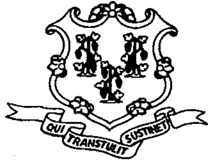

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051

DOCKET NO. 08-07-04 APPLICATION OF THE UNITED ILLUMINATING COMPANY TO INCREASE ITS RATES AND CHARGES

February 4, 2009

By the following Commissioners:

John W. Betkoski, III
Donald W. Downes
Anthony J. Palermino

DECISION

clarify the differences in the service termination process between metered and unmetered accounts. UI states that this will eliminate the possibility of post-dated final bills or back-dated move outs. Lundrigan and Colca PFT, p. 13.

The Department finds this approach reasonable and approves the Term and Condition. There were no comments from the parties on this issue.

5. Decoupling

a. Introduction

Section 107 of Public Act 07-242, An Act Concerning Electricity and Energy Efficiency, (Act) requires the Department to implement decoupling of UI's distribution revenues from the volume of electricity sales. The Act further requires the Department to achieve decoupling through one of the following means, either singly or in combination:

- ✓ a mechanism that adjusts actual distribution revenues to allowed distribution revenues,
- ✓ rate design changes that increase the amount of revenue recovered through fixed distribution charges, or
- ✓ a sales adjustment clause and/or rate design changes that increase the amount of revenue recovered through fixed distribution charges.

b. UI Proposal

UI states it has experienced an unprecedented reduction in sales, resulting in negative sales growth in 2006, 2007 and 2008. Additionally, UI believes that the potential for additional reductions in sales from other initiatives such as the Integrated Resource Plan (IRP), conservation and load management (C&LM) efforts and distributed generation installations will further increase the deficit between the sales that were allowed in Docket No. 05-06-04 and UI's actual experience. UI goes on to state that this experience justifies the implementation of a true sales and revenues decoupling mechanism. Vallillo PFT, p. 4.

UI proposes to implement what it believes to be a simple and effective decoupling mechanism to comply with the directive of Public Act 07-242 and describes the mechanism as follows. The Department determines UI's revenue requirement in a formal rate case proceeding. In the first year following the rate case, if the Company's actual revenues are different from the approved revenue requirement due to a variance between actual sales and the sales forecast used to determine the revenue requirement, the Company's revenues would be trued-up, that is, increased or decreased to the allowed revenue requirement. UI believes the true-up process should be conducted annually, but could be done more frequently if required. By truing up actual revenues (up or down) to approved revenue requirements, UI claims its decoupling mechanism will assure that the revenue the Department approves in a rate case will actually be realized, no more, no less. If sales differ from the forecast for any reason, the decoupling mechanism assures that UI is neutral to those changes. Response to Interrogatory OCC-126; Tr. 10/15/08, pp. 155-158, Id., p. 6

Once the true-up amount is determined, rates would be adjusted going forward to recover a shortfall or refund any excess through a line item on customer bills. UI believes that the potential for frequent rate cases can be mitigated by applying an appropriate index to adjust the Company's revenue requirements for subsequent years or through a multi-year rate plan. Id.

UI proposes to implement its decoupling mechanism through a tariff rider and suggests the following language be applied:

> The Company's annual revenue requirement as approved by the Department of Public Utility Control in a regulatory proceeding shall be trued-up at the end of the 12 month period in question. Each customer shall be either credited or debited, on a kWh basis, for either the under or over recovery of annual revenue requirements on a sales basis. This charge or credit will continue for a 12 month period until the time of the next true-up and any residual amount will be included in the next years' true-up. Response to Interrogatory OCC-127.

UI proposes that no customer be excluded from the decoupling mechanism and that the calculation be performed as soon as calendar year data is available, approximately the beginning of February of the following year. Any applicable charge or credit would be applied to the customer's bill beginning in the March meter cycle following the period subject to reconciliation.[13] Id.

UI notes that although it would have an assurance of recovering its authorized revenue requirement it would not be insulated from any other business risk. The Company must continue to manage all expenditures individually and collectively to meet all its service obligations to achieve its allowed ROE. For instance, if UI's revenues are exactly equal to the DPUC approved amount, but the Company experiences a cost overrun for tree-trimming, it must offset this overrun in order to achieve its allowed ROE. As a result, the proposed decoupling mechanism does not provide a guarantee that UI will achieve its allowed ROE because management still must work hard to manage the Company's operations, contain costs, provide high quality customer service and deliver electricity reliably to earn its allowed ROE. Id.

As part of its decoupling proposal UI offers to add incremental investments of $4.5 million and $18 million in 2009 and 2001, respectively, to its current C&LM efforts. The Company would add this investment to its rate base with the same capitalization and rate of return as standard distribution investments. Similar to the current treatment of C&LM funds, the Department would determine the utilization of these funds. UI claims the benefit of this aspect of its proposal provides additional investment in C&LM without requiring an increase to the current 3 mill/kWh line item charge on customer bills. Id., p. 7

UI points out that its uncollectible expense is independent of the proposed decoupling mechanism. For example, if uncollectible expense is greater than the amount approved in rates, UI states it must offset the increase with other cost

[13] March is used in the Proposal because UI anticipated implementing its decoupling mechanism February, 2009.

reductions or experience a lower return on equity. Therefore, this expense would not be trued-up as part of the mechanism. Id.

c. Position of the AG

The AG states the evidence presented demonstrates that the proposed decoupling mechanism is unnecessary and inappropriate. In support of its position the AG argues that the proposal unfairly and improperly shifts the business risk of variation in sales from UI to its customers, thereby guaranteeing that UI's allowed revenues will be achieved. The Department should not require that utility customers provide this assurance. Instead, this business risk should remain with UI. The AG further argues that UI's ROE provides a cushion to absorb sales fluctuation and it is the ROE that provides an incentive for the Company to operate in a lean and efficient manner. AG Brief, pp. 24-26.

The AG continues stating UI did not include any downward adjustment to its ROE as part of its decoupling proposal, despite the fact that the Act requires this adjustment and the proposed mechanism would eliminate a substantial business risk that is currently embedded in UI's ROE. As a result, UI's proposal would result in a substantial windfall to its shareholders at the expense of its customers. Id.

Based on the foregoing, the AG recommends the Department reject UI's decoupling proposal. However, should the decoupling proposal be approved, the AG states that the Department must adjust UI's ROE downward by .5% and 1.0% to recognize the elimination of the significant business risk associated with fluctuation in sales. Id.

d. Position of the OCC

OCC states that the requirement of Public Act 07-242 to decouple distribution revenues from sales volumes is an important issue in this docket, as the Department's treatment of decoupling here may become precedent for its implementation of decoupling with respect to the three gas distribution companies in the state. OCC notes that the Department has addressed The Connecticut Light and Power Company (CL&P), in the Decision dated January 28, 2008, in Docket No. 07-07-01, Application of The Connecticut Light and Power Company to Amend Rate Schedules (CL&P 2007 Rate Case Decision). OCC Brief. pp. 34-50.

OCC continues, stating that Section 107 of the Act has a legislative predecessor, Section 21 of Public Act 05-1, An Act Concerning Energy Independence which required the Department to conduct an investigation regarding decoupling. The Department reported its findings to the Legislature in its Decision dated January 18, 2006 in Docket No. 05-09-09, DPUC Investigation into Decoupling Energy Distribution Company Earnings from Sales (Decoupling Decision). Id.

OCC's position is that the broad-scale decoupling scenario proposed by UI is fundamentally incompatible with time-tested and well-proven ratemaking principles that are an integral part of Title 16 of the Connecticut General Statutes which the Act does not override. In support of its position OCC cites information from The National

Association of State Utility Consumer Advocates (NASUCA) which recently articulated its position on decoupling in NASUCA Resolution 2007-001. Id.

OCC points out that NASUCA generally concluded that utility ratemaking, being forward-looking and based on a thorough review of utility revenues and expenses in rate case proceedings, should offer utilities no more than a reasonable opportunity to recover their costs. Further, decoupling diminishes the utility incentive to control costs that otherwise would exist between rate cases, and, decoupling is not necessary to assure the implementation of cost-effective energy efficiency programs in utility franchise territories. OCC observes that the results of its analysis are generally consistent with the predicates embedded in this NASUCA resolution. Id.

OCC argues that any sound regulatory assessment of decoupling must first verify that the claimed disincentive to promote conservation exists. In other words, if this so-called disincentive can be shown to be weak or nonexistent, the case for decoupling would be weakened beyond repair. OCC believes the notion that traditional regulation provides utilities with a disincentive to promote energy conservation is "vastly overblown" and asserts that utilities that are subject to traditional regulation often have been very effective in promoting conservation because traditional regulation provides several proven means to address the effects of conservation efforts on utility operations. Putting this point another way, decoupling is generally not an effective means to promote conservation. While it insulates the decoupled utility from any revenue risks associated with conservation efforts, OCC argues this protection is unnecessary. Id.

OCC states that UI's advocacy of decoupling in this proceeding has nothing to do with conservation programs and cites UI's testimony in support of this position stating that the Company insisted that the purported disincentive to promote conservation was not the reason to support decoupling. Tr. 10/15/08, pp. 222-225. Instead, UI provided evidence that the underpinning for decoupling is revenue stability which OCC observes would violate traditional ratemaking principles. Id.

OCC notes that UI did not adjust its ROE to reflect decoupling and argues that UI wrongly asserts that the market has already priced decoupling into the Company's required rate of return. UI's claim would be true if each company in the Company's proxy group employed a decoupling mechanism similar to the one proposed by UI. However, only two of the twenty companies in the proxy group have decoupling mechanisms in place at present and those mechanisms are dissimilar to UI's proposal. Therefore, if UI's decoupling mechanism is approved, the Company's ROE must be adjusted to reflect the decreased risk associated with UI's revenue recovery as well as to fulfill the requirements of the Act. Put simply, OCC declares that since decoupling reduces the company's business risk, its required rate of return is also reduced. OCC points out that the Department has recognized this important point in its Decoupling Decision. In that Decision the Department observed that decoupling could produce an inequitable shift of normal business risks from utilities to their ratepayers. Id.

In summary, OCC believes that decoupling mechanisms inherently harm ratepayers by shifting normal business risks of utilities onto ratepayers. Further, decoupling is not an effective means to promote energy conservation, and may in fact have anti-conservation effects. As a result, because Section 107 of the Act gives the

Department substantial discretion in implementing decoupling, OCC recommends the Department reject UI's proposal and approve a Conservation Adjustment Mechanism (CAM) instead. OCC notes that the Department opposed the use of a CAM in its Decoupling Decision but points out that a CAM should not be rejected out of hand simply because the Department's experience with this mechanism two decades ago was mixed. Rather, as with any regulatory tool, a CAM should be carefully reviewed and considered in the context created by all applicable facts and background conditions. Finally, as directed under the Act, approval of any decoupling mechanism requires an appropriate downward adjustment to the Company's allowed ROE. Id.

The Company's proposed decoupling mechanism should be rejected by the Department. Instead the Department should adopt a conservation adjustment mechanism (CAM) to recover lost sales margins directly associated with Company-sponsored conservation programs. Id.

e. Position of CIEC

CIEC opposes UI's proposed Revenue Decoupling Mechanism (RDM) stating that it is not required by law and would produce unwanted incentives for the utility. In addition, decoupling is unnecessary because UI's existing rate structure already provides incentives regarding the efficient use of energy. CIEC notes however that should the Department approve an RDM, UI's large customers should be exempted from the mechanism. CIEC Brief, pp. 10-17.

CIEC states that while Public Act 07-242, requires the Department to decouple UI's distribution revenues from the sale of electricity the Act does not mandate the use of an RDM. Further, CIEC believes that rate design, which may be used to fulfill the requirements of the Act and has been approved as the decoupling approach for CL&P, is the preferred option. Id.

CIEC goes to argue that contrary to the legislative intent of the Act, the proposed RDM in not a tool to promote conservation but instead is a means to provide revenue stability for UI. CIEC goes on to provide a lengthy explanation of UI's current and past conservation and load management (C&LM) efforts and cites UI's success in earning C&LM-related financial incentives as a reason why UI's RDM is not needed to incent UI to promote conservation. CIEC also claims that an RDM is unnecessary because there are several mechanisms in place that provide incentives to UI as well as adjusting UI's distribution revenues for lost sales. These include load curtailment, demand reduction and distributed generation programs. As a result, CIEC believes that there is no disincentive to UI to pursue energy efficiency or the installation of distributed generation. Id.

CIEC also believes that the proposed RMD is contrary to the state's economic development goals. For instance, CIEC states that since a decline in business activity would not impact distribution revenues UI would be indifferent to retaining or promoting business activity within its service territory. Finally, CIEC argues that an RMD will send improper price signals to customers since there would be no incentive for UI to keep rates competitive. Id.

f. Department analysis

Decoupling has been mandated. As a result, the Department must determine the degree to which UI should be provided with certainty in recovering the revenue requirement that is determined necessary to support the distribution of electricity. Primary among the reasons cited by Participants to deny UI's proposed mechanism is that in general Participants believe that no disincentive exists for UI to promote conservation. As such, they believe there is no need to implement full decoupling as proposed.

The reason to examine decoupling extends beyond whether UI is willing to implement cost-effective efficiency programs. This examination must consider the current regulatory landscape and the present and future impact of the multiple policies and initiatives that have been created to target energy use in the state. In addition, it is necessary to consider the impact that recent changes in society's overall attitude toward energy and energy-related issues may generally affect UI.

The Department recognized the need to decouple UI's distribution revenues from the volume of electricity sales prior to passage of Public Act 07-242 and as a result, began to decouple UI's rates in 2007. See, 2006 Decision, p. 119 and Supplemental Decision dated August 30, 2006, in Docket No. 05-06-04, Application of The United Illuminating Company To Increase Its Rates and Charges, pp. 19-24 (UI 2006 Supplemental Rate Case Decision). Through those Decisions, the Department required UI to begin the decoupling process by having the Company gradually increase the amount of distribution revenue it recovers through fixed charges. As a result of those Decisions, UI increased its fixed distribution charges in 2008 and 2009 to implement the rate increases that were granted under Docket No. 05-06-04.

While the Department chose to move forward with decoupling by increasing UI's fixed charges it expressed concerned that under this rate design strategy low use residential customers would realize disproportionately greater bill increases (on a percentage basis) than higher use customers.[14] As a result of this concern the Department sought to examine ways to mitigate this impact by exploring non-traditional rate design strategies. The Department required UI to examine the implementation of a sliding scale or tiered residential customer charges and to determine whether residential service connection amperage or other such standards could be used to establish customer charges. See, UI 2006 Supplemental Rate Case Decision, p. 23. Although these strategies were examined, none were implemented and the Department believes they should no longer be pursued. As a result, the Department remains concerned about the impact that continuing to implement decoupling by increasing fixed charges will have on bills for low use customers.

In Docket No. 05-06-04 OCC opposed the Department's plan to increase fixed charges, stating that by shifting distribution revenue recovery from energy charges to

[14] The Department expressed a similar concern regarding the use of fixed charges to implement decoupling for CL&P. See, Decision dated January 28, 2008, in Docket No. 07-07-01, Application of The Connecticut Light and Power Company to Amend Rate Schedules.

fixed charges the Department would discourage conservation. OCC Written Exceptions dated August 8, 2006, p. 12.[15] OCC restated these concerns in the instant proceeding.

Through the Decision dated September 29, 2008, in Docket No. 05-06-04RE04, Application of The United Illuminating Company To Increase Its Rates and Charges - Public Act 07-242, Seasonal Rates, Non Generation-Related Time-of-Use Pricing and Related Rate Design Issues, the Department took additional decoupling-related action by requiring the Company to eliminate time-of-day (TOD) rate differentials from its distribution rates by transferring the differentials to other bill components. As a result, by 2010 UI's peak and off-peak distribution rates will be identical. The Department took this action because having TOD differentials embedded in distribution rates created the potential for UI to under recover allowed revenue requirements as customers shift consumption to off-peak periods. Higher peak distribution charges also provided UI a perverse incentive to promote peak consumption since the Company would receive greater distribution revenues for energy used during peak times. Removing the differential from distribution rates will assure that UI is indifferent to the time period in which customers use energy. Decision, pp. 15-23.

Significant among the reasons cited to move forward with decoupling in Docket No. 05-06-04 was the Department's determination that traditional approaches to ratemaking have linked UI's financial health to the volume of electricity sold resulting in a strong incentive to maintain or increase the sale of energy. The Department found that the effect of this linkage is exacerbated in the case of distribution-only utilities, since the profit impact of electricity sales reduction is disproportionately larger for utilities without generation resources. In some cases, a 1% loss in sales can result in a 5% or greater reduction in profit. This concern remains valid today.

The Act requires the Department to implement decoupling of UI's distribution revenues from the volume of electricity sales through a sales/revenue adjustment mechanism, increases to fixed distribution charges or a sales adjustment clause and/or increases to fixed distribution charges. As noted, while the Department chose to move forward with decoupling through increases to UI's fixed charges, ongoing concerns surrounding the bill impact of this strategy on low use customers require that the Department examine the continued use of this strategy.

A CAM, which is advocated by OCC, is a type of sales adjustment clause. OCC recommends the use of a CAM despite the Department's finding that a CAM is burdensome to administer and has provided perverse incentives for electric distribution companies in the past. Decoupling Decision, pp. 17-19. The Department's findings in the Decoupling Decision remain valid today. As a result, the Department will not pursue a CAM for UI. Therefore, to comply with the Act the Department must consider a sales/revenue adjustment mechanism or the continued increase of fixed charges to advance decoupling.

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[15] OCC expressed this same concern in response to the Department's determination to implement decoupling for CL&P by increasing fixed charges for that utility in Docket No. 03-07-02, Application of The Connecticut Light and Power Company To Implement Time-of-Use, Interruptible or Load Response, and Seasonal Rates. See, OCC Written Exceptions in Docket No. 05-10-03, dated October 25, 2006, pp. 9-14.

As discussed in the Decoupling Decision, a full revenue adjustment clause is easier to administer than a CAM because it unnecessary to determine the cause of lower sales. The full revenue adjustment clause also provides relief and credit at appropriate times because the distribution company receives revenue when sales decline and it provides bill credits to customers when sales are higher than forecasted. In addition to removing the impact of weather, a full revenue adjustment mechanism removes variation due to demand elasticity and economic activity. A revenue adjustment mechanism can also provide benefits to both ratepayers and shareholders. For instance, a full revenue adjustment clause lowers earnings volatility which reduces risk to shareholders. In turn, reduced risk results in a lower cost of capital to the utility which can reduce rates. Decoupling Decision, pp. 17-19.

The Decoupling Decision noted that in 1991 the Department felt it was inappropriate to implement a sales adjustment clause because doing so would shelter electric utilities from the business risk associated with revenue recovery. In addition, the Department expressed concern with this type of clause because it removes the incentive for an electric distribution company to encourage economic development. However, the electric industry and regulatory landscape have changed dramatically since the early 1990s and ratemaking standards must evolve to accommodate these changes. Id.

UI's sales declined in 2006, 2007 and 2008. As a result, actual sales fell below forecasted levels in each year. Specifically, actual sales were 2.2% below their forecasted level in 2006, 3.3% below the forecast in 2007 and 6.3% below the sales that were expected in 2008. Because UI's rates (and therefore its revenue recovery) are based on forecasted sales, the Company did not recover the revenues that were allowed during this period.

Sales are forecasted to decline further in 2009 and 2010. Specifically, UI predicts that its sales will be 7.1% below the level forecasted for 2009 and 10.6% below the forecast in 2010. Forecasted sales were used to establish UI's rates through 2009 in Docket No. 05-06-04. As a result, UI will not recover its allowed revenues for the next two years. Declining sales is among the primary reasons UI has requested rate relief in the instant proceeding. Sales may vary for several reasons including economic activity, change in rates, customer growth or degradation, extreme weather conditions and the impacts of energy policies and conservation programs.

In 2007 UI experienced a dramatic increase in the cost to procure generation services on behalf of its customers. The increase in GSC costs was sustained throughout 2008 and will continue through 2009. This increase created never before realized price induced conservation. The Department believes the vast majority of this reduction is related to changed behavior. As such, the sustainability of this reduction is difficult to forecast. It is also difficult to predict whether additional behavior-related conservation will occur. Approval of a full decoupling mechanism could provide the benefit of future bill credits should ratepayers return to past consumption trends. Bill credits would also be forthcoming in the event extreme weather causes sales to rise. Should UI experience additional price related conservation full decoupling will provide UI an assurance that it will recover its revenues.

Conservation programs initiated by the state and electric distribution companies have also contributed to UI's declining sales. In year 2000 electric deregulation included the creation of the Connecticut Energy Efficiency Fund (C&LM Fund) and the Connecticut Clean Energy Fund (Clean Energy Fund). Combined, these Funds have lowered energy consumption through the programs they sponsor and both Funds have increased awareness about energy efficiency and renewable energy options.

Driven by increases in energy costs in 2007 and 2008, the programs sponsored by these Funds have recently witnessed unprecedented demand. The C&LM Fund reduced program incentives to meet the increased activity. See, Decision dated June 19, 2008, in Docket No. 07-10-03, DPUC Review of The Connecticut Light and Power Company's and The United Illuminating Company's Conservation and Load Management Plan For The Year 2008, and Decision dated September 24, 2008, in Docket No. 07-10-03RE01, DPUC Review of The Connecticut Light and Power Company's and The United Illuminating Company's Conservation and Load Management Plan For The Year 2008 – Program Incentive Structure. The programs supported by these Funds have impacted UI's sales.

Further, driven by global events as well as significant and sustained increases in energy costs Connecticut's energy policies have rapidly evolved over the last five years. The result has been a myriad number of programs and policy initiatives designed to reduce energy consumption, control peak demand and increase awareness about energy in general. These efforts, which are in addition to the C&LM Fund and Clean Energy Fund, include the following:

- ✓ The Distributed Generation Grant Program;
- ✓ The Electric Energy Efficiency Partners Programs;[16]
- ✓ Mandatory TOD rates of large use residential and business customers;
- ✓ Voluntary variable peak price tariffs for UI's largest business customers;
- ✓ Revised net metering standards to encourage smaller renewable projects;
- ✓ Increased efforts to enroll customers in demand response programs;
- ✓ Short-term measures under Docket No. 05-07-14;
- ✓ Class 3 renewable energy credits;

Finally, approval of UI's plans to install advanced metering and the impacts of the Regional Greenhouse Gas Initiative will impact UI's sales in the future.

In addition to the ongoing impact from conservation programs and potential future declines associated with energy-related policies, a downturn in the economy is occurring and will further depress sales over the rate period. The magnitude of sales that may be lost to this downturn is difficult to forecast. Therefore UI's revenue recovery is even more tenuous in 2009 and 2010. The sales/revenue adjustment clause proposed by UI would assure that UI recovers its allowed revenue requirement, no more, no less. Therefore, the risk of fluctuations in revenues associate with the changes in the volume of UI's sales would be eliminated.

[16] This program alone has the potential to increase ratepayer funding for energy efficiency by $60 million per year. This equals about 66% of the current statewide C&LM budget.

The OCC, CIEC and AG indicate that the principle reason for decoupling is to remove a disincentive for electric companies to promote conservation. This disincentive can occur when fixed costs are collected through variable energy and demand charges. Lower sales due to conservation reduce revenue recovery, lowering earnings to the electric company. As a result, a disincentive to fully support a reduction in sales is created. The theory is that decoupling mechanisms can reduce this disincentive which in turn should encourage more aggressive actions by the utility to promote conservation.

OCC, CIEC and AG argue that the C&LM Fund provides financial incentives for UI to support conservation. As a result, decoupling is unnecessary to assure that UI implements cost-effective energy efficiency programs in its franchise territory. The Department agrees. Through the programs supported by the C&LM Fund, and administered by UI, the Company has demonstrated its willingness to pursue conservation, energy efficiency and load management to the extent allowed by available C&LM funding. UI is rewarded for its efforts in this regard through the C&LM Fund's current incentive structure.

CIEC also argues that UI's existing rate structure already provides incentives regarding the efficient use of energy. As a result, UI's proposed decoupling mechanism is not a tool to promote conservation but instead is a means to provide revenue stability for UI. The Department agrees. UI too agrees that conservation is not the reason it proposed a full decoupling mechanism. Instead, revenue stability is UI's primary concern.

The determination as to whether to implement a full sales/revenue decoupling mechanism involves much more than UI's willingness to promote the C&LM programs. This issue must be reviewed in the context of the energy environment described herein.

The environment for traditional ratemaking did not include world wide concerns and related publicity regarding climate change and related issues. Nor did traditional ratemaking include the energy-related policies and programs noted herein. As stated, traditional ratemaking principles have linked UI's financial health to the volume of electricity sold. Based on Connecticut's current and future energy environment the Department believes that maintaining this link is contrary to fulfilling Connecticut's energy policy goals. Therefore, this link must be severed.

Based on the forgoing, the Department believes that no disincentive exists to having UI implement cost-effective energy efficiency programs in its franchise territory to the extent allowed by available C&LM funding. However, a full decoupling mechanism will impact areas where UI does not already receive incentives.

Since 2000, UI has changed from a vertically integrated utility to a distribution only company. While the Company's function has been dramatically altered this change has generally been of little concern to consumers or has gone unnoticed by them. Despite efforts to promote retail choice and regardless whether a consumer has chosen an alternate electric supplier, UI is still viewed as *the* energy provider by the general body of ratepayers. The Department believes this will not change. Therefore, UI will

continue to enjoy a unique and trusted relationship among its ratepayers and will remain an integral part of the communities it serves for the foreseeable future.

Success in achieving Connecticut's energy policy goals requires that the Department take advantage of this relationship to promote the energy-related programs and policies that have been recently set in place. UI will play a key role in aggressively targeting energy consumption in the future and the Department must consider this role as regulatory standards evolve. Approval of UI's proposal provides an opportunity for UI to work aggressively with its customers to reduce their energy consumption and lower their costs. This in turn will enhance its role as the trusted source of energy-related information for its customers. For example, with full decoupling in place UI should be indifferent as to whether a customer uses electricity, natural gas, propane or solar thermal energy to fulfill domestic hot water needs. As a result, UI should become the conduit for providing information pertaining to the most efficient use of our resources.

Those that oppose UI's decoupling mechanism argue that it is fundamentally incompatible with time-tested and well-proven ratemaking principles. Significant among traditional ratemaking principles are the review of utility expenses, the determination of an allowed return on investment and the manner in which revenues are recovered. Approving a full decoupling mechanism will only modify one of these standards; the manner in which revenues are recovered. The Department would continue to rigorously review UI's expenses and allowed return on investment. Therefore, while full decoupling deviates from the traditional manner in which UI's distribution revenues are recovered, full decoupling is compatible with the Department's continued regulatory oversight of UI. The careful review of UI's costs, construction program and allowed ROE in the instant proceeding can be cited as examples of the continued oversight the Department will apply.

Opponents that argue against changing the manner in which UI collects its distribution revenues fail to mention that revenue recovery for non distribution-related costs has evolved to accommodate the changing regulatory landscape. For instance, prior to deregulation UI's revenues were recovered through bundled charges and only the cost of the fuel necessary to operate power plants (or specific fuel-related costs) was subject to reconciliation through a fuel adjustment clause.

However, since the introduction of electric deregulation in 2000, the manner in which UI collects the revenues necessary to provide electric service to its customers has been dramatically altered. A majority of the total cost is now recovered through unbundled charges which are regularly reconciled and trued-up. Except for UI's distribution expense, these charges reflect a pass-through of costs to customers or legislatively mandated rates. For example, the revenue requirement associated with the Generation Services Charge (GSC), Bypassable Federally Mandated Congestion Charge (BFMCC) and Non-Bypassable Federally Mandated Congestion Charge (NBFMCC) is a pass-through that is reviewed annually. Any over/under recovery is trued-up through customer rates. For example, see, Docket No. 08-08-01, Semi-Annual Reconciliation of The Connecticut Light and Power Company's and The United Illuminating Company's Federally Mandated Congestion Costs and Generation Services Charge. The revenue requirement associated with the Competitive Transition

Assessment (CTA) and System Benefits Charge (SBC) are also reviewed and trued-up annually. For example, see, Docket No. 99-09-35RE14, DPUC Determination of UI's Standard Offer. Finally, the revenue requirement associated with providing Transmission service is reviewed, reconciled and trued-up twice a year. For example, see Docket No. 08-12-01, DPUC Semi-Annual Review of The Connecticut Light and Power Company and The United Illuminating Company's Transmission Adjustment Clause, and Decision dated December 14, 2006, in Docket No. 05-08-03, Application of The Connecticut Light and Power Company for Approval of a Transmission Adjustment Clause.

The reconciliation process for these bill components requires the Department to assure that UI recovers the entire cost for providing these services, no more, no less. Therefore, sales-related fluctuations in the revenue that support these unbundled charges are addressed through a revenue true-up. As a result, these bill components, representing approximately 80% of the total cost of providing electric service, have been fully decoupled.

Under traditional ratemaking significant utility, OCC and Department resources have been dedicated to forecasting sales at the time of a rate setting proceeding. Because forecasted sales have driven the final rates that UI charges this process has proven contentious. While approval of a full decoupling mechanism will not eliminate the need to forecast sales, it significantly reduces the effort that must be placed on this process and should eliminate most arguments regarding the reasonableness of the forecast.

UI will be assured of its revenue recovery. As a result, UI should be indifferent as to whether its revenues are collected through fixed charges, energy-based charges or a combination of these rates. UI's proposal relies on a kWh-based decoupling mechanism instead of increases to fixed costs. This allows UI to maintain higher kWh charges which will provide customers with energy-based price signals. The Department prefers this approach to continuing to advance decoupling through increases to fixed charges. Therefore, the Department finds that an energy-based decoupling mechanism is appropriate because approval of UI's plan allows the Department to reduce the emphasis on increasing fixed distribution charges to achieve decoupling. This in turn eliminates the Department's concern regarding the bill impacts associated with fixed cost recovery on low use customers. This also addresses the objections raised by the OCC and Environment Northeast as to the anti-conservation potential associated with fixed cost recovery of distribution revenues.

Approval of UI's proposal allows the Department to lower UI's ROE thereby providing real rate relief which can provide a stimulus for economic development. In addition, UI has a number of incentives in place to assure that it is made whole for or to assure UI's ongoing support of any number of energy related programs. Incentives provided under the DG Grant Program provide an example of these incentives. Approval of a full decoupling mechanism weakens UI's position to argue for future incentives and calls into question the need for allowing incentives that are in place to continue unabated at present levels. Reducing or eliminating current incentives would provide further real rate relief for consumers.

Approval of UI's proposal allows the Department to test UI's claim concerning the need for fewer rate case proceedings which will benefit UI and its ratepayers. For instance, UI spent nearly $1 million to present the instant application dedicating significant resources to this endeavor. Although UI may avoid these proceedings, the Department will continue to monitor the Company's ROE.

Opponents to a full sales/revenue decoupling mechanism argue that UI will have no reason to encourage economic development. One of the best ways to encourage economic development is by reducing electric rates. Approval of decoupling provides an opportunity to provide rate relief through a lower ROE. The Department has done so in this proceeding. Further, as noted herein, decoupling provides the opportunity for additional rate relief through the potential to reduce or eliminate other incentives.

The Department is concerned that this mechanism may create an indifference to the level of UI's overall rates, cost containment or create an incentive to inflate expenses when setting rates. The risk of revenue loss due to lower sales has provided an incentive for the Company to keep its rates down. Given that UI's rates are among the highest in the country the Department must retain incentives for UI to control its costs with the goal of achieving lower rates. Therefore, while the decoupling mechanism is being approved with modifications, and will be allowed to operate to reconcile UI's 2009 and 2010 revenue requirements, this method of advancing decoupling is not permanent. To clarify, UI's 2009 and 2010 revenue requirements will be reconciled under the decoupling mechanism approved herein in early 2010 and 2011, respectively. However, the decoupling mechanism is provisional and will not continue beyond 2010 unless expressly approved by the Department.

The Department intends to evaluate the operation of UI's decoupling mechanism in the later part of 2010 and determine whether to end, modify or allow decoupling to continue unchanged. As part of its ongoing evaluation the Department will review UI's reliability, customer service and other quality metrics as well as economic impacts on customer classes. Should the Department witness declines in these standards or observe unusual, significant or unwarranted cost increases it will not retain the decoupling mechanism approved herein.

Regarding uncollectibles, currently UI's allowed revenue requirement includes a level of uncollectible expense. Like other expenses, if UI reduces its uncollectible expense, the Company can improve its earnings. However, unlike other expenses, which are not directly linked to revenues, an increase to UI's uncollectibles means that additional revenues were not recovered. UI believes its uncollectible revenues should be reconciled as part of the decoupling mechanism.

Reconciling UI's uncollectible revenues as part of the decoupling mechanism would reduce UI's incentive to minimize this cost. Therefore, the Department believes that it is inappropriate to allow UI to reconcile its uncollectible revenues as part of the decoupling mechanism. As a result, to properly account for uncollected revenues, class sales and revenues will be used to determine the total revenues that will be reconciled under the decoupling mechanism.

The following provide examples. Assume that the allowed revenue requirement is $100 million and includes allowed uncollectibles of $5 million. Example 1, uncollectibles exceed the allowed amount. Assume that actual annual revenues total $97 million but actual uncollectibles total $8 million. The difference between the allowed and actual uncollectibles, $3 million, ($8 million minus $5 million allowed) will be added to actual revenues and reconciled to the approved revenue requirement. In this case there would be no decoupling adjustment ($97 million + $3 million = $100 million). In this example, UI would not recover the additional $3 million through the decoupling mechanism. However, as has always been the case, the incentive remains for UI to pursue recovery of these revenues.

Example 2, uncollectibles are lower than allowed and revenues increase due increased sales. In this case actual uncollectibles are $3 million and sales generate revenues of $105 million. The difference between the allowed and actual uncollectibles, a negative $2 million, ($3 million minus $5 million allowed) will be added to actual revenues and reconciled to the approved revenue requirement. In this example, UI would retain the additional $2 million which represents a decrease in from the allowed uncollectibles. In this case the decoupling adjustment would yield a credit of $3 million because actual revenues of $103 million ($105 million minus $2 million = $103 million) are greater than the allowed revenue requirement of $100 million.

As part of its decoupling proposal UI offers to add incremental investments to its current C&LM efforts, to add this investment to its rate base and to treat the investment as additional funding through its C&LM programs.

The Department has previously indicated that it does not favor rate base treatment of conservation as this would increase customer rates. See, Decision dated September 24, 2008, in Docket No. 07-10-03RE01, p. 5, as well as the analysis contained herein. Further, the proposal implies that UI would apply its current C&LM standards to the incremental investment. This aspect of the proposal is most unacceptable since UI would be in a position to earn both a C&LM incentive and an ongoing return on these dollars. Based on the foregoing, this aspect of the proposal is denied.

UI has experienced erosion in sales and believes that further degradation to sales will occur. As a result, the Company did not recover its allowed revenue requirement in 2006 and 2007 and is concerned it may not recover its distribution revenue requirement or that it will experience instability in revenue recovery going forward. To address this matter, and to comply with the Act, UI proposes a full sales/revenue decoupling mechanism intended to maintain stability in the recovery of its distribution revenues.

Deregulation significantly altered the structure of UI's business and Connecticut's electric industry in general requiring modifications to the regulatory structure. In addition, global events, combined with significant and sustained increases in energy costs, have resulted in the deployment of a number of energy policies and initiatives targeting energy and related issues. These efforts have directly impacted UI's sales and will continue to do so in the future. These changes require the Department to adapt regulatory standards to meet Connecticut's energy challenges. Evaluation of full

decoupling through implementation of this provisional mechanism is an appropriate step to keeping pace with these changes.

A sales/revenue adjustment mechanism will reduce earnings volatility previously associated with changes in sales. This will benefit the Company since fewer rate case proceedings should be needed and will benefit customers through the rate reduction that resulting from a lower ROE. This adjustment mechanism should eliminate any disincentive for UI to aggressively support conservation and other energy policy initiatives that would impact sales. The Department believes that UI will continue to support C&LM programs to the extent that program funding allows. However, faced with the potential for continued significant declines in revenue, without the assurance of full decoupling it is unreasonable to expect that UI would fully support all energy related policies and initiatives. Based on the foregoing, the Department approves a revenue decoupling mechanism subject to the modifications and tariff language discussed below.

The above reflects the Department's intention regarding the operation of the sales/revenue decoupling mechanism. However, as discussed below, UI must submit final tariff language for Department approval.

6. Revenue Decoupling Rider

UI seeks to implement its decoupling proposal through a tariff rider. Under the proposal, if the Company's actual revenues are different from the Department-approved revenue requirement due to a variance between actual sales and the sales forecast used to determine the revenue requirement, the Company's revenues would be trued-up, that is, increased or decreased to the allowed revenue requirement. The true-up would be calculated annually, allocated to each customer class based on revenue and recovered or refunded through a separate kWh-based line item on all customer bills. Sales, and therefore revenues would not be weather normalized or subjected to any other adjustments.

The Department finds that UI's proposed mechanism is straightforward. It compares actual revenues, minus uncollectible, to the Department-approved revenue requirement, minus allowed uncollectible, and excludes any adjustments for weather, conservation, economic activity, etc. Any difference is refunded to or collected from ratepayers. Sales will be reviewed at the time of the true-up, and used to assign the kWh value of the charge or credit. Revenues will form the basis for this mechanism and will include an adjustment to account for uncollected revenues. The level to which actual sales will vary from the forecasted level in a rate case is unknown. As a result, calculating the rate that will be applied to customer bills for the true-up could rely on the sales forecast that established base distribution rates (i.e., the forecast used in the rate setting proceeding) or could be calculated by using then current sales data or other means. Therefore, UI will be required to provide the historical and current sales forecast as part of its annual decoupling filing. UI will also be required to identify any uncollected revenues. The Department will determine the sales level that will be used to calculate the decoupling rate at the time of each decoupling proceeding.

Regarding bill presentation, the Department will require UI to implement a separate line item to reflect this adjustment. UI must propose a title for this line item when it submits its tariff proposal. The Department must approve the title of the line item that will appear on customer bills. The line item must be applied to all customers and billed on a kWh basis. Regarding Rate LPT, while distribution revenues are not billed on a kWh basis under this tariff, Rate LPT includes energy-based Transmission and other charges. Therefore, it is reasonable to assess an energy-based decoupling charge under Rate LPT.

To assure that only actual data is being reviewed the first decoupling filing should be submitted approximately 14 months after a rate case is decided, or as soon as actual data is available. The Department also believes that the decoupling mechanism should not be applied if the difference does not equal or exceed $1 million. However, an annual filing must be submitted for Department review. Therefore, if the difference is plus/minus $1 million, UI must submit a filing under its decoupling mechanism and must defer this amount for inclusion in the next decoupling filing. As noted above, uncollected revenues cannot be trued-up under this mechanism. The Department provides the following tariff language as a guide to finalizing this mechanism. However, UI must submit a tariff for final Department approval.

> The Company's annual distribution revenue requirement as approved by the Department of Public Utility Control in a regulatory proceeding, less uncollected revenues, shall be trued-up at the end of a 12 month period. Each customer shall be credited or debited, on a kWh basis, for the under or over recovery of the difference between the Department approved annual distribution revenue requirement and the Company's actual distribution revenues as approved by the Department in a decoupling proceeding. The calculation shall include an adjustment for uncollected revenues and must be based on actual sales and revenue data. A decoupling rate will not be applied to customer bills if the under or over recovery of the allowed revenue requirement does not exceed $1 million and the difference will be deferred for inclusion in a future decoupling adjustment filing or rate case proceeding, whichever occurs first. The Company must submit an annual decoupling filing which shall be subject to full review by the Department.
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> The charge or credit will be applied for a 12-month period. Any over or under recovery of the previous years' revenue decoupling adjustment or any deferred amount will be rolled into the calculation of the subsequent annual decoupling adjustment or rate case proceeding, whichever occurs first. At the time of each annual true-up the Company will present the sales forecast that was used to determine base distribution rates as well as its then current sales forecast and shall propose decoupling true-up rates based on both forecasts. The Company must also identify any uncollected revenues. The Department will determine the level of sales used to calculate the adjustment and final rates. There will be no carrying costs assigned to either the over or under recovery as determined under the decoupling mechanism.