



**Environment  
Northeast**

6 Beacon Street, Suite 415  
Boston, MA 02108  
617-742-0054  
[www.env-ne.org](http://www.env-ne.org)

November 6, 2008

Rockport, ME  
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*Via Hand Delivery and Electronic Mail*

Luly E. Massaro, Commission Clerk  
Rhode Island Public Utility Commission  
89 Jefferson Boulevard  
Warwick, RI 02888

**Re: Docket 3943, In Re: National Grid Gas Application to Implement New Rates**

Dear Ms. Massaro:

Enclosed for filing in the above-referenced matter, please find the Brief of Environment Northeast Concerning the National Grid Decoupling Proposal, As Amended (one original and 7 copies).

Kindly date stamp the enclosed extra copy and return it in the enclosed self-addressed stamped envelope. If you have any questions or concerns, please do not hesitate to contact me at 617-742-0054.

Sincerely,

Jeremy C. McDiarmid  
Staff Attorney

cc: Jeffrey H. Gladstone, Esq. (via first-class mail)  
Robert K. Taylor, Esq. (via first-class mail)

Enclosures

**STATE OF RHODE ISLAND  
PUBLIC UTILITIES COMMISSION**

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IN RE: NATIONAL GRID GAS )

APPLICATION TO IMPLEMENT NEW RATES )

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DOCKET NO. 3943

**BRIEF OF ENVIRONMENT NORTHEAST CONCERNING  
THE NATIONAL GRID DECOUPLING PROPOSAL, AS AMENDED**

Environment Northeast (“ENE”) appreciates the opportunity to submit this brief in support of the adoption of National Grid’s (the “Company”) proposed decoupling mechanism presented in this docket. As an organization that addresses large-scale environmental problems that threaten regional ecosystems, human health or the management of regionally significant natural resources, ENE applauds the Company’s initiative to propose a rate mechanism which will remove a powerful economic disincentive that stands as an obstacle to the Company’s support for increased investments in cost-effective energy efficiency in Rhode Island. As amended during the course of the proceeding, National Grid’s revenue-per-customer decoupling mechanism will help achieve the state’s economic, energy efficiency, and environmental goals. In particular, through its proposal, the Company recognizes the need to better align its financial incentives with customer and public policy interests in maximizing investments in energy efficiency opportunities that are cheaper than supply. ENE urges the Commission to adopt the

Company's proposed decoupling mechanism in order to save customers money through increased energy efficiency investments.

I. STATEMENT OF THE CASE

For ENE, the central issue in this proceeding is whether the Commission should align the incentives of National Grid with those of its customers by adopting the proposed revenue-per-customer decoupling mechanism.

On April 1, 2008, National Grid (the "Company") filed a petition for a "Request for Change in Gas Distribution Rates" with the Rhode Island Public Utilities Commission. See National Grid Transmittal Letter (April 1, 2008), NGrid Ex. 1. The petition contained a variety of components, including three, separate revenue decoupling proposals: (1) the Company proposes to redesign its rate structure to recover a greater percentage of revenue from fixed customer charges for all firm rate classes; (2) the Company proposes to redesign its rate structure to recover a greater percentage of revenue from fixed demand charges for commercial and industrial rate classes; and (3) National Grid has proposed a reconciling revenue per customer decoupling mechanism (the "RDM"). See Pre-Filed Direct Testimony of Nikolas Stavropoulos, NGrid Ex. 2, at 13; Pre-Filed Direct Testimony of James Simpson, NGrid Ex. 12, at 2:5-7.

As initially envisioned by the Company, the RDM would apply to each firm rate class.<sup>1</sup> See Simpson, NGrid Ex. 12, at 2:6-7; 4:3-4. As the proceeding progressed, the Company twice amended its decoupling proposal to reduce its scope. First, on September 12, 2008, it proposed excluding all large and extra large rate classes. See Transcript ("Tr.") 9/12/08 at 5:1-6:14.

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<sup>1</sup> Originally, the company had proposed exempting "new" customers in its large and extra large rate classes. See Simpson Direct, NGrid Ex. 12, at 6:14-7:8.

Second, on October 22, 2008, it proposed excluding low-income classes. See Testimony of Peter C. Czekanski, Tr. 10/22/08 at 8:20-11:19. The remaining firm rate classes to which the revenue decoupling mechanism will apply are (1) residential non-heat; (2) residential heat; (3) small commercial and industrial; and (4) medium commercial and industrial. See id. at 11:22-12:1. These remaining classes comprise more than 80% of National Grid's total distribution revenue and the vast majority of its customers. See Direct Testimony of Peter C. Czekanski, Appendix NG-PCC-3, NGrid Ex. 15; Testimony of James Simpson, Tr. 9/26/08 at 167:4-168:9. For the included classes, which comprise the vast majority of the National Grid's customers and revenue, the decoupling mechanism will eliminate the company's sensitivity to gas commodity sales, thus eliminating a financial disincentive for the company to support investments in cost-saving energy efficiency. See Simpson, Tr. 9/26/08, at 152:19-153:2.

Under current rate structures, National Grid derives a significant portion of its annual revenue through volumetric distribution rates.<sup>2</sup> See National Grid, Response to Division Data Request DIV 5-17, DIV. Ex. 13. As a result, its revenues are affected by the amount of gas it sells to its customers, giving the Company an incentive to maximize its sales in order to maximize its revenue. See Testimony of Nikolas Stavropoulos, Tr. 10/22/08 at 36:8-37:3; Simpson, Tr. 9/26/08 at 178:21-179:3; see also Testimony of Bruce Oliver, Tr. 10/23/08 at 178:4-11 (acknowledging that Company recovers less revenue when customers consume less gas). Thus, National Grid has an economic disincentive to support programs and policies—such as robust energy efficiency programs that capture all efficiency resources that are cheaper than

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<sup>2</sup> For example, the Utility estimates that approximately two thirds of distribution revenue from residential heating customers is collected through volumetric rates. Even under its proposed increase in customer charges, approximately one third of distribution revenues from residential heating customers will come from volumetric rates. See National Grid, Response to Division Data Request DIV 5-17, DIV Ex. 5.

supply—that would result in reductions in the consumption of natural gas. See id.; see also, Testimony of Seth Kaplan, Tr. 10/23/08 at 114-115.

The state of Rhode Island has made a policy commitment to energy efficiency as a means of saving its consumers money and reducing environmentally harmful emissions associated with the burning of natural gas. See R.I. Gen. Laws § 39-2-1.2 (d). In 2006, the Legislature authorized the Company to initiate a natural gas energy efficiency program, but did not require a specific funding level. See id. Thus, the size of utility-administered efficiency programs was not statutorily mandated. See id.

Under this change in law, the company is authorized to collect up to 15 cents per dekatherm to be used to administer efficiency programs for its customers.<sup>3</sup> See id. Currently, NGrid runs gas efficiency programs that are funded through a 10.7 cent per dekatherm charge. See Response to Division Data Request DIV 7-2, DIV Ex. 16; Simpson, Tr. 9/26/08 at 142:12-20. Mr. Farley, TEC-RI's witness, believes that these programs have been successful in saving Rhode Island rate payers money. See Testimony of John Farley, Tr. 9/29/08 at 165:11-20. The Company projects that annual savings under current programs will be 198,908 MMBtu. See Stavropoulos, NGrid Ex. 2 at 17:4-7; National Grid, Response to Division Data Requests, Attachment Div 7-2 A1, DIV Ex. 16.

At several points in written testimony and during hearings in this proceeding, National Grid witnesses indicated a willingness to increase the efficiency funding up to 15 cents per dekatherm. See, e.g., Stavropoulos, NGrid Ex. 2 at 17:7-11; Simpson, Tr. 9/26/08 at 142:8-20. Indeed, on November 2, 2008, the Company made a filing with the Commission in which it

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<sup>3</sup> In 2007, the Company and various stakeholders, including decoupling opponents TEC-RI and the Division of Public Utilities and Carriers (the "Division"), filed a settlement initiating gas efficiency programs.

proposes increasing the gas efficiency funding to 15 cents per dekatherm. See Energy Efficiency Program Plan, Settlement of the Parties, R.I.P.U.C. Docket 4000 at 17. In addition, one National Grid witness alluded to the possibility of asking the legislature to amend the statute to remove the perceived cap on gas efficiency funding.<sup>4</sup> See Stavropoulos, Tr. 10/22/08 at 27:19-28:1.

A primary goal of the RDM is to eliminate the incentive that every utility that collects revenue from volumetric charges faces to maximize its customers' sales. See Simpson, NGrid Ex. 12 at 2: 8-10. The proposed decoupling mechanism will remove an economic disincentive to efficiency investment by severing the link between the amount of revenue the company realizes and the amount of gas commodities it sells. See Stavropoulos, NGrid Ex. 2, at 15:18-20. Under the RDM, consumers would not see any changes in the components of their bills. See Simpson, NGrid Ex. 15, at 8-10. Moreover, a portion of distribution revenue would continue to be collected through volumetric rates. See Czekanski, Appendix NG-PCC-6, NGrid Ex. 15, at Vol. 4. 234-253. As a result, customers within a rate class who use less gas will continue to pay less in distribution and commodity charges than a fellow customer who uses more. See Simpson, Tr. 9/29/08 at 169:10-170:7; Farley, Tr. 9/29/08 at 158:5-10. For customers, this preserves an economic incentive to conserve on both the commodity and distribution side of the bill. See id.; Simpson, Tr. 9/26/08 at 130:22-131:5.

Under the RDM, annual decoupling adjustments to the distribution rates would be made through the DAC and will be reflected in slight adjustments to the customer's volumetric distribution rate. See Simpson, NGrid Ex. 15, at 9:19-10:2. If the actual average revenue per

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<sup>4</sup> One way to accomplish this would be to create a least-cost procurement model for natural gas efficiency programs, analogous to the current electric efficiency procurement structure.

customer is greater than the target revenue-per-customer for a given class, the distribution rate will decrease, returning over-collections to customers in that rate class. See id. By contrast, if the actual average revenue per customer is less than the target, customers will see a slight increase in their volumetric distribution rate. See id.

National Grid is a for-profit company. See Stavropoulos, NGrid Ex. 2 at 7:13-20; see generally National Grid October 2008 Investor Day Presentation, DIV Ex. 69. As such, it driven, in part, by financial incentives and disincentives. See Stavropoulos, Tr. 10/22/08, at 94:15-17, 167:4-168:21; Kaplan, Tr. 10/23/08 at 68:2-6. The current rate structure under which the company realizes more revenue when it sells more natural gas creates an economic disincentive to facilitating the investment in activities, equipment and programs that will lead to lower gas usage. See Stavropoulos, NGrid Ex. 2 at 14:10-15:6; Simpson, Tr. 9/26/08 at 178:21-179:3, 214:1-7; Kaplan, Tr. 10/23/08 at 114-115; Farley, Tr. 9/29/08 at 163:21-165:1, 174:14-19. The RDM is designed to eliminate this economic disincentive for included rate classes. See Stavropoulos, NGrid Ex. 2 at 13:6-9; Simpson, NGrid Ex. 12 at 2:7-3:4.

## II. PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. While National Grid's decoupling proposal has been paired with a proposed increase in distribution charges, these are two distinct and separate issues. See Comments of Environment Northeast Concerning the National Grid Decoupling Proposal, ENE Ex. 1 at 1-2; National Grid's Response to Requests for Admission by CLF, CLF Ex. 2 at 3-4.
2. As all for-profit companies, utilities like National Grid respond to financial incentives and disincentives. See Stavropoulos, NGrid Ex. 2 at 14:10-15:6; Simpson, Tr. 9/26/08 at 178:21-

179:3, 214:1-7; Kaplan, Tr. 10/23/08 at 114-115; Farley, Tr. 9/29/08 at 163:21-165:1; 174:14-19; see also, “Key Issues Facing Gas Utilities in State Public Utility Commissions,” DIV Ex. 41 at 19 (acknowledging existence of disincentive under traditional rate structures).

3. Under the current rate structure, customer reductions in consumption directly reduce company revenues. See Stavropoulos, Tr. 10/22/08 at 36:8-37:3; Simpson, Tr. 9/26/08 at 178:21-179:3; see also Testimony of Bruce Oliver, Tr. 10/23/08 at 178:4-11 (acknowledging that Company recovers less revenue when customers consume less gas). As a result, the Company faces a clear and direct financial disincentive to encouraging or assisting its customers in lowering their usage through energy efficiency, tighter codes and standards, or other approaches. See id.; see also, Kaplan, Tr. 10/23/08 at 114-115.
4. The proposed RDM removes the financial disincentive for National Grid to promote energy efficiency. See Stavropoulos, NGrid Ex. 2, at 15:18-20; Simpson, Tr. 9/26/08 at 168:10-21.
5. The gas commodity portion of a customer’s bill is roughly 70%, while the delivery/distribution portion is roughly 30%. As a result, savings that result from lowering usage come primarily from the commodity side. See Rebuttal Testimony of James Simpson, NGrid Ex. 13 at 18:1-2; Simpson, Tr. 9/26/08 at 121:14-20.
6. Customers’ economic incentive to reduce their usage through efficiency will be the same under the Company’s decoupling proposal as it is under current rate structures. See Simpson, Tr. 9/26/08 at 121:21-123:24, 170:2-8.
7. Implementing the decoupling mechanism would not remove the financial incentive for customers to conserve. See Simpson, Tr. 9/26/08 at 121:21-24. As under current rate

structures, lowering usage under the proposed decoupling mechanism would reduce bills compared to what they would otherwise be without reduced usage.

8. Under the current rate structure, which includes volumetric distribution rates, a customer who uses more gas will pay more for distribution than a customer within the same class who uses less gas. See Farley, Tr. 9/29/08 at 165:7-9; Simpson, Tr. 9/26/08 at 169:10-170:7. Under the company's RPC decoupling proposal, this will not change because customers will still pay a portion of distribution revenue through volumetric distribution rates. See id.; Simpson, NGrid Ex. 12 at 8-10.
9. The Company has an influence on a customer's decision to invest in energy efficiency. See Kaplan, Tr. 10/23/08 at 125:6-13; Testimony of Bruce Oliver, Tr. 10/21/08 at 21:7-17.
10. With decoupling, the Company can better be a partner in cost-effective conservation and efficiency efforts for which it may not get credit. See Kaplan, Tr. 10/23/08 at 74:4-75:12. There are other things a utility can do beyond the scope of its mandate, including advocating for stricter codes and standards, and facilitating third party delivery of efficiency services. See id.
11. Decoupling does not obviate the need for rate cases to ensure that the Company's costs are just and reasonable. See Stavropoulos, Tr. 10/22/08 at 133:9-23.
12. To date, at least 15 states have approved revenue decoupling mechanisms for at least 21 companies. See Simpson Rebuttal, NGrid. Ex. 13 at 2:6-3:6; Simpson Rebuttal, Updated Attachment NG-JDS-3; see also, Wayne Shirley, Jim Lazar, and Frederick Weston, The Regulatory Assistance Project, "Revenue Decoupling: Standards and Criteria, Report to the

Minnesota Public Utilities Commission” (June 30, 2008), (the “RAP Decoupling Report”), ENE Ex. 2 at 43.

13. California gas utilities have had extensive experience with decoupling. See Simpson, Tr. 9/12/08 at 55:17-56:6; RAP Decoupling Report, ENE Ex. 2 at 16-17; California PUC Brochure on Decoupling, CLF Ex. 9. Decoupling has been in place in California since 1978. See CLF Ex. 9. The California Department of Public Utilities continues to embrace decoupling. See, e.g., id. Through decoupling, California’s gas companies have been held to remarkably stable earnings despite increases in annual operating expenses.<sup>5</sup> See RAP Report, ENE Ex. 2 at 16-17.
14. The proposed RPC decoupling mechanism does not dilute the company’s financial incentive to prudently manage costs. See Simpson, Tr. 9/28/08 at 228:2-7.
15. The proposed RPC decoupling mechanism does not guarantee profits for the company. See Response to TEC-RI Data Request TEC-RI 1-53, TEC-RI Ex. 1-52; Simpson, Tr. 9/26/08 at 228:2-7; Farley Tr. 9/29/08 at 165:7-9; see also Tr. 8/27/08 at 59:12-20.
16. Under the proposed RPC decoupling mechanism, National Grid will still have a financial incentive to add new customers. See Response to Data Request TEC-RI 1-52, TEC-RI Ex. 3; Stavropoulos, Tr. 10/22/08 at 183:12-184:7; Simpson, Tr. 9/26/08 at 168:10-21.
17. So-called “partial” decoupling mechanisms do not eliminate the Company’s disincentive to invest in energy efficiency. See Stavropoulos, Tr. 10/22/08 at 98:19-99:22; Oliver, Tr. 10/23/08 at 179:20-180:2. Existing rate mechanisms, including the Weather Normalization Adjustment, declining block rates and increases in fixed charges do not eliminate National

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<sup>5</sup> As an example, over the past three years, Pacific Gas & Electric’s earnings have been \$1.01B, \$971M and \$918M despite a \$1.4B increase in operating expenses. See RAP Report, ENE Ex. 2 at 16-17.

Grid's financial disincentive to invest in energy efficiency because partial decoupling measures still result in a rate structure where the Company generates more revenue when sales are increased. See id.

18. The RPC decoupling mechanism will not lead to any cross-subsidization between rate classes because reconciliations will be occur on a rate-class by rate-class basis. See Czekanski, 10/22/08 at 179:23-180:4; Simpson, Tr. 9/12/08 at 10:13-24, Tr. 9/26/08 at 72:18-73:2; Farley, Tr. 9/29/08 at 195:17-22.
19. The Company plans to retain the current earnings sharing mechanism. See Response to Division Data Request DIV 6-38, DIV Ex. 15; Simpson, Tr. 9/26/08 at 228:8-18. As a result, the company and its customers will share in any revenue recovery that exceeds the allowed return on equity. See id.
20. Under a "straight-fixed-variable" ("SFV") model, the Company would collect 100% of its distribution revenue through fixed charges. Were the company to adopt a SFV model, it would eliminate the efficiency disincentive. See Simpson, Tr. 9/12/08 at 113:23-118:9. However, it would reduce economic signals to customers to conserve because they would not be able to control the distribution side of their bill through lower usage. Within a rate class, large users and small users would pay the same amount for distribution. See National Grid Response to ENE Record Request No. 1-1, ENE Ex. 5. If the Company were to introduce SFV, residential heating customers would See a 352% increase in their customer charges, from \$9 to \$40.69; residential non-heat would See a 132% increase in their customer charges, from \$7.50 to \$17.37; small commercial would See a 305% increase in their customer

charges, from \$14 to \$56.66; medium commercial would See a 575% increase in their customer charges, from \$45 to \$303.94. See id.

### III. ARGUMENT

#### THE COMMISSION SHOULD APPROVE NATIONAL GRID'S DECOUPLING MECHANISM TO CREATE ALIGNMENT OF THE COMPANY'S ECONOMIC GOALS AND THE EFFICIENCY GOALS OF ITS CUSTOMERS.

##### A. As a For-Profit Company, National Grid is Subject To Economic Incentives and Disincentives.

National Grid is a for-profit corporation serving as a regulated gas distribution company in Rhode Island. As such, its managers must balance their regulatory obligations to provide safe, reliable and affordable service to their customers with their fiduciary duty to earn a profit for the Company's shareholders. Ideally, these dual goals often work in concert with each other. Financial incentives and disincentives affect the way the Company acts, and, when possible, the Commission should shape regulatory policy in a way that aligns those financial incentives with the interests of Rhode Island ratepayers. By approving the Company's proposed RDM, the Commission can achieve an alignment of the National Grid's economic incentives with the customer and societal interest in maximizing investment in cost-effective energy efficiency programs.

##### B. Under Current Rate Structures, The Company Faces a Counter-Productive Economic Disincentive to Investment in Efficiency.

The Commission should adopt National Grid's RDM in order to remove the Company's financial disincentive to assisting its customers reduce their usage. Today, National Grid derives

a significant portion of its annual revenue through volumetric distribution rates. Through volumetric rates, the Company generates more revenue when it sells more natural gas, leading to economic signals that are counter-productive to robust energy efficiency investments that reduce gas usage. As a result, its revenues are affected by the amount of gas it sells to its customers, giving the Company an incentive to maximize its sales in order to maximize its revenue. Thus, National Grid has an economic disincentive to support programs and policies—such as robust energy efficiency programs that capture all efficiency resources that are cheaper than supply—that would result in reductions in the consumption of natural gas. In order to eliminate this powerful economic disincentive, the Commission should approve National Grid’s decoupling proposal.

C. The Commission Should Adopt the Revenue Decoupling Mechanism because it Advances Rhode Island’s Policy Commitment to the Investment in Cost-Effective Energy Efficiency.

The Commission should approve the Company’s decoupling mechanism because it will advance the state’s policy goals to invest in cost-saving energy efficiency. With the passage of the Comprehensive Energy Conservation, Efficiency and Affordability Act of 2006, Rhode Island increased its commitment to promote cost-saving investments in energy efficiency. See R.I. Pub. Laws of 2006, Chapters 236, 237 (June 29, 2006).

In addition to creating a Least Cost Procurement Model for electric efficiency programs, the Act authorized National Grid to administer gas efficiency programs, funded through a volumetric charge.<sup>6</sup> See R.I. Gen. Laws § 39-2-1.2 (d). Specifically, the statute states:

(d) Effective January 1, 2007, and for a period of seven (7) years thereafter, each gas distribution company shall include, with the approval of the commission, a charge of up to fifteen cents (\$0.15) per deca therm delivered to demand side management programs, including, but not limited to, programs for cost-effective energy efficiency, energy conservation, combined heat and power systems, and weatherization services for low income households.

Although the statutory language appears to require National Grid to include a charge for demand side programs, it does not prescribe a specific amount. See id. Nor does the statute require specific types of programs. See id. As a result, the Company, with Commission approval, has wide discretion to propose spending levels and specific programs. In practice, this has led to settlement discussions with members of the DSM collaborative. See, e.g., National Grid Response to Division Data Request DIV-7-2, DIV Ex. 7. With this leeway, it is imperative that the Commission align the company's financial interests with the efficiency policy goals articulated in the Act. The Commission can and should achieve this alignment by adopting the Company's proposed decoupling mechanism.

Although the Company does not have a monopoly on energy efficiency products and services, because it has regular contact with customers (e.g., monthly billing) and collects and disburses ratepayer funds for efficiency purposes, National Grid is in a unique position to effect positive ratepayer decisions regarding efficiency investments. See Simpson Rebuttal, NGrid Ex.

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<sup>6</sup> The Act authorizes an efficiency charge of 15 cents per dekatherm, and National Grid currently runs a gas efficiency program with a charge of 10.7 cents per dekatherm.

13 at 15:19-28, Cf. Oliver, DIV Ex.3 at 13. Witnesses testified that the Company can have a positive impact on a customer's usage decisions. See Kaplan, Tr. 10/23/08 at 125:6-13; See also Oliver, Tr.10/21/08 at 21:7-17 (conceding that utilities can influence customer efficiency decision). As Mr. Simpson noted, "it is widely accepted that utility sponsored energy efficiency programs are necessary, and it has been shown on numerous occasions that utility-sponsored energy efficiency programs are successful at removing barriers that would otherwise prevent all cost-effective energy measures from being adopted." Simpson Rebuttal, NGrid Ex. 13 at 15:22-26.

The 2006 Act recognizes that an increase in DSM programming could affect the revenues of the utility. Section 39-1-27.7 (d) of the General Laws states:

If the commission shall determine that the implementation of system reliability and energy efficiency and conservation procurement has caused or is likely to cause under or over-recovery of overhead and fixed costs of the company implementing said procurement, the commission may establish a mandatory rate adjustment clause for the company so affected in order to provide for full recovery of reasonable and prudent overhead and fixed costs.

The Commission should acknowledge that these principles apply in the context of National Grid's gas DSM programs as well as its electric programs. Adopting the proposed RDM would be consistent with this statutory language because "energy efficiency and conservation...is likely to cause under or over-recovery" of fixed costs necessitating a "mandatory rate adjustment clause" (*i.e.*, decoupling) to allow "full recovery"—and disallow over-recovery—"of reasonable and prudent overhead and fixed costs." See R.I. Gen. Laws § 39-1-27.7 (d).

Additionally, the implementation of the company's decoupling mechanism will allow the Company to be a forceful advocate for efficiency in less-direct ways. See Simpson Rebuttal, NGrid Ex. 13 at 4:6-9, Response of ENE to Commission's First Data Request, ENE Ex. 4 at 4-5. As has been acknowledged throughout the proceeding, in addition utility-administered efficiency programs, there are other forces that reduce gas consumption, including improved efficiency codes and standards, technological improvements, and competitive marketplace for efficient products. See Simpson, NGrid Ex. 12 at 19:9-18; Kaplan, Tr. 10/23 at 135-136. Because it is in a unique position to interact and advise customers and policymakers, National Grid can and should be a strong advocate for these cost-saving energy efficiency measures that occur outside the scope of its DSM programs. For these reasons, there is a strong public interest—both in terms of cost savings and environmental goals—In aligning National Grid's financial incentives with those of customers in supporting consumption reductions through the adoption of its revenue decoupling mechanism.

- D. The Commission Should Adopt the National Grid's proposed Revenue-per-Customer Decoupling Mechanism because it will *Eliminate* the Economic Disincentive to invest in Cost-Saving Energy Efficiency.

The Commission should adopt the RDM because National Grid has designed a decoupling mechanism that will *eliminate* the disincentive to invest in energy efficiency programs because it severs the link between sales and revenue on a per-customer basis. If the Company's decoupling mechanism is adopted, National Grid will no longer have an economic incentive to maximize the amount of gas each customer uses because actual revenues-per-customer will be reconciled against a target revenue-per-customer. Moreover, the Commission has the authority to set a target revenue-per-customer level that it is just and reasonable. Because

it would achieve the public policy goal of removing a potent obstacle to maximizing cost-effective energy efficiency investments, the Commission should approve the proposed RDM.

E. The Commission Should Conclude that National Grid’s Proposed Decoupling Mechanism is the Most Viable Way to Eliminate the Efficiency Disincentive.

1. *So-called “partial” decoupling mechanisms advocated by the Division do not eliminate the disincentive to energy efficiency investments.*

This Commission should conclude that partial decoupling mechanisms do not achieve the goal of eliminating the sensitivity of National Grid to gas sales. During the hearings in this docket, the Division’s decoupling witness Mr. Oliver made reference to a series of “partial” decoupling mechanisms—a weather normalization adjustment, the use of fixed customer charges, and declining block rates—to suggest that these mechanisms were somehow sufficient to eliminate the disincentive. See Oliver, Tr. 10/21/08 at 103:8-15; see also Oliver, DIV Ex. 3 at 4. Even his own testimony makes clear that these structures do not eliminate the Company’s sensitivity to sales. See Oliver, Tr. 10/23/08 at 179:20-180:2; see also Stavropoulos, Tr. 10/22/08 at 98:19-99:22 (concluding that none of the claimed partial decoupling measures in place remove the disincentive individually or collectively). As a result, the Commission should reject the Division’s call to preserve the status quo and should instead adopt the RDM that fully eliminates the disincentive to efficiency investments.

2. *Adoption of National Grid’s Proposed Decoupling Mechanism Will Not Guarantee Profits.*

Because the Company, under its decoupling mechanism, will need to manage its costs carefully and prudently in order to earn its allowed return on equity, the Commission should conclude that the decoupling mechanism does not “guarantee” utility profits. For each

applicable rate class, the mechanism would set a target revenue-per-customer based on test year billing determinants. Thus, the total revenue generated by a particular rate class will be dependent upon the number of customers. The result is a decoupling mechanism that does not guarantee the company profits—in this regard, the Company’s motivation to reduce expenses and remain fiscally efficiency is no different from current practice because the better it is able to manage and reduce its costs, the better its chances of achieving its allowed ROE. See Tr., 8/27/08 at.57:21-23. Accordingly, the Commission should conclude that the decoupling mechanism does not guarantee Company profits.

3. *Straight Fixed Variable Would Lead to Inequitable Results and Discontinuities in Customer Bills.*

During the hearings, National Grid witness Simpson and Division witness both discussed an alternative to the Company’s RDM, known as “straight-fixed variable” (“SFV”), in which all distribution revenue would be collected through fixed charges. See Simpson, Tr. 9/12/08 at 114-115; Oliver, Tr. 10/21/08 at 110-112. SFV models reduce economic signals to customers to conserve because they would not be able to control the distribution side of their bill through lower usage. See ENE Ex. 5. According to the Company, were SFV employed in Rhode Island, fixed customer charges would increase between 131% and 1,519% depending on the rate class. See id. The Commission should concluded that SFV is a poor policy choice because it (1) would lead to dramatic increases in monthly charges; (2) would reduce customers’ ability to control their bills, and (3) would lead to an inequitable result in which large and small users within the same rate class pay the same amount for distribution regardless of the difference in usage.

F. The Company's Modifications to its Original Decoupling Proposal are Reasonable and Have No Bearing on the Applicability of the Mechanism to the Excluded Rate Classes.

Because the Company's modifications to its RDM are reasonable, the Commission should adopt them. Originally, the Company's proposal would have included customers in all firm rate classes, except "new" large and extra large customers. Since its April 1<sup>st</sup> filing, the Company has twice amended its decoupling proposal. First, it exempted all customers in the large low load, large high load, extra-large low load and extra-large high load rate classes. Second, the Company proposed to exclude low-income rate classes from the decoupling mechanism. In its initial Comments, ENE advocated for amending the decoupling mechanism to avoid unintended consequences associated with rate classes with small, heterogeneous membership. See ENE Comments, ENE Ex. 1 at 12. The Company's proposed exclusion of the large and extra large rate classes addresses ENE's articulated concerns.<sup>7</sup> By excluding large and extra large firm customers, this avoids small, heterogeneous classes from bearing a disproportionate burden resulting from changes in customer count. See MA Dept. of Public Utilities, "Investigation by the Department of Public Utilities on its own Motion into Rate Structures that will Promote Efficient Deployment of Demand Resources," D.P.U. 07-50-A, ENE Ex. 3 at 54-55.

Because the amended decoupling proposal will eliminate the efficiency disincentive for the vast majority of the Company's revenue and customers, the Commission should find that the RDM is appropriate for the remaining classes (*i.e.*, residential non-heat, residential heat, small

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<sup>7</sup> In contrast to excluding these rate classes, ENE advocated for the application of the decoupling mechanism across all rate classes. Nevertheless, the Company's proposed changes relieve ENE's concerns because relatively small, heterogeneous rate classes would no longer be subject to the decoupling mechanism.

commercial and industrial and medium commercial and industrial). Although ENE continues to believe that all firm customers should be subject to the decoupling mechanism, the vast majority of National Grid customers would still be subject to the under the Company's proposed exemptions of certain rate classes. Under the revised RDM proposal, approximately 80% of the company's revenue will be subject to the decoupling mechanism.

The Commission should adopt the decoupling mechanism because its design eliminates any risk of cross-subsidization. The Commission voiced concerns about potential cross-subsidization several times during the hearings. See, e.g., Tr. 9/26/08 at 72:18-73:1, Tr. 9/29/08 at 189-191. Yet, because it would reconcile differences between actual and target revenues separately for each rate class, the Company's RDM proposal avoids cross-subsidization between rate classes by reconciling. Any adjustments to distribution rates would be based solely on revenues per customer *within a rate class*. As explained by National Grid's witness Mr. Simpson, customers in one rate class would not be affected by any revenue surpluses or shortfalls in another rate class. See Simpson, Tr. 9/12/08 at 10:13-24. Thus, the RDM's design avoids any chance revenue fluctuations in one class will have an impact in other rate classes.

**G. The Commission Should Adopt National Grid's Full Decoupling Mechanism as Other States Have Done.**

As discussed by Mr. Simpson, several states and jurisdictions have adopted revenue decoupling mechanisms to facilitate increased efficiency investments and greater revenue stability for utilities. See Response to TEC-RI Data Request TEC-RI 1-77, TEC-RI Ex. 13; Simpson Rebuttal, Updated Attachment NG-JDS-3. According to the Regulatory Assistance Project, another ten states are currently considering decoupling mechanisms. See ENE Ex. 2 at

43. The longest-standing and most established decoupling mechanisms are in California which has had decoupling for its gas utilities for nearly 30 years.<sup>8</sup> Through decoupling, California's gas companies have been held to remarkably stable earnings despite increases in annual operating expenses.

Massachusetts, in a July 16, 2008 Order from its Department of Public Utilities, will require decoupling for both its gas and electric utilities as a component of each company's next rate case. See MA Dept. Pub. Util., Investigation by the Department of Public Utilities on its own Motion into Rate Structures that will Promote Efficient Deployment of Demand Resources, D.P.U. 07-50-A, ENE Ex. 3. Massachusetts has acknowledged that decoupling is necessary to align the interests of gas utilities with their customers in order to lower customers' energy bills.

The MA DPU correctly found:

Full decoupling completely and effectively removes the disincentives that distribution companies currently face regarding expanded deployment of demand resources. Other ratemaking alternatives such as base rate redesign, LBR recovery (or targeted decoupling), partial decoupling, and shareholder incentives do not sufficiently address the issue of disincentives.

Id. at 47.

The only feasible way to break the counterproductive – *and costly*– link between utility sales and revenues is through a full decoupling mechanism like the one proposed by National Grid in this Docket. At this time of high energy prices, this Commission should afford Rhode Island ratepayers the same benefits as these other states by adopting the RDM proposal, and thus implementing a full decoupling mechanism in this docket.

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<sup>8</sup> Despite Mr. Oliver's claim of "revisionist" history, the evidence in the record demonstrates California's long and successful history with decoupling. See Simpson, Tr. 9/12/08 at 55:17-56:6; RAP Decoupling Report, ENE Ex. 2 at 16-17; California PUC Brochure on Decoupling, CLF Ex. 9; Cf. Oliver, Tr. 10/23/08 at 183:1-14.

IV. CONCLUSION

For the foregoing reasons, the Commission should adopt National Grid's proposed full decoupling mechanism, as amended by the Company during this proceeding.

Respectfully submitted,

ENVIRONMENT NORTHEAST

By its attorneys,



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Jeremy C. McDiarmid  
ENVIRONMENT NORTHEAST  
8 Beacon Street, Suite 415  
Boston, MA 02108  
617-742-0054  
[jmcdiarmid@env-ne.org](mailto:jmcdiarmid@env-ne.org)

Roger E. Koontz  
ENVIRONMENT NORTHEAST  
15 High Street  
Chester, CT 06412  
[rkoontz@env-ne.org](mailto:rkoontz@env-ne.org)

W. Mark Russo  
FERRUCCI RUSSO P.C.  
55 Pine St.  
Providence, RI 02903  
[mrusso@frlawri.com](mailto:mrusso@frlawri.com)

CERTIFICATE OF SERVICE

I hereby certify that on November 6, 2008, I delivered a true copy of the foregoing document either by first class mail or by electronic mail to the Docket 3943 Service List.

A handwritten signature in black ink, appearing to read "Jeremy C. McDiarmid". The signature is written in a cursive style with a large initial "J" and "M".

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Jeremy C. McDiarmid