April 26, 2019

Via Hand-Delivery

Ms. Lora W. Johnson, CMC
Clerk of Council
City Hall - Room 1E09
1300 Perdido Street
New Orleans, LA 70112

Re: Revised Application of Entergy New Orleans, LLC for a Change in Electric and Gas Rates Pursuant to Council Resolutions R-15-194 and R-17-504 and for Related Relief
City Council of New Orleans Docket No. UD-18-07

Dear Ms. Johnson:

Please find enclosed one original and two copies of the **Surrebuttal Testimony and Exhibit of Pamela G. Morgan on Behalf of the Alliance for Affordable Energy** in the above-captioned docket.

Thank you for your attention to this matter. Please contact me if you have any questions with regards to this filing.

Sincerely,

Logan A. Burke

Logan Atkinson Burke
Executive Director
Alliance for Affordable Energy
4505 S. Claiborne Avenue
New Orleans, LA 70125
(504) 208-9761
logan@all4energy.org

Enclosures
cc: Official Service List

BEFORE THE

COUNCIL OF THE CITY OF NEW ORLEANS

REVISED APPLICATION OF	**)**	
ENTERGY NEW ORLEANS, LLC	**)**	
FOR A CHANGE IN ELECTRIC AND	**)**	
GAS RATES PURSUANT TO	**)**	**DOCKET NO. UD-18-07**
COUNCIL RESOLUTIONS R-15-194	**)**	
AND R-17-504 AND FOR RELATED	**)**	
RELIEF	**)**	

SURREBUTTAL TESTIMONY AND EXHIBIT

OF

PAMELA G. MORGAN

ON BEHALF OF THE

ALLIANCE FOR AFFORDABLE ENERGY

APRIL 26, 2019

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I. INTRODUCTION

Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT POSITION.

A. My name is Pamela G. Morgan. My business address is P.O. Box 1263, Tubac, Arizona, 85646. My current position is President of Graceful Systems LLC.

Q2. ON WHOSE BEHALF ARE YOU SUBMITTING TESTIMONY?

A. I am submitting testimony on behalf of the Alliance for Affordable Energy ("AAE").

Q3. ARE YOU THE SAME PAMELA G. MORGAN WHO FILED DIRECT TESTIMONY IN THIS DOCKET ON FEBRUARY 1, 2019, ON BEHALF OF AAE?

A. Yes.

II. PURPOSE OF TESTIMONY

Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am responding to the Rebuttal Testimonies of Mr. Owens and Dr. Faruqui on behalf of Entergy New Orleans ("ENO"). Specifically, I (1) address the comments and concerns Mr. Owens raises regarding the recommendations I made about the decoupling mechanism ENO proposed in its Direct Testimony; (2) describe one additional decoupling mechanism recommendation I have that addresses one of Mr. Owen's concerns; and (3) address the disagreement Dr. Faruqui expresses with regard to my Direct Testimony concerning Lost Revenue Adjustment Mechanisms ("LRAMs"), of which ENO's proposed Lost Contribution to Fixed Costs ("LCFC") mechanism is an example.

III. DECOUPLING

Q5. FOR THE CONVENIENCE OF THE COUNCIL OF THE CITY OF NEW ORLEANS ("COUNCIL"), WILL YOU REPEAT THE DECOUPLING RECOMMENDATIONS MADE IN YOUR DIRECT TESTIMONY?

A. Yes.

1. Remove the decoupling mechanism from any calculation that subjects its effectiveness to a dead-band.[1] In other words, calculate the decoupling adjustment first and then, if a Formula Rate Plan ("FRP") is in place to adjust revenue requirement going forward, apply the dead-band there.

2. Whether the decoupling mechanism remains embedded in the FRP or not,[2] clarify in the tariff that decoupling will operate only on revenues ENO receives from energy- and demand-driven billing determinants, and not on either:

    a. Revenues from customer charge billing determinants or minimum bill requirements in tariffs; or

    b. Revenues collected under tariff riders that are subject to full reconciliation (*i.e.*, ENO receives only the costs within the rider, not more or less depending on its sales).

[1] A dead-band is most typically a range of variances for what is being measured, such as earned return on common equity for ENO or power costs, within which no rate action occurs to handle the variance. For example, if a power cost adjustment mechanism had a dead-band of $50 million, any variance between the test year amount and the actual would not be subject to collection or return unless it exceeded $50 million either way. ENO's 'dead-band' is more of a trigger. No rate change would happen under its Formula Rate Plan ("FRP") unless the earned return on equity variance from the baseline (as calculated) was greater than 50 basis points. Once that point is reached, all of the variance becomes subject to return or collection.

[2] It may be easiest and most transparent to extract the decoupling mechanism from the FRP and have a stand-alone tariff. This is not necessary, however, so long as the changes I recommend occur.

3. Clarify in the FRP tariff that the decoupling comparison being made is between the most recent approved throughput-based revenues for fixed costs and the actual revenues ENO receives for fixed costs. The most recent approved throughput-based revenues for fixed costs would be those approved in this general rate case or those ensuing from any future FRP (if the Council approves this regulatory mechanism) that results in new rates and, thus, new throughput-based revenues for fixed costs.

Q6. DOES ENO COMPLETELY REJECT THE RECOMMENDATIONS YOU MADE REGARDING A DECOUPLING MECHANISM FOR THE COMPANY?

A. No. I appreciate the testimony of Messrs. Klucher, Thomas, and Owens that the recommendations I made for modifying the decoupling proposal ENO submitted in this case offer the potential for finding common ground, may have merit, and may be such that ENO could be supportive provided their concern regarding recovery of revenue lost to their energy efficiency programs is addressed.[3]

Q7. DO YOU AGREE WITH ENO'S OBSERVATION THAT YOU DID NOT PARTICIPATE IN, OR REVIEW, THE MANY PROCEEDINGS REGARDING DECOUPLING THAT PRECEDED ITS DECOUPLING PROPOSAL IN THIS CASE?

A. Yes. I did not participate in any of the proceedings or workshops that led to the Council's Resolution No. R-16-103, including the decoupling examples ENO prepared before

[3] *See* Rebuttal Testimony of Joshua B. Thomas at 3:20-22 (Mar. 2019) ("potential to find common ground"); Direct and Rebuttal Testimony of Matthew S. Klucher at 22:16-20 (Mar. 2019) ("may have some merit); Rebuttal Testimony of D. Andrew Owens at 5:13-17; 6:19–7:2 (Mar. 2019) ("Owens Rebuttal") ("would be supportive").

submitting its proposed decoupling mechanism in this case. Rather, I approached its mechanism with eyes steeped in a comprehensive study of decoupling mechanisms across the country that I performed in 2009 and then in 2012-13, and regulatory proceedings regarding decoupling in which I participated before and after that. I also drew on my general regulatory experience with Portland General Electric during the years I was employed first in its regulatory department and then as its Vice President of Regulatory Affairs.

Q8. DO YOU AGREE WITH MR. OWENS THAT YOUR RECOMMENDATIONS ARE NOT RELEVANT TO A DETERMINATION OF WHETHER ENO'S PROPOSAL COMPLIES WITH THE SPECIFIC DECOUPLING STRUCTURE ESTABLISHED IN THE COUNCIL'S DECOUPLING RESOLUTION?

A. I do not entirely agree with Mr. Owens on this. I do find that the Resolution – and ENO's FRP/decoupling mechanism proposal – combines cost recovery and revenue recovery in a way I find somewhat confusing. Revenue decoupling is a regulatory mechanism that targets revenue solely. Some states/utilities developing/implementing decoupling have simultaneously worked on how to make sure that the authorized revenues to which decoupling compares actual revenues year by year change to reflect cost increases or decreases that the utility experiences. It is most transparent for everyone, however, if these goals are achieved sequentially, not simultaneously. This is why I recommended performing the revenue decoupling calculations first—designed into a temporary refund or surcharge—and then making any necessary going-forward rate adjustments for the outcome of the FRP if the Council approved it. In other words, the recommendations in

my Direct Testimony attempted to de-link the revenue (decoupling) and cost recovery (FRP) adjustments.

This approach reconciled for me ordering paragraphs 2 and 9 of the Council's Resolution No. R-16-103. Ordering paragraph 2 describes, on the one hand, a decoupling calculation based on the fixed cost revenue requirements calculated in that year's FRP filing and new rates based on that revenue requirement and, on the other hand, in ordering paragraph 9 describes an annual true-up to review and adjust the allowed revenues. Revenue decoupling is always backward looking; a true-up for what actually happened compared to what was expected to happen. One can certainly update the "what was expected" component for the subsequent decoupling cycle, but that is a separate matter from the decoupling adjustment itself.

My recommendations responded to both ordering paragraphs and to that part of ordering paragraph 2 that contemplated the possibility that the Council would adopt a decoupling mechanism even if it revised or denied ENO's proposed FRP.

My second recommendation added to this first step a limitation that the decoupling applies only between the revenue assumed for ratemaking that represented fixed costs designed into volumetric or demand-based charges (other than minimum bills) and the actual revenue received under the portions of those volumetric or demand-based charges that were for fixed cost recovery.

My last recommendation supported the first two by suggesting that the tariff – whether decoupling only or decoupling and FRP – make clear that the revenue comparison between ratemaking assumed revenues and actual revenues happened first. Then, if there was an FRP, ENO could use the revenue emerging from the decoupling mechanism in the

FRP calculations to determine whether the earned return on common equity was inside or outside of the dead-band and to make any found going-forward rate changes necessary if it was outside the dead-band.

Q9. DID YOUR RECOMMENDATIONS ALSO ACCOMMODATE ORDERING PARAGRAPH 7 OF THE COUNCIL'S RESOLUTION NO. R-16-103?

A. Yes. Ordering paragraph 7 specifies that there be no weather normalization to the revenue for the purpose of decoupling. This is the most common approach across jurisdictions. The actual revenue is not adjusted for weather while total revenue assumed for ratemaking (setting the levels of billing determinants for each rate schedule) generally is done on a 'normal weather' basis. I am not certain whether the going-forward rate changes that emerge from an FRP cycle are based on weather-normalized revenue or not. By having the revenue decoupling adjustments happen first, however, using actual revenues without regard to weather, the mechanism can honor this paragraph of the Resolution without interfering with what might make sense for going-forward rates based on the FRP.

Q10. DO YOUR ANSWERS ABOVE REFLECT A BETTER UNDERSTANDING OF ENO'S FRP (AS PROPOSED AND AS APPLIED IN THE PAST) THAN YOU PREVIOUSLY HAD?

A. Yes. My current understanding is that the FRP is like a mini-rate case in which some items are not re-litigated, notably return on common equity, and a much shorter time schedule applies. Using a historical test year, called the Evaluation Period ("EP") in the FRP, and just like period I in ENO's general rate case filing, ENO makes certain, specified adjustments to its actual costs (and revenues, although this is what I am recommending

decoupling apply to first), and if the EP shows under- or over-earning, it make a respective going-forward rate adjustment after Council review and approval.

Occasionally, some around the country have argued against revenue decoupling and proposed more frequent rate cases instead. Frequent rate cases, however, are not a substitute for decoupling. For jurisdictions that use a future or forecast test year, frequent rate cases can decrease the difference between the revenue assumptions used for ratemaking and the actual revenues. This result requires that (1) actual weather closely match the future 'normal' weather assumed for ratemaking, (2) the forecasted energy efficiency savings closely match those achieved; and (3) little to no non-utility energy efficiency or conservation occurs. These are somewhat heroic assumptions. With a historical test period, the proposition that all three are true becomes even more unlikely. Moreover, the near-term incentive to increase sales to achieve throughput-driven revenue, remains. What also remains is the utility's fear of losing this revenue through its energy efficiency programs, should it be on a historical test year or even just be wrong about the savings it forecast to achieve in a future test year.

Mr. Owens[4] is clear that it is this last matter with which ENO is particularly concerned and why it proposed the LCFC. With the LCFC, ENO would calculate and charge during any given year, the per kWh margin (or contribution to fixed costs) it calculates that it will "lose" as customers participate in that year's energy efficiency programs. This recovery, subject to some form of later true-up, will stop at the end of that year; it does not cumulate. Even though the kWh savings from that now-concluded

[4] *See* Owens Rebuttal at 9:13-21.

program year, and thus the 'lost margin,' would continue into the next year, ENO would forgo recovering this 'lost margin' for the period of months that it prepares, files, processes and awaits the Council's decision on its FRP. If the FRP filing shows an earned return on common equity inside the dead-band, ENO will forgo recovering that program year's "lost" margins until the FRP results in a new, historic test year that would reflect actual kWh sales, and thus the sales lost to energy efficiency programs by comparison with the past historic test year.

Q11. IN LIGHT OF THE ABOVE, DO YOU STILL RECOMMEND THAT THE COUNCIL ADOPT A DECOUPLING MECHANISM WITH THE CHANGES YOU OUTLINED?

A. Yes. While I cannot say whether the decoupling mechanism ENO proposed is exactly what emerged from all the years of back and forth on decoupling amongst the stakeholders, I do strongly urge the Council to adopt my recommendations:

(1) approving a revenue decoupling mechanism that operates separately from any FRP, is backward-looking in its reconciliation, and removes the need for any LCFC; and

(2) ensuring that there are no gaps that could penalize ENO for achieving the most energy efficiency that it can, whether that occurs directly through ENO's programs or through what ENO influences indirectly through market transformation, support of energy codes and standards, and general energy conservation education and support.

Q12. DO YOU HAVE AN ADDITIONAL RECOMMENDATION FOR THE DECOUPLING MECHANISM?

A. Yes. I agree with Mr. Owens that the decoupling/FRP mechanism as proposed does not adequately address the LCFC issue and that the recommendations I made in my Direct

Testimony may not fully resolve the issue. My prior recommendations will ensure that (1) ENO recovers any revenues designated for fixed cost recovery but lost because of customer usage changes pursuant to its energy efficiency programs; and (2) ENO returns to its customers any collection of revenues in excess of ENO's necessary fixed cost recovery that are gained because of customer decisions outside of ENO's control. This result is achieved because of the backward-looking comparison of actual to ratemaking assumed throughput-driven fixed cost revenues year by year.

ENO is concerned, however, that because any ratemaking based on this backward-looking comparison will occur only after the year is over, it may still 'lose' revenue because of its energy efficiency programs due to the lag in recovery. Of course, ENO may have over-recovered fixed costs based on throughput in a given year, but I will assume for the moment that has not occurred. I suggest this is primarily an accounting question: what is necessary under Generally Accepted Accounting Principles ("GAAP") for ENO to 'close its books' for the calendar year subject to decoupling; *e.g.* to close the books on Calendar Year ("CY") 2020, with the amount of revenue post-decoupling, even though the refund or surcharge will occur later? Subject to confirmation by accountants, I recommend that the Council order ENO to book the difference between rate case throughput-driven revenue and actual throughput-driven revenue (per rate class) on a monthly basis, applying a Council-approved carrying charge evenly to balances owed customers and balances owed the utility. The net result of these monthly bookings at the end of the year should also accrue carrying charges until the required ratemaking adjustment occurs.

The decoupling filing will show the net calculation of the monthly differences for each class. For any rate class for which the net amount shows more actual revenues

collected than assumed for ratemaking purposes, ENO would design a rate credit (cents/kWh) to return the refund to ratepayers over the subsequent twelve months. For any rate class for which the net amount shows fewer actual revenues collected than assumed for ratemaking purposes, ENO would design a rate surcharge or refund (cents/kWh) to collect the shortage or return the overage, respectively, during the subsequent twelve months. All decoupling adjustments would take effect on the same date each year.

ENO is correct that usage may differ from what was expected in this design. It should track the amounts actually returned or collected, with carrying charges, in the same way that it is tracking the difference between the actual revenues and the ratemaking assumed revenues. This difference can be rolled into the next year's decoupling filing until the net credit or surcharge is fully returned or collected, respectively.

IV. THE LOST CONTRIBUTION TO FIXED COSTS MECHANISM

Q13. WHAT WAS YOUR RECOMMENDATION REGARDING THE LCFC IN YOUR DIRECT TESTIMONY?

A. In my Direct Testimony, I recommended that, assuming the Council adopted a decoupling mechanism with the changes I suggested, the Council find ENO's proposed LCFC unnecessary to enable ENO to recover its fixed costs notwithstanding sales lost to its energy efficiency programs. Decoupling will ensure that ENO recovers the amount of fixed costs the Council approved recovery of in its last rate case or—if the Council approves the proposed FRP mechanism and rates are reset—the level of fixed cost recovery assumed for purposes of those rates.

Above, I addressed the additional recommendation I developed to assure ENO that decoupling will cover the fixed cost revenue it expects to lose because of energy efficiency savings through its programs. Assuming the Council adopts all of the changes I recommended to ENO's proposed decoupling mechanism, I continue to suggest that the Council find the LCFC unnecessary.

Q14. DOES DR. FARUQUI, TESTIFYING FOR ENO, DISAGREE WITH SOME OF THE REASONS YOU OFFERED FOR WHY DECOUPLING IS SUPERIOR TO THE LCFC?

A. Yes, he does. The disagreement between us is academic, however, if the Council adopts the decoupling as I have recommended. That said, Dr. Faruqui offers a few points to which I will respond.

I criticized the "level playing field" argument Dr. Faruqui made repeatedly in his Direct Testimony[5] as support for ENO's LCFC. I noted that the risks associated with utility investments in energy efficiency differ significantly from those associated with electricity generating plants. Specifically, energy efficiency investments present no operational risk, no risk of capital additions and possibly regulatory lag in recovering those costs, and no risk of investment write-offs because the technology has become obsolete.

Dr. Faruqui addresses only the last risk difference, arguing that utilities could face obsolescence in the energy efficiency technologies their programs promote, such as the obsolescence of compact fluorescent lightbulbs as LED light bulbs became a mature technology. Dr. Faruqui did not cite any instance in which a utility was forced to write-off some investment in energy efficiency technology because of obsolescence, and I am aware

[5] *See, e.g.*, Revised Direct Testimony of Dr. Ahmad Faruqui at 23:7 (Sept. 2018).

of none. I am aware, through direct personal experience, of a utility facing a write-off of a significant amount of its investment in a nuclear generating plant when that plant became economically obsolescent. Hypothetically, I suppose that a write-off of energy efficiency investment could occur, but the much shorter time frames between program planning and implementation—usually with full regulatory support—make it highly unlikely. Moreover, the operational and capital addition risk differences remain.

Notwithstanding that I have doubts about the validity of an argument for any particular utility energy efficiency program policy, I agree that utilities have sought and typically received some regulatory coverage for the portion of their approved revenue level allocated for fixed costs (costs not varying with usage) and charged to ratepayers on a volumetric or demand basis. In the 1990s, LRAMs were the common means of doing this. As experience was gained with these LRAMs, their adverse consequences became clear:

1. LRAMs guaranteed utilities revenue for fixed cost recovery even if sales gains elsewhere (*e.g.*, weather-driven sales or new customers) offset the losses assumed to be occurring because of the utility's energy efficiency programs;
2. LRAM proceedings were highly contentious because the usage "lost" to the energy efficiency programs could be determined only by arduous evaluation, measurement and verification ("EM&V") studies, that often required a long time to prepare making it impossible for utilities, stakeholders or regulators to know how much the utility should recover until the studies were done;

3. LRAMs addressed only sales "lost" to energy efficiency programs suitable for subsequent EM&V studies. They provided the utility no coverage for market transformation programs, for which EM&V is difficult if not impossible, nor indirect utility efforts, such as support for codes and standards or education for utility customers to help them engage in conserving behavior.

Consequently, many states switched to a decoupling mechanism as a way to avoid these adverse consequences. Dr. Faruqui and I agree that decoupling is a way to address what he has called "recovery of fixed costs."[6]

Q15. DO YOU AND DR. FARUQUI AGREE THAT NATIONAL DEMAND-SIDE MANAGEMENT ("DSM") AND ENVIRONMENTAL GROUPS SUPPORT RECOVERY OF FIXED COSTS?

A. Yes. The materials Dr. Faruqui cites for this proposition are the same as those I cited, quoted from, and in one case attached as a AAE Exhibit PGM-3 to my Direct Testimony. It seems pointless to argue about what they say. My understanding of them remains that both the Natural Resources Defense Council ("NRDC") and the American Council for an Energy-Efficient Economy ("ACEEE") strongly favor decoupling over an LRAM as the best policy to address "recovery of fixed costs." For example, I found this quote in the ACEEE report both Dr. Faruqui and I reference:

> ACEEE strongly recommends full revenue decoupling as the preferable approach to address *both* lost margin recovery and the throughput incentive. While LRAM does address recovery of fixed costs, it does not remove the throughput incentive. Furthermore,

[6] Rebuttal Testimony of Dr. Ahmad Faruqui at 6:10-12 (Mar. 2019) ("Faruqui Rebuttal").

while under-collection of authorized revenues is addressed by both LRAM and decoupling, only symmetrical decoupling requires over-collection of revenues to be refunded to customers.[7]

Just as Dr. Faruqui "clarified" that by "LCFC recovery" he actually meant "recovery of lost fixed costs, be it through an LRAM or decoupling,"[8] I am happy to clarify that the NRDC report we both cite details serious concerns about LRAMs—rather than say NRDC does not support LRAMs, and that ACEEE only expresses its preference for decoupling and details the disadvantages of LRAMs compared to decoupling.

Q16. IS THERE A REASON YOU SUPPORT DECOUPLING OVER AN LRAM THAT THE NATIONAL DSM AND ENVIRONMENTAL GROUPS DO NOT EMPHASIZE AND DR. FARUQUI DOES NOT ADDRESS?

A. Yes. I support decoupling over an LRAM approach such as the LCFC because decoupling is a bridge to a time when energy efficiency is a service, or part of a service, that produces its own revenue, rather than a program that gives money or other incentives away to people that can purchase electricity only from a monopoly utility.

As I explained in my deposition, we have utilities (or, in some states, third-party administrators) providing energy efficiency programs because of the decisions made early in the last century to structure the market such that companies making electricity-using equipment and companies producing and distributing electricity were completely separate. This division had, and still has, nothing to do with how electricity users actually make

[7] ACEEE, *Aligning Utility Business Models with Energy Efficiency*, https://aceee.org/sector/state-policy/toolkit/aligning-utility. For the Council's convenience, pertinent portions of the toolkit are attached as AAE Exhibit PGM-4.
[8] Faruqui Rebuttal at 6:9-10.

decisions. People decide to try to maintain a given temperature in their home or business or to get a certain level of lighting or to manufacture goods for sale. They never decide, per se, to buy a certain amount of electricity. Nonetheless, people are responsible for the amount of electricity that their equipment uses as they go about trying to whatever job they are trying to do with that equipment. Sometimes, people do not even choose the equipment that they use in this attempt. Other times they do choose the equipment but have little understanding of how much electricity input the equipment will require from time to time as they try to do the job they set out to do.

Energy efficiency programs leave all this in place, adding better information and/or financial incentives to persuade individuals to choose equipment that requires less electricity than other equipment choices that are part of the same kind of job a person or organization might be trying to do. But the programs leave responsibility with the electricity user to actually get the savings the equipment could make possible, and there is generally no feedback loop by which a program participant can know this is happening.

This is the best we can do while the old market divisions remain in place. One can imagine a service to a person or organization that bundles the equipment and electricity—along with any information or feedback necessary—to assist them in achieving their goal (completing the job they are trying to do). The jobs they are trying to do are likely to include an economic decision grounded in the trade-off between how much of that job they require and the cost of achieving that result, but may include other outcomes and trae-offs as well. For example, if a person was trying to maintain a comfortable temperature in the workplace of their organization, the organization may pay a service provider to supply any necessary equipment, structural modifications and energy inputs necessary, charging one

price that varies according to the temperature maintained in that space, as set by the organization from time to time. Ideally, the service would include accessible information so that the organization could make the necessary trade-offs between levels of comfort and the cost of obtaining each level.

Decoupling enables a slow transition to this type of service and the many others that energy providers might devise to help people do the jobs they are trying to do. Decoupling means that utilities and their regulators can experiment with service offerings and rate designs without knowing in advance exactly how much revenue each will produce and for which billing determinants. With a well-designed decoupling mechanism, perhaps ENO will want to experiment with services that further its goal of becoming customer-centric. The LCFC will not help it get there. Decoupling could.

V. CONCLUSION AND SUMMARY OF RECOMMENDATIONS

Q17. HAVING REVIEWED AND COMMENTED ON ENO'S REBUTTAL TESTIMONY, WHAT ARE YOUR CONCLUSIONS REGARDING ENO'S PROPOSED LCFC AND DECOUPLING MECHANISMS?

A. I continue to recommend the three changes I developed for ENO's proposed decoupling mechanism, with the addition of a fourth change that authorizes ENO to calculate the difference between actual and authorized through-based revenues for fixed cost recovery on a monthly basis during any year, applying a Council-set carrying charge rate evenly to balances owed customers and owed ENO. This should ensure that, on an accounting and financial reporting basis, neither ENO nor its customers suffer any regulatory lag with respect to the decoupled revenues.

Q18. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. In brief, I recommend that:

- The Council approves the four changes I recommend to the decoupling mechanism ENO has embedded within its proposed FRP.
- The Council rejects the LCFC ENO proposes as part of its DSMCR rider.

Q19. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

AFFIDAVIT

STATE OF AZ)
) ss.
COUNTY OF Pima)

I, Pamela Morgan, do hereby swear under the penalty of perjury the following:

That I am the person identified in the attached prepared testimony and that such testimony was prepared by me under my direct supervision; that the answers and information set forth therein are true and accurate to the best of my personal knowledge and belief; and that if asked the questions set forth herein, my answers thereto would, under oath, remain the same.

Pamela A. Morgan

Pamela Morgan

SWORN TO AND SUBSCRIBED BEFORE ME THIS 17 DAY OF April, 2019

LENORE CASILLAS
Notary Public - State of Arizona
PIMA COUNTY
My Commission Expires
April 30, 2021

Lenore Casillas

NOTARY PUBLIC

My commission expires: 04/30/2021

Exhibit PGM-4

American Council for an Energy-Efficient Economy, *Aligning Utility Business Models with Energy Efficiency*

Published on *ACEEE* (https://aceee.org)

Aligning Utility Business Models with Energy Efficiency

Click here [1] for a printer-friendly version of this page.

Energy efficiency in the utility industry has grown substantially in the past decade, largely due to its benefits in addressing many of the industry's most pressing concerns: system reliability, environmental regulations, and rising costs. Today the utility industry is rapidly evolving as it adapts to several new trends, including greater use of distributed energy resources, flattening energy sales, a need for emissions reductions, increasing penetration of plug-in electric vehicles, and growing attention to transmission and distribution constraints and grid resilience. In this new era of utility transformation, energy efficiency will play an important role as a low-cost utility resource that can help address these challenges by lowering costs, reducing emissions, and improving reliability.

At the same time, the traditional utility business model has continued to impede development of energy efficiency resources. For example, many utility stakeholders have viewed spending on energy efficiency programs as having a detrimental effect on utility revenues by reducing sales of the utility's core product, electricity or natural gas. Their reasoning is straightforward: While a utility's variable costs change in proportion to sales volume, short-term fixed costs associated with providing service do not. Therefore, a reduction in sales due to efficiency improvements leads to a reduction in revenue that is larger than the costs avoided. In addition, to the extent that energy efficiency displaces other capital investments, a utility's associated earnings opportunities are reduced. Together these factors affect the utility's balance sheet, reducing the financial benefits to its investors and providing a strong incentive for utilities not to invest in energy efficiency.

Comprehensive strategy to achieve high utility sector energy efficiency savings

1. Establish specific energy efficiency savings targets
2. Align utility ratemaking with energy efficiency by incorporating:
    1. Program cost recovery
    2. Full revenue decoupling
    3. Earnings opportunities tied to performance toward savings targets

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ACEEE research shows that a comprehensive policy strategy—both setting specific energy efficiency targets and providing opportunities for utilities to earn a return on efficiency investments and collect authorized revenues—is most closely associated with achieving high savings. Such a strategy is essential to sustaining long-term utility interest in capturing cost-effective energy efficiency resources. While many states have adopted a robust set of policies, many others still have not. For energy efficiency to play a large and sustained role in the utility of the future, more states need to adopt and maintain an optimal mix of policies that align utility business models with energy efficiency.

This toolkit covers the second part of that comprehensive strategy: aligning utility ratemaking with energy efficiency (information on utility energy savings targets can be found here [2].)

Utility Ratemaking

Electric and gas utilities are regulated as natural monopolies. Regulatory bodies, through judicial processes, set rates to ensure utilities are able to recover the cost of providing service while earning a reasonable return on investments. Utility rates recover a variety of costs, including expenses associated with operation of the system, fuel, depreciation costs associated with assets (generation, transmission, or distribution), and taxes. Rates also recover debt costs associated with financing and a return on equity, the reasonable rate of return for shareholders. The total cost of service, including the return on equity and debt, produces an annual revenue requirement. The revenue requirement represents the total revenue a utility needs to recover from customers to provide service. The revenue requirement is allocated by customer class and then converted into rates using billing determinants (therms, kWh, kW, and customer charges).

Types of Regulatory Tools

ACEEE finds that there are three general categories of regulatory tools that better align energy efficiency as a utility resource with the traditional utility ratemaking principles described above (each of these and various subcategories are described in more detail below). The three categories are:

- *Program cost recovery.* Recovery of the direct costs of energy efficiency programs
- *Removal of throughput incentive.* Recovery of lost contributions to fixed costs and elimination of throughput incentive (profits linked to increased energy sales) via symmetrical revenue decoupling
- *Performance incentives.* Creation of performance-based earnings opportunities for energy efficiency investments

These tools, combined with specific energy efficiency targets, can help utilities consider the value of energy efficiency in a way similar to their evaluation of other supply-side investments.

Program Cost Recovery

Energy efficiency program costs typically include program administration, implementation, and evaluation. Timely program cost recovery is an essential requirement for utility program implementation. According to the Institute for Electric Innovation [3] (IEI), program cost recovery is already in use in nearly every state. There are several options for achieving this, including recovery via base rates or through an additional charge, known as a rider, on a customer bill. We expand our discussion of the common approaches to program cost recovery below.

Public Service Surcharge

This method of recovering program costs relies on a customer bill surcharge, often known as a system benefits charge or public service surcharge. For example, states may require utilities to levy a specified charge (e.g., 3 mills or 0.3 cents per kWh) on all customer bills to fund energy efficiency programs.

In Connecticut, for example, **c**osts for energy efficiency programs are recovered through a Combined Public Benefits (CPB) charge. The CPB charge includes a Renewable Energy Investment Charge, which supports renewable energy programs; a Systems Benefit Charge, which allows electric companies to recover costs from implementing a variety of public policies, such as programs for low-income customers; and a Conservation and Load Management (C&LM) Charge,

which supports energy efficiency programs. The C&LM charge is set at 0.3 cents per kWh, but it can be increased by up to an additional 0.3 cents per kWh through an adjustment mechanism (See Conn. Gen. Stat. § 16-245l [4]).

Recovery of Costs in Base Rates

The advantage of recovering costs through general rate cases is that doing so is consistent with existing regulatory rules and procedures. Utilities can therefore be reasonably assured of timely cost recovery, particularly if there is a frequent balancing mechanism in place between rate cases.

Capitalization

A less common approach to cost recovery involves treating efficiency program costs like an investment in physical capacity, adding the unamortized cost and an approved return on capital to the revenue requirement, which is then passed on to the customer as an increase in per-kWh or per-therm rates at the next rate case. Although capitalization has been used in the past by some states, it is no longer the preferred method of cost recovery. This is because capitalization spreads out cost recovery over an extended period, raises the total cost of efficiency programs, and allows a return on capitalized program costs that is not tied to program performance.

In practice, according to IEI [3], in many states recovery of efficiency program costs takes place through some combination of base rate adjustments, system benefits charges, and other surcharges.

Removal of Throughput Incentive and Lost Margin Recovery

Energy efficiency programs are designed to reduce the amount of electricity and gas that customers use, but this reduction in sales can impact revenue recovery. Lost margin recovery attempts to mitigate this impact and is one of the most widely debated areas of policy related to utility sector energy efficiency programs.

Symmetrical Revenue Decoupling

Of those states that have enacted or are planning to enact policy for lost margin recovery, symmetrical revenue decoupling is the most commonly used or proposed mechanism. Decoupling is a policy meant to sever the link between utility sales and revenues by ensuring full cost recovery of authorized revenue requirements, no matter the level of sales or reason for change. In practice, a periodic adjustment (also known as a true-up) adjusts revenue recovery up or down, based on the difference between projected and actual sales. The adjustment is symmetrical, meaning refunds for customers in the event of over-recovery or charges for customers in the event of under-recovery. As a result the utility is able to recover authorized revenues regardless of sales, removing the disincentive to invest in energy efficiency programs due to reduced sales.

Interest in decoupling has continued to grow. In 2007, 15 states had decoupling for gas utilities and 5 states had policies for electric utilities. In 2015, 23 states had decoupling for gas utilities and 14 had policies for electric utilities. These numbers indicate that at least one major utility in each state has implemented decoupling.

Proponents of decoupling argue that, because the throughput incentive drives a wedge between a utility's responsibility to deliver investment returns to its shareholders and the promotion of energy efficiency among its customers, some mechanism of lost margin recovery is essential to the realization of robust energy efficiency gains. Other advantages of decoupling include shielding utility

revenues from fluctuations in sales, to a certain extent, and reducing the need for frequent rate cases with a corresponding reduction in regulatory costs.

One major criticism of decoupling is that it removes the normal business risk faced by utilities by guaranteeing they will receive their authorized revenues, no matter the cause of any shortfall (whether from the efficiency program itself, weather, the economy, or something else). In response, some commissions have approved the use of formulas for calculating the true-up that attempt to account for factors other than the efficiency program. Some commissions have also considered reducing the authorized rate of return for utilities with decoupling. We do not recommend that approach, because it would be seen as a disincentive and contrary to the original intent of these business model adjustments. Furthermore, symmetrical decoupling effectively shields customers from the risk of over-recovery of costs. Pamela Morgan's comprehensive study [5] of decoupling adjustments found that about 63% of decoupling adjustments were surcharges and 37% were refunds.

A 2009 article [6] by S. Kihm argues that decoupling is appropriate only in situations where regulators keep a utility's allowed rate of return close to its cost of capital, and that utilities earning a return on capital investments greater than the cost of capital still face the Averch–Johnson (A-J) effect, which is the incentive to acquire additional capital. Any difference between the two encourages large-scale investments by the utility because doing so raises the stock price, to the benefit of investors. This situation holds whether or not a decoupling mechanism is in place. Therefore, while decoupling may make utilities indifferent to fluctuations in sales, it does not necessarily remove the incentive to make large supply-side investments that benefit shareholders.

For more information on decoupling theory and application, see the Regulatory Assistance Project's guide to electricity regulation [7]; for how it has worked in practice, see Morgan's study [5].

Lost Revenue Adjustment Mechanisms

A second means of recovering lost marginal revenue is through a lost revenue adjustment mechanism (LRAM), sometimes referred to as lost contributions to fixed costs (LCFC). This mechanism allows a utility to recover authorized revenues that are reduced specifically as a result of energy efficiency programs. This removes disincentives to invest in efficiency.

Unlike decoupling, this mechanism does not attempt to completely sever the link between revenue and sales. As a result, utilities may still be motivated to increase sales because additional revenues from higher sales outside of the energy efficiency program context can still be retained by the utility. Some states, however, have mechanisms in place to help address concerns regarding the potential for over-collection of fixed costs (see 2015 ACEEE study [8] by Gilleo et al.). For example, in Nevada, utilities are explicitly prevented from over-earning and in recent years have refunded excess revenues to customers.

Finally, LRAMs have other disadvantages compared with symmetrical revenue decoupling. They require a robust evaluation process to accurately estimate savings from the energy efficiency measures because considerable amounts of money can be at stake. The verification challenges can lead to contentious rate cases and an incentive for utilities to maximize savings claims to increase lost revenue recovery. Also, the timing of energy efficiency program development, LRAM determinations, and ratemaking decisions are not always aligned, which can become a challenge to implementation.

The Gilleo et al. study reviewed the 17 states with LRAM policies at the time and found that while LRAM is not a complete substitute for decoupling, it can help bring parties to the table and may be a temporary solution on the way to full revenue decoupling. However ACEEE strongly recommends full revenue decoupling as the preferable approach to address *both* lost margin recovery and the

throughput incentive. While LRAM does address recovery of fixed costs, it does not remove the throughput incentive. Furthermore, while under-collection of authorized revenues is addressed by both LRAM and decoupling, only symmetrical decoupling requires over-collection of revenues to be refunded to customers.

Performance Incentives

While program cost recovery and lost margin recovery mechanisms serve to mitigate the utility disincentive to invest in energy efficiency due to a reduction in sales, these policies do not necessarily provide an *incentive for* such investment or for a certain level of performance. Even with a decoupling mechanism in place, investor-owned utilities often still have an incentive to make supply-side investments to provide greater returns to shareholders.

To incentivize utilities to provide energy efficiency programs for their customers, there should be a reasonable earnings opportunity for the successful implementation of energy efficiency programs. In general, the available incentive should be comparable to the return on investment in supply-side resources such as new generating capacity. Performance incentives are widely used by states that have adjusted utility business models beyond program cost recovery. A 2015 ACEEE study by Nowak et al. [9] reviewed performance incentives in the United States and identified 25 states that had such a policy in place. That research characterized four general types of performance incentives:

- *Shared net benefits incentives* provide utilities the opportunity to earn an amount equivalent to some portion of the benefits of a successful energy efficiency program. The amount is usually a percentage of the positive difference between program spending and the dollar valuation of energy savings achieved. Most incentives in this category also have a savings-based element, a threshold level set as the achievement of a minimum percentage of the energy savings performance goal for the utility. We call it shared net benefits because the incentive amounts are driven by net benefits; the greater the net benefits, the higher the incentive payment amount.
- *Energy savings–based incentives* reward utilities for achieving, and sometimes for exceeding, preestablished energy savings goals, measured in kWh or therms. Often, these energy savings targets for utilities may be tied to or derived from statewide energy efficiency resource standard (EERS) policies. For example, if the utility energy efficiency programs save 100% of the target, they are eligible for some specified incentive payment. Five of the six states with savings-based incentives have EERSs. The amount of the financial incentive the utility earns is often calculated as a percentage of total program spending or budget in a tiered structure (e.g., achieve 100% of the savings target and receive an amount equivalent to 6% of program spending; achieve 110% and receive 8%; and so on), but it is driven by the program energy savings achieved.
- *Multifactor incentives* are those in which the calculation of performance incentive amounts include multiple metrics, not only energy savings or energy savings net benefits. This approach is found in a handful of states where the mechanism is used to forward the achievement of several regulatory and public policy goals at the same time. For example, financial incentives may be tied to energy savings, demand savings, success in reaching low-income customers, and/or measures of customer service quality.
- *Rate-of-return incentives* allow utilities to earn a rate of return based on efficiency spending. This creates a correspondence between demand-side (energy efficiency) spending and supply-side (generation and transmission) investments. For example, a utility may earn a rate of return for efficiency investments equivalent to or comparable to the rate it earns for new energy supply capacity investments. This approach is far less common.

The major advantage of incentives is that they put energy efficiency and supply-side resources on relatively equal financial footing, enabling shareholders to earn a comparable financial benefit on

either investment. An important additional advantage with most of these mechanisms is that they are tied to a specific level of performance rather than spending.

Arguments against incentives include the cost and difficulty of implementing a robust evaluation mechanism to verify savings for performance-based incentives, as well as the view that ratepayers should not have to pay utilities for simply complying with regulatory mandates for energy efficiency. S. Kihm's 2009 article [6] also notes that the difference in scale of investments in energy efficiency programs versus supply-side resources encourages utilities to continue to favor the latter over the former, even when their respective rates of return are equal.

Other Resources:

Up-to-date information on the utility business model tools employed by each state, along with links to relevant dockets and legislation, can be found on ACEEE's State and Local Policy Database [10].

ACEEE Research on Utility Business Models and Utilities of the Future

White paper [11] on business model strategies that create a foundation for the energy-efficient utility of the future. M. Molina and M. Kushler, 2015.

Survey [8] of lost revenue adjustment mechanisms. A. Gilleo et al., 2015.

Updated survey [9] of performance incentives for energy efficiency. S. Nowak et al., 2015.

Discussion of the utility of the future [12], including regulatory models. S. Nadel and G. Herndon, 2014.

Case studies [13] of supportive utility regulation. D. York et al., 2013.

Other Research

Edison Electric Institute study [14] of sustainable utility business models that encourage energy efficiency.

Institute for Electric Innovation survey [15] of state electric efficiency regulatory frameworks, including cost recovery, decoupling, and performance incentives.

Article [16] discussing proper implementation of decoupling, including scenarios in which it will and will not be effective. S. Kihm, 2009.

Pamela Morgan's comprehensive study [5] of the rate impacts of decoupling. Graceful Systems LLC.

Guide to electricity regulation [7] in the United States by the Regulatory Assistance Project.

American Public Power Association's discussion [17] of the effect of energy efficiency on electric utility revenue requirements.

SEE Action guide [18] on aligning utility incentives with investment in energy efficiency.

Detailed description [19] of Connecticut's Combined Public Benefits Charge.

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[19] https://www.cga.ct.gov/2015/rpt/pdf/2015-R-0047.pdf

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **Surrebuttal Testimony and Exhibit of Pamela G. Morgan on Behalf of the Alliance for Affordable Energy** has been served on the persons listed below by electronic mail and/or U.S. First-Class mail, postage prepaid:

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Additionally, pursuant to the New Orleans, Louisiana Code of Ordinances, Ch. 158, Art. III, Div. 1, § 158-236, the following persons have been served with copies of the aforementioned document, in triplicate, via U.S. first-class mail, postage prepaid:

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Washington, DC, this 26th day of April, 2019.

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