



The Commonwealth of Massachusetts

DEPARTMENT OF PUBLIC UTILITIES

D.P.U. 07-50

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Investigation by the Department of Public Utilities on its own Motion into Rate Structures that will Promote Efficient Deployment of Demand Resources.

VOTE AND ORDER OPENING INVESTIGATION

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I. INTRODUCTION

The Department of Public Utilities (“Department”) opens this inquiry to investigate rate structures and revenue recovery mechanisms that may reduce disincentives to the efficient deployment of demand resources in Massachusetts.¹ This investigation will review features of current ratemaking practices by which electric and natural gas utilities in the Commonwealth recover their prudently incurred, just and reasonable costs (including return on investment), and will consider whether and how existing mechanisms may be changed to better align companies’ financial interests with the needs to (1) capture all available and economic system and end-use efficiencies and their associated reliability, economic and environmental benefits, and (2) foster the advancement of price-responsive demand in regional wholesale energy markets. In consideration of these pressing needs, the goal of this inquiry is to establish guidelines that will govern the Department’s approach to fulfilling its existing statutory obligation under G.L. c. 164, § 94 to investigate the propriety of any rate, price or charge collected within the Commonwealth for the sale and distribution of electricity or natural gas.

Currently, a gas or electric company’s total annual base distribution revenues are collected through charges determined during a base rate proceeding using a test year level of sales.² However, because consumption can and does vary after those charges have been set,

¹ Demand resources are installed equipment, measures or programs that reduce end-use demand for electricity or natural gas. Such measures include, but are not limited to, energy efficiency, demand response, and distributed resources.

² Electric and gas companies derive their regulated revenues from the delivery (or throughput services) of electricity or gas. Therefore, the Department’s references here
(continued...)

the effect of post-test year changes in sales on a company's revenues can be significant.

Consequently, once charges are set, electric and gas companies have a strong incentive to take actions to increase sales (thereby increasing revenues) and an equally strong incentive to avoid any decrease in sales (thereby decreasing revenues). These incentives may not be well aligned with important state, regional, and national goals to promote the most efficient use of society's resources, lower customer bills through increased end-use efficiency, enhance the price-responsiveness of wholesale electricity markets, mitigate the social and economic risks associated with climate change, and minimize the environmental impacts of energy production, transportation, and use. Moreover, these incentives also may deter actions and investments, such as the expansion of efficiency, demand response, and distributed resources that are effective in reducing natural gas or electricity demand under high-load conditions, that could moderate some of the impact of electricity and natural gas commodity price levels and volatility on end-use consumer prices. Importantly, reductions in wholesale commodity prices or price volatility benefit all end-use customers, not only those who participate in demand resource programs.³

² (...continued)
to sales mean delivery (or throughput services), unless otherwise stated or the context so implies.

³ Perhaps the most significant and unpredictable component of end-use electricity and natural gas costs is associated with the wholesale commodity purchase price. Reducing demand for electricity and natural gas under high-load conditions can contribute to a lowering and/or stabilization of this energy cost component. While beyond the scope of the present inquiry, the Department notes that there are other strategies to mitigate the impact of volatility in commodity markets, such as commodity price hedging,
(continued...)

In this context of elevated and volatile prices in wholesale energy commodity markets, the Department anticipates that demand resources will play an increasingly important role in Massachusetts and across the region in the provision of electric and gas service that is safe, reliable, and reasonably-priced. However, because demand resources are located on the customer side of the meter, in the current ratemaking context they always will reduce a company's sales. This inherent conflict between the incentive to increase sales promoted by current revenue-collection mechanisms and the reduced consumption resulting from the use of demand resources creates a significant barrier to the efficient deployment of these important resources, one that must be addressed expeditiously.

In opening this inquiry, the Department presents a straw proposal for a base revenue adjustment mechanism which renders electric and gas companies' revenue levels immune to changes in sales between rate proceedings (see Section III, below). The straw proposal describes a mechanism that severs the link between electric and gas companies' revenues and sales and, instead, ties company revenues to the number of customers served. However, at the customer level, the straw proposal retains unit-based energy and demand pricing to preserve the link between customers' costs and their levels of consumption. The Department's inclusion of a straw proposal at the outset of this inquiry is intended to provide initial guidance, to foster consideration of appropriate mechanisms, and to help focus the scope of the proceeding and the comments of interested persons.

³ (...continued)
alternatives to current basic/default service procurement practices, and the development of more sophisticated end-use metering and pricing mechanisms.

The key elements of the proposed base revenue adjustment mechanism are as follows:

- Each company's base distribution revenues will be reconciled on an annual basis to ensure that they are closely aligned with costs. This reconciliation is intended to ensure that a company will not be harmed by reduced sales nor will it experience financial benefits from increased sales.
- Each company will be allowed to recover a fixed amount of revenues per customer, for each customer class. This provision is intended to ensure that revenues are more closely aligned with a significant driver of costs on a company's system – the number of customers.
- The Department will determine each company's allowed revenues and allowed revenues per customer in the context of a base rate proceeding, using well-established ratemaking precedent including cost of service, cost allocation, and rate design. Allowed revenues will be collected through base customer, energy, and demand rates, established by customer class.⁴
- Every twelve months, each company will submit a reconciliation filing for Department review. Such filings will be used to make any reconciliation adjustments for the preceding year and to set the new base energy rates for the subsequent year.
- Each company's reconciliation filing will compare actual revenues with allowed revenues for the preceding year and will adjust base energy charges up or down to reconcile for differences. The adjustment in base energy charges also will include the recovery of an appropriate level of revenues for the subsequent year, calculated by multiplying the allowed revenues per customer by the projected number of customers.
- In its initial base rate proceeding establishing a new revenue recovery mechanism, each company will assess the extent to which the base revenue adjustment mechanism affects the company's risk profile and how any change in its risk profile should be incorporated in the company's rate structure.

⁴ References here to the terms base customer rates, base energy rates, and base demand rates to mean those rates through which a company recovers its distribution costs.

- When a company first implements its base revenue adjustment mechanism, certain features of current rate plans (e.g., performance based regulation (“PBR”) plans) may no longer be necessary or appropriate.⁵
- The Department will determine a schedule for implementing the base revenue adjustment mechanism for each gas and electric company in consideration of the need to move expeditiously, the resources required to implement such changes, and the specific circumstances of each company.

II. CURRENT RATEMAKING PRACTICE

The Department ensures the propriety of the rates for electric and gas service pursuant to G.L. c. 164, § 94. In practice, the Department has interpreted this to mean that rates must be “just and reasonable” and not unjustly discriminatory or unduly preferential. See Attorney Gen. v. Department of Pub. Utils., 390 Mass 208, 234 (1983); American Hoechst Corp. v. Department of Pub. Utils., 379 Mass. 408, 411 (1980). This statute does not prescribe a particular method by which the Department must fulfill its mandate and the Department has wide discretion in choosing an approach to rate regulation. Attorney General v. Department of Pub. Utils., 392 Mass. 262, 268-269 (1984); Attorney General v. Department of Pub. Utils., 390 Mass. 208, 233 (1983); Massachusetts Electric Company v. Department of Pub. Utils., 376 Mass. 294, 302 (1978).

A goal of the Department is to ensure that the public utility companies it regulates provide safe, reliable, and least-cost service to Massachusetts consumers. To this end, the Department has relied primarily on cost of service/rate of return (“COS/ROR”) regulation to determine rates. COS/ROR regulation permits companies to charge rates which allow them

⁵ However, any such changes will not affect company service quality programs or associated filings and Department review thereof.

(1) to recover prudently-incurred investment and operating expenses, and (2) a reasonable opportunity to earn a fair return on investment. Incentive Regulation, D.P.U. 94-158, at 3 (1995); Eastern Edison Company, D.P.U. 1580, at 13 (1984); Lynn Gas and Electric Company, D.P.U. 4576 (1934).

In calculating the total costs incurred by a company to deliver its services to the public, the Department approves a level of expenses, such as wages and benefits for employees, depreciation on plant in service, taxes, and other expenses that are found to be reasonable or otherwise have been prudently incurred by the company based on an historic test year, adjusted for known and measurable changes.⁶ Next, the company's allowable investment (or rate base) is determined. In order for costs to be included in rate base, the expenditures must be prudently incurred and the resulting plant must be used and useful in providing service to customers. A company also is allowed the opportunity to earn a reasonable rate of return on rate base, one designed to represent the return that the company's shareholders could earn in relation to other companies that are similarly situated and face similar levels of risk. The return on rate base is added to the company's other costs to produce the company's total revenue requirement. The total revenue requirement is allocated to each rate class based on cost-causation principles so as to avoid unreasonable price discrimination and subsidization

⁶ Fuel and purchased power costs for electric companies formerly were recovered through fully-reconciling mechanisms that operated independently of base distribution rates. G.L. c. 164, § 94G. Gas supply costs (i.e., gas commodity costs, as well as the cost of storing and transporting the gas from production areas to the gas utilities' service areas) continue to be recovered on a fully-reconciling basis outside of base rate proceedings through the cost of gas adjustment factor. See 220 C.M.R. §§ 6.00 et seq.

between classes of customers. See Boston Gas Company, D.T.E. 03-40, at 365-368 (2003); Fitchburg Gas and Electric Light Company, D.T.E. 02-24/25, at 252-255 (2002); Western Massachusetts Electric Company, D.P.U. 84-25, at 168-176 (1984); Boston Edison Company, D.P.U. 1720, at 112-120 (1984). Finally, the Department designs retail rates to generate revenue equal to the revenue requirement. These determinations are made in the context of a rate case under G.L. c. 164, § 94.

The enactment of St. 164 of the Acts of 1997 (“Restructuring Act”), as well as changes in the electric and gas industries, have significantly altered the way costs are incurred and rates are set in Massachusetts. In the electric industry, the former system of vertically-integrated electric utilities has been supplanted by unbundled generation, transmission, and distribution companies. Distribution rates continue to be determined by COS/ROR regulation. Electricity supplies are procured either directly by customers from retail competitive suppliers or, for customers remaining on basic/default (“basic”) service, from electric distribution companies through competitive solicitations where supplier costs are directly passed-through to customers on a reconciling basis. The costs of transmission service are collected by companies under fully-reconciling rates, with charges set by and under the jurisdiction of the Federal Energy Regulatory Commission.

Although rate regulation of gas local distribution companies (“LDCs”) has not changed as much as it has for electric distribution companies, the gas industry has become increasingly competitive. All LDCs in Massachusetts offer unbundled rates, allowing their customers to choose their own gas supplier at competitive commodity rates. Gas Transportation,

D.P.U. 85-178, at 66 (1987); Natural Gas Unbundling, D.T.E. 98-32-E (2000); Natural Gas Unbundling, D.T.E. 98-32-D (2000).⁷ LDCs do not profit on the gas commodity component of a gas bill; the cost of gas is a pass-through to LDC customers on a reconciling basis, similar to the collection of electricity commodity costs for basic service customers. LDCs earn a rate of return solely and entirely on their investment in local distribution facilities.

While the Department traditionally has relied on COS/ROR regulation in the determination of just and reasonable rates for companies under its jurisdiction, there are many variations and adjustments in the specific application of COS/ROR to individual utilities as circumstances differ across companies and across time. The Department has approved various rate adjustment mechanisms when it was found that such regulatory methods would better satisfy its public policy goals and statutory obligations. See e.g., Boston Gas Company, D.P.U. 96-50, (Phase I) at 261 (1996), NYNEX Price Cap, D.P.U. 94-50, at 139 (1995); Incentive Ratemaking, D.P.U. 94-158, at 42-43 (1995). For example, G.L. c. 164, § 1E authorizes the Department to require electric distribution companies and LDCs to implement PBR mechanisms.

PBR mechanisms often contain earnings caps and collars, where rates remain unchanged within a defined range, as well as earnings sharing mechanisms, where earnings that fall outside of a specified range are shared between customers and shareholders. Many

⁷ As with electricity, the competitive supply of gas to residential and small commercial customers has not materialized to a significant extent. Consequently, most supply to these customers, as well as to a smaller portion of the larger commercial and industrial customer base, is provided by the gas distribution companies through competitive procurements and contracts for commodity supply.

electric distribution companies and gas LDCs subject to the Department's jurisdiction have implemented PBR or PBR-like plans.⁸

Finally, a number of electric and gas companies also have fully-reconciling charges designed to recover costs that were traditionally recovered through base rates. These costs include pension expense, post-retirement other than pension ("PBOP") expense, and bad debt. See e.g., Boston Gas Company, D.T.E. 05-66, at 10-16 (2005); Bay State Gas Company, D.T.E. 05-27, at 178-186 (2005); NSTAR Pension, D.T.E. 03-47-A at 19-28 (2003).

⁸ For example, NSTAR Electric Company ("NSTAR Electric") operates under the terms of a simplified incentive plan ("SIP") that was approved as part of a settlement agreement. NSTAR Rate Plan, D.T.E. 05-85 (2005). NSTAR Electric's SIP is generally similar to a price-cap PBR mechanism but includes several other features. Id. at 4-6. Massachusetts Electric Company and Nantucket Electric Company d/b/a National Grid (together, "National Grid"), operate under a yardstick-based PBR mechanism that also was approved as part of a settlement agreement. Massachusetts Electric Company/Eastern Edison Company, D.T.E. 99-47 (2000). Under National Grid's PBR mechanism, base distribution rates were initially frozen and then allowed to increase annually based on external factors. Id. at 4-14.

Also, Bay State Gas Company, Boston Gas Company d/b/a Keyspan Energy Delivery New England, The Berkshire Gas Company, and Blackstone Gas Company operate under price-cap PBR mechanisms. Bay State Gas Company, D.T.E. 05-27 (2005); Boston Gas Company, D.T.E. 03-40 (2003); The Berkshire Gas Company, D.T.E. 01-56 (2002); Blackstone Gas Company, D.T.E. 01-50 (2001). Colonial Gas Company and Essex Gas Company d/b/a Keyspan Energy Delivery New England remain subject to distribution base rate freezes. Eastern-Colonial Acquisition, D.T.E. 98-128 (1999); Eastern-Essex Acquisition, D.T.E. 98-27 (1998).

III. STRAW PROPOSAL

A. Introduction

The Department must approach the setting of rates and charges for jurisdictional gas and electric companies in a manner that (1) meets its statutory obligations to ensure rates that are just and reasonable, not unjustly discriminatory, or unduly preferential, and (2) is consistent with long-standing principles including fairness, equity, and continuity. With this inquiry, the Department initiates an investigation into whether current ratemaking practices may be changed, adjusted, or supplemented in a way that continues to meet these obligations and principles and that better aligns company incentives with important demand resource, price mitigation, environmental, and other policy objectives. This is not an easy task; changes or adjustments to any ratemaking structure can lead to a significantly different distribution of equity and risks between the company and its customers, between classes of customers, among customers within a given rate class, and across time. The changes contemplated in this proceeding cannot be done in a piecemeal fashion if they are to meet the Department's objectives.

Consequently, the Department looks forward to engaging interested persons in a discussion about how to best meet this challenge. In the interest of starting this discussion, the Department offers a straw proposal in order to: (1) illustrate how a base revenue adjustment mechanism might work in its entirety; (2) focus the scope of this investigation; and (3) facilitate questions and comments from interested persons. By introducing this straw proposal, it is not the Department's intention to limit or constrain the ability of commenters to

present better approaches to achieve the same objectives. Rather, the straw proposal should be viewed as one method to meet the Department's objectives. Below, the straw proposal is presented with a statement of the objective, a set of design principles, a discussion of key elements, and a number of questions for commenters to address.

B. Objective of a Base Revenue Adjustment Mechanism

A base revenue adjustment mechanism should better align the financial interests of electric and gas companies with customer interests, demand resources, price mitigation, environmental, and other policy objectives. In particular, the base revenue adjustment mechanism should eliminate the current financial disincentive that electric and gas companies face regarding the deployment of customer-sited, cost-effective demand resources in their service territories.

C. Principles in Designing a Base Revenue Adjustment Mechanism

The base revenue adjustment mechanism should be designed to meet or appropriately balance the needs to:

- better align the financial interest of electric and gas distribution companies with customer interests, demand resources, price mitigation, environmental, and other policy objectives;
- ensure that electric and gas distribution companies are not financially harmed by the increased use of demand resources;
- meet the Department's rate structure goal of efficiency by more closely aligning company revenues with costs;

- meet the Department's statutory obligation to investigate the propriety of gas and electric rates in a way that is consistent with Department ratemaking precedent, including the review of cost-of service studies, cost-allocation, and rate design;
- be consistent with Department precedent related to rate continuity, fairness, and earnings stability;
- appropriately balance the risks borne by customers and those borne by shareholders;
- advance the goals of safe, reliable, and least-cost delivery service and promote the objectives of economic efficiency, cost control, lower rates, and reduced administrative burden;
- be applied uniformly across all electric and gas companies, to the extent appropriate and reasonable; and
- be simple, easily understood, and transparent.

D. Key Elements of the Proposed Base Rate Adjustment Mechanism

1. Periodic Reconciliation of Revenues

Under a base revenue adjustment mechanism, a company's revenues would be reconciled on an regular basis. If a company's sales volume changes over time (leading to lower or higher base distribution revenues than were allowed at the time rates were set), then the difference in revenues would be determined and periodically reconciled through distribution rates. This periodic reconciliation ensures that revenues would be more closely aligned with costs over time. Further, a company would not be financially harmed by or benefit from changes in sales.

The straw proposal includes a periodic reconciliation based on the revenues per customer associated with each customer class of each company. An allowed revenue per

customer would be determined at the beginning of the base revenue adjustment mechanism and this allowed amount would be used in subsequent revenue reconciliations. Consequently, revenues would be allowed to change in a way that corresponds to any change in the number of customers.

The proposed base revenue adjustment mechanism would have three primary components: (1) the determination of an allowed revenue per customer; (2) the periodic reconciliation of actual and allowed revenues; and (3) the adjustment of base rate charges to recover a target level of allowed revenues in a subsequent period. These components, as well as other elements of the straw proposal, are described below.

2. Determination of Allowed Revenues per Customer

The Department would determine a company's allowed revenues per customer in the context of a company's next base rate proceeding.⁹ The base rate proceeding would be consistent with all well-established ratemaking precedent, including cost of service, cost allocation and rate design. An allowed revenue per customer amount would be determined for each rate class, calculated as (1) the Department-approved allowed revenue requirement for the rate class, divided by (2) the number of customers served in the rate class during the test year.

⁹ As discussed above, some companies have fully-reconciling charges for expenses traditionally recovered through base rates, such as pension expenses, PBOP expenses, and bad debt. The continued need for or form of such fully-reconciling charges in the context of a base revenue adjustment mechanism would be addressed in individual company base rate proceedings, in consideration of their impact on company cost control incentives, simplicity, and related principles.

The Department highlights the need for completion of a base rate proceeding as a prerequisite for establishing a base revenue adjustment mechanism. In order to determine the appropriate level of revenues per customer for a company in a way that meets the Department's statutory obligations and ratemaking precedent, the Department must understand the company's underlying distribution revenue requirement and allocation of this revenue requirement among customer classes through an allocated cost of service study. Colonial Gas Company, D.P.U. 86-27-A at 9 (1988); Massachusetts Electric Company, D.P.U. 85-146, at 7 (1986).¹⁰

3. Annual Reconciliation Calculation

Companies would reconcile actual revenues with allowed revenues on an annual basis, for each rate class. Actual revenues for a reconciliation period would be defined as the amounts billed by the company to customers in the rate class during the reconciliation period. Allowed revenues for the reconciliation period would be calculated as the sum of (1) the product of the rate class' allowed revenues per customer and the number of customers in the rate class served during the reconciliation period, and (2) the rate class' reconciliation amount from the preceding reconciliation period. Upon the end of a reconciliation period, a company would calculate the difference between the rate class-specific actual and allowed revenues and

¹⁰ Lack of an allocated cost of service study does not always preclude the allocation of a company's established revenue requirement among its respective customer classes. However, implementing a rate mechanism that has as a core feature class revenues per customer without an allocated cost of service study may serve to distort prices, thereby frustrating the Department's goal to support the efficient deployment of demand resources.

recover (or credit) the difference from (or to) customers during a subsequent twelve-month recovery period. The recovery period would begin three months after the end of the reconciliation period.¹¹

4. Annual Adjustments to Base Rate Charges

Prior to each twelve-month recovery period, a company would determine each rate class' target level of allowed revenues for the recovery period, calculated as the sum of (1) the product of the rate class' allowed revenues per customer and the number of customers projected to be served in the rate class during the recovery period, and (2) the rate class' reconciliation amount from the most recently completed reconciliation period. The company would determine the revenues it projects to recover from each rate class' customer and demand charges, using (1) the charges approved by the Department in the company's most recent base rate proceeding, and (2) the projected customer and demand billing determinants for the recovery period. For each rate class, the difference between the target level of allowed revenues and the revenues projected to be recovered through the customer and demand charges would be recovered through the base energy charge. The adjusted base energy charge would be calculated using projected energy billing determinants for the recovery period. The new base energy charges, as calculated above, would remain unchanged throughout the recovery period (except as noted in Section III.D.5, below).

¹¹ For example, if a twelve-month reconciliation period was for a calendar year, the associated twelve-month recovery period would begin in April of the following year. The three-month lag is intended to allow for sufficient time to review a company's calculation of its reconciliation amounts before adjusting rates to recover those amounts.

5. Submission and Review of Reconciliation Filings

A company would submit a reconciliation filing for each reconciliation period within 30 days after the close of the period. The filing would describe with supporting documentation the proposed reconciliation amounts, including, for each rate class: (1) actual billed revenues during the reconciliation period; (2) allowed revenues per customer; (3) number of customers served during the reconciliation period; (4) the reconciliation amount from the previous reconciliation period; and (5) any other revenue adjustments provided for in the base revenue adjustment mechanism (see e.g., Section III.D.7, below).

The filing also would describe with supporting documentation, for the subsequent recovery period, the proposed rate class-specific target level of allowed revenues and adjustment to each rate class' base energy charge, including for each rate class: (1) the projected number of customers to be served in the recovery period; and (2) the projected customer, energy, and demand billing determinants for the recovery period.

Also, a company would submit a quarterly filing that includes information regarding actual and allowed revenues both for the quarter and cumulatively for the reconciliation period to that point. If, at the end of any quarter, the cumulative difference between the actual and allowed revenues is outside of a pre-determined percentage range, the company would be required to adjust its base energy charge to recover or refund the part of the difference that falls outside the range. Such adjustment would help mitigate the impact on customers' bills resulting from significant, unexpected changes in sales.

6. Accounting for Risk in Setting the Allowed Revenues

The Department expects that a significant change in the means by which a company recovers its allowed revenues, such as the base revenue adjustment mechanism described herein, could materially alter the distribution of risks among the company, its shareholders, and its customers. Consistent with long-standing Department ratemaking precedent, it is necessary to review and explicitly address this distribution of risk in the context of the determination of a company's initial revenue requirement and allowed revenues per customer. While accounting for risk would, of course, continue to be determined on a company-by-company basis, the Department will consider in the current inquiry whether it is appropriate to establish common principles or guidelines on how any new base revenue adjustment mechanism could affect the distribution of risks.

7. Shared Earnings Provision

A base revenue adjustment mechanism would include an earnings sharing provision. This provision would consist of a deadband (e.g., plus or minus 300 basis points) around the return on equity ("ROE") approved by the Department in the company's base rate proceeding. Earnings outside of this band would be shared equally between customers and the company. The company's annual reconciliation filings would include any and all necessary calculations and price adjustments associated with the earnings sharing mechanism.

8. Performance Based Regulation

Currently, many of the gas and electric companies operate under PBR plans. The most common PBR mechanism in place for these companies is a price cap plan which, as presently structured, has four essential elements: (1) a term over which the price cap plan is in effect; (2) an inflation factor; (3) a productivity factor that is used to offset the inflation factor; and (4) exogenous factors, defined as those costs or credits that are beyond the company's control and that are not incorporated in the inflation factor. Boston Gas Company, D.P.U. 03-40, at 472, 495-496 (2003); Electric Industry Restructuring, D.P.U. 95-30, at 73-74 (1995). Upon the implementation of a base revenue adjustment mechanism, a company's current PBR plan would no longer be in effect.¹² As part of this inquiry, the Department will consider what, if any, PBR features are consistent with the objectives and principles of a base revenue adjustment mechanism and, therefore, should be included as elements of the new mechanism.

9. Lost Base Revenue

Upon the implementation of a base revenue adjustment mechanism, a company's lost base revenue ("LBR") programs would terminate and no longer be in effect. Compensating a company for declines in base revenues resulting from demand-side management between rate

¹² Each electric and gas company would continue to maintain its current service quality program, with associated filing requirements and review by the Department. These service quality programs are an important aspect of the Department's oversight of the customer service provided by the regulated utilities and will continue to be important regardless of whether base distribution revenues are recovered through current practices or through a base revenue adjustment mechanism.

proceedings will no longer be necessary once a base revenue adjustment mechanism is in place.

10. Implementation Schedule

At the conclusion of this proceeding, the Department would determine a schedule for implementing the base revenue adjustment mechanism for each gas and electric company going forward in consideration of the need to move expeditiously, the resources required to implement such changes, and the specific circumstances of each company.

E. Comments and Questions

1. General Comments

The Department seeks comments on the straw proposal presented above. In particular, the Department seeks comments on which of the identified elements are appropriate for inclusion in a base revenue adjustment mechanism and whether there are other elements that should be considered. To guide commenters, specific questions on the identified elements are provided below.¹³ In responding to the questions, please identify any elements of a base revenue adjustment mechanism that should differ between electric and gas distribution companies. Also, identify any elements where a distribution company should be provided design flexibility (i.e., which components should be established through this inquiry and which components should be established for each company on a case-by-case basis).

¹³ Commenters are not required to respond to all questions.

2. Questions

Allowed Revenues per Customer

1. The Department's proposal that a company's allowed revenues per customer be determined through a subsequent base rate proceeding is intended to ensure that the allowed revenue levels, which serve as the basis for the base revenue adjustment mechanism, are closely aligned with the company's costs. Under what, if any, circumstances should the Department permit a company's allowed revenues per customer to be determined through some manner other than a base rate proceeding?
2. The Department's proposal uses an approach in which a company's allowed revenues per customer for each rate class does not change between base rate proceedings. An alternate approach would be to adjust the allowed revenues per customer values periodically, based on changes in each rate class' average usage per customer. Please discuss the merits of each approach.

Annual Reconciliation Calculation

3. The Department's proposal that a company's actual versus allowed revenues be reconciled annually is intended to balance three objectives: rate stability, rate continuity, and administrative efficiency. Do annual reconciliations strike an appropriate balance among these three objectives or would alternate reconciliation periods (e.g., quarterly or semi-annually) better do so?
4. The Department's proposal to determine a company's actual revenue based on billed revenues is consistent with the base rate treatment applied to distribution-related bad debt costs. An alternate approach would be to determine actual revenues based on payments received. Please discuss the merits of each approach.

5. The Department's proposal for determining billed revenues is based on actual consumption. An alternate approach would be to determine billed revenues based on consumption normalized for weather and/or other factors.
 - (a) Please discuss the merits of determining billed revenues using actual versus weather-normalized consumption.
 - (b) Should consumption be normalized for other factors (e.g., economic conditions)? If so, identify those factors and describe how the normalization for such factors could be done.

Annual Base Rate Adjustment

6. The Department's proposal to recover the difference between a company's target and projected revenues through adjustments to its base energy charges is intended to send appropriate price signals to consumers. An alternate approach would be to adjust both base energy and demand charges (where applicable) to recover this difference. Please discuss the merits of each approach.

Reconciliation Filings

7. The Department's proposal to require a company to submit quarterly filings identifying actual and allowed revenues is intended to ensure that changes in rates are made in a predictable and gradual manner.
 - (a) Under what circumstances should the Department allow an adjustment in base charges during a reconciliation period?
 - (b) Under what circumstances should the Department initiate a review of a company's base revenue adjustment mechanism?
8. What standards should the Department use to measure the performance of a company's base revenue adjustment mechanism over time?

Change in Risk

9. How will the implementation of a base revenue adjustment mechanism affect a company's risk and how should such considerations be reflected in a company's capital structure and ROE?

Shared Earnings Provision

10. The Department's proposal to include a shared earnings provision in the base revenue adjustment mechanism is intended to strike an appropriate balance between the risks borne by customers and shareholders associated with company earnings. Please comment on the merits of such a provision. Also, comment on the design of the proposed earnings sharing provision.

Performance Based Regulation

11. Please comment on the merits of implementing a base rate adjustment mechanism with and without the individual elements of a PBR plan (e.g., fixed term, inflation, productivity, performance standards, exogenous factors).

Implementation Schedule

12. Please comment on how the Department should schedule the implementation of a base revenue adjustment mechanism for each gas and electric company in light of the need to move expeditiously, the resources required to implement such changes, and the specific circumstances of each company. How should the Department determine the order of individual base rate proceedings?

Other Questions

13. How should the implementation of a base revenue adjustment mechanism affect the performance-based shareholder incentives that gas and electric companies currently are eligible to receive for promoting energy efficiency?

IV. PUBLIC PARTICIPATION

The Department invites all interested persons to participate in this investigation.

Interested persons may file comments on the issues and questions discussed above and the Department welcomes comments on any issues related to this investigation that are not specifically discussed in the Order. The Department anticipates that a number of persons will be interested in this proceeding. Therefore, the Department encourages interested persons to

present consensus positions and submit comments jointly, when possible. Initial written comments must be filed no later than the close of business on **Friday, August 10, 2007**.

Comments may not exceed 50 pages in length. All comments must be accompanied by an executive summary. One original and 17 copies¹⁴ of all comments should be filed with Mary L. Cottrell, Secretary, Department of Public Utilities, One South Station - 2nd Floor, Boston, Massachusetts 02110. All comments also should be submitted to the Department in electronic format.¹⁵ Comments will be available for public inspection at the Department's offices during business hours. Also, copies of comments that are filed electronically will be available on the Department's website.

The Department will issue a procedural notice following receipt of initial comments. At this time, the Department anticipates holding public hearings during the weeks of September 17, 2007 and September 24, 2007. The Department also anticipates organizing several panels for comments at these hearings. Persons who wish to participate on a panel

¹⁴ Where possible, copies should be printed on both sides of each page.

¹⁵ Electronic filings should be made using one of the following methods: (1) by e-mail attachment to dpu.efiling@state.ma.us; or (2) on a 3.5" disk or CD-ROM. The text of the e-mail, disk label, or CD-ROM must specify: (1) the docket number of the proceeding (D.P.U. 07-50); (2) name of the person or company submitting the filing, and (3) a brief descriptive title of the document. The electronic filing should also include the name, title and telephone number of a person to contact in the event of questions about the filing. Text responses should be created in either Corel WordPerfect, Microsoft Word, or Adobe Acrobat. Data or spreadsheet responses should be compatible with Microsoft Excel. The Department is unable to accept scanned files (including scanned "pdf" files) at this time. All documents submitted in electronic format will be posted on the Department's website: <http://www.mass.gov/dpu>.

must express their interest to the Department in writing by Friday, August 10, 2007. Each person who wishes to participate on a panel must: (1) provide their name, complete contact information (i.e., address, telephone number, fax number, and email address) and company affiliation, if any; (2) summarize their qualifications; (3) identify the subject matter on which they wish to comment; and (4) briefly summarize the conclusions and opinions on the subject matter on which they wish to comment and the bases therefor. The Department will endeavor to honor requests to participate on a panel, to the extent possible. However, in the interests of administrative efficiency, the subject matter and composition of the panels will be subject to the Department's discretion.

Following these hearings, interested persons will be given an opportunity to file reply comments. After reviewing the comments, the Department will determine the appropriate next steps.

V. ORDER

Accordingly, the Department

VOTES: To open an investigation into rate structures that will promote efficient deployment of demand resources; and it is

ORDERED: That the Secretary of the Department shall publish notice of this investigation in a statewide paper of daily circulation within the Commonwealth; and it is

FURTHER ORDERED: That the Secretary of the Department shall serve a copy of this Order upon all persons on the Department's official service list.

By Order of the Department,

/s/

Paul J. Hibbard, Chairman

/s/

W. Robert Keating, Commissioner

/s/

Tim Woolf, Commissioner