



May 25, 2017

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

**Re: Legal Comments of Natural Resources Defense Council on
Alternative Ratemaking Methodologies, Docket No. M-2015-2518883**

Dear Secretary Chiavetta:

In its Tentative Order entered in this matter on March 2, 2017, the Commission notes that current law may prohibit the use of certain alternative rate methodologies by certain utilities, and seeks comments on (among other things) what the Commission can do under its existing statutory authority.

Pursuant to the Commission's request, Natural Resources Defense Council (NRDC) submits the attached memorandum, prepared at NRDC's request by James M. Van Nostrand, Professor of Law at the West Virginia University College of Law and Director of the College's Center for Energy and Sustainable Development. The memorandum analyzes the authority of the Commission to incentivize, mandate, and otherwise support energy efficiency and conservation, renewable electricity generation, and alternatives to traditional rate regulation that have yet to be used in Pennsylvania, including but not limited to revenue decoupling and performance-based ratemaking.

If you have any questions concerning the memorandum or the analysis in it, please do not hesitate to call me at 570-447-4019.

Thank you very much.

Sincerely,

Mark Szybist
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MEMORANDUM

Authority of the Pennsylvania Public Utility Commission to Implement Incentives with Respect to Energy Efficiency and Conservation, Renewable Electricity Generation, and Alternatives to Traditional Rate Regulation

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April 3, 2017

I. INTRODUCTION

This memorandum analyzes the authority of the Commission to incentivize, mandate, or otherwise support energy efficiency and conservation, renewable electricity generation, and alternatives to traditional rate regulation that have yet to be used in Pennsylvania, including but not limited to revenue decoupling and performance-based ratemaking. The memorandum was prepared at the request of Natural Resources Defense Council (NRDC), and reflects the author’s analysis of the statutes, court decisions, and published orders of the Pennsylvania Public Utility Commission (Commission).¹

The focus of the analysis in this memorandum is on electric utilities, although some of the policies apply as well to natural gas utilities. Following a Summary of Findings, Section III examines relevant statutes administered by the Commission, and relevant judicial and Commission precedent thereunder. This section also includes a discussion of recent Commonwealth Court cases involving judicial deference to Commission decisions. Section IV considers precedent from other jurisdictions, where public utility commissions (PUCs) have used statutes and regulations that are the same or similar to the general statutory provisions administered by the Commission to further the development of energy efficiency, clean distributed energy resources (DERs), and renewable energy through alternatives to traditional rate regulation. Section V provides an analysis of the possible sources of authority for the Commission to implement measures to promote such initiatives, based on the applicable statutes and judicial decisions, and consistent with Commission precedent.

II. SUMMARY OF FINDINGS

Pennsylvania has relatively prescriptive legislative enactments with respect to defining the procurement obligations for renewable energy (the Alternative Energy Portfolio Standards Act of 2004) and energy efficiency (*Act 129*), and also has a statute on its books (§523(b)(4)) limiting the implementation of performance-based rate adjustments to the setting of “just and reasonable rates,” which has been interpreted to apply only to base rate proceedings. Other portions of *Act 129* arguably address the issue of decoupling—at least to the extent of the “lost

¹ An initial draft of this memorandum was presented to the Commission and its staff for discussion in January, 2017. The memorandum was subsequently revised to address comments from staff.

revenue” portion of a decoupling mechanism—and seemingly preclude the use of an “automatic adjustment clause.” At the same time, however, the Commission has broad and relatively untapped authority under the 1996 Electricity Generation Customer Choice and Competition Act (*Competition Act*) to institute “performance-based rates” as an alternative to traditional ratemaking mechanisms. The transformation that is currently underway in the electric utility industry—as DERs become more cost-competitive and customers increasingly take advantage of technological advances to control their energy usage through energy efficiency and demand response programs, both of which combine to pose a challenge to the business model of electric distribution companies—in many respects is comparable to the sweeping changes that were underway in the electric industry in the mid-1990s, which were addressed by the Pennsylvania legislature through its adoption of the *Competition Act* in 1996. The General Assembly responded to those rapid changes by including in the *Competition Act* a very broad grant of ratemaking authority authorizing the Commission to use “performance-based rates as an alternative to existing rate base/rate of return regulation.” The tools made available to the Commission in the *Competition Act* are still available, and could be deployed to address the sweeping changes currently underway in the electric utility industry, and to allow the industry to better align its operations with changing customer opportunities and environmental imperatives. The Commission thus has the flexibility to consider a broad array of incentives and performance-based regulatory policies.

III. RELEVANT STATUTES ADMINISTERED BY THE PUC

Pennsylvania’s jurisdictional electric utilities have long had a clear obligation to provide “adequate, efficient, safe and reasonable service and facilities,” pursuant to Section 1501 of the Public Utility Code, 66 Pa.C.S. §1501. Unlike in some states—most notably, New York—where PUCs have relied on statutes granting them broad general powers to undertake major regulatory initiatives (*e.g.*, promotion of energy efficiency or renewables, industry restructuring, performance-based or alternative ratemaking), the regulatory landscape in Pennsylvania is shaped by significant legislative actions. In particular, four major legislative initiatives contain provisions relating to the authority of the Commission to provide incentives with respect to energy efficiency and conservation, renewable electricity generation, and alternatives to traditional rate regulation (including decoupling and performance-based ratemaking):

- (1) Act 114 of 1986,
- (2) the *Competition Act* (1996),
- (3) the Alternative Energy Portfolio Standards Act of 2004, and
- (4) Act 129 (2008).

These major legislative enactments, and the precedent thereunder, are discussed in turn below.

A. Statutes

1. Act 114 of 1986

Through the 1986 amendments known as Act 114 of 1986, the following sections were included in the Public Utility Code:

Section 1505. Authority to Order Conservation and Load Management Programs: This section provides that the Commission may order a utility to establish a conservation and load management program as part of determining or prescribing safe, adequate and sufficient service. The plan must be “prudent and cost-effective.”²

Section 1319. Financing of Energy Supply Alternatives: This section authorizes energy utilities to establish a conservation and load management program, and requires the Commission to allow the utility “to recover all prudent and reasonable costs associated with the development, management, financing and operation of [such] program.”³

Section 523. Performance Factor Considerations: This section requires the Commission to consider “the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates,” and authorized the Commission to make “such adjustments to specific components of a utility’s claimed cost of service” as determined to be “proper and appropriate.” Among the criteria required to be considered by the Commission in evaluating the performance of electric utilities, §523(b)(4) specifies “[a]ction or failure to act to encourage development of cost-effective energy supply alternatives such as conservation or load management, cogeneration or small power production.”⁴

2. Competition Act (1996)

As part of the restructuring of the electric industry in 1996, the *Competition Act*, or Act 138, included the following provision:

Performance-based Rates and Alternative Regulation. The Commission has authority to use performance-based rates as an alternative to existing rate base/rate of return regulation, subject to the restrictions pertaining to rate caps in section 2804(4) (relating to standards for restructuring of electric industry).⁵

The General Assembly included a number of relevant findings in its enactment of the *Competition Act*, including an acknowledgement of the “advances in electric generation technology”; the effectiveness of competitive market forces rather than economic regulation in controlling the cost of generating electricity; the importance of electricity costs “in decisions made by businesses concerning locating, expanding and retaining facilities” in Pennsylvania; and the need to manage the transition in a manner that will “benefit all classes of customers and . . . protect this Commonwealth’s ability to compete in the national and international marketplace for industry and jobs.”⁶

3. Alternative Energy Portfolio Standards Act of 2004

² 66 Pa. C.S. §1505.

³ 66 Pa. C.S. §1319.

⁴ 66 Pa. C.S. §523.

⁵ 66 Pa.C.S. §2806(i).

⁶ 66 Pa.C.S. §2802.

Pennsylvania's Alternative Energy Portfolio Standard (*AEPS*), created by SB 1030 on November 30, 2004, requires each electric distribution company (EDC) and electric generation supplier (EGS) to retail electric customers in Pennsylvania to supply 18% of its electricity using alternative-energy resources by 2020. There are two categories of energy sources, or "Tiers," under the *AEPS*. The standard calls for utilities to generate 8% of their electricity using "Tier I" energy sources and 10% using "Tier II" sources by May 31, 2021. *73 P.S. §1648.3*. Generally, eligible resources must originate within the PJM regional transmission organization (RTO) (including Pennsylvania) in order to be counted for compliance. However, out-of-state resources located in the Mid-Continent ISO (MISO) (which also serves a portion of Pennsylvania) may be used in areas served by the MISO.

Tier I sources include new and existing facilities which produce electricity using the following sources/technologies: photovoltaic energy, solar-thermal energy, wind, low-impact hydro, geothermal, biomass, wood pulping and manufacturing byproducts from energy facilities within the state, biologically-derived methane gas, coal-mine methane, and fuel cells. *73 P.S. §1648.2*. Tier II sources include (new and existing) waste coal, distributed generation (DG) systems less than 5 MW in capacity, demand-side management, large-scale hydro, municipal solid waste, wood pulping and manufacturing byproducts from energy facilities outside the state, and integrated gasification combined cycle (IGCC) coal technology. *73 P.S. §1648.2*.

The *AEPS* was modified by H.B. 1203 in 2007 to provide a more detailed solar schedule, clarify the force majeure clause, confirm property rights for generators with respect to renewable energy certificates (RECs), add solar thermal to Tier I, clarify the retirement of Alternative Energy Credits or AECs, and expand the definition of customer-generator. Act 129 of 2008 added §2814 to the Pennsylvania Public Utility Code, which expanded the definition of alternative energy sources that qualify as Tier 1 sources to include specific categories of low-impact hydropower and biomass energy. *66 Pa.C.S. § 2814(a) and (b)*. Section 2814 also requires the Commission to increase, at least quarterly, the percentage share of Tier I resources to be sold by EDCs and EGSs to reflect any new Tier I resources added because of the amendment. *66 Pa.C.S. §2814(c)*.

With respect to incentives for investing in renewable energy resources, electric distribution companies are authorized to fully recover the reasonable and prudently incurred costs of complying with the *AEPS*. These include the costs for purchases of alternative energy or AECs, payments to credit program administrators, and costs levied by RTOs to ensure that alternative resources are reliable. The costs are recoverable through an automatic energy adjustment clause under §1307 and are considered to be a cost of generation supply. *73 Pa.C.S. §1648.3(a)(3)*.

4. Act 129

In 2008, the legislature enacted *Act 129*, which (1) required electric utilities to implement energy efficiency and conservation plans, (2) established certain load reduction targets that electric distribution companies must meet, and (3) required electric utilities to deploy smart meter technology to all customers within fifteen years. *Act 129* expressly authorizes recovery of costs related to an energy efficiency and conservation program through an automatic adjustment

mechanism, but decreased revenues due to reduced energy consumption may not be included within such a mechanism. Specifically, §66 Pa.C.S. §2806.1(k) states:

- (1) An electric distribution company shall recover on a full and current basis from customers, through a reconcilable adjustment clause under section 1307, all reasonable and prudent costs incurred in the provision or management of a plan provided under this section. . . .
- (2) Except as set forth in paragraph (3), decreased revenues of an electric distribution company due to reduced energy consumption or changes in energy demand shall not be a recoverable cost under a reconcilable automatic adjustment clause.
- (3) Decreased revenue and reduced energy consumption may be reflected in revenue and sales data used to calculate rates in a distribution-base rate proceeding filed by an electric distribution company under section 1308 (relating to voluntary changes in rates)

The smart meter technology section of *Act 129* also states that “lost or decreased revenue by an electric distribution company due to reduced electricity consumption or shifting energy demand” shall in no event be considered a “recoverable cost” associated with smart meter technology.⁷

B. Legal and Policy Analysis

In the following sections, the legal and policy analysis will discuss the Commission’s power to authorize and approve (1) incentives for energy efficiency and conservation (and the removal of disincentives, such as through decoupling), (2) incentives for renewable electricity generation, and (3) alternatives to traditional rate regulation, including performance-based ratemaking. Where applicable, the discussion will distinguish between the *legal* constraints on the Commission—arising from statutory language and associated legal precedent—and the constraints arising from the Commission’s enunciated *policy positions* or interpretations with respect to these issues.

(1) *Incentives for Energy Efficiency and Conservation (including Decoupling)*

The Commission has exercised its existing statutory authority to provide preferential treatment for the recovery of expenditures arising from EE&C programs. Section 1319 authorizes the recovery of “all prudent and reasonable costs associated with the development, management, financing and operation of [energy efficiency and conservation] programs.” The Commission has used its authority under §1307 to provide for the recovery of such costs through a surcharge and automatic adjustment mechanism. As discussed below, Pennsylvania courts have expressly affirmed the Commission’s authority to provide such treatment.⁸

In the early 1990s, the Commission commenced a proceeding to investigate demand-side management (DSM) options and required utilities to submit proposals for DSM programs. In its

⁷ 66 Pa.C.S. §2807(f)(4)(ii).

⁸ *Id.*

December 1993 order at the conclusion of that proceeding,⁹ the Commission adopted an Energy Efficiency Adjustment (EEA) mechanism to remain in effect for a five-year period, and made the following findings:

- DSM costs are recoverable under §1307 of the Public Utility Code (which authorizes “automatic adjustment mechanisms”) through a surcharge, with a line item charge on customers’ bills, with an annual adjustment.
- Alternatively, utilities can use a balancing account to accumulate costs until the next rate case, with balances earning interest at the Allowance for Funds Used During Construction (AFUDC) rate.
- Lost revenues are recoverable, with interest, but not through the surcharge mechanism given that “lost revenues are, by their nature, much more difficult to measure than DSM program costs” and thus will be treated as regulatory assets pending their verification through the ratemaking process in a general rate proceeding. The EEA approved by the Commission allowed recovery of lost revenues directly attributable to programs targeted to existing loads, limited to 95% recovery in the first program year and decreasing by 5% decrements thereafter for the five-year term of the pilot program.
- The EEA included financial incentives for each kilowatt-hour (kWh) saved as a result of the program, to be collected either annually or deferred for recovery in a general rate case within five years. The performance incentive was based on “shared savings” (defined as the difference between the present value of utility costs and avoided cost savings) for certain programs.

In approving the EEA mechanism, the Commission stated that DSM costs are “unique in that the goal of DSM activities is to reduce the demand for electricity while the corporate objective of electric utilities has, to date, been one of increasing demand to increase sales to increase revenues.”¹⁰ According to the EEA order:

“The investments and goals related to DSM require utilities to depart from traditional business practices, and to accomplish this we believe that measures must be taken to actively encourage the initiation of DSM programs. We find that, in the short run at least, it is appropriate to, in effect jump start DSM activity by providing a regulatory framework that addresses the remaining disincentives and institutional suspicion of DSM.”¹¹

Upon appeal of the Commission’s decision by the Pennsylvania Industrial Energy Coalition (PIEC), the Commonwealth Court of Pennsylvania upheld the use of a surcharge mechanism under §1307 for recovery of DSM costs, based on the following analysis:

⁹ Order No. I-900005, Re Demand-Side Management by Electric Utilities—Uniform Cost Recovery Mechanism, Dec. 13, 1993.

¹⁰ *Id.* slip opinion at 18.

¹¹ *Id.* at 18-19.

“Because Section 1319 directs the PUC to allow recovery of all prudent and reasonable costs for developing, managing, financing and operating DSM programs and because Section 1307 gives the PUC the discretion to establish by ether regulations or order the manner in which automatic recovery may be instituted and when such automatic adjustment of rates should be mandated, the surcharge method is permitted.”¹²

In its analysis, the Court also stated that “Section 1307 should have limited application and the PUC should not use it to disassemble the traditional rate-making process.”¹³

With respect to the recovery of lost revenues, the Commission took the position that lost revenue recovery is authorized as DSM costs “associated with the development, management, financing and operation of the program” under §1319.¹⁴ The Industrial Coalition, for its part, claimed that no calculation of lost revenues could accurately determine what revenues were lost due solely to a DSM program.¹⁵ Although the Court observed that “there is the possibility that a sufficiently reliable calculation could be developed,” it found that the issue was not yet ripe for review, given that the PUC was not proposing the use of a surcharge for recovery of lost revenues.¹⁶ With respect to DSM incentives, the Court also reversed that portion of the Commission decision allowing recovery of incentives through the surcharge mechanism, finding that §523 permits adjustments “only within a base rate case,” and thus “a mechanism permitting incentives through a surcharge is beyond the authority of the PUC.”¹⁷ The Court found that although “there is nothing to prohibit the determination of a calculation of incentives,” the Commission must “follow the requirements of Section 523 at the time of the base rate case in exercising its discretion of whether to make adjustments based on specific findings.”¹⁸ It should be noted that this decision was issued prior to enactment of the *Competition Act* in 1996, which expressly authorized performance-based rates. *66 Pa.C.S. §2806(i)*. It should also be noted that nothing in the plain language of §523 refers to “base rates” or limits the establishment of conservation incentives to base rate proceedings. Rather, the reference in the statute is to the setting of “just and reasonable rates,” which is not necessarily limited to base rate proceedings.¹⁹

The Pennsylvania courts have stated generally that rate adjustments or surcharges under §1307 “are limited in scope and not to be employed as a universally available alternative to a base rate case,” but rather is appropriate “where expressly authorized . . . or for easily identifiable expenses that are beyond a utility’s control, such as tax rate changes or changes in the costs of

¹² *Pennsylvania Indus. Energy Coalition v. Pennsylvania Public Utility Comm’n*, 653 A.2d 1336, 1349, appeal granted 665 A.2d 471, affirmed 670 A.2d 1152 (1995) [“*PIEC v. PUC*”].

¹³ 653 A.2d at 1349.

¹⁴ 653 A.2d at 1352.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ 63 A.2d 1351.

¹⁸ *Id.*

¹⁹ National Fuel Gas Distribution Corporation (NFG) in its comments in the Working Group Final Report in the ARRA Investigation, I-2009-2099881, urged that the *PIEC* decision be “narrowly construed,” due to “certain flaws” in the court’s analysis, specifically the absence of any statutory construction analysis to support the court’s conclusion that the language in §523 somehow limits the establishment of conservation incentives to base rate proceedings. Working Group Final Report at 35-37.

fuel.”²⁰ According to court precedent, a surcharge involves only a “preliminary and cursory” review, with a more comprehensive analysis to occur later during a reconciliation process:

“Indeed, the very function of the typical automatic adjustment clause is to permit rapid recovery of a specific identifiable expense item, with a more comprehensive analysis upon reconciliation of actual costs with previously projected costs used to establish the effective rate. The initial process is essentially a mathematical review of the projections provided by the utility. Therefore, there is no initial review to determine the appropriateness or necessity of the rate request.”²¹

At the same time, however, there is some basis for authorizing annual adjustments between base rate cases to reflect the effects of energy conservation efforts. All costs as well as revenues could be trued up through an annual adjustment mechanism, between base rate cases, so long as the changes are sufficiently modest so as not to constitute a “general rate increase” as defined by §1308(d), which effectively places a cap on the amount of the increase that could be made without a new rate case.²² The Commission could arguably implement such a mechanism under its existing statutory authority (including its authority to set performance-based rates under the *Competition Act*).²³

With respect to relevant Commission precedent under Act 129, the Commission in its 2011 order regarding compliance with Section 410(a) of the American Recovery and Reinvestment Act of 2009 (*ARRA Order*) stated the following in reconciling its authority under §523(b)(4) versus the limitations imposed under Act 129 regarding the recovery of lost revenues:

“The Commission believes that the statutory language of Act 129 indicates that decreased revenues of an electric distribution company due to reduced energy consumption resulting from Act 129 conservation programs can be recovered, to the extent that such revenues can be recovered, by being reflected in revenue and sales data used to calculate rates in a distribution base rate proceeding. The Commission also believes that 66 Pa.C.S. §523(b)(4) provides the Commission with authority to consider positive incentives for EDCs when determining just and reasonable rates in a base rate proceeding based upon an EDCs’ success regarding its Act 129 energy conservation program, and that Act 129 can be read harmoniously with Section 523(b)(4). Given Act 129’s limitations regarding an EDCs’ recovery of decreased revenues resulting from an Act 129 energy conservation program, it is important to distinguish between a positive incentive given to an EDC based on its success in implementing an

²⁰ *Popowsky v. Pennsylvania Public Utility Comm’n*, 869 A.2d 1144, 1160 (2005).

²¹ *Masthope Rapids Property Owners Council v. Pennsylvania Public Utility Comm’n*, 581 A.2d 994, 1000 (Pa.Cmwlt. 1990).

²² “[A] general rate increase means a tariff filing which affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility.” 66 Pa.C.S. §1308(d).

²³ See 66 Pa.C.S. §501; §1308(d); §2806(i); see Working Group Final Report, ARRA Investigation, I-2009-2099881 (Jan. 24, 2011) at 62.

Act 129 program and any such decreased revenues resulting from an Act 129 energy conservation program. Therefore any positive incentive sought by an EDC in a base rate proceeding because of success with an Act 129 program should not be based upon any such decreased revenues, but instead should be based upon measurable success at meeting the objectives of the Act 129 plan.”²⁴

The *ARRA Order* also acknowledged that Pennsylvania does not provide any positive incentives to utilities that would “provide benefits to utilities when they succeed in energy conservation efforts.”²⁵ The *ARRA Order* listed four possible approaches that could be used to provide such positive incentives:

Performance Target Incentives. If a utility meets its energy conservation targets, “the program should provide a benefit for the utility,” which would “motivate the utility to carry out the program effectively.” A utility could receive a reward calculated as either a percentage of the overall program budget or a fixed amount per approved program, with the utility ineligible for a reward if less than 70% of its goal is met and the reward capped at 130% of the goal, thereby giving the utility an incentive “not just to meet minimum energy efficiency standards, but to make efficiency programs as successful as possible.” Rewards would be paid through a surcharge to ratepayers the following year, or reflected as a regulatory asset or in the rate of return given to a utility in a future base rate proceeding.²⁶

Shared Energy Savings between Utility and Customer. The utility would receive a portion of savings achieved by its customer due to participation in the utility’s energy conservation program. “This way the utility is not losing as much revenue as it would otherwise lose from the energy conservation program.” To give the utility an incentive to increase energy savings rather than just meeting minimum standard, the utility could receive “an increasing percentage of the savings as the utility or consumer conserves a greater amount of power or more customers participate.” These benefits could be paid through a surcharge the following year, or reflected as a regulatory asset or in the rate of return in a future general rate proceeding.²⁷

Rate-of-Return Adder in a Base Rate Proceeding. A utility meeting program goals could request an adder to its rate of return in its next base rate case, and this adder would increase depending upon the amount of energy conservation that was achieved.²⁸

Capitalizing EE and DSM Investments. Utilities could be permitted to capitalize their energy efficiency and DSM programs and earn a return thereon at a rate higher than traditional supply-side investments, to be recovered in their next base rate case.²⁹

²⁴ Docket No. I-2009-2099881, Aug. 1, 2011, at 30.

²⁵ *Id.* at 23.

²⁶ *Id.* at 24.

²⁷ *Id.* at 25.

²⁸ *Id.* at 26.

²⁹ *Id.*

Notwithstanding its acknowledgement of a possible role for positive incentives in the *ARRA Order*, the Commission in its *2015 Implementation Order* declined to include the establishment of an incentive or alternative ratemaking mechanism as part of energy efficiency and conservation (EE&C) plans for electric utilities. According to the Commission, “Act 129 provides the appropriate mechanism for [electric distribution companies] to use to obtain revenue on its assets through just and reasonable rates.”³⁰ The Commission rejected the inclusion of a “well-designed performance incentive structure,” as proposed by the Keystone Energy Efficiency Alliance (KEEA), finding that “[s]uch incentives are contrary to the Act,” given that utilities are permitted to recover only “all reasonable and prudent costs incurred in the provision or management of a[n] [EE&C] plan.”³¹ According to the Commission, the performance-based incentives proposed by KEEA “amount to nothing more than an additional revenue stream due to reduced consumption, which can only be recovered by EDCs through a distribution rate proceeding” given the proscription against recovery of lost revenues through an automatic adjustment clause under §2806.1(k)(2) and the authorization under §2806.1(k)(3) to include such impacts in revenue and sales data used to calculate rates in general rate proceedings.³²

Finally, in *Petition of Philadelphia Gas Works for Approval of DSM Plan for 2016-2020*, Docket No. P-2014-2459362, the Commission in August 2016 rejected PGW’s proposed recovery of lost revenues in connection with an EE&C Plan, finding that “lost distribution revenues are not ‘costs’ associated with development, management, financing or operation of [PGW’s] program and are not recoverable under Section 1319(a).”³³ According to the Commission, the legislature in *Act 129* made a distinction between the recovery of “costs” and “decreased revenues,” citing 66 Pa. C.S. §2806.1(k)(2). Given this distinction, “the term ‘costs’ in Section 1319(a) does not include lost revenue.” It should be noted that this is contrary to the position taken by the Commission in the *PIEC* case—prior to the enactment of *Act 129*—that DSM costs “associated with the development, management, financing and operation of the program” under § 1319 include lost revenue recovery.³⁴

With respect to the issue of recovering lost revenues attributable to energy efficiency and conservation, a decoupling mechanism (or similar mechanism to provide for recovery of lost revenues) can probably not be implemented through an automatic adjustment clause, given the prohibition of §66 Pa.C.S. §2806.1(k)(2). The Commission ruled last year in the *Philadelphia Gas Works* case that “costs” under § 1319(a) does not include “lost revenues” attributable to an EE&C program.³⁵ Although there is no legal prohibition against a decoupling mechanism or lost revenue recovery generally, such a mechanism would likely need to be accomplished through a deferral mechanism with recovery in a subsequent base rate proceeding. (The *PIEC* case did not reach the issue of recovery of lost revenues through a base rate proceeding. That case, however, predated

³⁰ Docket No. M-2014-2424864, Implementation Order, June 19, 2015, at 134.

³¹ *Id.* at 134.

³² *Id.* at 136.

³³ Pennsylvania Public Utility Comm’n, *Petition of Philadelphia Gas Works for Approval of Demand-Side Management Plan for FY 2016-2020, and Philadelphia Gas Works Universal Service and Energy Conservation Plan for 2014-2016*, Docket No. P-2014-2459362 (Aug. 2016) slip opinion at 18.

³⁴ *PIEC v. PUC*, 653 A.2d at 1352 (1995).

³⁵ *Philadelphia Gas Works, supra*.

the enactment of Act 129.) The inclusion of §2806.1(k)(3) as part of Act 129—which expressly authorizes *pro forma* adjustments in base rate proceedings to reflect reduced revenues—arguably addresses the issue to be remedied by a decoupling mechanism. (The recovery of lost revenues is only one aspect of decoupling, of course, and does not remove the incentive for utilities to sell more electricity.)

An argument could be made that a performance-based decoupling mechanism—with the percentage recovery of deferred amounts scaled according to the utility’s performance in achieving EE targets, for example—is not an “**automatic** adjustment mechanism” given that recovery would not be a simple, mathematical process (*Masthope*) but rather conditioned on the utility’s performance. Section 523, however, was interpreted in *PIEC* to require that any performance-based mechanism be implemented in the context of a base rate case, which would seem to preclude the use of such a “semi-automatic” mechanism although, as noted above, §2806(i) of the Competition Act provides a separate, independent authorization for performance-based ratemaking.

In summary, although the Commission has acknowledged that the current process provides no positive incentives for utilities to pursue EE or DSM programs,³⁶ it has generally taken the position that the preferred treatment of DSM expenditures (a surcharge under §1307 for recovery of DSM-related costs and the ability to propose *pro forma* adjustments to reflect lost revenues) provides sufficient incentive to encourage investment in EE and DSM programs. The Commission has expressly recognized its authority under §523 to consider positive incentives for electric distribution companies for their EE&C programs, so long as they are (1) implemented in a base rate proceeding, and (2) not tied to decreased revenues arising from an EE&C conservation program, given the proscription of §2806.1(k)(2). As stated by the Commission in the *ARRA Order*, “[a]ny positive incentive . . . should not be based upon any such decreased revenues but instead should be based upon measurable success at meeting the objectives of the Act 129 plan.”³⁷

(2) Incentives for Renewable Electricity Generation

The *AEPS* has the effect of encouraging the development of renewable resources, and it operates in a manner very similar to the renewable portfolio standards (RPSs) in place in nearly 30 states across the U.S. With respect to incentives, the *AEPS* provides electric distribution companies with certainty that they will recover their costs of complying with the *AEPS*, defined very broadly to include costs for purchases of alternative energy or AECs, payments to credit program administrators, and costs levied by RTOs to ensure that alternative resources are reliable. Moreover, these costs are recoverable through an automatic adjustment mechanism. Beyond these measures, *AEPS* does not in and of itself provide additional incentives encouraging the development of renewable resources. There is nothing in the *AEPS* that prohibits the inclusion of other measures to incentivize the development of renewable resources or DERs, such as through an alternative form of regulation including performance-based ratemaking.

(3) Alternatives to Traditional Rate Regulation, including Performance-Based Ratemaking

³⁶ See *ARRA Order* at 23.

³⁷ *ARRA Order* at 30.

As discussed above, Pennsylvania law provides two separate grants of authority for the Commission to implement performance-based ratemaking and alternative forms of regulation:

- Section 523, enacted as part of Act 114 of 1986, which requires the Commission to consider “the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates,” and authorizes the Commission to make “such adjustments to specific components of a utility’s claimed cost of service” as determined to be “proper and appropriate.” Among the criteria required to be considered by the Commission in evaluating the performance of electric utilities, §523(b)(4) specifies “[a]ction or failure to act to encourage development of cost-effective energy supply alternatives such as conservation or load management, cogeneration or small power production.” Section 523(b)(7) further states that the Commission shall consider “[a]ny other relevant and material evidence of efficiency, effectiveness and adequacy of service.”
- Section 2806(i), enacted as part of the *Competition Act* in 1996, which authorizes the Commission “to use performance-based rates as an alternative to existing rate base/rate of return regulation.”

With respect to its authority under §523, the Commission relied on this statute in its 1993 EEA decision implementing incentive payments in connection with energy efficiency programs. The *PIEC* case, however, made the finding that performance-based adjustments pursuant to §523 can be implemented only in the context of a base rate proceeding; it should be noted, however, that the statute itself makes no reference to “base rates” but rather refers to the setting of “just and reasonable rates,” which may occur outside of base rate proceedings.³⁸ More recently, the Commission in its *ARRA Order* expressly recognized its authority under §523 to consider positive incentives for electric distribution companies for their EE&C programs, so long as they are (1) implemented in a base rate proceeding, and (2) not tied to decreased revenues arising from an EE&C conservation program.³⁹ It should be noted that the Commission’s authority under §523(b)(4) is limited to actions to encourage “development of **cost-effective energy supply alternatives** such as conservation or load management, cogeneration or small power production” (emphasis added). Thus, while the statute contemplates performance-based adjustments in the case of DSM (“conservation or load management”)⁴⁰ and certain supply-side options (“cogeneration or small power production”), any other measures sought to be included in a performance-based adjustment would need to fall within the broader category of “energy supply alternatives.”

With respect to the statutory authority under §2806(i), the Commission was given broad powers to implement “performance-based rates and alternative regulation” as part of the *Competition Act*. This authority does not seem to have been expressly exercised by the Commission and thus has not been tested in the courts. With respect to the *Competition Act*

³⁸ *Pennsylvania Indus. Energy Coalition v. Pennsylvania Public Utility Comm’n*, 653 A.2d 1336, 1349, appeal granted 665 A.2d 471, affirmed 670 A.2d 1152 (1995).

³⁹ *ARRA Order* at 30.

⁴⁰ “Cogeneration” and “small power production” are terms generally used in the Public Utility Regulatory Policies Act of 1978, or PURPA, which was enacted a few years earlier than Act 114 (1986).

generally, however, a Pennsylvania court in *Metropolitan Edison Co. v. Pennsylvania Public Utility Commission*⁴¹ observed that because the Commission is charged with enforcing the Code, including the *Competition Act*, its “interpretation of the Code, the Competition Act, and its own regulations are entitled to great deference and should not be reversed unless clearly erroneous.”⁴² The court went on to note that “[j]udicial deference is even more necessary when the statutory scheme is technically complex, as it is in this case.”⁴³ In *Pennsylvania Power Co. v. Public Utility Commission*, the Commonwealth Court acknowledged that “[a]s the administrative body charged with implementing the Competition Act, the [Commission] is entitled to substantial deference in the performance of its duties, and the [Commission’s] interpretation of the Competition Act should not be overturned unless it is clear that such construction is erroneous.”⁴⁴ Similarly, in *Popowsky v. Pennsylvania Public Utility Commission*, the Commonwealth Court examined the issue of the deference owed to the Commission’s interpretation of “prudent mix” under the *Competition Act* and stated that “[w]here this Court determines that a given issue ‘has not been addressed by the legislature, we are not to impose our own construction on the statute as would be necessary in the absence of an administrative interpretation, but review the agency’s construction of the statute to determine whether that construction is permissible.’”⁴⁵

As discussed in Section III below, the Commission’s statutory authority under the *Competition Act* potentially provides with Commission with broad discretion to fashion alternative forms of regulation—including performance-based incentives—that reflect the changing circumstances in the electric utility industry.

(4) Recent Court Cases Involving Judicial Deference to Commission Decisions

To evaluate what level of deference Pennsylvania courts may give a Commission decision to exercise its statutory authority under §2806(i), it may be helpful to consider recent court cases involving Commission decisions under other statutory provisions. The Commonwealth Court has issued three decisions over the past two years involving issues arising under the Commission’s statutory authority.

In *Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania v. Pennsylvania Public Utility Commission*,⁴⁶ the court upheld the authority of the Commission under the *Competition Act* to approve a PECO Energy program that would allow PECO’s Customer Assistance Program (CAP) customers to shop for and choose their electric generation supplier (EGS). In approving the program, the Commission had rejected a PECO proposal for EGS price ceilings, concluding that it lacked the power to cap EGS rates or impose other rate-related

⁴¹ 22 A.3d 353 (Pa.Cmwlt. 2011), appeal denied 40 A.3d 123, 615 Pa. 760, cert. denied, 133 S.Ct. 426, 184 L.Ed. 289.

⁴² *Id.* at 362, citing *Popowsky v. Pennsylvania Public Utility Comm’n*, 550 Pa. 449, 462, 706 A.2d 1197, 1203 (1997); *Energy Conservation Council v. Pennsylvania Public Utility Comm’n*, 995 A.2d 465 (Pa.Cmwlt. 2010)

⁴³ *Id.*, citing *Popowsky*, 550 Pa. at 462, 706 A.2d at 1203.

⁴⁴ 932 A.2d 300, 306 (Pa.Cmwlt. 2007).

⁴⁵ 71 A.3d 1112, 1117 (Pa.Cmwlt. 2013), citing *Bethenergy Mines, Inc. v. Department of Environmental Protection*, 676 A.2d 711, 715 (Pa.Cmwlt. 1996).

⁴⁶ 120 A.3d 1087 (Pa.Cmwlt. 2015).

restrictions. The court upheld the PUC's rejection of price ceilings as supported by substantial evidence – but disagreed that the Commission lacked authority to impose them, finding that under the *Competition Act* the Commission has broad authority to strike the proper balance between the benefits of competition versus the “need to continue and maintain programs that assist low-income customers to afford electric service.”⁴⁷ The court concluded that the passage of the *Competition Act* was “transformative,”⁴⁸ and that while the overarching goal of the Act “is competition through deregulation of the energy supply industry, . . . the scheme does not demand absolute and unbridled competition.”⁴⁹ The Commission is thus empowered to “impose CAP rules that would limit the terms of any offer from an EGS that a customer could accept and remain eligible for CAP benefits” so long as the Commission “provides substantial reasons why there is no reasonable alternative so competition needs to bend to ensure adequately funded, cost-effective, and affordable programs to assist customers who are of low-income to afford electric service.”⁵⁰ It was a 6-1 decision authored by Judge P. Kevin Brobson; Judge Patricia McCullough issued a dissenting opinion expressing the view that the Commission's decision was not supported by substantial evidence.

In *Dauphin County Industrial Development Authority v. Pennsylvania Public Utility Commission*,⁵¹ the issue was the authority of the Commission under §2807(f)(5) of the *Competition Act* to require default providers to offer time-of-use (TOU) rates to certain customers. The Commission, reading the statute through the lens of its broad Public Utility Code authority to set “just and reasonable rates,” had determined that a default provider could offer TOU rates to customer-generators solely through EGS and need not directly offer such rates itself. In a 3-0 decision authored by Judge Mary Hannah Leavitt, the court rejected the Commission's interpretation, writing that while it must defer to the Commission's construction of an ambiguous statute, the Commission's interpretation of section 2807(f)(5) was not entitled to deference because there is no ambiguity in that statute's mandate. Because the matter at issue did not concern the utility's *rates* but, rather, the *service* the utility must offer, the court stated that “[t]he statutory requirement that utility rates be just and reasonable does not authorize the Commission to ignore or alter other statutory directives.”⁵² The Commission's “just and reasonable rates” argument, said the court, was a “red herring.”⁵³

Most recently, in *Sunrise Energy LLC v. FirstEnergy Corp.*,⁵⁴ the Commonwealth Court considered the extent of the Commission's jurisdiction under the *AEPS* over breach of contract and quasi-contract claims arising between a solar power facility operator and a utility. The court found that while the regulatory scheme under the Public Utility Code was “pervasive,” the *AEPS* confers no authority upon the Commission to adjudicate matters arising under the *AEPS*.⁵⁵

⁴⁷ *Id.* at 1103.

⁴⁸ *Id.* at 1100.

⁴⁹ *Id.* at 1101.

⁵⁰ *Id.* at 1104, citing *PP&L Industrial Customer Alliance v. Pennsylvania Public Utility Commission*, 780 A.2d 773, 782 (Pa.Cmwlth. 2001).

⁵¹ 123 A.3d 1124 (Pa.Cmwlth. 2015).

⁵² *Id.* at 1135.

⁵³ *Id.*

⁵⁴ 148 A.3d 894 (2016).

⁵⁵ *Id.* at 904.

According to the court, the Commission “does not enjoy a roving mandate to adjudicate on the construction of the [AEPS],” noting that the AEPS “is not part of the Public Utility Code.”⁵⁶ The decision in Sunrise Energy was 5-2, with President Judge Mary Hannah Leavitt authoring the majority opinion. Judge Renee Cohn Jubelirer issued a dissenting opinion, joined by Judge Anne E. Covey, which expressed the view that “[i]t is beyond purview that the [Commission] is empowered with jurisdiction over the supervision and regulation of all public utilities and their provision of services in the Commonwealth, the restructuring of the electric utility industry, matters related to public utility tariffs, and provisions of the AEPS Act, and is considered to have specialized expertise to which the courts are to defer when reviewing decisions within its expertise.”⁵⁷ According to the dissenting opinion, rather than evaluating the AEPS “in a vacuum,” it should be evaluated *in pari materia* with the relevant portions of the Public Utility Code and the Competition Act, “all of which govern the provision of safe, reliable and efficient electric service.”⁵⁸ Because “the interpretation of these Acts must be uniform and consistent throughout the Commonwealth,” the dissent found that the Commission had jurisdiction over the determination at issue.⁵⁹

FirstEnergy and West Penn Power Company filed a Petition for Allowance of Appeal of the decision with the Supreme Court of Pennsylvania in January 2017, and the Commission filed an *amicus curiae* brief in support thereof. The Commission’s brief notes that “the majority analyzed the Commission’s duties solely under the AEPS Act without acknowledging or recognizing the panoply of enforcement powers granted to the Commission in the Public Utility Code, the Commission’s enabling legislation,” and thereby “flouts well established case law on the express and implied powers of administrative agencies as well as rules of statutory construction.”⁶⁰ The Supreme Court has not yet ruled on whether it will accept the appeal.

IV. PRECEDENT FROM OTHER JURISDICTIONS

A. Overview of State Statutes and Policies

Delaware

In 2007, the Delaware legislature established the nonprofit Sustainable Energy Utility (SEU) to operate programs to deliver comprehensive end-user efficiency and customer-sited renewable energy services. (SEU operates as “Energize Delaware.”) In March 2007, the Delaware Public Service Commission (DPSC) opened Regulation Docket No. 59 to consider whether to implement a revenue decoupling mechanism for the electric and natural gas utilities subject to its jurisdiction. At the time, no specific statute was in place that authorized or addressed revenue decoupling. Thereafter, the DPSC evaluated the issue of decoupling on a utility-by-utility basis when it set utility rates through rate case proceedings. In 2009, Delaware approved an Energy Efficiency Resource Standard (EERS) that set goals for consumption and peak demand for

⁵⁶ *Id.* at 907, 908.

⁵⁷ *Id.* at 910.

⁵⁸ *Id.*

⁵⁹ *Id.* at 910-11.

⁶⁰ *Sunrise Energy LLC c. FirstEnergy Corp. and West Penn Power Company*, No. 25 WAL 2017, Brief of *Amicus Curiae* Pennsylvania Public Utility Commission in Support of Petition of Allowance for Appeal (January 11, 2017), at 4.

electricity and natural gas utilities. The goals are 15% electricity consumption and peak demand savings and 10% natural gas consumption savings by 2015. Rules outlining how these goals were to be met were never finalized, however. In September 2009, the DPSC entered Order 7641, examining a modified fixed variable rate design for Delmarva (electric and gas). In 2011 the PSC approved a form of decoupling for the electric utility arm, Delmarva Power & Light. Prior to 2014, utilities had little involvement in efficiency programs, and available funding significantly limited progress toward the savings goals set forth in the Delaware EERS.

In August 2014, the Delaware state legislature passed SB 150, which directs the DPSC to “approve cost recovery for cost-effective energy savings resulting from cost-effective programs and portfolios and Commission-regulated affected energy providers.” SB 150 also states that “the Commission shall utilize a process that achieves the efficient and timely recovery on an annual basis . . . of appropriate costs and associated rates of return related to implementing [energy efficiency] activities and programs.” Nothing in SB 150 specifically addresses decoupling, nor are there other statutes that provide for performance-based ratemaking or alternative forms of regulation. As part of its 2012 rate case, Delmarva Power requested an alternative regulatory model that included a revenue decoupling mechanism. The proposed decoupling mechanism was abandoned as part of a settlement with intervenors, however, and was not adopted in the final order. *Docket 11-528*.

Maryland

With respect to incentives for renewable energy, Maryland's Renewable Energy Portfolio Standard, enacted in May 2004 and revised numerous times since, requires electricity suppliers (all utilities and competitive retail suppliers) to use renewable energy sources to generate a minimum portion of their retail sales. Beginning in 2006, electricity suppliers were required to provide 1% of retail electricity sales in the state from Tier 1 renewables and 2.5% from Tier 2 renewables. Tier 1 renewables include solar, wind, biomass, anaerobic decomposition, geothermal, ocean, fuel cells powered through renewables, small hydro, poultry-litter incineration facilities, waste-to-energy facilities. Tier 2 renewables include hydroelectric power other than pump-storage generation. The renewables requirement increases gradually, ultimately reaching a level of 20% from Tier 1 resources in 2022 and beyond, and 2.5% from Tier 2 resources from 2006 through 2018. The Tier 2 requirement eventually sunsets, dropping to 0% in 2019 and beyond.

A solar carve-out was established in 2007, and currently requires that a total of 2% of retail electricity sales come from solar resources by 2020. In April 2013, Maryland enacted legislation (HB 226) creating a resource carve-out for offshore wind facilities. The carve-out is stated as a maximum percentage of 2.5% of retail electricity sales in 2017 and beyond, with the actual requirements to be determined by the Maryland Public Service Commission (PSC) subject to the 2.5% limitation. Both the solar carve-out and the offshore wind carve-out are part of the overall Tier 1 requirement, and thus have the effect of reducing the requirements for other Tier 1 resources.

The Maryland legislature in 2008 enacted the EmPower Maryland Energy Efficiency Act, which directs the Maryland PSC to require electric utilities in the state to provide energy

efficiency services to its customers to achieve 10% of the 15% per-capita electricity use reduction goal by 2015. *Order 82344*. Utilities were also required to decrease peak demand by 15% by 2015. The PSC issued new EmPower targets with *Order 87082* in July 2015, which requires utilities to ultimately achieve savings of 2 percent per year by ramping up incremental savings at a rate of 0.2 percent per year beginning in 2016. Utilities must file their energy efficiency program plans with the PSC for approval. Utilities do not have an option to earn shareholder performance incentives, although cost recovery amortized over multiple years may include a return.

The Maryland PSC approved revenue-per-customer decoupling for the three investor-owned utilities in Maryland: PEPCO,⁶¹ Delmarva Power and Light,⁶² and Baltimore Gas & Electric.⁶³ Delmarva and PEPCO file bill stabilization adjustments monthly. Natural gas decoupling has been in place for Washington Gas Light since 2005.⁶⁴

Senate Bill 205 allows the Maryland PSC to approve financial incentive mechanisms for gas and electric companies, in appropriate circumstances, to promote energy efficiency and conservation programs. The statute provides that the PSC must “adopt ratemaking policies that provide cost recovery and, in appropriate circumstances, reasonable financial incentives for gas companies and electric companies to establish programs and services that encourage and promote the efficient use and conservation of energy.”⁶⁵ No such incentives have been approved, however.

New Jersey

New Jersey set energy savings goals of 20% savings by 2020 relative to predicted consumption in 2020 in its Energy Master Plan of 2008. However, these goals are advisory and lack consequence if they are missed. The New Jersey Board of Public Utilities (BPU) sets annual energy savings targets through its Comprehensive Resource Analysis (CRA) proceeding, but has yet to pursue a binding EERS that would require each electricity supplier/provider to meet long-term energy efficiency goals. Although they are required to submit individual energy master plans pursuant to the New Jersey Energy Master Plan, these have been delayed indefinitely.

In October 2006, the BPU approved requests by two of New Jersey’s gas companies, New Jersey Natural Gas and South Jersey Gas, to replace their existing weather normalization clauses with a decoupling mechanism, called the “Conservation Incentive Program.” It would capture gross margin variations related to both weather and customer usage. Under this program, the companies’ shareholders pay for conservation programs that reduce the amount of gas the company needs to serve its customers. If the company demonstrates that it has achieved savings in the gas supply costs that it passes through the customers, the shareholders then are allowed to impose a surcharge to recover their lost revenues; otherwise, the BPU does not permit utilities to recover lost revenues. The three-year pilot program applies to residential and most

⁶¹ Case Jacket 9092, Order 81517, July 2007.

⁶² Case Jacket 9093, Order 81518, July 2007.

⁶³ Letter Order, November 2007.

⁶⁴ Case Jacket 8990, Order 80130, August 2005.

⁶⁵ Senate Bill 205.

commercial customers. The BPU extended the three-year pilot program through 2016. *BPU Docket Nos. GR05121019 and GR05121020*.

Decoupling has not been implemented for New Jersey's electric utilities, although most recently discussions were convened in August 2016 by Senator Bob Smith, Chairman of the Senate Energy and Environment Committee, to explore legislation authorizing decoupling for electric utilities.⁶⁶

New York

In New York, the Public Service Commission (NYPSC) operates pursuant to a broad grant of authority under that state's Public Service Law. Under this grant of authority, for example, the NYPSC ordered the restructuring of the electric utility industry in 1996,⁶⁷ and its authority to do so was upheld in *Energy Assoc. of New York State v. Public Serv. Comm'n (Energy Assoc. v. PSC)*, 653 N.Y.S.2d 502 (1996). Key statutory provisions include:

- §66, *General powers of commission in respect to gas and electricity*, subsection 1 of which provides that the NYPSC shall "have general supervision of all gas corporations and electric corporations";
- §72, which authorizes the NYPSC to set "just and reasonable rates" and further provides that "in determining the price to be charged for gas or electricity[,] the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question";
- §65(1), which states that "[e]very . . . electric corporation . . . shall furnish and provide such service, instrumentalities and facilities as shall be safe and adequate and in all respects just and reasonable"; and
- §5(2), which provides that "[t]he commission shall encourage all persons and corporations subject to its jurisdiction to formulate and carry out long-range programs . . . for the performance of their public service responsibilities with economy, efficiency, and care for public safety, the preservation of environmental values and the conservation of natural resources."

According to the Court in *Energy Assoc. v. PSC*, this addition of §5(2) in 1970 was a revolutionary enhancement of the functions of the PSC in the management and control of the electrical industry in the state of New York, transforming the traditional role of the Commission from that of an instrument for simple case-by-case consideration of rates requested by utilities to one charged with the duty of long-range planning for the public benefit."⁶⁸ Earlier decisions in New York confirmed that the NYPSC has broad discretion to select the means for achieving the Legislature's goals of "just and reasonable rates," *Consolidated Edison v. PSC*, 47 N.Y.2d 94, 417 N.Y.S.2d 30, 390 N.E.2d 749 (1979),⁶⁹ and that the NYPSC "has been delegated . . . the difficult and sensitive responsibility of balancing the conflicting interests of the public and the utilities,"

⁶⁶ David Giambusso, *New Jersey Energy Experts Set to Take on 'Decoupling,'* POLITICO NEW JERSEY (August 12, 2016).

⁶⁷ NEW YORK PUB. SERV. COMM'N, Opinion No. 96-12, (May 20, 1996).

⁶⁸ 653 N.Y.S.2d at 508.

⁶⁹ Reversed on other grounds, 447 U.S. 530 (1980).

and in that capacity is expected to “adapt to the changing patterns in the industry.” *Matter of Rochester Gas & Electric Corp. v. PSC*, 117 A.D.2d 156, 160, 501 N.Y.S.2d 951 (3rd Dep’t 1986). Unless the NYPSC’s judgment was exercised “without any rational basis or without any reasonable support in the record,” its determination setting “just and reasonable” rates under § 72 is not to be set aside. *Matter of Abrams v. PSC*, 67 N.Y.2d 205, 501 N.Y.S.2d 777, 492 N.E.2d 1193 (1986).

Pursuant to this broad grant of authority, the NYPSC also implemented a renewable portfolio standard and an energy efficiency resource standard, both without benefit of any action by the legislature enacting a specific statutory authorization. Similarly, pursuant to this broad grant of authority, the NYPSC in April 2007 issued a policy statement on decoupling, and required each utility to file a decoupling proposal in its next rate proceeding. All six major utilities and ten gas companies have revenue decoupling in place.⁷⁰

In 2016, the NYPSC approved significant structural reforms to electric utility regulations as a part of its Reforming the Energy Vision (REV) proceeding, which calls for the use of markets and new regulations to achieve increased system efficiency, carbon reductions, and customer empowerment. In terms of decoupling, the PSC plans to increase alignment of utility profits with market-enabling activities and tying utility revenues to consumer value. Under its May 2016 *Order Adopting a Ratemaking and Utility Revenue Model Policy Framework*, utilities will have the opportunity to achieve revenues through: (1) traditional cost-of-service earnings (“platform service revenues”); (2) earnings adjustment mechanisms, which are based on incentives tied to system efficiency, energy efficiency, customer engagement, interconnection approvals, and affordability; and (3) reductions in greenhouse gas (GHG) emissions in accordance with the Clean Energy Standard and the mechanisms to be developed in that proceeding.⁷¹ Each major New York electric utility was required to file an “overall system efficiency” proposal by Dec. 1, 2016 for NYPSC approval.

Ohio

In 2008, the state passed SB 221, which establishes an alternative energy portfolio standard and an energy efficiency resource standard with energy savings goals for electric utilities, and allows for cost recovery and decoupling.

The Alternative Energy Portfolio Standard in SB 221 requires 25% of all kWh of electricity sold by electric distribution utilities and electric services companies to retail electric consumers under their standard service offers to be obtained from “alternative energy resources” by 2025. *O.R.C. 4928.64(B)*. “Alternative energy resource” encompasses both “advanced energy resources” and “renewable energy resources” that were placed in service after January 1, 1998. *O.R.C. 4928.64(A)*. In addition, “alternative energy” includes new and existing mercantile customer-sited advanced and renewable energy resources that the customer commits to integrate into the utility’s demand-response, energy efficiency, or peak demand reduction programs. *O.R.C. 4928.64(A)(1)*. Of the “25% by 2025” alternative energy requirement, at least

⁷⁰ Case 03-E-0640, Order Requiring Proposals for Revenue Decoupling Mechanisms (April 20, 2007).

⁷¹ Case 14-M-0101, Proceeding on Motion of the Commission in regard to Reforming the Energy Vision (May 19, 2016).

half (12.5% or more) must be generated from, “renewable energy resources,” including 0.5% from solar energy. Technologies qualifying under this “renewable tier” of the portfolio standard include solar photovoltaic or solar thermal energy, wind energy, hydroelectric power, geothermal energy, fuel derived from solid wastes through fractionation, biological decomposition, or other process not principally involving combustion, biomass energy, biologically derived methane gas, energy derived from non-treated by-products of the pulping process or wood manufacturing process, any fuel cell used in the generation of electricity, wind turbines located in territorial waters of Lake Erie, storage facilities that will promote the better utilization of renewable energy resources that primarily operates off peak, and distributed generation systems used to generate electricity from any listed energy resource. *O.R.C. 4828.01(A)(35)*.

The Energy Efficiency Resource Standard in SB 221 requires utilities to implement energy efficiency programs to achieve reductions in energy usage from 2009 to 2025 on the schedule set forth in *O.R.C. 4928.66(A)(1)(a)*, which required a 0.3% reduction in 2009, 0.5% in 2010, 0.7% in 2011, 0.8% in 2012, 0.9% in 2013, 1% per year for 2014 – 2018, 2% each year for 2019 – 2024, and cumulatively 22+% by 2025. Similarly, beginning in 2009, electric distribution utilities must implement peak demand reduction programs designed to achieve reductions in peak demand on the schedule set forth in *O.R.C. 4928.66(A)(1)(b)*, which requires a 1% reduction in 2009 and an additional 0.75% reduction each year from 2010 – 2018. With respect to decoupling mechanisms, SB 221 authorizes the PUCO to establish rules regarding the content of an application for approval of a “revenue decoupling mechanism.” *O.R.C. 4928.66(D)*. A revenue decoupling mechanism is defined as a rate design or other cost recovery mechanism that provides recovery of the fixed costs of service and a fair and reasonable rate of return, irrespective of system throughput or volumetric sales. *O.R.C. 4929.01(O)*. This mechanism is not to be considered an application to increase rates. The PUCO may approve the decoupling mechanism if it provides for the recovery of revenue that otherwise may be foregone by the utility as a result of energy efficiency or energy conservation programs and reasonably aligns the interests of the utility and its customers in favor of the program. *O.R.C. 4928.66(D)*.

It should be noted that SB 310, adopted by the Ohio legislature in 2014, modified the advanced energy resource and energy efficiency mandates, respectively, for 2015 and 2016, by effectively pausing the mandate escalation schedule.

SB 221 also amended Ohio’s state energy policy as broadly defined in the Revised Code. While not necessarily determinative of any outcomes, this portion of SB 221 was intended to provide the PUCO with guidance when promulgating administrative rules and to assist courts in resolving statutory ambiguities. New policies articulated in SB 221 include encouraging innovation and market access for cost-effective supply- and demand-side retail electric service (including, but not limited to, demand-side management, time differentiated pricing, and implementation of advanced metering infrastructure); and ensuring that an electric utility’s transmission and distribution systems are available to a customer-generator or owner of distributed generation so that the customer-generator or owner can market and deliver the electricity it produces.

The PUCO adopted rules to provide for decoupling, and an electric distribution utility may submit an application for approval of a revenue decoupling mechanism to the PUCO. In 2011,

American Electric Power Company implemented a decoupling mechanism as part of a rate case settlement with the Ohio Consumers' Counsel.⁷² Subsequently, the PUCO in August 2013 ordered all electric utilities to file straight fixed/variable rates instead of decoupling in their next rate case.⁷³

West Virginia

West Virginia has no alternatives to traditional rate regulation in place to encourage the development of energy efficiency, clean DERs, or renewable energy. The West Virginia Public Service Commission has not implemented decoupling for utilities, although it has adopted policies, pursuant to its general ratemaking authority, to permit lost revenue adjustments in individual rate proceedings. West Virginia formerly had an Alternative and Renewable Energy Portfolio Standard in place that encouraged the development of renewable and alternative energy, but that measure was repealed by the West Virginia legislature in 2015. There are no ratemaking mechanisms in place in West Virginia pertaining to the development of DERs.

B. Analysis of Precedent from other Jurisdictions

The precedent from other jurisdictions illustrates two different paths to implementing incentives and performance-based ratemaking mechanisms related to DSM, renewable energy and DERs. The first path, which New York has taken, is a broad grant of legislative authority, with no subsequent issue-specific legislative activity that infringes upon or narrows this broad grant of authority. Pursuant to its authority under the Public Service Law in New York, the NYPSC has restructured the electric utility industry (1996), adopted a renewable portfolio standard (2003), implemented a policy on decoupling (2007), adopted an energy efficiency resource standard (2008), and is in the process of defining a new utility business model, and associated regulatory framework, through its REV proceeding. No legislative action has provided any direction or “narrowed the playing field” with respect to the issues addressed in these initiatives, and thus the NYPSC can safely rely on its broad grant of legislative authority, as interpreted in several court decisions in the 1980s and 1990s, to pass sweeping regulatory reforms.

Most of the other states adjoining Pennsylvania illustrate the second path: specific legislative actions that narrow the discretion, and authority, of the PUCs to address matters that are within the scope of the various pieces of legislation. While the PUCs in each state have broad general grants of authority as well—almost all states have a statute granting PUCs wide latitude in determining “just and reasonable rates,” for example—such general grants of authority have less relevance where legislatures have “narrowed the playing field” with respect to a particular issue by enacting legislation addressing that issue. Maryland, Ohio, and Pennsylvania have each adopted forms of renewable portfolio standards and energy efficiency resource standards, for example, that largely define the terms of such programs and thereby preempt the PUCs from exercising much discretion with respect to the designs of such programs. Similarly, those states that have addressed decoupling through legislation—Ohio, for example—limit the flexibility of the PUCs to adopt any policies that arguably depart from the legislative directives.

⁷² Case No. 11-351-EL-AIR, Opinion and Order (December 14, 2011).

⁷³ Case No. 10-3126-EL-UNC, Order (August 21, 2013).

V. ANALYSIS

Pennsylvania has relatively prescriptive legislative enactments with respect to defining the procurement obligations for renewable energy (the *AEPS* statute) and energy efficiency (*Act 129*), and also has a statute on its books suggesting that certain performance-based rate adjustments can be effected only in the context of setting “just and reasonable rates” in a base rate proceeding. *§523(b)(4)*. Other portions of *Act 129* arguably address the issue of decoupling—at least to the extent of the “lost revenue” portion of a decoupling mechanism—and seemingly preclude the use of an “automatic adjustment clause.” Thus the authority the Commission might otherwise have to implement such a mechanism pursuant to its broad ratemaking authority has been narrowed by legislation that appears to specifically address the issue.

Fundamental changes are currently underway in the electric utility industry, as DERs become more cost-competitive and customers increasingly take advantage of technological advances to control their energy usage through energy efficiency and demand response programs—both of which combine to pose a challenge to the business model of electric distribution companies, as recognized by the NYPSC in its REV proceeding. This transformation in many respects is comparable to the sweeping changes then underway in the electric industry addressed by the Pennsylvania legislature in the *Competition Act*. The General Assembly responded to the rapid changes in the electric industry by including in the *Competition Act* a very broad grant of ratemaking authority authorizing the Commission to use “performance-based rates as an alternative to existing rate base/rate of return regulation.” *§2806(i)*. Currently there is a different sort of transformation underway in the electric utility industry, and the tools made available to the Commission in the *Competition Act* are still available, and could be just as useful in addressing the ongoing changes and to allow the industry to better align its operations with changing customer opportunities and environmental imperatives. The Commission thus likely has the flexibility to consider a broad array of incentives and performance-based regulatory policies. Such mechanisms could conceivably include a form of decoupling as a means of incentivizing energy efficiency programs (except to the extent expressly prohibited by provisions of *Act 129*, *i.e.*, recovery of lost revenues through an automatic adjustment clause).

If such an assertion of authority under the *Competition Act* were challenged through judicial review, the prospects are relatively good that the Commission’s actions would be upheld, based upon recent decisions from the Commonwealth Court. On the one hand, in the *Coalition* case, the Court in a 6-1 decision found that the Commission had interpreted its authority under the *Competition Act* too narrowly, and concluded that the Commission had relatively broad authority under the *Act* to protect low-income customers by approving CAP rules that would limit the terms of any offer from an EGS. The decision suggests that the Court may be inclined to take a relatively expansive view of the Commission’s authority when that authority is being exercised to promote ratepayer interests—as, presumably, it would be under *§2806(i)*. Moreover, Judge McCullough in dissent did not disagree that the Commission’s authority was broader than the Commission had determined; she differed from the majority only in that she would also have directed the PUC to **use** that authority on behalf of low-income ratepayers.

On the other hand, the *Dauphin County* and *Sunrise Energy* cases, both written by President Judge Mary Hannah Leavitt, are somewhat problematic in that they tend to examine

the Commission’s authority under each legislative enactment in isolation, rather than *in pari materia* with other major sources of the Commission’s authority – most particularly the broad grant of authority under the Public Utility Code and the obligation to set “just and reasonable rates.” While in *Coalition* the Court determined that the Commission’s “just and reasonable rate” concerns were a “red herring,” in *Dauphin County* and *Sunrise Energy* the Court regarded the Commission’s ratemaking duties as decisionally irrelevant. Given that the Commission operates under several different statutes of overlapping scope, this jurisprudential approach is troubling. But at the same time, in the *Sunrise Energy* decision the unhelpful language is merely dicta, and there is a strong dissenting opinion that includes a proper analysis of the Commission’s broad authority under the various enabling statutes. Moreover, even if the approach used by the Court in *Coalition* and by the majority in *Sunrise Energy* (*i.e.*, looking at each legislative enactment in isolation) were followed by the Commonwealth Court in reviewing a Commission assertion of authority under the *Competition Act*, the Commission would have strong support for its actions, given the broad grant of authority in the *Competition Act* under §2806(i) to use performance-based rates and alternative regulation. In other words, the Commission may not need to rely on authority outside of the *Competition Act* in order to support its initiative.

It is more difficult to handicap the prospects for judicial review of Commission decisions that are appealed to the Supreme Court of Pennsylvania. The November 2015 elections resulted in substantial turnover in court personnel—three new Democratic judges were elected (Donohue, Dougherty and Wecht)—and there have not been many decisions issued by the “new court” to inform much analysis of the court’s philosophy regarding judicial deference of administrative agency decisions involving energy or environmental issues. One decision that provides some guidance is *Robinson Township v. Commonwealth of Pennsylvania*, issued in September 2016, which struck down four additional portions of Act 13 (enacted in 2012).⁷⁴ The *Robinson IV* decision invalidated the sections of Act 13 that authorized the Commission to review municipal zoning ordinances regulating oil and natural gas operations and that gave gas companies the ability to “fast track” their challenges to municipal regulations by filing with the Commonwealth Court as the court of first resort. *Robinson IV* also struck down a “physician gag rule” as a “special law” creating requirements that differed for the natural gas industry as compared to other industries without such difference having a substantial relationship to a legitimate legislative goal. Another section relating to notice by the DEP of spills and releases to public water systems was also found to violate the Pennsylvania Constitution’s prohibition on “special laws” by unjustifiably differentiating between public and private water supplies, as owners of private water supplies were not required to be notified by the DEP under the statute. Finally, another section of Act 13 relating to powers of eminent domain was found to violate the Fifth Amendment of the U.S. Constitution and Article I, Section 10 of the Pennsylvania Constitution by permitting the taking of private property for a private purpose. The *Robinson IV*

⁷⁴ 147 A.3d 536 (2016), commonly referred to as *Robinson IV*. The Supreme Court had issued an earlier decision in December 2013—*Robinson II*—in which it struck various Act 13 provisions including, among others, Sections 3304 (providing for zoning uniformity within the Commonwealth), and 3215(b) (creating setbacks from various water bodies as well as a process for waivers from those setbacks). *Robinson Township v. Commonwealth of Pennsylvania*, 83 A.2d 901 (Pa. 2013). *Robinson IV* reviewed a July 2014 Commonwealth Court decision (*Robinson III*) issued on remand from the December 2013 *Robinson II* decision.

decision has been described by some commenters as a victory for the environmental community,⁷⁵ which may be interpreted to suggest that the “new court” may be favorably disposed to a Commission decision that promotes progressive electric utility policies minimizing environmental impacts through energy efficiency and renewable energy. It would be risky to infer much from *Robinson IV*, however, given the unusual breadth of Act 13 and the lengthy judicial history of the *Robinson* litigation.

⁷⁵ Elizabeth Van Nostrand and Tina Batra Hershey, *Environmentalists Score Big in their War Against Fracking*, JPHMP Direct (October 25, 2016), available at <https://jphmpdirect.com/2016/10/25/environmentalists-score-big-in-their-war-against-fracking-by-elizabeth-van-nostrand-jd-and-tina-batra-hershey-jd-mph/>