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October 9, 2018

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

VIA ELECTRONIC FILING

**RE: Implementation of Act 58 of 2018 Alternative Ratemaking for Utilities;
Docket No. M-2018-3003269**

Dear Secretary Chiavetta:

Attached for filing with the Pennsylvania Public Utility Commission are the Comments of the Pennsylvania Energy Consumers Alliance, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Philadelphia Area Industrial Energy Users Group, PP&L Industrial Customer Alliance, and West Penn Power Industrial Intervenors to the Tentative Implementation Order in the above-captioned proceeding.

If you have any questions concerning this matter, please contact the undersigned. Thank you.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By

A handwritten signature in blue ink, appearing to read 'Matthew L. Garber', is written over a horizontal line. The signature is fluid and cursive.

Matthew L. Garber

Enclosure

- c: Chairman Gladys M. Brown (Via First-Class Mail)
- Vice Chairman Andrew G. Place (Via First-Class Mail)
- Commissioner John F. Coleman, Jr. (Via First-Class Mail)
- Commissioner Norman J. Kennard (Via First-Class Mail)
- Commissioner David W. Sweet (Via First-Class Mail)

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Implementation of Act 58 of 2018 : Docket No. M-2018-3003269
Alternative Ratemaking for Utilities :

**COMMENTS OF THE
PENNSYLVANIA ENERGY CONSUMERS ALLIANCE,
MET-ED INDUSTRIAL USERS GROUP,
PENELEC INDUSTRIAL CUSTOMER ALLIANCE,
PHILADELPHIA AREA INDUSTRIAL ENERGY USERS GROUP,
PP&L INDUSTRIAL CUSTOMER ALLIANCE, AND
WEST PENN POWER INDUSTRIAL INTERVENORS**

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Customer Alliance, and West Penn Power Industrial
Intervenors

Dated: October 9, 2018

I. INTRODUCTION

On June 28, 2018, Pennsylvania Governor Tom Wolf signed into law Act 58 of 2018 ("Act 58"). Act 58 amends Chapter 13 of the Public Utility Code ("Code") to authorize utilities to request, and the Pennsylvania Public Utility Commission ("PUC" or "Commission") to approve, alternative ratemaking methodologies to adjust rates between rate cases filed pursuant to Section 1308(d) of the Code. Act 58 specifically defines four types of alternative ratemaking (*i.e.*, revenue decoupling, formula rates, performance-based rates and multiple year rate plans) but also contains flexibility for other forms of alternative ratemaking.

On August 23, 2018, the Commission issued a Tentative Implementation Order ("TIO"), which was published in the *Pennsylvania Bulletin* on September 8, 2018.¹ Pursuant to the procedures set forth in the TIO, the Pennsylvania Energy Consumer Alliance ("PECA"), the Met-Ed Industrial Users Group ("MEIUG"), the Penelec Industrial Customer Alliance ("PICA"), the Philadelphia Area Industrial Energy Users Group ("PAIEUG"), the PP&L Industrial Customer Alliance ("PPLICA"), and the West Penn Power Industrial Intervenors ("WPPII") (collectively, the "Industrial Customers") jointly file these Comments with the PUC.

Concurrent with signing Act 58, Governor Wolf issued a letter to the Commission emphasizing the importance of robust Commission oversight for mechanisms that are approved under the new law.² The Governor stated:

I further understand that the Commission intends to conduct a robust public comment process and formally adopt appropriate requirements prior to considering any rate proceeding proposing alternative rate mechanisms. This process will allow the Commission to further clarify the consumer protections—such as periodic review and oversight of any automatic adjustments—that it will require in this new context, and will allow stakeholders to weigh in with concerns, and provide greater certainty to utilities about the new mechanisms that will be considered. I believe

¹ 48 Pa. Bull. 5691 (Sept. 8, 2018).

² *Letter from Governor Thomas Wolf to the Pennsylvania Public Utility Commission* (June 28, 2018) ("*Letter from Governor Thomas Wolf*") (attached as Attachment 1).

that formalizing the consumer protections that will apply in the context of alternative ratemaking is in the best interest of the Commonwealth and urge the Commission to move forward expeditiously.

The TIO provides some clarifications regarding the Commission's interpretation of Act 58; however, the TIO omits the discussion of the specific consumer protections that will apply to future proposals by utilities for alternative ratemaking methodologies and, instead, suggests that the details of consumer protections should be addressed in the base rate proceeding when a utility proposes such a mechanism. This process, however, would create uncertainty for stakeholders, especially for consumers that will be required to participate in multiple proceedings to ensure that their interests are appropriately balanced against the utility's desire for greater revenue certainty.

Rather than leaving the consumer protections as a subject for litigation in each rate case, the Industrial Customers urge the Commission to immediately commence a rulemaking as contemplated under Section 1330(d) of Act 58. As set forth below, the regulations adopted by the Commission should include a number of fundamental consumer protections that have been adopted in other jurisdictions for similar alternative ratemaking methods. Specifically, the Industrial Customers request that the Commission: (a) establish mandatory time limitations on alternative ratemaking mechanisms so such mechanisms will be reviewed in a base rate case on a periodic basis; (b) necessitate an earnings-sharing mechanism and reduction to Return on Equity ("ROE") when approving alternative ratemaking mechanisms; and (c) require alternative ratemaking mechanisms to be implemented in ways that do not shift costs interclass or intraclass, as well as ensure that mechanisms can be designed on a customer-class basis.

II. COMMENTS

The Industrial Customers include various large commercial, institutional and/or industrial energy consumers. The Industrial Customers' members contribute substantially to Pennsylvania's economy, providing jobs, investing in their local communities, and providing the revenue basis to

support a significant portion of Pennsylvania's utility infrastructure. By the nature of their businesses, the Industrial Customers' members depend heavily on energy supply, and energy bills comprise a large portion of their operating costs. Consequently, ratemaking policy developments significantly impact the Industrial Customers and their members, and by extension, the communities and employees who depend on them.

While the TIO contemplates that consumer protection can be proposed for consideration in rate cases, the Industrial Customers believe the promulgation of regulations to implement Act 58 is essential to streamlining the adoption of alternative ratemaking proposals in Pennsylvania. All interested parties should litigate the appropriate structure for the alternative ratemaking mechanisms—and the consumer protections that will be presumed to accompany those mechanisms—one time as part of a rulemaking proceeding. This will establish binding "rules of the road" for alternative ratemaking proposals under Act 58.

Other jurisdictions have studied the types of consumer protection mechanisms that must accompany alternative ratemaking mechanisms. For example, prior to recommending specific alternative ratemaking policies to its legislature, the Texas Public Utility Commission commissioned a study by Christensen Associates Energy Consulting LLC ("Christensen Study").³ The Texas PUC's report to its legislature ("Texas PUC Report") and the Christensen Study are attached to these Comments as Attachment 2.⁴ The consumer protections proposed herein include

³ *Alternative Electricity Ratemaking Mechanisms Adopted By Other States*, Christensen Associates Energy Consulting LLC (prepared for Public Utility Commission of Texas) (dated May 25, 2016) ("Christensen Study"). The Christensen Study served as a starting point for a 2017 report by the Texas Public Utility Commission to the Texas Legislature. Report to the 85th Texas Legislature on Alternative Ratemaking Mechanisms, Public Utility Commission of Texas (January 2017) ("Texas PUC Report").

⁴ The Texas PUC provided the Christensen Study to the Legislature as a part of the Texas PUC Report but did not adopt the Christensen Study's recommendations at that time, advising that further analysis and study be done before implementing substantial changes. However, the Christensen Study provides valuable insight into optimal safeguards and customer protections through its analysis of alternative ratemaking mechanisms throughout the United States.

many of the recommendations from the Christensen Study, which could be characterized as "built-in accountability mechanisms." Just as many alternative ratemaking methodologies have *automatic adjustments* between rate cases, the Industrial Customers believe the regulatory framework surrounding alternative ratemaking should also provide *automatic protections* to ensure, as a practical matter, robust Commission oversight. These specific consumer protections are proposed to provide accountability commensurate with the flexibility added into the ratemaking process by Act 58. Generally applicable safeguards will also help avoid inequities across the Commonwealth by preventing competitive disparities in different territories as new methods of ratemaking are explored.

A. Establish time limitations on alternative ratemaking mechanisms.

The Commission should establish a regulation limiting the length of time that an alternative ratemaking mechanism can be used before the utility must file a new rate case where all costs and investments are examined, including the mechanism itself. The Industrial Customers request a regulatory limit of no more than three years to five years.

The need for regular base rate cases is evidenced by a variety of alternative ratemaking mechanisms. For example:

- Formula rate experience at the Federal Energy Regulatory Commission shows how quickly rates can grow with automatic adjustments. For example, PPL's Formula Transmission Rate has been in place for over 10 years and has increased by 400% during that time.
- Straight Fixed Variable Rate Designs are subject to the need for occasional price updates due to inflation.⁵

⁵ Christensen Report at 15.

- Performance-based rates need periodic re-evaluation, including examination of whether the original metrics for earning the rate premium need to be strengthened.

These challenges point to a need for relatively frequent review by the Commission. The Christensen Study states that "nearly all alternative ratemaking mechanisms require at least periodic review of revenue requirements and the prudence of costs," and recommends "a regular timeframe for adjusting rates and reconciling them with utility costs," suggesting three to five years between rate cases as an example.⁶ The Industrial Customers agree with this analysis and recommend the Commission adopt a regulation to that effect.

B. Include an earnings-sharing mechanism and reduction to Return on Equity.

Other jurisdictions that have implemented alternative ratemaking recognize that: (a) the utility's earnings must be closely monitored to ensure that the realized Return on Equity ("ROE") remains just and reasonable; and (b) the authorized ROE should include a reduction to reflect the reduced earnings volatility and risk for the utility. The Industrial Customers urge the Commission to incorporate both of these consumer protections into the regulations that govern alternative ratemaking.

Bond rating and credit agencies have recognized that alternative ratemaking mechanisms reduce earnings volatility and risk for utilities. For example, revenue decoupling shifts usage and weather-related risks to customers rather than utilities.⁷ The Christensen Study summarizes how other jurisdictions have addressed this issue, including ROE reductions as high as 50 basis points.⁸ As part of the rulemaking, the Commission should seek input on a standard ROE adjustment for Pennsylvania utilities that implement alternative ratemaking mechanisms.

⁶ *Id.* at vii; *see also id.* at 51, 53.

⁷ *Id.* at 21.

⁸ *Id.* at 19-20.

In addition, the regulations should require an earnings-sharing mechanism to keep utilities' earned ROEs within an appropriate range, consistent with market-based returns. The Christensen Study explains how an earnings-sharing mechanism would function.

Because automatic rate change mechanisms can result in actual ROEs that differ significantly from authorized ROEs, earnings sharing mechanisms are desirable as a means of maintaining ROEs within bands considered to be consistent with market-based returns. Authorized ROEs are set through the regulatory process at levels consistent with prevailing [Transmission & Delivery Utility ("TDU")] ROEs, with financial market data, and with the risk profile of the particular utility to which the ROE would apply. Authorized ROEs may also depend upon the utility's achievement of certain operating performance metrics, as described below. Authorized ROEs may be updated annually. At the inception of a TDU's automated rate change mechanisms, bands around the authorized ROE are defined within which no change would be made to the actual ROE. Similar to the [formula rate plans] of utilities in Alabama and Mississippi, the actual ROE could be ratcheted up or down if it falls outside of the bands. The adjustment of any actual ROE falling outside the band could be limited to a pre-specified number of basis points in order to limit the volatility of rates over the plan period. The treatment of adjustments could be symmetric (the same when actual ROEs are too high as when they are too low) or asymmetric. Adjustments to the authorized ROE would entail sharing between customers and shareholders the difference between the actual ROE and the relevant band, which would be accomplished by reducing customers' rates when the actual ROE is too high and increasing rates when the actual ROE is too low.⁹

Utilities may benefit from a reduced risk profile with certain alternative ratemaking methods, but they should not also expect to retain excessive profits. Fluctuating factors such as interest rates can quickly change cost calculations and provide utilities additional opportunity for revenue growth when ratepayers bear the risks. Because ratepayers would be bearing increased risks, excessive profits beyond a risk-adjusted ROE should be shared with ratepayers.

C. Require alternative ratemaking to be implemented on a customer-class basis to avoid interclass and intraclass cost shifting.

A utility's cost to serve ratepayers varies by customer class. Each class must be responsible for its own costs, and historic cross-class subsidies must be removed. The Public Utility Code

⁹ *Id.* at 54-55.

forbids unreasonable cross-class subsidies,¹⁰ and Lloyd v. Pa. Public Utility Commission established cost of service as the regulatory standard for ratemaking.¹¹ The goal of eliminating cross-class subsidies is still ongoing, raising the Industrial Customers' concerns that alternative ratemaking mechanisms, which add additional variables into the ratemaking process, might result in additional interclass or intraclass subsidies.

Consistent with the holding in Lloyd, alternative ratemaking and reconciliation mechanisms must also be class based. To prevent the perpetuation of new cross-class subsidies, the Industrial Customers respectfully request that the Commission establish a regulation requiring alternative ratemaking mechanisms enabled under Act 58 to be developed, evaluated, and reconciled on a customer-class basis. The mechanisms must also be consistent with the Lloyd decision and other requirements in the Code. For example, a utility may be facing declining revenues due to usage reductions in the residential class (whose rates are heavily dependent on volumetric kWh or Mcf sales) while the revenues from the Commercial and Industrial classes are not declining. Striving to eliminate interclass and intraclass cost subsidies as part of establishing base delivery rates in a rate case while authorizing implementation of alternative rate mechanisms that reintroduce interclass and intraclass cost shifting and subsidies would be inconsistent and contrary to cost causation principles. Commission regulations should require that alternative ratemaking mechanisms be designed consistent with cost-causation principles.

D. Establish a Rulemaking Docket so consumer protections are established as binding regulations.

The need for consumer protections was highlighted by various parties during the legislative process leading to the passage of Act 58. Governor Wolf, in signing Act 58 into law, issued a

¹⁰ 66 Pa. C.S. § 1304 ("No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service.").

¹¹ *Lloyd v. Pa. PUC*, 904 A.2d 1010, 2006 Pa. Commw. LEXIS 438 (Pa. Commw. Ct. 2006).

letter to the Commission urging the Commission to adopt consumer protections even though many specific consumer protective proposals were not included in the text of Act 58.¹² The Governor reiterated the need for close Commission scrutiny of any alternative ratemaking proposal.

The Industrial Customers agree that Act 58 references general principles of consumer protection; however, those general principles of consumer protection must be complemented by *specific* standards that ensure future Commissions maintain robust oversight in a rapidly changing utility ratemaking environment.

To ensure appropriate and consistent oversight, the Commission should utilize a Rulemaking Docket to establish specific standards that provide built-in accountability for utilities. A Policy Statement or Implementation Order alone is insufficient to ensure a clear, enduring framework as this Commission, and future Commissions, explore alternative ratemaking options. A Rulemaking Docket will provide consumers maximum assurance and comfort as the Commission explores new options in ratemaking within the Commonwealth. Although utilities may submit alternative ratemaking proposals while the regulations are being developed, it is in the public interest to provide long-term certainty to all stakeholders regarding the basic consumer protections that will apply in Pennsylvania through the promulgation of regulations. Safeguards established in a Rulemaking Docket will also help prevent inequities across service territories by providing standards that are clear and generally applicable throughout the Commonwealth.

Consequently, the Industrial Customers respectfully ask the Commission to open a Rulemaking Docket and implement the substance of Sections A, B, and C herein as proposed regulations.

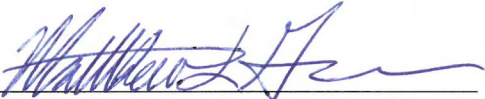
¹² See *Letter from Governor Thomas Wolf* (Attachment 1).

III. CONCLUSION

WHEREFORE, the Pennsylvania Energy Consumers Alliance, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, the PP&L Industrial Customer Alliance, and the West Penn Power Industrial Intervenors respectfully request that the Pennsylvania Public Utility Commission consider these Comments.

Respectfully submitted,

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