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IDAHO PUBLIC
UTILITIES COMMISSION

**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

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| IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO CONVERT SCHEDULE 54-FIXED COST ADJUSTMENT-FROM A PILOT SCHEDULE TO AN ONGOING, PERMANENT SCHEDULE | **CASE NO. IPC-E-11-19**<br><br>**REPLY COMMENTS OF THE IDAHO CONSERVATION LEAGUE** |

The Idaho Conservation League (ICL) hereby replies to the Staff proposal, which would reduce the value of the current Fixed Cost Adjustment (FCA) to ratepayers without any corresponding benefits. ICL acknowledges that the primary reason to initiate the FCA pilot was to remove a company-identified disincentive towards energy efficiency.[1] But capturing all non-weather related changes in consumption, as the current FCA does, delivers additional benefits beyond removing this disincentive. Staff acknowledges the current FCA breaks the linkage between Idaho Power's financial health and its retail electric sales.[2] Whether intended or not, the Company, and by extension ratepayers, derive two additional benefits from breaking this linkage: (1) mitigating the risk of fixed costs recovery, and (2) creating a strong incentive for the utility to control costs on a daily basis. Instead of sharing these benefits with ratepayers, the Staff proposal would eliminate them. The Commission can best align the interests of the utility and ratepayers, and maximize the benefits of the FCA, by approving the current mechanism.

[1] Staff Comments at 3; Order 30267 at 13.
[2] Staff Comments at 3.

ICL agrees with some of the Staff proposal. Maintaining the 3% cap on FCA rate adjustments is an important protection for ratepayers. Combining the FCA with the PCA on customer bills into an "Annual Adjustment Mechanism" line item increases clarity. And the annual DSM report is the best venue to document the Company's commitment to energy efficiency. However, ICL disagrees with Staff's proposal to share fixed costs recovery. In support of their proposal Staff raises four main "shortcomings": (1) the scope of the current FCA, (2) dealing with new customers, (3) potential cross-class subsidies, and (4) spurring investment in energy efficiency.[3] As explained below, none of these issues support changing the current FCA.

Staff's primary concern is that the FCA captures all non-weather related changes in consumption.[4] While true, the Commission should maintain this structure because it provides two additional benefits beyond removing the disincentive towards energy efficiency—mitigating risks and incenting cost controls. The National Association of Regulatory Commissioners recognizes that "decoupling can reduce risk for the utility by ensuring that its revenues and return on investment remain stable."[5] The Commission recognized the FCA would stabilize fixed cost recovery when initiating the pilot.[6] Idaho Power admits this benefit in this case.[7] Moody's Investor Services recently reviewed more than a decade of decoupling in California and concluded these mechanisms reduce gross profit volatility and strengthen long-term credit.[8] Capturing all non-weather related changes in consumption maximizes the value of the FCA as a risk mitigation

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[3] Staff Comments at 4 -7.
[4] *Id.* at 4.
[5] NARUC *Decoupling for Electric and Gas Utilities: Frequently Asked Questions* at 9, (2007)
[6] Order 30267 at 13("The annual FCA true-up mechanism assures a more stable utility recovery of fixed costs that are now recovered in the energy rate component[.]")
[7] Cavanagh Direct at 4; Youngblood Direct at 12.
[8] *See* Exhibit 2, SNL Financial LC, *Moody's: Decoupling is positive for utility company credit ratings,* (November 11, 2011)(This article describes the findings of a Moody's report published on November 4, 2011. The report is available to purchase for $550. As a non-profit organization, ICL has insufficient means to purchase the full report.)

tool.[9] Instead of sharing this benefit with ratepayers the Staff proposal cuts it in half and leaves it with the Company.

Instead of reducing the value of the FCA, the Commission can ensure ratepayers share in this benefit. In our opening comments, ICL proposed that the best way to share this benefit is by reducing Idaho Power's capital ratio. While we stand by this recommendation, we also acknowledge that other risk mitigation factors influence the magnitude and timing of this kind of change. For instance, the FCA is one part of a broader package of risk mitigation tools that includes the Power Cost Adjustment and the binding ratemaking treatment in I.C. § 61-541. Accordingly the Commission can share the risk mitigation value with ratepayers in this case, in any of the six other pending cases that impact rates, or in the next general rate case.[10] But the FCA is only valuable as a risk mitigation tool, regardless of when and how the Commission decides to share this benefit, if the FCA continues to capture all non-weather related changes in consumption. Beyond removing the disincentive towards energy efficiency, maximizing the risk mitigation value is a separate reason to reject the Staff proposal and approve the current FCA.

The current FCA also benefits ratepayers by providing a powerful incentive to control costs. The FCA, by fixing revenue, severely restricts Idaho Power's ability to increase revenue by increasing sales.[11] Idaho Power acknowledges this by describing their "sacrifice of the upside from increased electricity sales" as an offset for "increased certainty about recovery of authorized costs."[12] This cost control incentive is not aimed at controlling additions to rate base.[13] Rather, by establishing a cap on fixed cost recovery between rate cases the FCA focuses the utility on daily

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[9] Normalizing sales mitigates the risk caused by weather related changes, but only the FCA captures changes due to customer counts, customer consumption, and the economy.
[10] *See* IPC-E-12-06, -07, -08, -09, -13, -14, (IPC-E-12-14, Inclusion of Langley Gulch, is likely the most appropriate of these six cases.).
[11] *See* NARUC at 9; Regulatory Assistance Project, *Revenue Regulation and Decoupling: A Guide to Theory and Application* at 45 - 46, (June 2011).
[12] Cavanagh Direct at 4.
[13] *See* ICL Comments at 3.

activities that can reduce actual cost below the cap. While the utility enjoys the immediate benefits of reducing costs, these benefits will flow to ratepayers in the next rate case. The staff does not mention this cost control incentive, but their proposal would cut this benefit in half.

Restricting the FCA to only 50% of the foregone fixed costs weakens the incentive to control costs and increases the incentive to promote sales. While this might benefit ratepayers in the short term during times of declining sales, it harms ratepayers when loads are increasing. Counter to Staff's comment, the current FCA does not penalize Idaho Power when loads increase.[14] Rather the FCA establishes a limit on fixed costs recovery and returns to ratepayers over collections due to increased sales. Idaho Power states the "penalty" of missing the upside of increased sales is offset by certainty in recovering fixed costs.[15] The Staff proposal would reduce this certainty and penalize ratepayers when sales increase by allowing Idaho Power to keep 50% of the over collected fixed costs. Further, the Staff proposal cuts in half the incentive to control costs. Beyond removing disincentives towards energy efficiency and mitigating risks, maintaining a strong cost control incentive is a separate reason to reject the Staff proposal and approve the current FCA.

In regards to new customers, ICL reiterates it is not clear there is a meaningful difference between new and existing customers.[16] Staff seems to agree by speculating that new customers may add costs "higher than that embedded in rates," or "virtually no additional fixed costs."[17] Despite this uncertainty, and without referring to any data, Staff then states they believe new customers add a different amount of fixed costs then those contained in the current mechanism.[18] The problem alleged by Staff is this allows the Company to recover "a higher level of *class* fixed

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[14] Staff Comments at 5.
[15] Cavanagh Direct at 4.
[16] ICL Comments at 10.
[17] Staff Comments at 5 – 6.
[18] *Id.* at 6.

costs that what was approved in the rate case."[19] While this may be true, it is also true the Commission approves the fixed cost per customer and fixed cost per energy before the Company collects anything through the FCA. While the FCA may increase the class revenue, the Staff does not provide any evidence that it increases the authorized fixed revenue per customer beyond that approved by the Commission.

Further, the Staff proposal does not directly address this potential issue. If the Commission agrees the potential difference between new and existing customers warrants investigation a better venue is through the cost of service study in the next rate case. Then, if necessary, the parties can use actual data to refine the FCA at a future time. This solution, as opposed to the Staff proposal, directly addresses this issue and does not eliminate the benefits of the current FCA mechanism.

Staff also argues the FCA fails to minimize cross subsidies across customer classes.[20] While the Commission should avoid cross subsidies, this is a larger issue that the FCA can correct. In the recent general rate case the parties could have reduced cross-subsidies revealed in the cost of service model, but choose not to in favor of reaching settlement.[21] Staff also points to the "disproportionate amount of DSM rider revenue generated by the residential class."[22] ICL agrees with Staff this issue warrants attention.[23] But the proper solution is to expand residential programs, not weaken the current FCA and partially reinstitute the disincentive towards energy savings in this customer class. Finally, despite raising the cross-subsidy issue Staff continues to imbed this within the FCA by blending the deferral balance for both residential and commercial

[19] *Id.* (emphasis in the original).
[20] Staff Comments at 6.
[21] Order 32426 at 8, (ICL participated in this case and agreed to this outcome).
[22] Staff Comments at 6.
[23] *See* Order 32113 at 3, 6, IPC-E-10-09 (Prudency of 2008-2009 DSM spending); Order 32331, IPC-E-11-05 (Prudency of 2010 DSM spending).

classes.[24] ICL agrees with Staff that cross-subsidies "is more appropriately at cost of service issue and should be addressed by the Company in its next rate case."[25] This issue, while important, does not support changing the current FCA, other than to stop blending the deferral balance, which is a Staff sanctioned cross-class subsidy.

Finally, Staff argues the current FCA may not be spurring greater investment in energy efficiency.[26] However, Staff's recognition that growing energy savings in the residential class is on par with the industrial class belies this argument.[27] The classes not included in the FCA have rate designs with customer, demand, and energy charges that more fully separate fixed costs from variable costs. The FCA trades this type of rate design for a true up mechanism to accomplish this same objective in the residential and small commercial classes.[28] Further, these classes are traditionally the hardest in which to acquire energy efficiency due to the wide diversity of individuals and the small savings per customers. While savings in the commercial sector outpaced the residential class, Staff admits they cannot distinguish savings attributable to small commercial from large commercial customers.[29] As for the residential class, the fact that growth in energy savings has been on par with savings in the industrial class is a testament to the efficacy of the FCA. Regardless, Staff's proposal to weaken the FCA does not address this perceived problem. Rather it is likely to hamper the Company's incentives to purse the "considerable amount of cost-effective achievable energy efficiency" cited by Staff.[30]

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[24] Staff Comments at 7.
[25] Staff Comments at 6.
[26] Staff Comments at 7.
[27] *Id.*
[28] *See* Gale Direct at 3-5, IPC-E-04-15, (Mr. Gale explains the Company initially resisted the FCA "believing that significant movement in the rate design would address the same issues that a true-up mechanism would.")
[29] *Id.* (While staff states the small commercial class is 3% of the whole, they do not indicate whether the savings in this sector is evenly portioned between the two rate classes.)
[30] Staff Comments at 7.

The current FCA provides three distinct benefits. All parties agree that it removes the inherent disincentive towards energy efficiency. ICL notes this also holds true for other actions that impact sales such as customer owned distributed generation. The current FCA delivers a separate set of benefits by incenting cost control and mitigating risks. This second set can only be realized by continuing to capture all non-weather related changes in fixed costs recovery. The Staff proposal, instead of sharing these benefits, severely impairs them, without addressing any of the alleged "shortcomings" they identify. Approving the current FCA maximizes these benefits while allowing the Commission to directly address the potential issues in other forums. Mitigating risks should reduce the cost of capital and ratepayers can share in this immediately or in future rate cases. Ratepayers directly benefit by aligning utility financial interests with ratepayers interest in controlling their own energy bills and the utility's costs. Instead of cutting the FCA in half, ICL urges the Commission to approve the current FCA and ensure ratepayers share in these benefits.

Respectfully submitted this 15th day of March, 2012

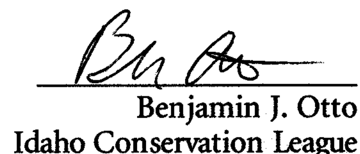

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**Exhibit 2**

SNL Financial LC
*Moody's: Decoupling is positive for utility company credit ratings*
(November 11, 2011)

Friday, November 11, 2011 11:41 AM MT Exclusive

# Moody's: Decoupling is positive for utility company credit ratings

By Abby Gruen

Decoupling in California has strengthened the long-term credit of a number of utilities by reducing their profit growth volatility, according to a recent Moody's report.

Utilities facing rising costs and capital needs, and regulators having to balance state energy efficiency plans with consumer bill fatigue, are turning more to decoupling mechanisms as a means to manage all-in rate increases.

"Moody's believes an increased use of single issue rate riders and trackers, alongside a more proactive and widespread adoption of energy efficiency programs, can hold a critical key to bridging the gap to a 21st century business model," Moody's analyst Ryan Wobbrock wrote in the Nov. 4 report.

In California, which has had decoupling for more than a decade, PG&E Corp., Sempra Energy subsidiaries San Diego Gas & Electric Co. and Southern California Gas Co., and Edison International subsidiary Southern California Edison Co. had less gross profit growth volatility than their peers over the past seven years, Moody's found.

"Decoupling, particularly when you have lower than expected sales growth, is an important issue, particularly because there has been evidence that weather adjusted sales for many utilities has been declining in some cases because of conservation efforts," Glenrock Associates LLC equity analyst Paul Patterson said. "It is one more tool in the kit to decrease volumetric risk associated with utilities, and it may become more of an issue in the future."

Moody's sees a generally positive regulatory environment for utilities, which have been able to get sizable base rate increases in a number of recent rate cases. Moody's predicts that regulators will gradually phase in special recovery and decoupling mechanisms in the future.

"To that end, a more deliberative transition towards single-issue rate riders, trackers and increasing acceptance of various revenue decoupling mechanisms accompanying energy efficiency conservation programs, would be widely viewed to be a credit positive," Wobbrock wrote in the Nov. 4 report.

Moody's said offsets to base rate increases from lower commodity prices may be "running their course," and suggested that annual true-up provisions in decoupling rules may be a means to manage consumer rate shock.

"We view these decoupling and special rate making mechanisms to be positive for the credit profile, not only because they give increased visibility and cost recovery assurance, but also because they can allow for more frequent smaller, automatic-type 'bites of the apple' that can help reduce rate shock potential," Wobbrock said in an interview.

Regulatory adoption has varied across the U.S. where disparate views can divide commissions. Opponents of decoupling say utilities have more incentive to control costs when they are affected by them, Moody's said.

Moody's found that decoupling did not stabilize credit ratios, such as cash flow coverage of interest and debt, which it factors in to its credit rating process, but it did find that decoupling causes predictable gross profit, which is a "quantitative credit positive."

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## CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of March 2012, I delivered true and correct copies of the foregoing REPLY COMMENTS OF THE IDAHO CONSERVATION LEAGUE to the following via the method of service noted:

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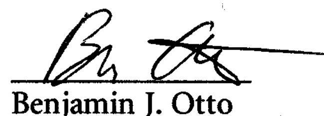

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