

Reply Comments of Strata Policy on Alternative Ratemaking Methodologies

Before the Pennsylvania Public Utility Commission

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ABOUT STRATA

Strata is a public policy research center in Logan, Utah, that seeks to help people make informed decisions about issues that impact the freedom to live their lives. We work to achieve more prosperous and free societies by conducting academic research on energy and environmental issues.¹ We draw from the collective academic strength and ideas from a strong network of academics and professionals across the world.



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¹ A statement on Strata's policies regarding research independence and integrity is available at: <http://www.strata.org/research-policy/>

Comments of Strata Policy

Strata Policy submits these reply comments pursuant to the Pennsylvania Public Utility Commission's (PUC) secretarial letter dated March 23, 2017 allowing reply comments to be submitted regarding the PUC's tentative order requesting information on alternative ratemaking methodologies by July 31, 2017. Strata Policy is a public policy research organization based in Logan, Utah, that uses public choice theory and constitutional political economy to evaluate the legal and economic ramifications of government actions, especially as they relate to energy and environmental policy. In these comments, Strata Policy expresses support for decoupling and offers additional information regarding specific benefits of decoupling in a state with restructured retail electric power markets.

Introduction

Decoupling is closely associated with proponents of energy conservation and advocates for distributed energy resources for good reasons. As has been carefully established in comments filed in this proceeding, standard ratemaking practices can create a bias for regulated utilities toward increasing system throughput. Such a bias naturally inclines the utility against customer efforts to reduce consumption from the grid, whether by efficiency efforts or by self-generation. We add here one more argument for decoupling, which is in effect a generalization of the views expressed with respect to energy efficiency and distributed energy resources.

Standard ratemaking practices give distribution utilities an indirect interest in the business plans of its customers, but in states such as Pennsylvania which have restructured the electric power industry to promote competition, the residual monopoly utility ought not play favorites among competitors. The Pennsylvania law implementing retail restructuring requires it to be implemented "in a manner that does not unreasonably discriminate against one customer class to the benefit of another."² This neutrality is best achieved by "quarantining the monopoly," which is to say fully isolating the monopoly elements from commercial interests in competitive sectors of the industry. While structural separation of the regulated utility from generation ownership and retailing is preferred (not required by Pennsylvania³), even with full separation the regulated utility will prefer some customer plans over others under traditional ratemaking practices.

² 66 PA Stat. § 2804(2)

³ 66 PA Stat. § 2804(5)

The Energy Efficiency View of Decoupling

Many commenters have argued for decoupling on the grounds that it removes a disincentive for utilities to encourage energy efficiency.⁴ This argument is fundamentally correct. By eliminating (or mitigating, in the case of partial decoupling) the throughput incentive, decoupling does in fact remove a disincentive for energy efficiency among utilities.⁵ Also pointed out in many submitted comments is that decoupling alone does not provide any positive incentive for energy efficiency.⁶ Given that Pennsylvania already includes a number of positive incentives through Act 129, this argument may be irrelevant--decoupling can complement already-existing efficiency programs.

Advocates for distributed energy resources have also endorsed decoupling on similar grounds. Consumer self-generation diminishes utility throughput just as efficiency improvements do--self-generated power is power no longer bought from the utility. Mr. Miller's testimony on behalf of the Keystone Energy Efficiency Alliance, Clean Air Council, and Natural Resources Defense Council speaks sensibly and comprehensively to this point.

Generalizing the Energy Efficiency View

The energy efficiency argument for decoupling is simply a special case of decoupling's effect: separating the utility's interests from the business models of grid users. While public utility commissions seek to set fair and just electricity rates, the information asymmetry between regulated utilities and the regulators allows some degree of utility influence over ratemaking procedures. The current ratemaking protocol incentivizes utilities to underestimate demand during the rate case proceeding and dial up throughput once the rate case is complete in order to boost returns on equity. Nothing short of a new rate case can counteract the ongoing collection of excess revenues, and nothing at all can currently be done to claw back excessive profits. Decoupling provides the tools to prevent these problems and additionally protects utilities from under recovery in case of overestimating sales. These points are made in ACEEE's comment, which says: "Utilities are protected from under recovery of revenues while customers are protected from over recovery. Revenue decoupling is a mechanism that alleviates utility concerns of

⁴ Comments making this argument include those of NEEP, KEEA, CAC, NRDC, AEE Institute, Sierra Club, PECO, and others.

⁵ Lazar, J., Weston, F., & Shirley, W. 2016. *Revenue Regulation and Decoupling: A Guide to Theory and Application*. Burlington, VT: Regulatory Assistance Project.

⁶ This is notably addressed by the comments of PECO and AEE Institute, among others.

revenue erosion and cost recovery.”⁷ By distancing utilities’ bottom line from sales, decoupling creates the conditions for accurate sales projections--the majority of required decoupling adjustments are very small.⁸

Some commenters have said that in light of Act 129’s strict and influential energy efficiency requirements, decoupling seeks to solve a problem that does not exist.⁹ This is only true when decoupling is seen myopically as an energy efficiency policy. Decoupling’s benefits should instead be seen more holistically as a way to divorce the regulated utility’s interest in the specifics of generators’, retailers’, and end-use customers’ plans.

Decoupling Bolsters Restructuring

“Quarantining the monopoly” is a phrase borrowed from the federal government’s antitrust case against AT&T, intended to identify the appropriate goal of the government in regulating natural monopolies. The phrase has since been used to describe what ought to be a central goal of electricity market restructuring: isolating the natural wires monopoly from the rest of the market.¹⁰ Restructuring has not succeeded in all states equally and, in large part, a state’s success is dependent on the state regulator’s ability to quarantine the monopoly.¹¹ Other states have experienced varying levels of success on this front. Pennsylvania stopped short of requiring full divestiture of transmission and distribution assets, but does require utilities holding those assets to make them publicly available.¹² Generally, Pennsylvania’s restructuring has been a moderate success.¹³

Decoupling fits comfortably within the principle of quarantining the monopoly and should further boost retail competition in Pennsylvania. In fact, energy efficiency programs without decoupling can worsen

⁷ Comment of ACEEE.

⁸ Morgan, P. 2013. *A Decade of Decoupling for US Energy Utilities: Rate Impacts, Designs, and Observations*. Graceful Systems, LLC.

⁹ See e.g. comments of IECPA, OCA, PSU, the Pennsylvania Law Project, and OSBA, among others.

¹⁰ Kiesling, L. 2014. “Incumbent Vertical Market Power, Experimentation, and Institutional Design in the Deregulating Electricity Industry.” *The Independent Review* 19(2): 239-264.

¹¹ Giberson, M. & Kiesling, L. 2016. *Vision for a clean, cheap, cutting-edge, customer-focused electric power business*. Working Paper. Earth Stewardship Alliance: Arlington, VA.

¹² 66 PA Stat. § 2804(5-6)

¹³ See e.g. Distributed Energy Financial Group LLC. 2015. *Annual Baseline Assessment of Choice in Canada and the United States*. Washington, DC: Distributed Energy Financial Group. or Kleit, A. N., Shcherbakova, A. V., & Chen, X. 2012. Restructuring and the retail residential market for power in Pennsylvania. *Energy Policy* 46:(443-451).

utilities' perverse incentive to underestimate sales projections. Decoupling eliminates the adversarial relationship between utilities and energy efficiency, distributed generation, and demand response.

Conclusion

Strata Policy appreciates the opportunity to publicly comment on this ongoing alternative ratemaking docket and is available for further information if it would assist the commission.