

Testimony of Eric Ackerman

Good morning. My name is Eric Ackerman. I am the Director of Alternative Regulation at the Edison Electric Institute, and I thank you for the opportunity to speak today.

As you consider the appropriateness of alternative ratemaking methodologies, I urge you to be guided by the need to balance the desire for increased innovation with the requirement to recover capital investments in a way that recognizes the value of the grid to all customers.

The term alternative regulation, or “altreg,” connotes a set of innovative rate making policies and procedures which have evolved over the last 10-15 years in response to a paradigm shift in the investor-owned electric utility industry. Privately financed electric utilities are making capital investments in an environment of flat to declining sales. This is a paradigm shift in the sense that for most of our history we made needed capital investments against a background of increasing sales volumes. Traditionally, increasing kwh use per customer produced incremental revenues that offset the need for new financing. Some would argue that sales growth and fixed cost recovery through volumetric (kWh) rates for residential and small business customers were design features of the original regulatory compact.

We don’t have sales growth today, but we still have a need to make major capital investments in infrastructure of all kinds to ensure continued safe and reliable operations. As a result, our interest coverages and credit ratings are far more sensitive to the impact of any delay in recovering costs in rates. This is where altreg comes in. Altreg innovations such as forward-looking test years (e.g., Pennsylvania’s fully projected test year), capital trackers, decoupling, formula rates, and multi-year rate plans – all share the characteristic that they allow the utility to recover increased costs without going through a rate case. Altreg is adaptive regulation in action. The Distribution System Improvement Charge (DSIC) is an example of altreg.

In 2008, and again in 2014, EEI joined with the Natural Resources Defense Council in recognizing that customers are using the grid in new ways, and that because of this, new

regulatory policies are needed. They are needed to ensure the fair and adequate recovery of costs incurred to build and maintain the grid, and to provide utilities increased flexibility to meet customers' changing service needs. In 2008 the focus of our concerns was the need for new policies to support an aggressive nationwide energy efficiency campaign. We recommended (1) regulatory mechanisms that provide cost recovery for prudent utility investments in energy efficiency between rate cases, (2) an earnings opportunity tied to verifiable success in delivering cost-effective energy savings, and (3) mechanisms that allow utilities to recoup fixed costs as power sale volumes decline. These are the three legs of a regulatory "stool" that supports aggressive energy efficiency, and we continue to support them. Increased energy efficiency remains the starting point for cost-effective strategies to reduce carbon emissions, and these three legs of the stool allow utilities to incorporate energy efficiency into their core business models.

By 2014 the scope of our concerns had broadened to include distributed energy resources. We recognized that new distributed technologies are providing new opportunities for customers to use the grid more effectively and efficiently. We urged regulators to view the retail electricity distribution business, not as a commodity business, dependent on growth in electricity usage; but as a network business that is meeting customers' evolving energy service needs. We urged regulators to rethink how utility costs are recovered, and to consider the need for new rate designs and new approaches that balance the desire for continued innovation with the need to recover the costs of the grid. We affirmed that, consistent with principles of rate design espoused by Professor Bonbright, utilities deserve assurances that the recovery of their authorized non-fuel costs will not vary with fluctuation in electricity use; and equally, that customers deserve assurances that cost will not be shifted unreasonably to them from other customers.¹

Against this background, let me address some of the specific questions posed in the commission's notice of this hearing.

¹ See James C. Bonbright, Albert L. Danielsen and David R. Kamerschen, "Principles of Public Utility Rates, 2nd Edition," Public Utilities Report (March, 1988)

1. Whether revenue decoupling or other similar rate mechanisms encourage energy utilities to better implement energy efficiency and conservation programs.

- In principle we believe they do, recognizing that whether revenue decoupling is needed in a given situation depends very much on the extent to which other similar rate mechanisms are in place.
- By assuring the recovery of costs incurred to build, operate, and modernize the grid, updated rate designs, supplemented with revenue decoupling, free utilities to pursue aggressive energy efficiency programs without worrying about the impact on their credit rating, or the potential for inappropriate cost shifting among customers.

2. Whether such rate mechanisms are just and reasonable and in the public interest.

- Properly implemented, we believe they are.

3. Whether the benefits of implementing such rate mechanisms outweigh any costs associated with implementing such mechanisms.

- We believe they can with appropriate oversight, as elaborated below.

4. Alignment of alternative rate mechanisms with utilities' implementation of EE and conservation.

In our view regulatory support for energy efficiency and conservation can best be accomplished via a three-legged stool consisting of:

- Decoupling (and/or updated rate designs) to ensure recovery of allowed fixed costs
- EE program cost tracker – to keep up with lost distribution revenue between rate cases
- Incentive mechanisms – to offer utilities an earnings opportunity tied to verifiable success in delivering cost-effective energy savings (e.g., via shared savings, service fees, etc.).

5. Whether benefits of alternative rate mechanisms exceed associated costs.

- Assurance of a net benefit for customers should be a design criterion for performance incentive mechanisms. Incentives should be large enough to motivate utility performance, but not so large as to exceed to benefit customers would realize through strong performance.
- For other altreg mechanisms, the commission should monitor impacts in terms of parameters such as energy savings, peak load management, rate volatility, and possible cost-shifting - to ensure that benefits justify any costs.

6. Whether there is an optimal altreg rate mechanism for EE and conservation.

- No, altreg policies need to fit the circumstances of the utility and the service territory, as well as regulatory policies and preferences.

7. Identification of best practices in other jurisdictions.

- See the EEI Altreg survey, 2015 update, a copy of which has been included.

8. Identification of cost of capital impacts.

- A number of highly qualified researchers have analyzed the possible relationship between decoupling and the market cost of equity, using a variety of methods, and found that decoupling has no discernable impact of the utility's cost of equity capital.
- I can provide references as requested.

In conclusion, Pennsylvania already has done a lot of the right things to preserve the regulatory compact in the face of changing customer needs. The use of a fully forecasted test year and capital cost trackers, including a Distribution System Improvement Charge – reflect a recognition that the distribution business is becoming a service business, whose costs are incurred independent of power volume. As customers' service needs continue to evolve, the Commission must continue to balance innovation with appropriate cost recovery. Revenue decoupling, together with updated rate designs, can give Pennsylvania utilities greater flexibility to serve customers' evolving needs. It is very appropriate to give serious consideration to both.

Thank you.