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MAR 25 2010

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IN THE MATTER OF THE
GENERIC INVESTIGATION OF
REGULATORY AND RATE
INCENTIVES FOR GAS AND
ELECTRIC UTILITIES

Docket Nos. E-00000J-08-0314
G-00000C-08-0314

**COMMENTS OF FREEPORT-MCMORAN
COPPER & GOLD INC. AND ARIZONANS
FOR ELECTRIC CHOICE AND
COMPETITION REGARDING UTILITY
DISINCENTIVES AND POTENTIAL
DECOUPLING FOR ARIZONA UTILITIES**

Freeport-McMoRan Copper & Gold Inc. and Arizonans for Electric Choice and Competition (hereafter "AECC") hereby submit these Comments Regarding Utility Disincentives and Potential Decoupling for Arizona Utilities in connection with the above referenced matter. These Comments are filed in response to the Notice of Inquiry ("NOI") issued by the Arizona Corporation Commission ("Commission") on February 23, 2010, in connection with the above captioned matter and address the questions set forth in the NOI.

**AECC COMMENTS REGARDING UTILITY DISINCENTIVES
AND POTENTIAL DECOUPLING FOR ARIZONA UTILITIES**

1. What financial disincentives to utilities are created by the implementation of energy efficiency measures?

Response:

AECC is familiar with the various arguments advanced by utilities and other parties regarding claimed financial disincentives that impede utility support of

1 implementing energy efficiency measures. AECC considers these arguments to be largely
2 overstated.

3 The “lost margins” argument is widely recited by utilities and is, in part, an
4 unintended consequence of efforts by regulatory commissions to reduce utility risk
5 through the adoption of fuel adjustor mechanisms. Utilities that are at risk for recovery of
6 fuel and purchased power costs have a natural economic incentive to reduce high energy
7 production costs through energy efficiency. This incentive is evidently reduced when
8 utilities are assured recovery of high marginal fuel costs through fuel adjustor
9 mechanisms. As fuel adjustor mechanisms are an obvious benefit to utilities, the claim
10 that “lost revenue” recovery is necessary to remove the disincentive to undertake energy
11 efficiency is tantamount to requesting a new benefit that is made necessary by virtue of
12 having been awarded a previous benefit. Viewed in this broader context, the argument for
13 lost margin recovery is not persuasive.

14 It should also be borne in mind that any “lost margins” from energy efficiency are
15 short-term in nature. To the extent that energy efficiency reduces sales levels, the utility is
16 able to re-establish its margins in its next rate filing reflecting the new sales volumes. In
17 addition, in-between rate cases, utilities are able to recover new margins from new
18 customers that join the system.

19 Further, the argument that without “lost margin” recovery the utility is biased in
20 favor of supply-side solutions does not square with the reality of regulatory lag associated
21 with new supply-side investments. One of the reasons to invest in energy efficiency is to
22 avoid incurring new fixed costs. One of the implicit assumptions in the “lost margins”
23 argument is that the cost of supply-side alternatives is somehow recovered without
24 regulatory lag – which of course is not the case in Arizona. The upshot is that utilities
25 should have an incentive to invest in energy efficiency – without extra payments for “lost
26 margins” – if investing in energy efficiency allows the utility to avoid supply-side

1 investments that are subject to regulatory lag.

2 **2. Should the Commission consider a decoupling or decoupling-like mechanism**
3 **that would allow Companies to recover weather-adjusted fixed costs that are lost as**
4 **a result of energy efficiency programs that drive conservation? If so, why?**

5 **Response:**

6 AECC recommends against adoption of decoupling mechanisms. At the most
7 fundamental level, decoupling is as much a “revenue assurance” mechanism as it is a
8 “conservation enabling” mechanism. As such, it is sure to capture a much wider range of
9 effects than just customer responses to utility-sponsored energy efficiency programs.

10 For example, decoupling provides unwarranted insulation to the utility from the
11 effects of price elasticity. Generally, all sellers of goods face a risk that price increases
12 will reduce sales. But, with decoupling, if customers respond to utility rate hikes by
13 reducing their electricity or gas consumption, fixed charges are increased to compensate
14 the utility for any resultant reduction in per-customer usage. Thus customers would face a
15 rate increase as a result of reducing their energy consumption in response to a prior rate
16 increase. Such an increase reflects an undue transfer of risk from utilities to customers.

17 Further, to the extent that customers reduce usage in response to economic
18 conditions or otherwise practice self-funded energy conservation, these behaviors will be
19 captured in the decoupling adjustment and unduly increase rates to customers.

20 Decoupling can also cause rates to be adjusted due to changes in weather-related
21 usage. However, this problem appears to be precluded by the structure of the question,
22 which assumes that weather-related effects are removed from the decoupling adjustment.

23 Declining usage per customer due to energy conservation can be properly reflected
24 in rates as part of a general rate proceeding. In contrast, revenue decoupling is an example
25 of single-issue ratemaking, which occurs when utility rates are adjusted in response to a
26 change in a single cost or revenue item considered in isolation. Single-issue ratemaking

1 ignores the multitude of other factors that otherwise influence rates, some of which could,
2 if properly considered, move rates in the opposite direction from the single-issue change.

3 When regulatory commissions determine the appropriateness of a rate or charge
4 that a utility seeks to impose on its customers, the standard practice is to review and
5 consider all relevant factors, rather than just a single factor. To consider some costs in
6 isolation might cause a commission to allow a utility to increase rates to recover higher
7 costs in one area without recognizing counterbalancing savings in another area. For this
8 reason, single-issue ratemaking, absent a compelling public interest, is generally not
9 sound regulatory practice. In AECC's view, revenue decoupling does not present such a
10 compelling public interest.

11 **3. If you believe the Commission should adopt such a mechanism, how should it**
12 **be structured?**

13 **Response:**

14 Although AECC opposes the adoption of any decoupling mechanisms – for any
15 customer classes, some structures are more harmful to customers than others.

16 The least harmful structure is to apply decoupling to the distribution fixed costs of
17 residential customers by targeting (weather-normalized) average distribution-fixed cost
18 recovery per customer. Under such an approach, decoupling rate adjustments are made
19 when average fixed-cost recovery per customer deviates from the baseline (used to set
20 base rates) due to changes in average usage per customer.

21 **a. Should certain customer classifications be exempt?**

22 **Response:**

23 Yes. Decoupling should not be applied to non-residential customers. This is
24 because a change in “average fixed-cost recovery per customer” has greater meaning
25 when applied to residential customers, due to their relative homogeneity compared to
26 other customer classes. In contrast, attempting to attribute to utility-sponsored energy

1 conservation projects changes in "average fixed-cost recovery per customer" of non-
2 residential customers is highly problematic and without merit as a ratemaking mechanism.
3 Firstly, given the tremendous diversity among non-residential customers, the concept of
4 an "average" non-residential customer for this purpose is meaningless. Consequently, the
5 average fixed-cost recovery per customer of non-residential customers will be very
6 sensitive to the composition of these customers; for example, the opening or closing of a
7 major industrial facility would impact such a calculation without at all being
8 representative of utility-sponsored conservation programs. Moreover, changes in the
9 overall economy are far more likely to influence average fixed-cost recovery per customer
10 for non-residential customers than energy conservation programs. Application of
11 decoupling to these customers would result in undue changes in rates in response to these
12 factors that are unrelated to energy conservation.

13 **4. How should weather-related changes in customer usage be treated? Should**
14 **they be excluded and if so, how?**

15 **Response:**

16 If decoupling is adopted, then weather-related changes in customer usage should be
17 adjusted using generally-accepted weather normalization techniques. Failure to weather-
18 normalize will simply insulate the utility from weather-related risk in the decoupling
19 mechanism.

20 **5. What mechanism should be used for recovery of unrecovered fixed costs**
21 **associated with energy efficiency? What are your views of utilizing a deferral**
22 **mechanism but requiring that accumulated costs be amortized over several years, if**
23 **deferrals were large?**

24 **Response:**

25 Energy efficiency can be properly reflected in rates as part of a general rate
26 proceeding. This can be accomplished through the use of a projected test period that is

1 close in time (e.g., 12 months) to the date of filing.

2 AECC is opposed to the use of a deferral mechanism for recovery of “net lost
3 revenues” associated with energy efficiency, as it would constitute an unwarranted
4 application of single-issue ratemaking. [See AECC Response to Question 2, above.]

5 Moreover, if such costs are recognized, but deferred, the recovery obligation shifts
6 among customers on an inter-temporal basis. Customers who benefited from the deferral
7 may no longer be on the system when the costs are recovered. Similarly, new customers
8 who did not benefit from the deferral are required to pay for it. AECC does not support
9 such an inter-temporal cost shift.

10 **a. If the Commission was to adopt decoupling and use a deferral**
11 **mechanism, how should usage related to new customer additions be treated**
12 **during the deferral period, i.e., should it be excluded or included?**

13 **Response:**

14 AECC is opposed to the adoption of decoupling and a deferral mechanism for the
15 reasons discussed herein.

16 **b. Should both programmatic and non-programmatic energy**
17 **savings be included in the deferrals? If so, how should non-programmatic**
18 **energy savings be measured and verified?**

19 **Response:**

20 AECC is opposed to the adoption of decoupling and a deferral mechanism for the
21 reasons discussed herein.

22 **6. What features can be adopted as part of a decoupling proposal that would**
23 **prevent the Company from over-earning, and address concerns that decoupling**
24 **proposals necessarily mean deviating from the “matching principle”?**

25 **a. Should the Commission consider a “cap on earnings” as part of its**
26 **approval of a decoupling plan?**

1 **Response:**

2 AECC does not support decoupling for the reasons discussed herein. However, if
3 it is adopted, an earnings test should be considered.

4 **b. Should a lower return on equity be adopted when considering rate cases**
5 **for decoupled Companies to recognize that such companies may incur less risk**
6 **compared to non-decoupled companies?**

7 **Response:**

8 Yes, given the reduced risk to a utility that benefits from decoupling, a downward
9 adjustment to return on equity to recognize this reduced risk is entirely appropriate.

10 **c. Should the Commission require that Companies' decoupling**
11 **mechanisms and deferrals be reviewed after some period of time, i.e., after**
12 **three years of operation, unless the Company comes in for a rate case sooner?**

13 **Response:**

14 AECC does not support decoupling for the reasons discussed herein. However, if
15 it is adopted, the mechanism should be reviewed periodically.

16 **7. Please state whether the information provided in the Revenue Decoupling**
17 **Data Report filed in compliance with Decision No. 70665 supports or argues against**
18 **revenue decoupling in the case of natural gas companies.**

19 **Response:**

20 AECC is primarily concerned with electric utility issues and has not reviewed this
21 report in any detail.

22 **8. What disincentives to customer conservation may be caused by virtue of the**
23 **adoption of decoupling or decoupling-like mechanisms?**

24 **Response:**

25 Decoupling penalizes customers as a whole or as a class for practicing energy
26 efficiency. This is not likely to create a disincentive at the individual customer level

1 unless decoupling is applied to a sufficiently small class such that the actions of individual
2 customers impacted their respective decoupled rates.

3 **9. Are price signals to consumers skewed by decoupling, and if so, how?**

4 **Response:**

5 While there are many problems with decoupling, the skewing of price signals is not
6 generally one of them.

7 **10. What type of revenue decoupling mechanism is appropriate for Arizona or**
8 **does it vary by company and with different facts?**

9 a. **Revenue per customer?**

10 b. **Sales margin per customer?**

11 c. **Total margin revenue?**

12 d. **Total class revenue?**

13 e. **Usage per customer?**

14 **Response:**

15 AECC does not support adoption of any decoupling mechanism for Arizona.
16 However, if decoupling is adopted, it should be based on "sales margin per customer," but
17 only for a relatively homogenous class such as residential. [See AECC discussion of
18 "average fixed-cost recovery per customer" in Response to Question 3, above, which is a
19 specific application of "sales margin per customer."] Once "sales margin per customer"
20 is established, it is highly correlated with "usage per customer."

21 "Revenue per customer" is a particularly poor target as it fails to take account of
22 the fuel and purchased power savings to the utility when energy conservation occurs, or
23 when usage per customer otherwise declines. The same is true for "total class revenue."
24 "Total margin revenue" is highly problematic if customer loads fall due to loss of large
25 customers or other economic factors.

26

1 **11. Should the Commission impose penalties for failure to meet specific**
2 **designated DSM goals?**

3 **a. Should the opportunity to have periodic rate adjustments be tied to**
4 **meeting specific energy efficiency requirements?**

5 **Response:**

6 No. AECC supports the adoption of a pre-specified maximum annual percentage
7 rate increase on customers for meeting the designated goals. If meeting the goals were to
8 cause an unreasonable cost burden on customers, then utilities should not be penalized for
9 not meeting these goals.

10 **12. What means should be employed to track conservation associated with specific**
11 **DSM programs for purposes of evaluating the success of decoupling?**

12 **Response:**

13 As AECC does not believe that adoption of decoupling constitutes a “success” for
14 customers, AECC has no suggested means of evaluating it in terms of “success.”

15 **13. What mechanisms are needed to assure data quality and accuracy of**
16 **forecasting customers, usage and utility driven energy efficiency savings?**

17 **Response:**

18 AECC has no suggestions at this time.

19 **14. Should decoupling mechanisms include a low-income component?**

20 **Response:**

21 No.

22 **a. Should utility energy-efficiency programs be structured to align costs**
23 **and benefits among rate classifications?**

24 **Response:**

25 Yes, it is reasonable for programs to be structured such that costs and benefits are
26 aligned.

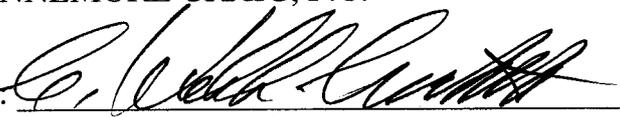
1 **15. What additional issues should the Commission consider when addressing**
2 **utility disincentives to implementing its energy efficiency requirements?**

3 **Response:**

4 AECC encourages the Commission to give strong weight to the cost to customers
5 of removing alleged utility disincentives. Of particular concern is the amount of foregone
6 energy efficiency that occurs when funds are diverted to utility incentives and other uplift
7 costs rather than to programs.

8 RESPECTFULLY SUBMITTED this 25th day of March 2010.

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