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October 22, 2018

VIA ELECTRONIC FILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor (filing room)
Harrisburg, PA 17120

In re: Alternative Ratemaking Methodologies; Docket No.: M-2015-2518883; **THE PENNSYLVANIA STATE UNIVERSITY'S COMMENTS TO PROPOSED POLICY STATEMENT**

Dear Secretary Chiavetta:

Enclosed for filing with the Pennsylvania Public Utility Commission is The Pennsylvania State University's Comments to the Commission's proposed Policy Statement in the above-referenced matter. Copies have been served in accordance with the attached Certificate of Service.

If you have any questions regarding this filing, please do not hesitate to contact me.

Very truly yours,

Thomas J. Sniscak

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Whitney E. Snyder
Counsel for The Pennsylvania State University

WES/das
Enclosures
cc: Gladys M. Brown, Chairman
Andrew G. Place, Vice-Chairman
Norman J. Kennard, Commissioner
John F. Coleman, Jr., Commissioner
David W. Sweet, Commissioner
Kriss Brown, Law Bureau (via electronic mail)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Alternative Ratemaking Methodologies	Docket No. M-2015-2518883

COMMENTS OF

THE PENNSYLVANIA STATE UNIVERSITY

TO THE PROPOSED POLICY STATEMENT

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DATED: October 22, 2018

The Pennsylvania State University (Penn State or PSU) submits these comments for the Pennsylvania Public Utility Commission (Commission) to consider regarding its proposed policy statement issued for comment on May 23, 2018 (Policy Statement).

I. BACKGROUND

A. Procedural History

On June 28, 2018, Governor Wolf signed into law Act 58 of 2018, effective on August 27, 2018 ("Act 58"). Act 58 amends the Public Utility Code, adding section 1330 to provide for alternative ratemaking for natural gas distribution, electric distribution and water/wastewater companies.

Act 58 emphasizes the policy behind alternative ratemaking:

> § 1330. Alternative ratemaking for utilities.
>
> (a) Declaration of policy. --The General Assembly finds and declares as follows:
>
> (1) Innovations in utility operations and information technologies are creating new opportunities for all customers, and it is in the public interest for the commission to approve just and reasonable rates and rate mechanisms ***to facilitate customer access to these new opportunities while ensuring that utility infrastructure costs are reasonably allocated to and recovered from customers and market participants consistent with the use of the infrastructure.***
>
> (2) It is the policy of the Commonwealth that ***utility ratemaking should encourage and sustain investment through appropriate cost-recovery mechanisms to enhance the safety, security, reliability or availability of utility infrastructure and be consistent with the efficient consumption of utility service.***

66 Pa. C.S. § 1330. (emphasis added).

On May 23, 2018 the Commission entered a Proposed Policy Statement Order at Docket No. M-2015-2518883 seeking comments from interested stakeholders on proposed guidelines each utility and stakeholder should consider in a Section 1308 rate proceeding involving alternative ratemaking methodologies.

The Proposed Policy statement also emphasizes the Legislature's objective in allowing alternative ratemaking mechanisms. Policy Statement at § 69.3301. It then enumerates 13 factors the Commission will consider in determining whether rates are just and reasonable:

> (a) In determining just and reasonable distribution rates that promote the efficient use of electricity, natural gas or water, as well as the use of distributed energy resources, the Commission will consider, among other relevant factors:
>
> (1) How the rates align revenues with cost causation principles as to both fixed and variable costs.
>
> (2) How the rates impact the fixed utility's capacity utilization.
>
> (3) Whether the rates reflect the level of demand associated with the customer's anticipated consumption levels.
>
> (4) How the rates limit or eliminate inter-class and intra-class cost shifting.
>
> (5) How the rates limit or eliminate disincentives for the promotion of efficiency programs.
>
> (6) How the rates impact customer incentives to employ efficiency measures and distributed energy resources.
>
> (7) How the rates impact low-income customers and support consumer assistance programs.
>
> (8) How the rates impact customer rate stability principles.
>
> (9) How weather impacts utility revenue under these rates.
>
> (10) How the rates impact the frequency of rate case filings and affect regulatory lag.
>
> (11) If or how the rates interact with other revenue sources, such as Section 1307 automatic adjustment surcharges, 66 Pa. C.S. § 1307 (relating to sliding scale of rates; adjustments), riders such as 66 Pa. C.S. § 2804(9) (relating to universal service and energy conservation policies) or system improvement charges, 66 Pa. C.S. § 1353 (relating to distribution system improvement charge).
>
> (12) Whether the alternative rate mechanism includes appropriate consumer protections.
>
> (13) Whether the alternative rate mechanism is understandable and acceptable to consumers and comports with Pennsylvania law.

Id. at § 69.3302. Finally, the Policy Statement illustrates possible distribution ratemaking and rate design options. *Id.* at § 69.3303.

B. Penn State

Penn State is a large user of both electricity and natural gas in the Commonwealth. It is a customer of multiple jurisdictional utilities and has customer accounts in large industrial, large business, small business, and residential billing classes. As such, it is uniquely situated and interested regarding the Commission's alternative ratemaking policy and procedure to make sure it is not only fair and hits the targeted Act 58 objectives but is equally so for all customer classes.

Penn State has dedicated a specific investment of $69 million to energy savings programs over the next five years and plans to improve its overall energy utilization by 20 percent over the next 10 years. Pennsylvania's energy utilities are essential partners in Penn State's sustainability, energy efficiency and conservation efforts. Penn State therefore commends the Commission's initiative in investigating the extent to which alternative ratemaking methodologies might remove not only disincentives that might presently exist that dissuade energy utilities from aggressively pursuing energy conservation and efficiency initiatives, but also incentives that might exist for energy utilities to resist passively or aggressively end-users' energy conservation and efficiency measures.

II. SUMMARY OF COMMENTS

PSU generally supports consideration of some form of revenue decoupling as a means of reconciling demand-side energy efficiency and conservation measures with utility revenue requirements on a utility-by-utility basis. However, the attractive attributes of alternative ratemaking methodologies should not obscure the benefits of the traditional ratemaking process, such as transparency, opportunities for stakeholder input, and continued Commission supervision. Decoupling or any alternative rate regulation therefore should not displace a periodic review proceeding—at a reasonable interval—open to all stakeholders and customers, to examine:

- the justness and reasonableness of the rates under the alternative mechanism;

- whether it needs to be adjusted or discontinued; and,
- the utility's compliance or non-compliance with the objectives of Act 58 which are the *quid pro quo* for the utility being excused from traditional rate base/rate of return regulation.

Finally, as the Commission has recognized in other contexts, one size does not necessarily fit all, and alternative ratemaking methodologies therefore should be considered on a utility-by-utility and customer class-by-customer class basis.

Penn State applauds the Commission's Policy Statement because it strikes an appropriate balance at this early juncture of alternative ratemaking between flexibility for implementation while ensuring alternative rate mechanisms comply with the law. The Commission is correct to have alternative rate mechanisms proposed and adjudicated within base rate proceedings. The Policy Statement also recognizes the importance of continuing to tie rates to the polestar of ratemaking - cost of providing service.

Penn State has the following concerns related to the initiation of alternative ratemaking. Specifically, alternative ratemaking must, by law:

- Move toward elimination of inter-class and intra-class cost shifting, or subsidization pursuant to *Lloyd v. Pennsylvania Public Utility Com'n*, 904 A.2d 1010, 1019–21 (Pa. Cmwlth. 2006).

- Ensure any implementation of alternative rates is intended to and in fact does promote the policies of Act 58 – facilitating implementation of and access to efficient energy consumption while ensuring adherence to cost of service principles. Alternative Rate Mechanisms should be subject to rigorous audit and review to confirm they are promoting infrastructure investment, efficiency and conservation, and reliability. Rates should be reviewed annually during the early years of any alternative rate mechanism implementation to confirm this and be subject to ongoing review over a reasonable interval.

- Ensure a forum for quality of service issues as they relate to rates.

- Ensure adequate time is available for parties to litigate and the Commission to consider initial alternative rate mechanism proposals. Penn State has major misgivings that the 9-month period, with its 60- day suspension period, and its equal amount of time after an ALJ's decision, leaves too short a period to thoroughly examine and develop a record on both the general rate increase itself as well as the major step of proposing a new, and perhaps radically different, ratemaking regime. Accordingly, the alternative plans should be submitted at least 3 months prior to the filing of a rate case if they are to be consolidated.

As detailed below, Penn State believes the Policy Statement should more fully address these concerns, while maintaining the flexibility for each utility to implement alternative rate mechanisms that are just and reasonable for all classes of customers. Specifically, Penn State makes the following recommendations or revisions to the proposed Policy Statement:

A. Section 69.3302(a)(4) should be modified to remove the phrase "limit or" to make clear that rates should not move from current subsidies to larger, yet "limited" subsidies, which would be in direct contravention of *Lloyd v. Pennsylvania Public Utility Com'n*, 904 A.2d 1010, 1019–21 (Pa. Cmwlth. 2006) and result in discriminatory rates.

B. Section 69.3302(a)(1) should be modified to add a provision that cost of service studies that include load characteristics of distributed generation are required to justify allocations of costs to structure and design rates under alternative rate mechanisms. Cost of service studies are required to provide substantial evidence that rates are non-discriminatory, just and reasonable, and consider customer incentives use of efficiency measures and distributed energy resources.

C. The Policy Statement should provide that Decoupling, or any alternative rate regulation therefore does not displace a periodic review proceeding—at a reasonable interval—open to all stakeholders and customers, to examine:

- **the justness and reasonableness of the rates under the alternative mechanism;**
- **whether it needs to be adjusted or discontinued;**
- **include the ability for parties to address quality of service issues which are presently a subject that is to be considered in general rate base/rate of return proceedings under the Public Utility Code;**
- **the utility's compliance or non-compliance with the objectives of Act 58 which are the *quid pro quo* for the utility being excused from traditional rate base/rate of return regulation; and,**

- **Section 69.3302(b) should be modified to add a provision that during each of the first five (5) years of an Alternative Regulation plan the Commission will direct an annual audit and review of any implemented alternative rate mechanisms by the Commission or a third-party auditor to ensure they are promoting infrastructure investment, efficiency and conservation, and reliability – the policy behind Act 58. This ongoing review should be open for participation by all parties to the rate case in which such alternative rates were approved, and after the initial five (5) years such audits should occur over a reasonable interval determined by the Commission on a utility-by-utility basis considering how its plan is or is not complying with Act 58's goals.**

D. Section 69.3302 should also be modified to add a subsection (c) that requires utilities to give notice and details of any proposed alternative rate mechanism, including analysis of the factors in subsection (a), at least three months prior to the filing of their alternative regulation filing proposing implementation of the mechanism. This will give parties additional, necessary time to consider such proposal within the context of the base rate case.

III. COMMENTS

A. <u>The Policy Statement Should be Modified to Properly Reflect Consideration of Elimination of Cost-Shifting.</u>

Currently the Policy Statement provides that one factor the Commission will consider regarding alternative ratemaking is: "(4) How the rates ***limit or*** eliminate inter-class and intra-class cost shifting." *Id.* at § 69.3302(a)(4). While Penn State agrees with the Commission that cost-shifting or subsidization is an important factor to be considered, Penn State finds the language "limit or" problematic because it could imply that if cost-shifting or subsidization is limited, it is just and reasonable. That is contrary to law. Cost-shifting or subsidization is discriminatory and cannot be ignored based on other ratemaking factors such as gradualism. The movement must be to elimination under applicable law.

In *Lloyd v. Pennsylvania Public Utility Com'n*, 904 A.2d 1010, 1019–21 (Pa. Cmwlth. 2006), the court very clearly explained that cost to provide service is the "polestar" of ratemaking that cannot be surpassed by other ratemaking concerns.

> [W]hile permitted, gradualism is but one of many factors to be considered and weighed by the Commission in determining rate

> designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time. Watergate East, Inc. v. Public Service Commission of District of Columbia, 665 A.2d 943 (D.C.App.1995). Because the flat percentage increase in transmission charges increases any previous discrimination in rates, and the Commission offers no explanation how discrimination in distribution and transmission rate structures are eventually going to be gradually alleviated, in effect, the Commission has determined that the principle of gradualism trumps all other ratemaking concerns—especially the polestar—cost of providing service.

Id. at 1020. Just as gradualism cannot serve to increase subsidies, neither can promotion of efficiency or cash flow certainty via alternative rate mechanisms be used to excuse a lack of movement to eliminate subsidies or to enlarge subsidies. *Lloyd* is clear that cost-shifting must move towards elimination. *Id.* Penn State respectfully submits the Commission cannot reverse or ignore *Lloyd* by substituting "limiting" as an alternative to doing away with subsidies. "Limit" suggests continued existence under any reasonable interpretation of that word. Thus, any alternative rate mechanism must serve not just to promote efficiency, but also provide for a material and timely elimination of cost-shifting or subsidization between rate classes.

Additionally, Penn State submits that the Policy Statement's use of the term "or limit" is inappropriate because it can be read to suggest that an alternative mechanism could increase cost-shifting as long as such cost-shifting increase is "limited." That too violates the *Lloyd* principles discussed above. Instead, the Commission should be considering, when ruling upon alternative rate mechanisms, whether the proposal provides a reasonable and timely plan to eliminate subsidies.

B. **The Policy Statement Should be Modified to Emphasize that Alternative Rate Mechanisms must have rates structures and rate designs that continue to be based on appropriate Cost of Service Studies that Include Load Characteristics of Distributed Generation.**

Currently the Policy Statement provides that one factor the Commission will consider regarding alternative ratemaking is: "(1) How the rates align revenues with cost causation principles as to both fixed and variable costs." *Id.* at § 69.3302(a)(1). Penn State agrees that cost causation principles are integral to the setting of any rate. However, the Commission should emphasize that such causation must be demonstrated via appropriate cost of service studies. The Policy Statement also provides that the Commission will consider: "(6) How the rates impact customer incentives to employ efficiency measures and distributed energy resources." However, the Commission should likewise emphasize that this consideration be included in a cost of service study. Accordingly, the Commission should add the phrase "based on Cost of Service Studies that include load characteristics of distributed generation" to the end of subsection (a)(1).

Because Cost of Service Studies are the best way to establish and design rates and allocating costs to the cost-causer, and to identify subsidies between and among customer classes, such studies should remain a requirement under any alternative rate mechanism. Act 58 itself underscores that alternative rate proposals must "ensur[e] that utility infrastructure costs are reasonably allocated to and recovered from customers and market participants consistent with the use of the infrastructure." *Id.* at § 1330(a)(1). As the Commonwealth Court has explained:

> The primary consideration in establishing a rate structure is the cost of service, although this court has recognized that other concerns are properly considered as well. Cost of service is determined by consideration of cost-of-service studies, in which costs are first "functionalized" among categories of generation, transmission and distribution, and then classified within each function as demand/capacity costs, commodity/energy costs or customer costs (expenses, such as meters and billing, affected by the number of customers served).

Allegheny Ludlum Corp. v. Pennsylvania Public Utility Com'n, 612 A.2d 604, 606–07 (Pa. Cmwlth. 1992) (citing *Peoples Natural Gas Co. v. Pennsylvania Public Utility Commission*, 552 A.2d 1135 (Pa. Cmwlth. 1989); J. Cawley and N. Kennard, Rate Case Handbook, A Guide to Utility Ratemaking before the Pennsylvania Public Utility Commission (Pennsylvania Public Utility Commission 1983) (Cawley and Kennard) at 257–61); J. Cawley and N. Kennard, Rate Case Handbook, A Guide to Utility Ratemaking before the Pennsylvania Public Utility Commission (Pennsylvania Public Utility Commission 2018) (Cawley and Kennard) at 138-141. *See also Duquesne Light Co. v. Pennsylvania Public Utility Com'n*, 643 A.2d 130 (Pa. Cmwlth. 1994) (overturning Commission decision as not based on substantial evidence where no cost of service study was presented)).

Moreover, given that the Commission issued its Final Policy Statement on Combined Heat and Power (Docket No. M-2016-2530484) ("CHP") to seek ways to advance the development of CHP in Pennsylvania, alternative rate mechanisms should consider ways to support such. Electric utility rates for CHP, and other types of distributed generation, should consider the load characteristics of such technology when undertaking cost of service studies. Distribution rates pertaining to those distributed energy resources should be developed in compliance with 52 Pa. Code § 57.35 to reduce the burden of distribution demand charges in power sales to distributed generation facilities. Gas utilities rates should consider the higher load factors typical for such facilities and make appropriate cost-based adjustments in distribution rates for the sale or delivery of gas to such facilities.

C. **The Policy Statement Should be Modified to Allow for Ongoing Review of Alternative Rate Mechanisms.**

Currently the Policy Statement recognizes certain factors that should be considered at the outset when implementing alternative rate mechanisms, but the Policy Statement lacks any discussion of ongoing review for newly implemented rate structures. The General Assembly was very clear that implementation of alternative rate mechanisms is to "encourage and sustain investment through appropriate cost-recovery mechanisms to enhance the safety, security, reliability or availability of utility infrastructure and be consistent with the efficient consumption of utility service." 66 Pa. C.S. § 1330(a)(2). Thus, the Commission should ensure that any implemented alternative rate mechanism is actually working to serve such purpose.

Accordingly, Section 69.3302(b) should be modified to add a provision that the Commission or a third-party auditor selected by the Commission will audit and review any implemented alternative rate mechanisms to ensure they are promoting infrastructure investment, efficiency and conservation, and reliability on an annual basis. This ongoing review should be open for participation by all parties to the rate case in which such alternative rate mechanisms were approved and should include the ability for parties to address quality of service and other tariff provisions issues.

Adding such provisions will ensure the Commission and interested parties can determine whether such rate mechanisms are achieving their purpose. This review process will also provide a forum for parties to address service and other tariff change issues that may recur more consistently than future rate cases that utilize alternative rate mechanisms.

D. <u>The Policy Statement Should be Modified to Allow for Sufficient Time to Consider Alternative Rate Mechanisms.</u>

Currently the Policy Statement appropriately places consideration of alternative rate mechanisms within a utility's 1308(d) base rate proceedings and advises the utility to include information in its filing regarding the factors in the Policy Statement at section 69.3302(a). However, Penn State is concerned that a base rate case (which places parties under significant time constraints as it must effectively be decided within nine months, 66 Pa. C.S. §1308(a)-(b)), may not provide enough time for parties to properly vet and litigate alternative rate proposals, especially while alternative ratemaking in Pennsylvania is in its infancy.

Accordingly, Policy Statement Section 69.3302 should also be modified to add a subsection (c) that requires utilities to give notice and details of any proposed alternative rate mechanism, including analysis of the factors in subsection a, at least three months prior to the filing of their alternative rate mechanism. This will give parties additional, necessary time to consider such proposal within the context of the base rate case.

IV. CONCLUSION

Penn State asks the Commission to fully consider its proposed modifications to the Policy Statement discussed above. These modifications will not remove the flexibility inherent in the Policy Statement but will promote better understanding of alternative ratemaking principles and the ability for customers and advocates to fully vet and monitor such proposals. Penn State appreciates the opportunity to submit these comments and looks forward to participating in this ongoing proceeding.

Respectfully submitted,

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