

COMMONWEALTH OF PENNSYLVANIA



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February 25, 2016

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Enclosed please find the Testimony of Tanya J. McCloskey on behalf of the Office of Consumer Advocate, in the above-referenced proceeding.

If you have any questions, please feel free to contact me.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Tanya J. McCloskey".

Tanya J. McCloskey
Acting Consumer Advocate
PA Attorney I.D. # 50044

Enclosure

cc: Jeremy Hubert, Fixed Utility Valuation Engineer
217737

**BEFORE THE PENNSYLVANIA
PUBLIC UTILITY COMMISSION**

Testimony Of

**Tanya J. McCloskey
Acting Consumer Advocate**

**Regarding
Alternative Ratemaking Methodologies
Docket No. M-2015-2518883**

**Harrisburg, Pennsylvania
February 25, 2016**

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**Chairman Brown, Vice Chairman Place, Commissioner Powelson,
Commissioner Coleman, and Commissioner Witmer**

Thank you for the opportunity to present testimony at this *En Banc* hearing on Alternative Ratemaking Methodologies. The testimony I present here today will provide an overview regarding the use of alternative ratemaking in Pennsylvania. My Office will be providing comments on March 16, 2016 that will address in more detail the issues presented by alternative ratemaking methodologies from the consumer's perspective and that will respond to the specific questions posed by the Commission in its Secretarial Letter.

In its Secretarial Letter and accompanying questions, the Commission has sought information on alternative ratemaking methodologies, particularly in the context of energy efficiency and conservation performance. The Commission stated that the purpose of this hearing is to inform the Commission as to: (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 such rate mechanisms. As I will address in this testimony, in my view, Pennsylvania's regulatory model for energy efficiency and conservation has worked well and achieved the proper balance of costs and benefits.

Alternative ratemaking methodologies can cover a broad spectrum of mechanisms and methodologies including the introduction of surcharges, changes in rate design (such as straight fixed variable rate design or fixed charges), performance based ratemaking, mandatory requirements or metrics, revenue decoupling, and I am sure others. The Pennsylvania General Assembly has provided for some of these methodologies and mechanisms, such as the use of

surcharge mechanisms within the statutory requirements and the consideration of performance factors in setting rates. See, *e.g.*, 66 Pa.C.S. §§ 523(b), 1307, 1319, 1505(b), and 2806.1.

In 2008, the Pennsylvania General Assembly passed Act 129 that, among other things, established a comprehensive regulatory structure for implementing energy efficiency and demand side response programs by our electric utilities. The OCA has supported energy efficiency and demand response for many years and has been strongly supportive of Act 129 and the programs implemented through this statutory mandate. The OCA has participated in all of the proceedings to establish the Energy Efficiency and Demand Response Plans since 2009, offering expert testimony on those Plans and possible improvements to the Plans. The OCA has also participated regularly in the stakeholder collaborative processes of each utility. This process brings together stakeholders with a wide range of experience who work together to improve these Plans.

The OCA has also been a strong supporter of the Low Income Usage Reduction Programs (LIURP) operated by our electric and natural gas utilities. Pennsylvania has long been a leader in delivering energy efficiency to low income customers as a means of providing affordable service. Pennsylvania initiated its programs in the 1980s and has continued to support these programs. A 2009 Report on Pennsylvania's LIURP programs found that between 1989 and 2005, over \$330 million had been spent on weatherization treatments for more than 292,071 households. Long Term Study of Pennsylvania's Low Income Usage Reduction Program, John Shingler, Consumer Services Information Project, Penn State University (January 2009).

Currently, under Act 129, Pennsylvania's seven major electric utilities spend approximately \$240 million annually on energy efficiency and demand response programs. The Final Report from the Statewide Evaluator regarding Phase I of the Act 129 programs shows that

the seven major electric utilities spent approximately \$803 million on the Phase I programs, producing approximately 5.4 million MWH/yr in verified energy savings and 1,540 MW of demand reduction. Act 129 Statewide Evaluator Final Report on Phase I of Act 129 of 2008, pg. [xx]. Statewide, this was 123% of the mandated energy savings goal and 113% of the mandatory demand reduction goal. Phase II is proving to be equally successful, with additional energy savings of approximately 1.5 million MWH/yr through the second quarter of Program Year 6. SWE Program Year 6 Semi-Annual Report, pg. 2 (May 6, 2015). In addition, electric ratepayers support approximately \$30 million on an annual basis for LIURP. For the natural gas utilities in Pennsylvania, ratepayers supported approximately \$18.25 million in expenditures in 2014 for our LIURP programs. Several natural gas companies also provide energy efficiency programs with recovery through distribution base rates or surcharge mechanisms.

Under Act 129, our utilities have largely met and exceeded the mandated energy efficiency goals. Those mandatory goals were recently re-established by the Commission for Phase III after a robust Technical Potential Study completed by the Commission's independent Statewide Evaluator. In addition, the Commission established new goals for energy savings for low income customers and the government/non-profit/ education sector, as well as encouraged the further development of comprehensive energy efficiency programs.

Act 129 provides a balanced and comprehensive regulatory structure for the implementation of energy efficiency in Pennsylvania. Act 129 establishes mandatory energy efficiency and peak demand reduction goals for Pennsylvania electric utilities, establishes specific consumption reduction requirements for low income customers and the government/non-profit/education sector, establishes the annual spending cap for these programs, provides for full and current recovery of the costs of the energy efficiency and demand response programs

through a surcharge mechanism, excludes the recovery of decreased revenue through the surcharge mechanism but allows such recovery on a prospective basis in a base rate case, establishes significant mandatory penalties for a utility's failure to achieve the requirements of Act 129, and provides for the continuation of these programs if cost-effective. The full and current recovery of expenses under Act 129 through a surcharge mechanism is not subject to an earnings test. That is, unlike the case of the Distribution System Improvement Charge, a utility may increase its rates to reflect Act 129 costs without regard to whether the utility is earning more than its allowed rate of return on an overall basis. Act 129 contains both "carrots" and "sticks" to achieve the energy efficiency and demand response intended by the General Assembly within the spending limitations set forth by the General Assembly.

At the same time, in furtherance of its energy efficiency and demand response goals, the General Assembly in Act 129 mandated the deployment of smart meters throughout Pennsylvania and the implementation of voluntary time of use pricing and real time pricing plans. The significant infrastructure investment, now anticipated to be approximately \$2 billion over the next several years, is also recovered by the electric utilities on a full and current basis through a surcharge, with a return on the capital investment. These smart meter surcharge rate increases – including the return on equity – are permitted through an automatic surcharge without regard to whether or not the utility is earning more than its allowed return on an overall basis. As in the case of energy efficiency programs, however, Act 129 also specifically precludes the recovery of any decreased revenues associated with the smart meter programs or new rate designs from being recovered between base rate cases. 66 Pa.C.S. § 2807(f)(4).

This brings me to the Commission's question of whether revenue decoupling or other similar rate mechanism would encourage utilities to better implement energy efficiency and

conservation programs. In passing Act 129, the General Assembly squarely spoke to this issue for Pennsylvania and effectively rejected the decoupling approach. Specifically, while establishing automatic surcharges to recover the costs of our energy efficiency, demand response, and smart meter programs, the General Assembly declared that such cost recovery may not include “decreased revenues of an electric distribution company due to reduced energy consumption or changes in energy demand.” 66 Pa.C.S. §§ 2806.1(k)(2), 2807(f)(4).

It should be noted that the issue of lost revenue recovery through a revenue decoupling mechanism was not new to Pennsylvania at the time of the passage of Act 129. In 2006, the issue of revenue decoupling was brought to the foreground in Pennsylvania when National Fuel Gas Distribution Company filed a rate case that included a proposed “decoupling” mechanism. That filing was met with 1,267 individual consumer complaints, nearly all in opposition to the decoupling proposal. Following a public input hearing where 168 customers testified in opposition to the proposal, NFGD withdrew the proposal. The Commission subsequently further investigated decoupling in 2007 in its Investigation of Conservation, Energy Efficiency Activities & DSR by Energy Utilities & Ratemaking Mechanisms to Promote Such Efforts, Docket M-00061984, just one year prior to the passage of Act 129.¹

As I mentioned above, Act 129 is clear that the costs recovered through the surcharge recovery mechanism may not include “decreased revenues of an electric distribution company due to reduced energy consumption or changes in energy demand.” 66 Pa.C.S. §2806.1(k)(2). Lost revenues are to be addressed on a prospective basis in a base rate case. 66 Pa.C.S. §2806.1(k)(3). Act 129 has effectively precluded the use of a “decoupling” mechanism between base rate cases related to energy efficiency and demand response programs. I would hasten to add that even in the absence of the statutory prohibition against decoupling, such

¹ See also, Investigation Into Demand Side Management By Electric Utilities, Docket No. I-900005.

mechanisms raise significant concerns about improper single issue ratemaking, retroactive ratemaking, and the just and reasonable requirements of Section 1301.

While Act 129 applies only to electric utilities, the Commission is authorized through various sections of the Public Utility Code to order or approve energy efficiency programs for natural gas companies. Through Section 1505(b), the Commission is authorized to order a utility to establish conservation and load management programs. Section 1319 provides that the Commission shall allow recovery of conservation or load management programs implemented by a natural gas or electric utility that are found to be prudent and cost effective. The Commission is also required to consider a natural gas utility's efforts in pursuing cost-effective conservation and load management opportunities when determining just and reasonable rates. 66 Pa.C.S. §523(b); 52 Pa. Code §69.35. Some of our natural gas utilities, in addition to their Low Income Usage Reduction Programs, have already implemented conservation programs where they are cost-effective. Notably, Philadelphia Gas Works and PECO Energy Gas Company have had programs in place for about five years. UGI Gas has a proposal pending in its current base rate case filing.

Since the enactment of Act 129, the Pennsylvania General Assembly has amended the Public Utility Code to permit the use of a fully forecasted future test year to set base rates. 66 Pa.C.S. §315(e). This is relevant to the discussion here in the context of the provision of Act 129 that allows utilities to reflect lost revenues from Act 129 programs prospectively in a base rate case. Under this new provision of the Public Utility Code, a utility can effectively look a full two years forward from the date of its filing in determining its revenues and expenses. Pursuant to Act 129, the revenue impact of the efficiency programs can be properly reflected on a prospective basis in this rate setting process. In the context of a base rate case, the impact of

energy efficiency programs can be reflected in the fully forecasted *pro forma* revenues and sales estimates when determining a just and reasonable level of rates. 66 Pa.C.S. § 2806.1(k)(3). By reflecting the impact on sales in the context of a base rate case, the Commission can reflect the anticipated consumption reductions, address all other factors that may offset the need for a rate change, and address any burdens to ratepayers.

Given the ratemaking methodologies we have in place and the success we have with Act 129, it is not clear how any form of revenue decoupling will further advance the goals that Pennsylvania is seeking to achieve. Pennsylvania has robust energy efficiency programs within the mandates of Act 129 and a robust distribution base rate process that now allows for the use of a fully forecasted future test year to be used in setting rates.

As I mentioned, the Commission has considered decoupling mechanisms in the past, both before and after the passage of Act 129. Notably, in its Order regarding the American Recovery and Reinvestment Act following the passage of Act 129, the Commission was required to determine whether “ratemaking policies for electric and gas utilities ...align their financial incentives with the promotion of energy efficiency and conservation.” Compliance of Commonwealth of Pennsylvania with Section 410(a) of the American Recovery and Reinvestment Act of 2009, Docket No. I-2009-2099881, Order at 30-31 (Aug. 1, 2011)(ARRA Order). The Commission reviewed its existing authority under Act 129 and other provisions of the Public Utility Code as well as its regulations. The Commission concluded:

Upon consideration of the Section 410(a) of the ARRA and our review of existing Commission policies and practices in regard to energy conservation, it appears that the Commission has already given consideration to and, further, has adopted numerous policies that, in the aggregate, reflect a general policy to align utility financial incentives with cost-effective and verifiable energy conservation by consumers.

Indeed, to highlight just one key example, by virtue of Act 129, Pennsylvania has invested millions of ratepayer dollars to finance and incentivize both consumers and utilities to conserve energy and reduce peak demand in a cost-efficient manner.

ARRA Order at 30-31. Similarly in its recent Phase III EE&C Order, the Commission concluded:

The Commission did not propose the establishment of an incentive or alternative revenue mechanism for EDCs. The Commission believes that Act 129 provides the appropriate mechanism for EDCs to use to obtain revenue on its assets through just and reasonable rates.

Energy Efficiency and Conservation Programs, Docket No. M-2014-2424864, Implementation Order at 134 (June 19, 2015). I fully agree with the Commission's conclusions.

Our Comments to be filed on March 16, 2016 will provide a more comprehensive discussion of decoupling mechanisms and other alternative ratemaking methodologies, given the many forms of mechanisms, the different impacts of the design of the mechanism, and the protections that may or may not be afforded. In considering whether such rate mechanisms are just and reasonable and in the public interest, I would like to raise some general considerations here that are often overlooked in a discussion of revenue decoupling.

A great deal of focus in the revenue decoupling debate is put on the customer's total bill and the argument that the change in the usage rate occasioned by revenue decoupling is generally small when properly designed. A critical distinction is often lost in this argument, that is the distinction between those customers that can participate in energy efficiency programs and reduce their usage sufficiently to offset the increased usage rate and those customers that cannot participate (or cannot participate sufficiently) in energy efficiency programs. Not all customers are able to engage in energy efficiency due to the lack of financial means to pay for the necessary investment, the lack of ownership of their residence or business, or the inability to reduce energy

usage any further due to health and safety concerns. These low to moderate income households and otherwise vulnerable households end up bearing the brunt of these increasing prices between base rate cases. In a base rate case, where offsets can be recognized and principles of affordability can be applied, these impacts can be better addressed.

Alternative ratemaking methodologies must also be considered in relationship to other utility operations and policies of the Commonwealth. One of the important policies that this Commission and the Commonwealth have sought to forward is the extension of natural gas service to unserved and underserved areas. Revenue decoupling could reduce the incentive for utilities to engage in timely main extensions as the benefit of adding new customers (and the associated revenue) is muted with some forms of revenue decoupling. Similarly, the Commonwealth has implemented retail choice for both natural gas commodity and electric generation service. In this retail choice environment, the utility may be sending signals on the distribution side to reduce energy usage but the alternative supplier may be sending signals to use more energy since its business is volumetric based. This could be even more problematic if the alternative supplier is an affiliate of the distribution utility.

I would also note that Pennsylvania utilities are engaged in significant infrastructure repair and replacement programs that by their very nature will require base rate cases to properly reflect investment, reset the DSIC, and align rates with changing cost responsibility. The purported benefit of extending the time between base rate cases through decoupling is unlikely to be realized with our accelerated infrastructure repair and replacement programs.

Operationally, the Commission has raised the question of whether revenue decoupling could reduce the incentive for timely storm repair. This is certainly a question that

presented itself in Maryland as a result of storms in 2010 and 2011. The Maryland Public Service Commission subsequently limited the revenue decoupling mechanism so that utilities could only recoup lost revenues for the first 24 hours of a storm event. The Maryland PSC observed “that by eliminating the risk of a decrease in monthly revenue arising from a disruption in electric service, approval of the BSAs [the decoupling mechanism] may have made the Companies financially indifferent to the prospect of extended outages and resulted in rates that are not just and reasonable.” In the Matter of the Investigation into the Just and Reasonableness of Rates as Calculated Under the Bill Stabilization Adjustment Rider of Potomac Electric Power Company, et al., Case No. 9257, et al., Order No. 84653 at 3 (Jan. 25, 2012). The Maryland PSC further stated:

OPC [Office of Peoples’ Counsel] is correct that customers face an existing hardship when electric outages occur as a result of Major Storms and they should not be further burdened by being required to compensate electric utilities for revenue the utilities would otherwise have collected had electricity been delivered. As OPC and Montgomery County commented, that outcome can be demoralizing to customers who perceive an intrinsic unfairness in paying for service they did not receive.

Maryland Order at 11.

I would also caution against consideration of revenue decoupling based only on past trends in usage or sales. The energy industry continues to change as policies on both the state and federal level evolve. There may be new opportunities for the growth and development of the energy sector. We are already seeing a growth in the use of natural gas for heating, industrial processes, electric generation, and transportation. Similarly, there is a growing use of electric vehicles. Electrification, particularly with increased renewable production, is being viewed as a means of reducing emissions. Any policies that are considered must consider this larger picture and the overall impact that may result.

While most of the Commission's questions and my discussion here go to decoupling to address the impacts of energy efficiency, I would like to raise a concern about the use of revenue decoupling as a means to address distributed generation on the utility system, particularly as it concerns the residential class. As the Commission is well aware, the question of reduced utility sales due to distributed generation, net metering and the proper payment for residential solar is an issue being considered by many states. One of the concerns with distributed generation is that as more customers install solar behind the utility meter, thereby reducing their purchases from the utility grid and avoiding some or all distribution charges, the costs to support the distribution system must be paid by other customers. The lost distribution revenues resulting from net metering fall on those customers who are unable to reduce their utility purchases through installation of distributed generation. Revenue decoupling does not address this fundamental issue with distributed generation and may even exacerbate the concerns. With decoupling, all of the foregone utility distribution revenue from reduced utility sales are automatically shifted to other customers through the decoupling mechanism. Under current net metering policies, if such distributed generation grows, then the impact of this usage based cost shift could become substantial. That is not to say that I have the solution as we sit here today, and I will say that many alternative approaches to this concern, such as increased fixed customer charges, suffer from serious infirmities. These issues are being reviewed in other states where there is a significant level of distributed generation and we should continue to closely watch the outcomes in those states for guidance on these matters.

Thank you again for the opportunity to present this testimony today. I look forward to your questions and the continuing dialogue as to how best to move Pennsylvania forward into the future.