COMMONWEALTH OF PENNSYLVANIA

March 16, 2016

E-FILED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
PO Box 3265
Harrisburg, PA 17105-3265

Re: En Banc Hearing on Alternative Ratemaking Methodologies
Docket No. M-2015-2518883

Dear Secretary Chiavetta:

I am delivering for filing today the Comments on Alternative Ratemaking Methodologies, on behalf of the Office of Small Business Advocate, in the above-captioned matter.

If you have any questions, please contact me.

Sincerely,

Elizabeth Rose Triscari

Elizabeth Rose Triscari
Deputy Small Business Advocate
Attorney ID #306921

Enclosures:

Cc: Brian Kalcic

Office of Small Business Advocate
Suite 202, Commerce Tower | 300 North Second Street | Harrisburg, PA 17101 | 717.783.2525 | Fax 717.783.2831 | www.osba.state.pa.us

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

***En Banc* Hearing on Alternative Ratemaking Methodologies**	:	**Docket No. M-2015-2518883**

COMMENTS OF THE OFFICE OF SMALL BUSINESS ADVOCATE ON ALTERNATIVE RATEMAKING METHODOLOGIES

I. INTRODUCTION

On December 31, 2015, the Secretary of the Pennsylvania Public Utility Commission ("Commission") issued a Secretarial Letter noticing an *En Banc* Hearing on Alternative Ratemaking Methodologies on March 3, 2016 ("Secretarial Letter"). The Secretarial Letter outlined three rate issues to be covered at the hearing: (1) whether revenue decoupling or other similar rate mechanisms encourage energy utilities to better implement energy efficiency and conservation programs; (2) whether such rate mechanisms are just and reasonable and in the public interest; and (3) whether the benefits of implementing such rate mechanisms outweigh any costs associated with implementing the rate mechanisms. The Secretarial Letter also listed several topics to guide this discussion.

The following persons and/or organizations were invited to submit written testimony and appear at the *en banc* hearing: Eric Ackerman of Edison Electric Institute, Mark Newton Lowry, PhD of Pacific Economics Group, Peter H. Kind of Energy Infrastructure Advocates LLC, Richard Sedano of the Regulatory Assistance Project, Kyle Rogers of the American Gas Association, Maureen Mulligan of the Keystone Energy Efficiency Alliance, Scott R. Koch of PPL Electric Utilities Corporation, Mark Balmert of NiSource Corporate Services Company, Tanya J. McCloskey of the Pennsylvania Office of Consumer Advocate, Frances

Mansberger of the Industrial Energy Consumers of Pennsylvania, and Hugh Gilbert Peach, PhD of H. Gil Peach and Associates.

The Office of Small Business Advocate ("OSBA") and other organizations representing the interests of customers, including low-income customers, were not invited to participate in the *en banc* hearing. However, the Secretarial Letter did provide for other interested parties to submit written comments following the en banc hearing. The OSBA thanks the Commission for the opportunity to submit the following comments in response to certain of the topics listed in the Secretarial Letter. These comments focus on the alternative ratemaking mechanism, revenue decoupling.

II. COMMENTS

A. Alignment of Alternative Rate Mechanisms with the Energy Utilities' Implementation of Energy Efficiency and Conservation Programs

The primary focus of alternative ratemaking mechanisms such as revenue decoupling is the "throughput incentive" inherent in "standard" utility ratemaking practices. To the extent that a utility's margins are positively related to sales volumes (or throughput), a utility has an incentive to promote additional sales or, equivalently, to oppose implementation of energy efficiency or conservation programs. A primary purpose of revenue decoupling is to break the "link" between throughput and margins, so that a utility no longer has a reason to promote sales and/or oppose conservation programs.

In the OSBA's view, a relevant question is whether utility incentives are misaligned (vis-à-vis the implementation of energy efficiency programs) in Pennsylvania? At least with respect to electric distribution companies ("EDCs"), the OSBA submits the answer is "no."

Act 129 requires EDCs to develop a comprehensive energy efficiency/conservation plan to meet Pennsylvania's conservation goals. That plan must include specific programs for each rate class. Moreover, EDCs are subject to significant penalties if conservation goals are not met, which is a significant motivation to implement energy efficiency programs.

According to the Energy Association of Pennsylvania ("EAP"), total EDC spending on Act 129 energy efficiency programs makes Pennsylvania rank as the fifth largest state in energy efficiency spending in the nation.[1] In short, Act 129 effectively aligns utility incentives so as to meet the Commonwealth's energy efficiency goals. An equivalent statutory requirement could be developed for Pennsylvania's gas or water industries, if deemed appropriate.

B. Identify the Statutory and Regulatory Barriers, if any, Associated with Alternative Rate Mechanisms in Pennsylvania

In simplest terms, a revenue decoupling mechanism tracks actual versus authorized revenue collections between base rates cases and adjusts rates, as needed, so as to ensure a utility fully recovers its authorized revenue requirement. However, Sections (K)(2) and (K)(3) of Act 129 reads as follows:

> (2) Except as set forth in paragraph (3), decreased revenues of an electric distribution company due to reduced energy consumption or changes in energy demand shall not be a recoverable cost under a reconcilable automatic adjustment clause.
>
> (3) Decreased revenue and reduced energy consumption may be reflected in revenue and sales data used to calculate rates in a distribution-base rate proceeding filed by an electric distribution company under Section 1308 (relating to voluntary changes in rates).

Act 129 clearly prohibits an EDC from recovering decreased revenues on a retroactive basis via any reconcilable automatic adjustment clause, such as a revenue decoupling mechanism. Therefore, in order to implement revenue decoupling in Pennsylvania, Section (K)(2) of Act 129 must be amended.

---

[1] Testimony of T. Fitzpatrick before the Pennsylvania House Consumer Affairs Committee on September 1, 2015, on behalf of EAP.

C. Identify the Impact of Alternative Ratemaking Approaches on a Utility's Cost of Capital

An EDC's sales will vary between base rate cases due to a number of factors, such as: 1) consumers' conservation efforts; 2) weather; 3) changes in economic conditions; and 4) changes in the price of electricity. If EDC margins are fully decoupled from sales, the EDC will be insulated from the impact of *all* of the above sources of sales (revenue) variability between base rate cases, not just conservation. Put simply, revenue decoupling would eliminate an EDC's business risk as it relates to revenue variability.

Pennsylvania utilities already benefit from a number of alternative ratemaking approaches including: 1) guaranteed cost recovery associated with any number of approved cost tracking / recovery mechanisms; 2) the ability to employ a distribution system improvement charge ("DSIC") between base rate cases; and 3) permission to use a fully projected future test year in a base rate proceeding. All of these ratemaking approaches act to reduce an EDC's earnings risk. However, revenue decoupling would further reduce risk by eliminating perhaps the single largest risk that remains for an EDC, namely, the business risk associated with sales variability. If revenue decoupling were to be approved for Pennsylvania EDC's, the Commission should implement a commensurate reduction in an EDC's allowed return on equity.

D. Whether Allowing Decoupling to be used as an Attrition Mechanism Results in more Rate Increases than Decreases Independent of the Energy Efficiency and Conservation Program Success

If the underlying long-term trend in average use per customer, independent of conservation, is declining, then revenue decoupling would produce more rate increases than decreases for ratepayers between base rate cases. Since the long-term trend in electricity sales is generally considered to be flat (at best) or declining, the OSBA concludes that revenue decoupling will produce more rate increases than decreases for ratepayers between base rate cases.

E. Identification of any Risk of Interclass or Intraclass Cost Shifts, including Low Income Community Cost Impacts, and Whether those Cost Shifts are Inappropriate

Under the revenue-per-customer decoupling model, all required rate adjustments are typically made on a rate class basis. In other words, there is no shifting of revenue responsibility between rate classes. However, intraclass cost shifting will occur.

Consider the example where Year 1 sales to customers in Rate Class A fall below forecast (base rate case) levels. Under revenue decoupling, all distribution revenues lost in Year 1 are fully recoverable in Year 2. Therefore, customers in Rate Class A will be subject to a Year 2 surcharge to make up the shortfall from Year 1. In practice, those customers that exhibit greater than (class) average reductions in their Year 1 usage will see an overall reduction in their distribution service bills, but customers that exhibit smaller than class average reductions in their Year 1 usage will see an overall increase in their distribution service bills.

From a rate class perspective, there are no truly avoidable distribution service charges under revenue decoupling, *i.e.*, a class's distribution service revenue requirement is a zero sum game. Therefore, by definition, revenue decoupling will shift revenue/cost responsibility among customers in a given rate class. Unless the rate design implemented under revenue decoupling happens to be cost based, the intraclass cost shifting that results from revenue decoupling is inappropriate.

F. Impacts Alternative Rate Mechanisms may have on Incentives for Customers to Participate in Energy Efficiency and Conservation Programs.

Since Pennsylvania EDCs have been restructured, revenue decoupling only addresses the distribution service portion of a customer's bill. To the extent that a revenue decoupling based rate design incorporates higher kWh (avoidable) charges and lower fixed (unavoidable) charges than otherwise in place, customers would see an apparent increase in the monthly payback associated with adopting energy efficiency measures. All else equal, therefore, one would expect customers to have a greater incentive to participate in conservation programs. However, as discussed above, there are no truly avoidable distribution service charges under revenue decoupling. Therefore, one must conclude any such incentive effects are illusory and misplaced, since they are only made possible from the cross-subsidies provided by other ratepayers in a given rate class.

G. Is there a need for a Fixed-Rate Element, and whether those Fixed-Rate Elements should be Customer-Based, Demand-Based, or Time-of-Use Based

Under traditional ratemaking practices, utility rate design incorporates a customer charge for residential service, and both a customer charge and demand charge for commercial and industrial service. The levels of such charges are typically guided by the results of the cost-of-service study filed in an EDC's base rate case.[2]

If such fixed-rate elements are cost based, an EDC's customer and demand charges will reflect, respectively, the customer-related and demand-related costs that the utility incurs in providing service to each of its rate classes. Revenue decoupling does not overturn traditional cost-of-service principles. In other words, if utility rates are to remain cost based, an EDC's rate design should continue to reflect appropriately sized customer and demand charges under revenue decoupling. To artificially slant distribution rate design away from cost-based fixed charge levels (in order to incent customers to participate in energy efficiency programs) is inappropriate, as the practice would result in intraclass subsidization.

---

[2] The Commonwealth Court has unambiguously decided that cost of service should be the "polestar" criterion for rate-setting. In *Lloyd v. Pa. PUC*, the Court held that other rate-making concerns could not trump cost of providing service. *Lloyd v. Pa. PUC*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006).

III. CONCLUSION

The OSBA respectfully requests that the Commission consider its comments above in reviewing the efficacy and appropriateness of alternative ratemaking methodologies, and specifically with respect to revenue decoupling.

Respectfully submitted,

Elizabeth Rose Triscari
Deputy Small Business Advocate
Attorney ID No. 306921

For:

John R. Evans
Small Business Advocate

Office of Small Business Advocate
300 North Second Street, Suite 202
Harrisburg, PA 17101

Dated: March 16, 2016