenue decoupling and provide a report and recommendations to the Governor, the President of the Senate, and the Speaker of the House of Representatives by January 1, 2009,"[1] as a potentially powerful tool to unleash greater energy efficiency in Florida.

[1] HB 7135, Section 114 (2008)

The Florida Legislature also identified the development of "demand side renewable energy systems" as a priority in modifications to the Florida Energy Efficiency and Conservation Act ("FEECA") goal setting process n HB 7135.[2] Given the need to achieve greater energy security, spur investment in energy efficiency and demand side renewable technology and reduce greenhouse gas emissions, the time is right for Florida to implement rate structures, policies and measures that promote clean energy resources such as energy efficiency and demand side renewable technologies.

At the outset, we wish to highlight the distinction between demand reduction via energy efficiency, *i.e.*, reductions in purchases from the grid across most hours of the year, and demand reduction via demand response, *i.e.*, reduction in purchases from the grid in a relatively few hours per year, typically less than 100 hours, during periods of peak electricity usage. It is important to distinguish between these two categories because reductions in annual consumption from energy efficiency are much more effective at reducing annual electric bills and the environmental impacts associated with annual electricity use than are reductions in peak demand due to demand response.

Both consumers and utilities face challenges in tapping our State's abundant energy efficiency and demand side renewable energy resources. By tying the utilities' financial health and earnings to the amount of energy sold, rather than to the delivery of least cost energy services, the current regulatory structure sends the wrong economic signals to utilities, and discriminates against energy efficiency and demand side renewable energy. Consumers face challenges as well, including a lack of information regarding the benefits of energy efficiency and the advantages and availability of high-efficiency products and services; the lack of "real-time" information about energy costs; and high up-front costs for installing energy efficient equipment and measures. Policies for renewable energy and utility-led energy efficiency should be judged on the degree to which they help consumers overcome these challenges as well as accomplish the overall energy goals of the Governor and Legislature.

As a result of these challenges, Florida lags far behind other states in energy savings. As presented on Table 1 below, our State's largest utilities achieved minimal results from energy efficiency programs operated in 2006. The results show energy efficiency savings levels (annualized reduction in sales of electric energy resulting from program activity in the stated year) of well below the 1% annual savings goal widely accepted as a benchmark for demonstrating leadership in energy efficiency. Furthermore, Florida ranked 29th in the nation in the 2006 Energy Efficiency Scorecard published by the American Council for an Energy Efficient Economy (ACEEE).[3]

[2] HB 7135, Section 38 (2008)

[3] Eldridge, M et al, "The State Energy Scorecard for 2006," American Council for an Energy-Efficient Economy, June 2007.

Table 1.

**Ranking of Annual Sales saved with Energy Efficiency/DSM Programs 2006 & 2007**[4]

| Name of Utility | 2007 Sales (GWh) per PSC | 2007 EE Savings (GWh) (increm) per PSC 10-yr Plans | Pct. 2007 Sales Saved with EE (incremental) per PSC | 2006 Sales (GWh) per PSC | 2006 EE Savings (GWh) (increm) per PSC 10-yr Plans | Pct. 2006 Sales Saved with EE (incremental) per PSC | 2006 Sales (GWh) per EIA | 2006 EE Savings (GWh) per EIA (incremental) | Pct. 2006 Sales Saved with EE (increm.) per EIA |
|---|---|---|---|---|---|---|---|---|---|
| Florida Power and Light | 105,415 | 226 | 0.21% | 103,659 | 214 | 0.21% | 103,653 | 199.0 | 0.19% |
| Progress Energy Florida | 39,282 | 45 | 0.11% | 39,432 | 34 | 0.09% | 39,432 | 37.5 | 0.09% |
| Tampa Electric | 19,533 | 21 | 0.11% | 19,025 | 20 | 0.11% | 19,025 | 17.1 | 0.09% |
| JEA | 12,751 | 0 | 0% | 12,694 | 0 | 0% | 12,800 | 12.7 | 0.10% |
| Gulf Power | 11,521 | 14 | 0.12% | 11,429 | 15 | 0.13% | 11,429 | 11.3 | 0.10% |
| City of Tallahassee | 2,756 | 9 | 0.33% | 2,715 | 0 | 0% | 2,714 | 10.8 | 0.40% |
| Gainesville Regional Utilities | 1,877 | 14 | 0.75% | 1,849 | 2 | 0.11% | 1,849 | 3.4 | 0.18% |

The first step and most immediate step the Commission could take to improve energy efficiency performance in Florida is to require utilities to implement programs to achieve all cost effective energy efficiency potential. Current Commission policy uses the Rate Impact Measure (RIM) cost-effectiveness test as the ultimate screen for energy efficiency measures. This test measures short term rate impacts to ratepayers rather than long term economic benefit to the whole body of ratepayers from an energy efficiency measure. Florida is the only state in the nation that still utilized this test as the exclusive test for measure cost-effectiveness. The Legislature has expressed its intent in HB 7135 for the Commission to find alternatives to the RIM test in the following language; "[i]n establishing the goals, the commission *shall* take into consideration ... The costs and *benefits to the general body of ratepayers as a whole*, including utility incentives and participant contributions."[5] (emphasis added).

We urge the Commission to establish the cost-effectiveness test as its first order of business in the FEECA goal setting process. Without the a clear signal from the Commission identifying the appropriate cost-effectiveness test, the goal setting proceedings will devolve into extended and protracted debate over cost-effectiveness tests rather than a discussion on long term goal setting. The Legislature's intent is best realized through the use of the Total Resource Cost (TRC) cost effectiveness test. It measures the net costs of energy efficiency programs as the sum of costs and benefits to the utility and its customers (lost utility revenues are not a program cost); this best reflects the customer's long term interest in a least-cost energy service system – and meets the legislative mandate.

Secondly, a properly implemented revenue decoupling policy, in combination with energy efficiency incentives, can significantly improve utility energy efficiency and demand side renewable energy performance in Florida. Putting a priority on energy

[4] Table based on FPSC and US EIA data (2007-2008)

[5] HB 7135, Section 39 (2008)

efficiency and renewable energy means that the Commission should *at least* level the financial "playing field." Extensive research documents that energy efficiency is unlikely to be a priority for utilities because traditional regulation creates a rapid and large response of utility profits to sales growth (or decline).

Removal of financial disincentives.

The rate structure should account for and address the impact of energy efficiency programs and demand side renewable energy resources in reducing sales of electricity from traditional generation.[6] This will ensure the utility earnings are not harmed by the pursuit of these programs or deployment of these resources. Mechanisms include:

*a. Decoupling revenues from sales*

We generally favor decoupling revenues from sales as a straightforward approach to breaking the link between utility throughput and utility recovery of fixed costs for and earnings on traditional generation. Decoupling is consistent with Florida's traditional cost-based regulation, in which the use of annual true-ups to align costs and revenues is a standard approach.

The end result is that utilities should no longer have an incentive to maximize their sales because the rate of return does not change within the revenue requirement. Nor is there a disincentive to promote efficiency. Decoupling should have the effect of stabilizing the revenue stream of a utility because its revenues are no longer dependent on sales. There a number of variations in how the computations can be done. The true up mechanism is symmetrical. If sales increase, rates drop in the next period; if sales decrease, rates increase to compensate. Therefore, decoupling removes the risk to utilities that they will under-recover fixed costs at the same time it removes the risk to consumers that utilities will over-recover.

*b. Lost revenue adjustment mechanisms ("LRAMs")*

An alternative to decoupling is a lost revenue adjustment mechanism. LRAMs are designed to enable the utility to adjust its rates to recover only those lost margins that result when its efficiency programs cause a reduction in its sales. A properly designed LRAM must determine the net revenue lost by the utility due to energy conservation—that is, the gross revenue loss net of any current cost savings associated with the foregone sales. Several states have used and/or are using LRAMs. A LRAM presumes that the effects of utility energy conservation initiatives on utility sales are measurable.

LRAMs may not be the best approach for addressing the impact of energy efficiency programs on sales. First, a LRAM presumes that the effects of utility energy

[6] We emphasize that revenue impacts of changes in electricity sales are not a "cost" of energy efficiency or demand side renewable energy.

conservation initiatives on utility sales can be easily distinguished from the effects of external conservation factors on those sales, such as naturally occurring improvements in efficiency. In fact, it can be difficult to precisely identify the effect of reductions from utility energy efficiency on utility sales. Analysts must exercise judgment to estimate the quantity of reductions that may have occurred due to energy efficiency in the absence of the utility's programs, and to subtract those "naturally occurring" efficiency reductions from the reductions attributed to the utility's efforts. Thus, LRAMs require careful, independently conducted evaluations to establish conservation program impacts on sales. In addition, LRAMs are not effective at addressing net lost revenues due to government efficiency standards or renewable energy portfolio standards or reducing the harm to consumers that results from utility over-recovery of fixed costs. Decoupling addresses these concerns directly and more effectively.

Performance goals and incentives.

It is important to note that removing the financial disincentive created by the current rate structure *does not* provide the utility a positive "incentive" to pursue efficiency and distributed renewable generation aggressively, as it does not offer a corresponding additional benefit to the utility. Therefore, it may be appropriate for a utility to receive financial incentives if it performs well in achieving energy efficiency goals. The incentives used in other jurisdictions include shared savings; performance targets, which may include energy savings goals, cost-effectiveness goals, and other factors; and a rate of return adder.[7] Penalties for poor performance may also be appropriate.

Performance incentives must be measured against the attainment of a savings goal. We recommend that the Commission endorse an aggressive energy efficiency savings goal as a metric to measure the success of utility efficiency programs. To date, most U.S. investor-owned utilities do not operate a comprehensive suite of conservation programs without a defined mandate.[8] For example, an Energy Efficiency Resource Standard ("EERS") require utilities to meet a minimum percentage of their load with energy efficiency, are an effective tool for driving investment in more cost-effective energy efficiency.

As illustrated in Table 2 below, in states with these proven policies and regulatory frameworks, utilities have achieved high levels of annual energy efficiency savings.

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[7] Rate of return adders are sometimes also considered a method for addressing the utility disincentive to energy efficiency. If a given performance incentive is large enough and structured properly, it can serve dual purposes in an indirect fashion. However, we note that it is possible to structure a performance incentive in such a way that it overcompensates for some energy efficiency programs even as it creates a disincentive for other programs.

[8] Leading states have committed to meeting substantial portions of their energy needs through efficiency. For example, California has adopted procurement rules that require the state's utilities to invest in all cost-effective energy efficiency – approximately 1% of total load. Illinois and New York have committed to reduce consumption 15% by 2015, and New Jersey has committed to reduce consumption 20% by 2020. These commitments are based upon decades of experience and numerous technical and economic potential studies. American Council for an Energy-Efficient Economy, *State EERS and RPS and Activity*, 2007.

Regardless of the specific form of performance incentive, the utility should only receive an incentive if it meets or exceeds explicit performance goals for energy savings and resulting net economic benefits. Some performance incentive could be available for attaining those goals, but the available incentive should grow as utility achievements surpass the goals.

In addition to incentives, some states employ penalty provisions for poor performance. In summary, any shareholder incentive mechanism should meet at least the following criteria:

- No reward for poor performance relative to a reasonable energy efficiency achievement goal.
- Some reward for achieving challenging energy efficiency goals.
- Highest rewards for substantially surpassing challenging energy efficiency goal.
- A substantial share of the net benefits (shared savings) should benefit customers.

Table 2.
**Ratemaking Treatment of Energy Efficiency in States with High Levels of Investor-Owned Utility Energy Savings in 2005 or 2006**

| Jurisdiction | Entity | Formal or Informal Energy Goal[1] | Recovery of Direct Program Costs[2] | Treatment of Utility Financial Disincentive to Energy Efficiency | Performance Incentives | Annual Savings Achieved in 2005 or 2006[3] |
|---|---|---|---|---|---|---|
| Minnesota | Interstate Power & Light | Yes | Yes | No[4] | Yes | 2.9 % |
| California | SDG&E | Yes | Yes | Decoupling | Yes | 2.0 % |
| California | Southern California Edison | Yes | Yes | Decoupling | Yes | 1.7 % |
| California | PG&E | Yes | Yes | Decoupling | Yes | 1.4 % |
| Massachusetts | Massachusetts Electric Co. | No | Yes | Decoupling | Yes | 1.3 % |
| Connecticut | Connecticut IOUs | Yes | Yes | Decoupling | Yes | 1.1 % |
| Vermont | Vermont Energy | Yes | Yes | No | Yes | 1.0 % |

1 American Council for an Energy-Efficient Economy, State EERS and RPS and Activity, 2007
2 Kushler et al, Aligning Utility Interests with Energy Efficiency Objectives: A Review of Recent Efforts at Decoupling and Performance Incentives, October 2006.
3 Nichols, David. Pre-filed Testimony in South Carolina Docket 2007-358-E, January 2008, Exhibit No.6.
4 Minnesota abandoned its lost revenue adjustment mechanism in favor of substantial performance incentives several years ago.

Responses to critiques of decoupling.

Some critics contend that decoupling rates effectively compensate utilities for lack of use of their products. This view of decoupling rates illustrates an unfortunate assumption about the nature of utilities' "products." Regulated utilities do not operate in the "free market." Instead, they provide a resource and a service within a regulatory framework. Regulation inherently creates financial incentives that encourage utilities to invest in certain resources and discourage them from investing in others. Thus, utilities should not be viewed as simply providers of as many kilowatt-hours (or therms) as possible. Instead, utilities should be viewed as providers of safe, reliable energy services at least cost and with minimal environmental impact. This view makes energy efficiency the most profitable investment for utilities results in most overall benefits for the state economy, consumers, public health and the environment. Decoupling is consistent with this view and can result in the delivery of better quality, lower cost "products" to utility customers.

Similarly, some critics of decoupling mischaracterize decoupling as "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 consumer consumption."[9] This is an obvious mischaracterization, as the author states that the "revenue stream" and "utility earnings" are both guaranteed. Only in the theoretical case where costs are certain and not subject to control can this statement be true. However, decoupling provides an even greater cost-control incentive because the effects of poor cost-control are not masked by growth-driven revenue increases. In fact, the current regulatory structure imposes unfair costs on customers.

The use of growth as a rate-mitigation tool results in higher total costs for consumers and increased environmental harm from energy use. The benefits are illusory: delaying rate adjustments to allow the recovery of *approved* fixed costs is not cost savings but cost deferral. Over the long term, all customers will benefit from decoupling combined with ambitious energy efficiency requirements, through reduced costs and improved reliability.

Depending on the nature and pace of the energy efficiency procured, it is possible that some consumers will see short-term increases in their rates. We consider this rate adjustment effect acceptable, however, for several reasons. First, regulators are likely to adjust rates to allow the recovery of *approved* fixed costs with or without decoupling: with decoupling they do so through modest, periodic true ups; under traditional regulation they do so through more dramatic, less frequent rate adjustments. Second, with decoupling, total energy costs decline and, over time, all energy bills will decline. Third, decoupling mechanisms protect consumers from utility over-recovery of fixed costs. Finally, it is possible to target efficiency programs to serve low-income consumers

[9] Kowalczyk, I, "Additional Comments in PUE-2007-00049," MeadWestvaco Corporation letter to Virginia State Corporation Commission, August 21, 2007.

and to increase low-income protection programs to ensure that any short-term increase in rates does not result in a decline in service.

There are some critics oppose the isolation of utility revenues from other factors such as the normal business risk associated with weather. In fact, mechanisms to account for weather fluctuation are used in both decoupling and other regulatory circumstances. These well-established methods are routinely used in decoupling mechanisms to avoid reallocation of weather risk by using weather-adjusted retail sales rather than actual sales to calculate appropriate rate true-ups.[10] Regulators will be able to make weather-related adjustments before determining whether or not utilities have met specified efficiency targets.

Some critics prefer to limit decoupling to residential and commercial customer service classes. We disagree with this approach. The reductions in annual energy use that result from energy efficiency will benefit customers in all classes. Moreover, some of the most cost-effective efficiency opportunities lie with industrial customers. However, it may be appropriate to design the decoupling mechanism to ensure that there is no unjustified shifting of recovery of revenues from one class of customers to another.

Some other critics are concerned that decoupling sends an inappropriate price signal to customers when a portion of their bill goes up even though they are making the effort to conserve. Although this effect is real, it is insignificant. Consumers who invest in energy efficiency can reduce their energy bills by as much as 30 percent or more. In contrast, the modest adjustments to their bill due to decoupling are unlikely to fluctuate more than a few percentage points, and the fluctuations can go in either direction. Given the relative size of bill savings and rate adjustments, we do not believe that the rate adjustments will discourage consumers from improving efficiency. In addition, as utilities increase their investments and efforts, a much larger number of consumers will have the opportunity to participate in energy efficiency programs, thereby increasing awareness among consumers of the potential scale of bill savings that efficiency can deliver.

Conclusion

We recommend that the Commission indicate in its report due on January 1, 2009, that a properly implemented revenue decoupling policy, that includes energy efficiency performance goals and targets, will make Florida a leader in energy efficiency implementation – ultimately improving the role of utilities as not only sellers of electricity, but providers of energy services. We look forward to continued collaboration with staff on this and other policies that promote energy efficiency in Florida.

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[10] Idaho Power (2006). *Idaho Power's Application to Implement a Rate Mechanism to Mitigate Financial Disincentives to Investment in Energy Efficiency,* Case No. IPC-E-04-15.

Idaho Public Utilities Commission (2007). *Order No 30215 in the Matter of the Petition of Idaho Power Company for Modification of the Load Growth Adjustment Factor within the Power Cost Adjustment (PCA) Methodology,* Case No. IPC-E-06-08.

Sincerely,

/s/ George Cavros

George Cavros, Esq.
On behalf of Southern Alliance for Clean Energy