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March 16, 2016

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

SUBJECT: Comments of PECO Energy Company on Alternative Ratemaking Methodologies, Docket No. M-2015-2518883

Dear Secretary Chiavetta:

Attached are PECO's comments to in response to the Pennsylvania Public Utility Commission's December 31, 2015 Notice convening an *en banc* hearing on March 3, 2016 and inviting interested parties to submit written comments on or before March 16, 2016 on "the efficacy and appropriateness of alternative ratemaking methodologies."

If you have any questions regarding this matter, please call me at 215-841-5777.

Sincerely,

Copies to: C. Walker-Davis, Director, Office of Special Assistants
P. T. Diskin, Director, Bureau of Technical Utility Services
D. P. Hosler, Director, Bureau of Audits
J. E. Simms, Director, Bureau of Investigation & Enforcement
Office of Consumer Advocate
Office of Small Business Advocate

Enclosures

**BEFORE THE**
**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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| ***EN BANC* HEARING ON ALTERNATIVE RATEMAKING METHODOLOGIES** | : : : | **DOCKET NO. M-2015-2518883** |

**COMMENTS OF PECO ENERGY COMPANY**
**ON ALTERNATIVE RATEMAKING METHODOLOGIES**

PECO Energy Company ("PECO" or the "Company") submits these Comments in response to the Pennsylvania Public Utility Commission's ("PUC" or the "Commission") December 31, 2015 Notice convening on *en banc* hearing on March 3, 2016 and inviting interested parties to submit written comments on or before March 16, 2016 on "the efficacy and appropriateness of alternative ratemaking methodologies." PECO appreciates the opportunity to comment on this issue and broadly supports the Commission's stated goal of promoting energy conservation and efficient utility operations. The March 3 hearing was an important first step in this process and provided valuable perspectives on the challenges and opportunities related to alternative rate mechanisms, such as decoupling, and rate designs that may be better aligned with emerging technologies and customer preferences. The Company believes that the fundamental challenge facing the Commonwealth is the need to ensure sustainable funding of a safe, secure, reliable and affordable grid while fairly allocating the costs of the grid. A collaborative, consensus-based process that incorporates data-gathering from Pennsylvania's AMI infrastructure, utilizes innovative rate designs and provides for robust customer education and choice will support the development of rate designs that are aligned with these goals and support the efforts of Pennsylvania's utilities to best serve their customers in an evolving future.

## I. OVERVIEW OF POSITION

At the Commission's December 17, 2015 public meeting, Commissioner Powelson, in commending the parties for reaching a settlement of PECO's most recent base rate proceeding, stated as follows:

> The time has come to better align rate structures in a way that equally benefits all stakeholders, including ratepayers, utilities and the environmental community.[1]

PECO concurs that, with technological advances, the evolution of distributed generation and microgrids, and the trend toward lower emissions energy sources, retail electric service may look very different in the years ahead than it does today. The Commission is taking appropriate action to recognize these trends and proactively plan for those changes. PECO has successfully implemented nationally-recognized energy efficiency and demand response programs and, in fact, has consistently exceeded the reductions in customer usage mandated by the General Assembly and the Commission under Act 129. In addition, PECO accelerated its installation of smart meters to enable its customers to better manage their energy consumption. And, as the Commission is aware, PECO has been a consistent supporter of retail electric and natural gas competition and has enabled the deployment of distributed generation, by enrolling more than 3,100 customers in its net metering program.

Pennsylvania has been at the forefront of utilizing innovative regulatory approaches to promote investment in electric and gas infrastructure, including the use of a fully projected future test year, distribution system improvement charges ("DSIC") and automatic adjustment clauses that true-up actual and projected costs. That said, the potential impacts of implementing new rate mechanisms must be carefully assessed in the context of Pennsylvania's overall regulatory

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[1] *Pennsylvania Public Utility Commission v. PECO Energy Company – Electric Division*, Docket Nos. R-2015-2468981, *et al.* (Statement of Commissioner Robert F. Powelson).

framework.[2] "Revenue decoupling," the focus of the March 3 hearing, provides a viable option for leveraging increased energy efficiency and demand reduction from the Commonwealth's Act 129 programs and PECO supports the use of this alternative ratemaking methodology if done properly. However, as noted at the *en banc* hearing, decoupling does not, in and of itself, address the appropriate allocation of costs among customers, an issue that will become increasingly important as the deployment of distributed generation expands.[3] To ensure that these critical issues are addressed, PECO encourages the consideration of a broad range of options for innovative rate designs, supported by analysis of interval data, pilot rate structures and robust customer education. As this process moves forward, the Commission should also recognize that there may be multiple rate designs that successfully address these issues and that the answer may vary from one utility to the next and from one utility group (e.g., electric companies) to another (water utilities).

## II. GUIDING PRINCIPLES FOR AN ALTERNATIVE RATEMAKING PLAN

In the attachment to its December 31, 2015 Notice, the Commission inquired whether there was an "optimal" alternative ratemaking mechanism for encouraging energy efficiency and conservation and more efficient system operations. PECO respectfully submits that determination can only be made, if at all, on a case-by-case basis with full knowledge of a utility's operations and customer base. To this point, the Company concurs with the views expressed by PPL witness Scott R. Koch (p. 5):

> PPL Electric believes a uniform alternative rate mechanism for all Pennsylvania utilities may not be optimal. There are many variations and options of alternative ratemaking and it's crucial to

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2 As Eric Ackerman, the Director of Alternative Regulation for the Edison Electric Institute, testified (p. 3): "whether revenue decoupling is needed in a given situation depends very much on the extent to which other similar rate mechanisms are in place."

3 *Id.*, p. 2.

> set up the mechanism correctly based on unique characteristics of both the customer and the company.

As Mr. Koch implied, not only do utilities vary in terms of their needs, but alternative rate methodologies can differ significantly depending on whom is discussing them. For example, as David F. Ciarlone of the Industrial Energy Consumers of Pennsylvania ("IECPA") pointed out (p. 6): "The term 'decoupling' itself presents a challenge. It is so overused that it has lost precise definition." Notably, Mr. Ciarlone's observation was borne out by the other testimony presented at the March 3 hearing. Thus, Dr. H. Gil Peach distinguished between Decoupling 1.0, which he characterized as a "vanilla" – and "harmless" – rate decoupling mechanism, and Decoupling 2.0 (pp. 11-13); Eric D. Miller of the Keystone Energy Efficiency Alliance favored a "full" decoupling approach with performance incentive mechanisms ("PIMS")(p. 13); and Richard Sedano of the Regulatory Assistance Project spoke of "full", "partial" and "limited" decoupling variations (*see* Guide, pp. 11-13).

Assuming that the Commission proceeds with broader regulatory action, PECO urges the Commission to consider a range of ratemaking methodologies and encourage individual companies to fashion innovative proposals that best meet the needs of their respective customers, provided those approaches are consistent with the overarching principles of sustainable funding and fair allocation of costs.

**1. The Act 129 Energy Efficiency Program Has Been a Success, Though the Opportunity Exists to Improve the Program Framework.** Pennsylvania's utilities, working with the Commission, have successfully executed energy efficiency and demand response programs under Act 129.[4]: But, there are opportunities to improve these programs through

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[4] Indeed, as noted by Tanya J. McCloskey, Pennsylvania's Consumer Advocate, Pennsylvania's seven major electric customers produced approximately 5.4 million MWH per year in energy savings and 1,540 MW of demand reduction during Act 129's Phase I and are on course to generate more savings during Phase II (p. 3).

statutory reforms. As currently structured, the statutory limitations on lost revenue recovery and lack of incentives for exceeding program mandates provide no positive incentive for utilities to maximize the potential of their energy efficiency programs. Addressing the need to assure sustainable funding of the grid through innovative rate mechanisms will further serve to align the utility business model with energy efficiency and a cleaner energy supply.

2. **Rates Should Reflect Cost Causation.** Alternative ratemaking methodologies, properly structured, can provide the opportunity to better reflect cost causation and send customers appropriate price signals than current rate methodologies. PECO notes that its commercial and industrial customers have shifted to demand-based rates which achieves this alignment. Moreover, to the extent practicable, fixed costs should be recovered through fixed charges, which would result in all customers, including distributed generation and net-metered customers, paying their fair share of grid costs.

3. **Customer Impacts Should Be Minimized.** As a corollary to the preceding consideration, efforts should be made to minimize the impact of an alternative ratemaking methodology on any individual customer or class of customers. At the March 3 hearing, the Commission was presented with starkly different views regarding the effects of decoupling on low-income customers (*see*, *e.g.*, McCloskey (pp. 8-9) and Sedano (p. 6)). In addition, questions were posed regarding the need and/or desirability of including industrial customers in revenue decoupling programs.[5] These issues must be fully evaluated on a utility-specific basis as part of any restructuring of Pennsylvania's existing ratemaking practices.

4. **A Balanced Approach Should Be Taken.** Under Act 129, utilities are entitled to recover, on a full and current basis, "all reasonable and prudent costs incurred in the provision or

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[5] Mark N. Lowry of the Pacific Economics Group Research LLC opined that decoupling need not extend to large industrial customers, while Dr. Peach reported that large customers in the State of Washington had been allowed to design their own energy efficiency programs.

management" of their EE&C plans, but are prohibited from recovery of lost revenues through a reconcilable automatic adjustment clause and can incur very substantial monetary penalties (i.e., up to $20.0 million) if they fail to achieve their required reductions in consumption. 66 Pa.C.S. § 2806.1(k). If the Commission wishes to encourage additional energy efficiency and conservation, it should support a more balanced approach.

If common equity returns are lowered based on unsubstantiated claims that the adoption of a particular alternative ratemaking tool will make utilities less risky investments or if, for example, "asymmetrical caps" on decoupling adjustments such as those favored by Mr. Miller (p. 9) are approved, utilities will have no positive incentive to help their customers use less energy. Indeed, as noted by Mr. Ackerman (p. 4), research has found that "decoupling has no discernable impact on the utility's cost of equity capital." Accordingly, if utilities are to continue to face a substantial downside should they fall short of statutorily-mandated or administratively-imposed performance metrics, fairness and sound public policy dictate that they be provided the opportunity to benefit financially if they exceed those targets.

Notably, the witnesses at the March 3 hearing, for the most part, agreed with this fundamental proposition. In his pre-filed testimony (p. 3), Mr. Ackerman opined that increased energy efficiency and conservation could best be achieved through a regulatory strategy that he described as a "three-legged stool," consisting of:

- Decoupling (and/or updated rate designs) to ensure recovery of allowed fixed costs;

- EE [Energy Efficiency] program cost tracker – to keep up with lost distribution revenue between rate cases; and

- 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.).

Mr. Miller echoed these sentiments when he testified that the best way to align utility incentives with advanced energy resources was to adopt a "full" revenue decoupling program complimented by performance incentive mechanisms that provide positive financial incentives to utilities that voluntarily exceed performance mandates set by Act 129. As Mr. Miller observed (p. 6):

> [W]hile revenue decoupling removes utilities' financial disincentives to pursue advanced technologies that reduce energy consumption, it does not provide a positive incentive to utilities to pursue these technologies *per se*. Therefore, in order to better incentivize utilities to aggressively pursue actions that will reduce energy consumption, the Commission should adopt targeted performance incentive mechanisms ("PIMs") alongside revenue decoupling.
>
> A PIM is a mechanism that links a utility's revenue to its performance in meeting targets that advance the public policy goals of the Commonwealth. PIMs can be used for a multitude of desired policy goals, such as energy efficiency, advanced metering, peak load reduction, and reliability, among others.

Finally, Dr. Peach, in discussing his preferred Decoupling 2.0 model, stressed the need for "an incentive mechanism," noting that such an "add-on" to the "vanilla" Decoupling 1.0 methodology would create the desired "pull" toward more robust energy efficiency and conservation programs (pp. 10, 13).

Further review and analysis would be required to determine what type or types of PIMs could best be incorporated into an alternative ratemaking methodology given the unique characteristics of Pennsylvania's existing regulatory landscape. And, as suggested previously, what might work well for one utility might not make sense for another. The critical point is that a balanced approach must be taken and potential risks and rewards aligned equitably. This will likely require a combination of statutory and regulatory changes to implement consensus-based recommendations on alternative rate designs aligned with sustainable funding and fair allocation of costs goals.

## III. CONCLUSION

PECO appreciates the opportunity the Commission has provided to offer these Comments on alternative ratemaking methodologies and looks forward to working with the Commission and interested stakeholders on this important initiative.

Respectfully submitted,


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