

COMMONWEALTH OF PENNSYLVANIA



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March 16, 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:

Attached for electronic filing please find the Office of Consumer Advocate's Comments in the above-referenced proceeding.

Respectfully Submitted,

/s/ Brandon J. Pierce  
Brandon J. Pierce  
Assistant Consumer Advocate  
PA Attorney I.D. #307665

Enclosure  
218453

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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COMMENTS  
OF THE  
OFFICE OF CONSUMER ADVOCATE

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**I. INTRODUCTION**

On December 31, 2016, the Pennsylvania Public Utility Commission (Commission) issued a notice of *En Banc* Hearing on Alternative Ratemaking Methodologies at Docket No. M-2015-2518883 to be held on March 3, 2016. Among those invited to testify at the *En Banc* Hearing was the Office of Consumer Advocate (OCA). After the *En Banc* hearing, all interested parties were invited to submit comments to the Commission no later than March 16, 2016.

The OCA appreciates the opportunity to not only have provided testimony at the *En Banc* hearing but also to submit Comments on alternative ratemaking methodologies, and more specifically, revenue decoupling. The Commission's Secretarial Letter seeks comments primarily in the context of energy efficiency and conservation (EE&C) and demand response. In Pennsylvania, Act 129 of 2008 sets forth a balanced and comprehensive regulatory framework for the implementation of EE&C and demand side management (DSM). Under this structure, Pennsylvania has developed robust energy efficiency and DSM programs that have largely met or exceeded the requirements of Act 129. 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.<sup>1</sup> Act 129 also mandated the deployment of smart meters throughout Pennsylvania and the implementation of voluntary time of use pricing and real time pricing plans.

Pennsylvania also has other alternative ratemaking methodologies related to achieving energy efficiency and demand side management goals. *See, e.g.*, 66 Pa. C.S. §§ 523(b), 1307, 1319, and 1505(b). Further, Pennsylvania has long-standing low income usage reduction programs (LIURP) that address the specific needs of low income customers for energy efficiency and conservation efforts.

Given the ratemaking methodologies in place in Pennsylvania, and the success of Act 129, the OCA sees no additional benefit to further alternative ratemaking methodologies. The current alternative ratemaking policies and regulations are promoting robust energy efficiency and conservation effectively and efficiently within the mandates of Act 129. Changes are likely to increase costs to ratepayers, particularly those who cannot further reduce their usage, with no impact on the advancement of Pennsylvania's EE&C goals. In the remainder of these Comments, the OCA addresses alternative ratemaking as it exists in Pennsylvania, as well as additional alternative ratemaking methodologies identified by the Commission in its Secretarial Letter. In Appendix A, the OCA provides brief responses to the topics attached to the Secretarial Letter.

### **III. ALTERNATIVE RATEMAKING IN PENNSYLVANIA**

The issue of alternative ratemaking is not new to Pennsylvania. In 1986, the General Assembly, through Act 114 of 1986, included several provisions in the Pennsylvania Public

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<sup>1</sup> 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.

Utility Code to address the implementation of energy conservation measures, to provide for timely cost recovery of any implemented measures, and to provide for performance factor considerations related to actions (or failure to act) to encourage the development of conservation and load management measures. *See* 66 Pa. C.S. §§ 1505(b), 1319, and 523(b)(4).<sup>2</sup> Through Section 1505(b), the Commission is authorized to order a utility to establish conservation and load management programs, stating:

In determining or prescribing safe, adequate and sufficient services and facilities of a public utility, the commission may order the utility to establish a conservation or load management program that the commission determines to be prudent and cost-effective.

66 Pa. C.S. § 1505(b).

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<sup>2</sup> Section 2203(8), enacted as part of natural gas competition in 1999, provides that universal service and energy conservation programs are available and funded in each NGDC's service territory:

The commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each natural gas distribution service territory. The commission shall encourage the use of community-based organizations that have the necessary technical and administrative experience to be the direct providers of services or programs which reduce energy consumption or otherwise assist low-income retail gas customers to afford natural gas service. Programs under this paragraph shall be subject to the administrative oversight of the commission, which shall ensure that the programs are operated in a cost-effective manner.

66 Pa. C.S. § 2203(8). Similarly, Section 2804(9), enacted as part of electric competition in 1996, provides that universal service and energy conservation programs are available and funded in each EDC's service territory:

The commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution territory. Policies, activities and services under this paragraph shall be funded in each electric distribution territory by nonbypassable, competitively neutral cost-recovery mechanisms that fully recover the costs of universal service and energy conservation services. The commission shall encourage the use of community-based organizations that have the necessary technical and administrative experience to be the direct providers of services or programs which reduce energy consumption or otherwise assist low-income customers to afford electric service. Programs under this paragraph shall be subject to the administrative oversight of the commission which will ensure that the programs are operated in a cost-effective manner.

66 Pa. C.S. § 2804(9).

Section 1319(a) 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. Section 1319(a) provides:

If:

(1) a natural gas or electric public utility elects to establish a conservation or load management program and that program is approved by the commission after a determination by the commission that the program is prudent and cost-effective;

or

(2) the commission orders a natural gas or electric public utility to establish a conservation or load management program that the commission determines to be prudent and cost-effective;

the commission shall allow the public utility to recover all prudent and reasonable costs associated with the development, management, financing and operation of the program, provided that such prudent and reasonable costs shall be recovered only in accordance with appropriate accounting principles. Nothing in this section shall permit the recovery of costs in a manner prohibited by section 1315 (relating to limitation on consideration of certain costs for electric utilities). Nothing in this section shall permit the recovery of the cost of producing, generating, transmitting, distributing or furnishing electricity or natural gas.

66 Pa. C.S. § 1319(a).

The Commission is also required to consider a utility's efforts in pursuing cost-effective conservation and load management opportunities when determining just and reasonable rates.

Section 523(b) in pertinent part provides:

As part of its duties pursuant to subsection (a), the commission shall set forth criteria by which it will evaluate future fixed utility performance and in assessing the performance of a fixed utility pursuant to subsection (a), the commission shall consider specifically the following:

...

(4) Action or failure to act to encourage development of cost-effective energy supply alternatives such as conservation or load management, cogeneration or small power production for electric and gas utilities.

(5) Action or failure to act to encourage cost-effective conservation by customers of water utilities.

...

(7) Any other relevant and material evidence of efficiency, effectiveness and adequacy of service.

66 Pa. C.S. § 523(b).<sup>3</sup>

In 1991, the Commission instituted an Investigation into Demand Side Management by Electric Companies; Uniform Cost Recovery Mechanism at Docket No. I-90005. In that proceeding, the Commission issued an Order requiring the implementation of demand side management programs by major electric utilities to reduce energy usage and provide a method for those utilities to recover from ratepayers the costs of implementing the programs. The Order was appealed to the Commonwealth Court by the Pennsylvania Industrial Energy Coalition. The Commonwealth Court affirmed the majority of the Order of the Commission; however, it overturned the part allowing recovery of incentives and costs of physical facilities through the surcharge mechanism and adopting the calculation for incentives. The Commonwealth Court's decision was further appealed by the Commission to the Supreme Court of Pennsylvania which affirmed the Commonwealth Court's decision. *See Pa. Indus. Energy Coalition v. Pa. PUC*, 543 Pa. 307 (Pa. 1996) (aff'g *Pa. Indus. Energy Coalition v. Pa. PUC*, 653 A.2d 1336 (Pa. Commw. Ct. 1995)).

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<sup>3</sup> The Commission also has other regulations and policy statements in place that allow it to monitor energy conservation efforts, ensure that certain conservation standards are met, and provide for the timely recovery of cost-effective energy conservation programs. For example, the Commission's regulations call for reporting on energy conservation initiatives through its universal service and energy conservation reporting requirements for both electric and natural gas companies. 52 Pa. Code § 54.71-78 (electric) and § 62.5 (natural gas). Through these reports, the Commission can assess the on-going efforts of the companies in their low income energy efficiency programs. As early as 1983, the Commission adopted a Policy Statement on the financing of energy supply alternatives. 52 Pa. Code §§ 69.31 to 69.36. Among the energy supply alternatives included in the policy statement were conservation and load management initiatives. 52 Pa. Code § 69.31 and § 69.34.

In 2006, the issue of revenue decoupling—a form of alternative ratemaking—was brought to the fore in Pennsylvania when National Fuel Gas Distribution Company filed a base rate case that included a proposed decoupling mechanism. NFG voluntarily withdrew this proposal after it resulted in the filing of 1,267 formal complaints, testimony of 168 public input hearing witnesses, and the introduction of legislation in the Pennsylvania House of Representatives that would have required the PUC to “disallow any proposed rate, rate increase or rate surcharge based in whole or in part on the utilization of a revenue decoupling mechanism.” House Bill 2594 of 2006; *see also Pa. PUC v. National Fuel Gas Distribution Company*, R-00061403, Recommended Decision (Oct. 31, 2006); Statement of Chairman Wendell F. Holland (Nov. 30, 2006); and PUC Final Order (Dec. 4, 2006).

The Commission subsequently further investigated alternative ratemaking and revenue decoupling in 2007 in its *Investigation of Conservation, Energy Efficiency Activities & DSR by Energy Utilities & Ratemaking Mechanisms to Promote Such Efforts*, Docket No. M-00061984, just one year prior to the passage of Act 129.<sup>4</sup>

In Act 129 of 2008, the General Assembly passed landmark energy efficiency and demand response legislation that requires each major electric distribution company (EDC) in Pennsylvania to reduce energy consumption and peak demands by a series of statutorily imposed minimums. 66 Pa. C.S. § 2806.1(c),(d).<sup>5</sup> The Act also establishes specific consumption reduction

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<sup>4</sup> In the Commission’s investigation, numerous parties filed comments and reply comments. The docket remains open, but no activity has taken place since December 3, 2008, when the last set of Reply Comments was filed.

<sup>5</sup> The General Assembly also recognized the importance of energy efficiency when enacting Pennsylvania’s Alternative Energy Portfolio Standards (AEPS) Act in 2004. Under the AEPS Act, energy efficiency technologies and demand response or load management technologies are specifically recognized as alternative energy sources. 73 P.S. § 1648.2. These resources can be used to meet the Tier II requirements. 73 P.S. §§ 1648.2 and 1648.3. As such, alternative energy credits associated with energy efficiency and demand response programs would be recoverable on a full and current basis through an automatic adjustment clause pursuant to Section 1307. 73 P.S. § 1648.3(a)(3).

requirements for low income customers and the government/non-profit/education sector, and establishes the annual spending cap for these programs. The Act accomplishes its mandates through 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. The failure of an EDC to achieve the specified reduction targets results in a financial penalty of not less than \$1,000,000 and not more than \$20,000,000. 66 Pa. C.S. § 2806.1(f)(2). Act 129 explicitly permits utilities to recover the costs of conservation programs in a timely manner through an automatic adjustment clause *without regard to overall earnings*. 66 Pa. C.S. § 2806.1(k)(1). While Act 129 prohibits the recovery of decreased revenues due to conservation measures between base rate cases, the Act permits the utilities to reflect reduced revenues prospectively through *pro forma* energy sales and revenue calculations in base rate cases. 66 Pa. C.S. §§ 2806.1(k)(2),(3). Further, the Act provides for continuation of these programs if cost-effective. 66 Pa. C.S. § 2806.1(b)(2).

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. This significant infrastructure investment 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 rate of 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).

Following the passage of Act 129, the Commission further considered alternative ratemaking when it initiated an investigation to ensure compliance by the Commonwealth of Pennsylvania with Section 410(a) of the American Recovery and Reinvestment Act. Section 410(a) conditioned the allocation of certain Federal funds to the Commonwealth on a requirement that the Commission consider implementing ratemaking policies for electric and gas utilities that align their financial incentives with the promotion of energy efficiency and conservation. *See Compliance of Commonwealth of Pennsylvania with Section 410(a) of the American Recovery and Reinvestment Act of 2009*, Docket No. I-2009-2099881, Order (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 (emphasis added).

Similarly, in its recent Phase III EE&C Order in June 2015, 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) (emphasis added).

Act 129 has demonstrated substantial and committed EE&C spending within the requirements of the Act and achievement of the consumption and demand reduction goals mandated by the Act. 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 has already provided additional cumulative annual energy savings of over 2 million MWh/yr at the end of Program Year 6,<sup>6</sup> achieving 93% of Phase II's energy savings target. *SWE Program Year 6 Annual Report* at 7 (March 8, 2016).<sup>7</sup> Phase II continues until May 31, 2016.<sup>8</sup>

In addition, electric ratepayers support approximately \$30 million on an annual basis for Low Income Usage Reduction Programs (LIURP).<sup>9</sup> For the natural gas utilities in Pennsylvania,

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<sup>6</sup> Program Year 6 ran from June 1, 2014 through May 31, 2015.

<sup>7</sup> It should be noted that there is no demand response in Phase II.

<sup>8</sup> A concern has been expressed about the potential for backsliding under Act 129. The mandatory goals of Act 129 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 that increased the required energy savings for low income customers, established new goals for the government/non-profit/education sector, and encouraged the further development of comprehensive energy efficiency and demand response programs within the budgets allowed.

<sup>9</sup> Pennsylvania initiated its programs in the 1980s and has continued to support these programs.

ratepayers supported approximately \$18.25 million in expenditures in 2014 for LIURP. Several natural gas companies also provide energy efficiency programs with recovery through distribution base rates or surcharge mechanisms. A 2009 Report on Pennsylvania's LIURPs 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).

Beyond the robust energy efficiency programs within the mandates of Act 129 and the conservation and load management mechanisms available to both natural gas and electric utilities, a robust distribution base rate process now allows for the use of a fully forecasted future test year to be used in setting rates. 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 in that Act 129 allows utilities to reflect decreased 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. 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. By reflecting the impact on sales in the context of a base rate case, the Commission can assure that prospective rates reflect the anticipated energy efficiency consumption reductions, address all other factors that may offset the need for a rate change, and address any burdens to ratepayers.

The OCA submits that Pennsylvania has numerous alternative ratemaking methodologies available that have worked well in encouraging the robust development of energy efficiency and

demand response within the mandates of Act 129. As is discussed more below, further changes to the regulatory framework are unlikely to provide further benefits to consumers that would outweigh the risks and costs.

#### **IV. COMMENTS ON ALTERNATIVE RATEMAKING METHODOLOGIES**

Alternative ratemaking takes many forms, including revenue decoupling, straight fixed variable rate design, modified straight fixed variable rate design, high fixed customer charges, and automatic adjustment charges, among others. The OCA discusses below its concerns with revenue decoupling, straight fixed variable rate design, and high fixed customer charges.

##### **A. Revenue Decoupling**

At its most fundamental level, revenue decoupling separates a utility's cost recovery from the amount of energy it sells. Under traditional rate making, revenue equals the price per unit multiplied by sales, whereas under decoupling, this relationship between price, sales, and revenue is severed. When revenue is decoupled, rates are adjusted more frequently—at least annually—to ensure that utility revenue achieves the target revenue.

There are various approaches to decoupling. Full revenue decoupling protects a utility's revenue collections from any deviation of actual sales from expected sales, no matter the cause. In full revenue decoupling, utility revenues are protected from such things as economic risk and weather. Partial decoupling protects only a portion of a utility's total revenue from variation between actual and anticipated sales—again, regardless of the cause. Limited decoupling sets limits on what type of variations in sales result in decoupling adjustments. Examples of limited decoupling include:

- recovering losses due to weather (actual sales are adjusted for their deviation from weather-normalized revenues, called a “weather normalization adjustment” or “WNA”);
- lost-margin mechanisms (recovering lost revenue related to energy efficiency programs, and thus, as some argue, reducing disincentives for utilities to promote such programs, called “lost revenue adjustment mechanism” or “LRAM”); and
- variations due to other factors (economy, end-use efficiency, any outside factor that is not weather-related).

As an initial matter, the Pennsylvania General Assembly rejected a decoupling approach in adopting Act 129. While establishing automatic surcharges to recover the costs of energy efficiency, demand response, and smart meter programs, the General Assembly declared that such cost recovery shall 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); *see also* 66 Pa. C.S. § 2807(f)(4) (prohibiting recovery of lost or decreased revenues due to reduced electricity consumption or shifting energy demand in between base rate cases due to smart meter technology). It is further worth noting that even in the absence of the statutory prohibition against decoupling, such mechanisms raise significant concerns about improper single-issue ratemaking, retroactive ratemaking, and the just and reasonable requirements of section 1301. 66 Pa. C.S. § 1301.

Revenue decoupling has been advanced in some other states as a tool to encourage energy efficiency investment by utilities.<sup>10</sup> Proponents of revenue decoupling argue that it will remove the disincentive of the utility to implement such programs and provide other benefits.

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<sup>10</sup> In many states, revenue decoupling is not applied to every utility in the state. Also, revenue decoupling is more often in use by natural gas utilities.

Among the other purported benefits are that it will lower overall energy bills due to the effects of reduced usage on a customer's bill and it will extend the time between base rate cases. Some proponents of revenue decoupling argue that it will also reduce the risk profile of the utility, thus lowering the overall rate of return required by the utility. Others have argued, however, that revenue decoupling has now been shown to increase the required rate of return of utilities. A general consensus has seemed to emerge, however, that revenue decoupling alone is insufficient to encourage robust energy efficiency program implementation by utilities. *En Banc Hearing on Alternative Ratemaking Methodologies*, Docket No. M-2015-2518883, Testimony of Dr. Hugh Gilbert Peach at 10 (March 3, 2016). The commentators suggest that revenue decoupling must be coupled with performance incentive mechanisms (PIMS) to achieve robust energy efficiency. *En Banc Hearing on Alternative Ratemaking Methodologies*, Docket No. M-2015-2518883, Testimony of the Keystone Energy Efficiency Alliance, Clean Air Council, and Natural Resources Defense Council at 6-7 (Feb. 25, 2016); Remarks of Mark Newton Lowry to the Pennsylvania PUC *En Banc Hearing* at 6 (March 3, 2016).

As noted throughout these comments, Pennsylvania has achieved robust energy efficiency without revenue decoupling and the associated PIMS. Introducing revenue decoupling on top of Pennsylvania's regulatory framework does not seem likely to advance Pennsylvania's goals and will raise additional concerns about the benefits of such an approach and the protection of consumers. As noted, there are several forms of decoupling, each with its own potential risks and benefits. One method generally associated with energy efficiency is the lost revenue adjustment mechanism, or LRAM. Under the LRAM, only the lost distribution revenues directly caused by energy efficiency measures are recovered. This mechanism raises significant concerns about the robustness of the measurement and verification of the savings produced by the energy

efficiency measure when these energy savings (or lost revenues) are used to adjust rates. A concern has also been raised that such a mechanism could create a perverse incentive for utilities to discourage customer-initiated energy efficiency outside of the utility program or for utilities to discourage improvements in building codes and standards that result in more efficiency. LRAMs are no longer in widespread use by utilities that have a form of decoupling. Recently, in October 2105, the Montana Public Service Commission discontinued its LRAM mechanism, finding, *inter alia*:

[T]he LRAM does not eliminate the throughput incentive. Because LRAM only adjusts rates to account for volumes of energy saved, it only mitigates the throughput incentive with respect to those volumes, and even then, only if the savings are measured accurately. The LRAM may actually create a perverse incentive to maximize both the estimates of savings attributable to utility efforts and actual sales volumes, because both reward the utility with revenues. Although the LRAM was intended to mitigate the throughput incentive, it does so only in a limited way, and only if certain assumptions are accurate.

*In the Matter of the Lost Revenue Adjustment Mechanism of NorthWestern Energy*, Public Service Commission of the State of Montana, Regulatory Division Docket No. D2014.6.53, Order No. 7375a at 10-11 (Oct. 15, 2015).<sup>11</sup>

The more common form of decoupling is full revenue decoupling using a revenue-per-customer approach. As noted earlier, this form of revenue decoupling insulates that utility from any deviation in actual sales from expected sales. The cause of the deviation could be from anything, such as economic activity, weather, energy efficiency, change in building codes, and the like. The reason for the deviation is irrelevant to the adjustment. Maine had the unfortunate

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<sup>11</sup> Montana PSC Commissioner Roger Koopman commented on the LRAM that, "Raising rates on consumers when they respond positively to energy conservation is one of the worst ideas policymakers have ever come up with. Once again, this commission has shown the courage to challenge existing bad policy, and to stand up for the consumer who has been paying dearly for it." Montana Public Service Commission votes to discontinue Lost Revenue Adjustment Mechanism, MTN News, Oct. 16, 2015, available at <http://www.krtv.com/story/30279064/montana-public-service-commission-votes-to-discontinue-lost-revenue-adjustment-mechanism>.

experience of introducing full revenue decoupling in 1991 just prior to the onset of the recession. “By 1993, deferrals accumulated by the adjustment mechanism had reached \$52 million, and the PUC and the utility agreed to end the experiment.” *Decoupling for Electric & Gas Utilities: Frequently Asked Questions (FAQ)*, The National Association of Regulatory Utility Commissioners at 8. (Sept. 2007).<sup>12</sup>

Within a full revenue decoupling approach, there are a myriad of program designs, but most fundamentally, revenue decoupling results in an adjustment between rate cases (either up or down) to the usage rates paid by consumers. Revenue decoupling does not address the underlying rate design but simply makes an adjustment to the usage rate. To avoid paying a higher total bill, a customer must reduce usage sufficiently to offset the usage rate increase.

Decoupling may also increase the underlying rates (before adjustment) paid by the consumers if it increases the required cost of capital (and thus, rate of return) as some argue, must be accompanied by performance incentive mechanisms to be paid for by consumers, and must be accompanied by consumer education so that customers understand the adjustments being made to their bills on a regular basis and have information about how to control their overall bill. These impacts would have to be factored into any consideration of full revenue decoupling.

Full revenue decoupling also presents other potential risks that must be managed or addressed. The Commission raised the question of whether revenue decoupling could reduce the incentive for timely storm repair. This question presented itself in Maryland as a result of storms in 2010 and 2011. The Maryland Public Service Commission subsequently limited its revenue decoupling mechanism so that utilities could only recoup lost revenues for the first 24 hours of a

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<sup>12</sup> Available at [http://www3.epa.gov/statelocalclimate/documents/pdf/supp\\_mat\\_decoupling\\_elec\\_gas\\_utilities.pdf](http://www3.epa.gov/statelocalclimate/documents/pdf/supp_mat_decoupling_elec_gas_utilities.pdf). It should be noted that Central Maine Power, through a settlement in 2014, implemented limited decoupling for energy efficiency. See Central Main Power Co. Request for New Alternative Rate Plan (“ARP 2014”), State of Maine Public Utilities Commission, Docket No. 2013-00168, Order Approving Stipulation (Aug. 25, 2014).

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.

Revenue decoupling can also place at greater risk low to moderate income households, or otherwise vulnerable households, who cannot participate in energy efficiency programs or cannot reduce their usage sufficiently to offset any increased costs associated with the revenue decoupling mechanism. 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 households end up bearing the brunt of the increasing prices between base rate cases. This impact is exacerbated with the use of revenue decoupling as a means to address distributed generation. Customers with distributed generation systems can often avoid 100% of the variable distribution charges in a month, far more than with energy efficiency alone. With decoupling, all

of this foregone utility distribution revenue is automatically shifted to other customers through the decoupling mechanism.

Consideration must also be given to whether the potential benefits of decoupling have value and whether they will arise given other regulatory initiatives. The proponents of revenue decoupling often argue that revenue decoupling will increase the time between base rate cases and thus reduce the costs associated with base rate filings. Frequent base rate filings by Pennsylvania energy utilities have not necessarily been a problem in the past, and it does not seem likely that for most Pennsylvania energy utilities, frequent base rate filings will pose a problem. Even with the accelerated infrastructure repair and replacement programs that are underway, the General Assembly has provided the Distribution System Improvement Charge (DSIC), with a cap on the level of charges, to assist with the recovery of such costs.<sup>13</sup> The DSIC is not intended as a substitute to the periodic base rate case where the infrastructure investment is reviewed, the investment is fully reflected in rate base, and the DSIC is reset to zero. Additionally, the base rate process provides the opportunity to fully review the utility's operations, the utility's rate structure, the affordability of overall rates, and other issues of importance. The benefit of further extending the time between base rate cases is unlikely to arise or result in additional value to Pennsylvania consumers.

Other Pennsylvania regulatory initiatives may have an impact on the benefits of revenue decoupling in Pennsylvania. Energy efficiency derives the most significant benefit from the savings on generation costs. In a retail choice state such as Pennsylvania, generation is subject to retail choice with many alternative suppliers providing generation service. Some alternative suppliers may offer energy efficiency products of their own. This could have two possible

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<sup>13</sup> Pennsylvania utilities also have other automatic adjustment clauses providing dollar for dollar recovery of expenses that mitigate the need to file more frequent base rate cases. Under revenue decoupling, these automatic adjustment clauses, as well as the DSIC, would not be part of the revenue adjustment mechanism.

consequences. It could impact the amount of additional energy efficiency that the utility can realize even with decoupling, or the utility's energy efficiency could crowd out the market, thus reducing the ability of alternative suppliers to attract customers. Other alternative suppliers, however, have a business model that is volumetric-based. The alternative supplier and the utility may be sending inconsistent signals to the customers due to these different business models. This can result in customer confusion, particularly if the alternative supplier is an affiliate of the distribution company.

One of the important policies that this Commission and the Commonwealth have sought to forward is to bring the benefit of natural gas service to more of Pennsylvania's residences and businesses. Revenue decoupling could reduce the incentive to engage in timely main extensions as the benefits of adding new customers (and the associated revenues) could be muted with some forms of revenue decoupling.

For all of the foregoing reasons, the OCA submits that revenue decoupling will not encourage energy utilities to better implement energy efficiency and conservation programs, as Pennsylvania already employs a balanced, comprehensive, and robust EE&C paradigm through Act 129, other statutory mechanisms (including other alternative ratemaking mechanisms), LIURP, and the fully forecasted future test year, to name a few. The introduction of a revenue decoupling mechanism would not better align with the Commonwealth's energy goals and corresponding rate mechanisms. Furthermore, a decoupling mechanism would not be just and reasonable and in the public interest, nor would the benefits outweigh the costs.

#### **B. Straight Fixed Variable (SFV) and High Fixed Customer Charges**

Another alternative ratemaking mechanism is straight fixed variable rate design (SFV), which is different from revenue decoupling. Under SFV, all of the utility's fixed costs are

recovered in a fixed monthly charge. Variable costs are included in usage rates. The definition of fixed cost can vary, but regardless of the accounting methodology, the outcome for the customer is the same. A large fixed cost is a component of the bill every month that does not vary with usage. High fixed customer charge designs are structured similarly.<sup>14</sup>

Increasing the fixed charge, whether through a straight fixed variable approach or by establishing a high fixed customer charge, suffer from serious infirmities. First, is the problem of defining “fixed” costs. The Commission has traditionally relied on the basic customer method, which is defined in Bonbright’s *Principles of Utility Rates* as “those operating and capital costs found to vary with number of customers regardless, or almost regardless, of power costs.” *Principles of Utility Rates*, James C. Bonbright at 347 (1961). Those costs include metering, billing, and customer service costs. *Id.* In other words, fixed customer charges may only include direct costs. Proponents of SFV and high fixed customer charges, however, often seek to expand that definition to encompass as many charges in the fixed component as possible. This approach severs the relationship between usage and the embedded costs of the utility system.

The second problem with increasing the fixed customer charge is that such a rate structure is contrary to effective energy efficiency and conservation efforts. High fixed charge rate structures promote additional consumption because a consumer’s price of incremental consumption is less than what an efficient price structure would otherwise be. That is, an SFV or fixed rate design, produces a negative impact on a customer’s incentive to conserve energy because the more costs that are fixed, the less benefit the customer receives from conserving

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<sup>14</sup> Modified Straight Fixed-Variable (MSFV) describes a rate structure where a portion of fixed costs are recovered through fixed customer charges and the balance through volumetric rates. The balance between fixed and volumetric recovery has been loosely driven by customer direct and indirect costs. MSFV rates are based on average usage of a rate class and can lead to a gap among customers who have usages patterns that vary from the average.

energy.<sup>15</sup> In the case of high fixed charges, converting a volumetric rate into rates that yield a given revenue regardless of the amount of service purchased converts the rate into a “take or pay” billing feature. Again, such a design negatively impacts EE&C efforts.

SFV rate design and high fixed customer charges are also contrary to a long line of Commission decisions—and particularly the consistent Statements of former Chairman James Cawley—that warn against high fixed customer charges because of their negative impact on customer conservation. As noted by then-Chairman Cawley, for example, in an August 27, 2009, Statement regarding the base rate case settlements of UGI Penn Natural and UGI Central Penn Gas Companies: “From a policy perspective, allocating costs to variable distribution charges, instead of allocating them to a fixed customer charge, provides a stronger incentive for customers to conserve....” *Pa. PUC v. UGI Penn Natural Gas Pa. PUC v. UGI Central Gas*, R-2008-2079660, R-2008-2079675, Statement of Chairman Cawley (August 27, 2009). *See also Pa. PUC v. PG Energy*, Docket No. R-00061365 (Order entered November 30, 2006) (Statement of then-Vice Chairman Cawley noting that “the significant reduction in residential customer service charges from those in the case as filed, combined with the reduction or elimination of declining block charges for certain Honesdale customers, should help to provide strong incentives and rewards for energy conservation for these customers.”); *Pa. PUC v. Duquesne Light Company*, Docket No. R-00061346 (Order entered November 30, 2006) (Statement of then Vice Chairman Cawley regarding the reduction or elimination of declining block charges as an incentive for conservation).

In fact, SFV—which some now promote as a method of driving further energy efficiency—has previously been used for the opposite reason; that is, to promote a policy of

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<sup>15</sup> In addition, if the distribution charges cannot be avoided by conservation, this would have to be accounted for in determining the cost-effectiveness of the energy efficiency measure.

*increased* consumption in the interstate natural gas transmission industry. As discussed in its well-known Order No. 636,<sup>16</sup> FERC's adoption of a straight fixed variable pricing method was the result of a national policy to encourage *increased* use of domestic natural gas by promoting additional interruptible (and incremental firm) gas usage. FERC's SFV pricing mechanism greatly reduced the price of incremental (additional) natural gas consumption. This resulted in significantly increasing the demand for, and use of, natural gas in the United States after Order No. 636 was issued in 1992.

In the introductory statement of the Order, FERC stated:

The Commission's intent is to further facilitate the unimpeded operation of market forces to stimulate the production of natural gas . . . [and thereby] contribute to reducing our Nation's dependence upon imported oil . . . .

FERC Order No. 636 at 8. With specific regard to the SFV rate design adopted in Order No. 636,

FERC stated:

Moreover, the Commission's adoption of SFV should maximize pipeline throughput over time by allowing gas to compete with alternate fuels on a timely basis as the prices of alternate fuels change. The Commission believes it is beyond doubt that it is in the national interest to promote the use of clean and abundant gas over alternate fuels such as foreign oil. SFV is the best method for doing that.

FERC Order No. 636 at 128-29.

FERC's objective in adopting SFV pricing shows that the price signal that results from SFV pricing (and by extension, high fixed charge pricing, as well) is meant to *promote additional consumption*, not reduce consumption. Thus, a rate structure that is heavily based on a fixed monthly customer charge sends an even stronger price signal to consumers to use more

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<sup>16</sup> Federal Energy Regulatory Commission, Docket Nos. RM91-11-001 and RM87-34-065, Order No. 636 (Apr. 9, 1992). FERC Order No. 636 had two primary goals. The first goal was to enhance gas competition at the wellhead by completely unbundling the merchant and transportation functions of pipelines. The second goal was to encourage the increased consumption of natural gas in the United States.

energy because the incremental (volumetric) charge per unit of energy is less (or in the case of a high fixed charge design, non-existent).

Straight fixed variable rate design for gas utilities can also cause low-use customers to leave the system entirely due to high fixed charges. This is inconsistent with Commonwealth and Commission policies of promoting natural gas use. Further, SFV rate design may also create intraclass subsidies, as a small apartment dweller could pay the same high fixed cost as a much larger homeowner. Essentially, this merges demand and customer charges. The OCA, therefore, submits for all of these reasons, that any mechanism that would raise the fixed customer charge would not achieve the Commission's goals nor be in the public interest.

### **C. Required Conditions to Adopting Revenue Decoupling in Pennsylvania**

Should the General Assembly and the Commission determine to make changes to the current regulatory model to accommodate revenue decoupling now or in the future (which, again, the OCA submits is not necessary or in the interests of Pennsylvania's consumers), the OCA submits that any revenue decoupling mechanism must be accompanied by at least *all of the following consumer protections*:

- Specific authorization from the General Assembly in light of the Act 129 mandate;
- Capped adjustments (i.e. an upper threshold on any percentage increase period over period);
- No revenue requirement increase from the test period allowed;
- Specific targeted programs over and above those programs already in place;
- Clear, specific measures of success for incremental benefits that exceed costs;
- Clear, automatically enforceable reliability metrics;

- Periodic evaluations as a means for establishing the overall impacts, as well as the effectiveness of design and administration;
- Reduced ROE to reflect reduced risk to the utility;<sup>17</sup>
- Mechanisms implemented only after a base rate proceeding;
- Periodic base rate case filings;
- Align rate structures and implement rate design correctly;<sup>18</sup>
- Determine what components are impacted by decoupling;
- Storm adjustment that is limited to 24 hours following a storm event (i.e. as exists in Maryland);
- Exclude all automatic adjustment revenues (as these are already collected dollar-for-dollar);
- Apply a comprehensive policy to all utilities (i.e. not just for those with declining load);<sup>19</sup>
- Implemented in a manner that does not discourage the use of the most efficient and environmentally sound resources for a particular application (i.e. residential heating);<sup>20</sup> and

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<sup>17</sup> The OCA submits that guaranteeing revenue recovery lowers the overall risk of providing service, and thus, lowers the cost of equity requirement. Other commentators have taken the opposite view.

<sup>18</sup> Decoupling must be accompanied by appropriate retail rate designs that encourage cost-effective conservation measures by individual customers. Results will be much better if customers—not just utilities—have the incentive to conserve. Rather than advocating higher customer charges and lower usage charges (which assure utility revenues but reduce the benefits of conservation to customers), it may be more appropriate to take exactly the opposite approach in order to maximize the benefits that customers receive from taking conservation measures.

<sup>19</sup> To use an example, some types of rate programs will benefit the shareholders of utilities whose sales are growing between rate cases (as has been true for most electric utilities), while other types of programs will benefit the shareholders of utilities whose sales are declining (like many natural gas utilities). If left to the sole discretion of the utility, each utility will understandably select the type of program that most benefits its shareholders, even if that program is not necessarily the most cost-effective or beneficial to customers. The Commission, on the other hand, is obligated to balance the interests of utility shareholders and consumers and to approve only those programs that the Commission determines best serve the overall public interest.

- Adequate consumer education.

Further, the goal of any decoupling mechanism must be to encourage and deliver cost-effective energy and efficiency and conservation measures, not simply to insulate the utility revenue stream. Decoupling programs must also be designed to benefit customers as well as utilities. The OCA submits that the implementation of any revenue decoupling mechanism must be accompanied by this full suite of consumer protections.

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<sup>20</sup> Natural gas and electric utilities should also look to coordinate their efforts, as most NGDC customers are also customers of EDCs. It is vital that opportunities not be lost to produce the greatest feasible demand and consumption reductions by addressing potential gas and electric synergies.

V. **CONCLUSION**

The OCA appreciates this opportunity to provide the Commission with these Comments and looks forward to working with all stakeholders to achieve the best possible energy efficiency and conservation programs. The OCA submits that Pennsylvania currently has a multitude of robust and comprehensive methodologies and mechanisms in place that properly align and balance consumers' and utilities' needs with cost-effective and efficient practices.

Respectfully submitted,

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DATED: March 16, 2016

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

APPENDIX A  
ACCOMPANYING THE  
COMMENTS OF  
THE OFFICE OF CONSUMER ADVOCATE

March 16, 2016

## Topics Designed to Guide the Discussion

1. Alignment of alternative rate mechanisms with the energy utilities' implementation of energy efficiency and conservation programs;

*OCA Response: See Act 129, 66 Pa. C.S. §§ 2806.1(K)(2), 2807(f)(4). Further, see the OCA's Comments at page 8 regarding the Commission's Order concerning the American Recovery and Reinvestment Act of 2009, in which the Commission determined that it "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."*

2. The statutory and regulatory barriers, if any, associated with alternative rate mechanisms in Pennsylvania;

*OCA Response: For revenue decoupling, see §§ 2806.1(K)(2), 2807(f)(4).*

3. Whether the benefits of alternative rate mechanisms exceed any costs associated with implementing the rate mechanisms;

*OCA Response: With the robust performance of Act 129, the expectation is that any incremental benefits will be outweighed by the costs, particularly if a utility's ROE is not lowered and PIMs are included.*

4. Whether there is an optimal rate mechanism for encouraging energy efficiency and conservation programs;

*OCA Response: Act 129 has been successful.*

5. Whether there is an optimal alternative rate mechanism for encouraging more efficient system operations;

*OCA Response: Ratemaking under the current Public Utility Code has worked well.*

6. Identification of best practices in other jurisdictions;

*OCA Response: The OCA has no additional info to provide.*

7. Pros and cons of alternative rate mechanisms, such as straight fixed variable rate design, lost margin recovery mechanisms for conservation programs or incentive regulation tied to energy efficiency and conservation performance;

*OCA Response: See pages 11-22 of the OCA's Comments.*

8. Identification of cost of capital impacts;

*OCA Response: The OCA anticipates lower ROE awards as risk is shifted from utilities to customers. Some commentators suggest that ROE will need to be increased and PIMs are needed. See the OCA's Comments at pages 12-13 and 15.*

9. Whether an annual cap on adjustments is appropriate or necessary;

*OCA Response: If revenue decoupling is implemented, there must be an annual cap. However, there should be no adjustments to the underlying revenue requirement.*

10. 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;

*OCA Response: It is likely that more rate increases will occur.*

11. Whether alternative rate mechanisms have a disparate impact on new customers versus existing customers and whether there are rate mechanisms that mitigate or eliminate these disparate impacts;

*OCA Response: The OCA does not believe so.*

12. Concerning the revenue-per-customer decoupling model, should there be a difference between the adjustment made if use per customer is rising and the adjustment made if use per customer is declining, in order for the utility to be "made whole," independent of utility conservation efforts;

*OCA Response: The revenue-per-customer does operate independent of utility conservation efforts because it adjusts for everything (i.e. economic effects and weather). Under the revenue-per-customer mechanism, if use per customer goes down, then there is a charge and vice-versa.*

13. Whether periodic rate proceedings to "re-link" revenue with other ratemaking inputs are necessary;

*OCA Response: Yes. See the OCA's Comments at pages 17 and 23.*

14. Identification of any risk of interclass or intraclass cost shifts, including low income community cost impacts, and whether those cost shifts are inappropriate;

*OCA Response: As to interclass cost shifts, the OCA does not see any shifts that would occur. With regard to intraclass shifts, the risks are high that costs will be shifted on to low- and moderate-income and vulnerable consumers who cannot participate in energy efficiency programs or cannot reduce their usage sufficiently to offset any increased costs associated with the revenue decoupling mechanism. 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 households end up bearing the brunt of the increasing prices between base rate cases. This impact is exacerbated with the use of revenue decoupling as a means to address distributed generation. Customers with distributed generation systems can often avoid 100% of the variable distribution charges in a month, far more than with energy efficiency alone. With decoupling, all of this foregone utility distribution revenue is automatically shifted to other customers through the decoupling mechanism.*

15. Whether alternative rate mechanisms increase customer bill volatility;

*OCA Response: This is possible, depending on how often bills adjust. If adjustments occur monthly, then yes. The less often bills adjust, the less potential volatility (i.e. if bills adjust yearly, it will produce less volatility than monthly adjustments).*

16. Imposition of conditions by other state regulatory commissions as a result of implementation of novel rate designs;

*OCA Response: See the OCA's Comments at pages 15-16, regarding Maryland's revision of its revenue decoupling mechanism to allow utilities to recoup lost revenues for only the first 24 hours of a storm event.*

17. Impacts alternative rate mechanisms may have on incentives for customers to participate in energy efficiency and conservation programs;

*OCA Response: There is no incentive to customers from these mechanisms because the focus is on the utility. Moreover, alternative ratemaking, namely revenue decoupling, can be, and has been, viewed negatively by customers and, thus, create negative views by consumers of EE&C generally (see the OCA's Comments at page 5 regarding NFG's attempt to implement revenue decoupling).*

18. Whether a utility can increase its profitability;

*OCA Response: A utility should not be permitted to earn profits above its authorized return. There should be an earnings cap to prevent this.*

19. 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;

*OCA Response: There should be a fixed rate for direct customer costs. This is the current methodology used. See the OCA's Comments at pages 18-22.*

20. Whether large volume electricity and natural gas consumers should be excluded from the rate mechanisms;

*OCA Response: Large volume users may have different usage patterns and needs that may need to be addressed independently of other customers. However, authority must still reside with PUC.*

21. Whether decoupling diminishes a utility's incentive to restore service after a storm;

*OCA Response: See the OCA's Comments at pages 15-16, regarding Maryland's revision of its revenue decoupling mechanism to allow utilities to recoup lost revenues for only the first 24 hours of a storm event.*

22. Integration with the currently existing Distribution System Improvement Charge ("DSIC") programs.

*OCA Response: Pennsylvania has many expense surcharges recovered on a dollar-for-dollar basis, including the DSIC. Thus, a smaller portion of distribution would be subject to revenue decoupling (which raises more questions about its value). However, as to the DSIC, the purported benefit of avoiding rate cases may not materialize. See the OCA's Comments at page 17.*