Testimony of David F. Ciarlone
On Behalf of the Industrial Energy Consumers of Pennsylvania
Before the Pennsylvania House Consumer Affairs Committee
House Bill 1782 – Alternative Rate Making

October 23, 2017

Good morning Chairman Godshall, Chairman Caltagirone and members of the House Consumer Affairs Committee. My name is David Ciarlone. I am here on behalf of the Industrial Energy Consumers of Pennsylvania (IECPA), of which I am a recent past President . We are a trade organization formed in 1982 by large energy-intensive customers with one or more facilities in Pennsylvania. Our 13 members spend more than $1 billion annually on natural gas and electricity and provide more than 41,000 good paying jobs in the Commonwealth. In my day job, I am Senior Manager, Energy and Carbon Strategy for Arconic, which operates three manufacturing plants in addition to corporate functions and a research and development facility in the Commonwealth.

We appreciate the opportunity to address HB1782 and explain our opposition.

We are pleased that, with your invitation to include IECPA in this discussion, the Committee recognizes manufacturing's crucial role in Pennsylvania's economy. As noted by the National Association of Manufacturers[1]:

- Manufacturing accounts for 12.35% of Pennsylvania's total gross output
- Manufacturing provides over 566,000 jobs within Pennsylvania, which is over 9.6% of the state's non-farm workforce.
- The average annual compensation for each of these jobs is $72,500, which is more than 39% higher than non-manufacturing jobs.
- The average annual contribution to Gross State Product for each of these jobs is $150,406.
- Manufacturing accounts for over 91% of Pennsylvania's exports.

Beyond these raw statistics, it would be useful to briefly share why our perspective differs from that of most energy consumers. We are Energy-Intensive, Trade-Exposed (EITE) businesses. "Energy-Intensive" means that very small changes in energy price multiply into very large changes in cost and operating income. "Trade-Exposed" means that we cannot pass cost increases on to our customers without the risk of losing that customer to one of our global competitors.

[1] National Association of Manufacturers, Pennsylvania Data Sheet, Revised March 2017 (attached)

As we have shared with this Committee in the past, our EITE nature demands that we assess all energy policy proposals using five criteria:

- Affordability is the measure by which our energy price compares favorably to the costs paid by our competition and sister facilities in other states. This is not limited to a simple comparison of energy costs. It includes consideration of the degree to which energy costs contribute to a competitive advantage in total cost of production.
- Reliability is important in three dimensions. First is our ability to maintain production schedules and customer retention by keeping our promises to our customers on delivery dates. Second is our ability to maintain our production facilities free of damage due to unscheduled disruptions in operations. Finally, and most important, is our ability to maintain a safe work place. Sudden, unplanned stoppages to operating equipment is extremely hazardous.
- Stability is important because our stakeholders demand financial results that do not vary wildly month to month. Energy prices that are not stable discourage investment in future projects.
- Predictability is important because our stakeholders need to trust that we can write long-term business plans on which we can reliably deliver. Unpredictable energy costs undermine the confidence in our long-term business plans, which also discourages investment in future projects.
- Sustainability has two dimensions. The first is our responsibility to be good stewards of the environment, while the second is our responsibility to the long-term success of our business and that of our suppliers. Maintaining focus on both of these dimensions require a focus and a commitment to the long-term.

It is from this perspective and by using these criteria that we oppose HB1782.

For reasons that we will explain, we oppose HB1782 on three different grounds:

1. The Bill is Overly Broad
2. The Bill Seeks to Put Utility Rates Beyond Reasonable Scrutiny
3. The Bill Aims to Protect the Utility at the Expense of its Customers

1. The Bill is Overly Broad

As drafted, it is difficult to understand what HB1782 is trying to accomplish and it is impossible to determine what it would cost. In less than four pages HB1782 lists five or six alternative ratemaking mechanisms – *three of which it defines for the first time*[2] – and authorizes the Public Utility Commission (PUC) to approve rates

[2] For example, HB1782 defines the term "distributed energy resource" so broadly that it could be almost any asset or practice that was not a baseload generation station owned by a utility affiliate.

that include any them either individually or in combination – and that's it. The sheer sweep of this Bill is breathtaking.

To its great credit, the PUC has invested a great deal of time and effort exploring the concepts and mechanisms of alternate ratemaking, and, one must infer, developing an extensive and detailed record. In docketing those hearings and for the subsequent filings, the PUC asked several specific questions to which it sought detailed answers. IECPA was pleased to share our views in detailed testimony delivered to an En Banc hearing of the PUC in 2016[3] (copy attached). Several other parties also contributed their own extensive testimony.

By way of example, *"decoupling"* was a key focus of the PUC's hearings. HB1782 provides a simple 5-line definition for the term "decoupling mechanism"[4]. An unbriefed member of the General Assembly would be excused for not being aware that this simple term contains a wide array of concepts and specific mechanisms; that each specific decoupling mechanism impacts different classes of customers in different ways; and that Pennsylvania's larger industrial customers are, for all intents and purposes, already "decoupled". We are concerned that an insufficiently defined "decoupling mechanism" could inadvertently create a situation in which costs could be allocated to industrial customers in violation of the principle of *'cost causation'*[5] and to the detriment of manufacturing in Pennsylvania.

We expect the PUC to have a great deal to say on the whole area of alternate ratemaking, including findings and recommendations. We also expect to participate in a robust discussion of those findings and recommendations once they are introduced to the General Assembly.

Contrary to this orderly process, HB1782 would preempt discussion and give the PUC authorities that it may not seek using terms in ways that it might not define. In this haste, HB1782 not only puts the cart before the horse, it denies itself the benefit of the thorough record being developed by the PUC. The General Assembly should resist a rush to legislation with vaguely defined mechanisms and indeterminate customer costs. We should wait for the PUC.

2. <u>The Bill Seeks to Put Utility Rates Beyond Reasonable Scrutiny</u>

In addition to the decoupling mechanism, discussed above, HB1782 introduces Pennsylvania to four other ratemaking mechanisms[6]:

- Performance-based rates;
- Formula rates;

[3] Industrial Energy Consumers of Pennsylvania, Testimony to Pennsylvania Public Utility Commission *En Banc* Hearing on Alternate Rate Making Methodologies, February 25, 2016
[4] House Bill 1782, Printer's No. 2418, Page 3, lines 16-2
[5] 'Cost Causation' is a common term in ratemaking meaning simply that the person who causes or benefits from a cost should pay that cost.
[6] House Bill 1782, Printer's No. 2418, listed on Page 2, lines 21-26 and defined on pages 3 and 4.

- Multi-year rate plans; and
- "cost-recovery mechanisms and rates to support and fully recover the allocated costs to deploy infrastructure and distributed energy resources"

All four of these mechanisms share a common consequence: they would increase the distance between utility distribution rates and reasonable scrutiny by the PUC.

The fourth of these mechanisms is not even a mechanism. In keeping with the general lack of specificity of HB1782, it is an entire category of undefined mechanisms.

"*Performance-based rates*" mechanisms are particularly out of place in 2017. The idea of awarding higher returns to utilities that keep their social contract is contrary to the present flow of events in which large energy companies, who were once regulated utilities, are abandoning their various troubled merchant businesses for the safety of regulated cost-based rates.

Both "*formula rates*" and "*multi-year rate plans*" create the risk of single-issue ratemaking. Single-issue ratemaking is a practice that state commissions usually try to avoid. Single-issue ratemaking adjusts rates by looking at only one or a small number of cost inputs while deliberately sidestepping the comprehensive assessment provided by a rate case. Our experience shows that because they measure only a small number of carefully selected inputs, these exercises almost always result in rate increases, even in cases where costs and conditions across the utility's entire business would justify a rate decrease.

We frequently hear utilities offering to spare us the trouble and cost of rate cases, but the facts do not reveal these offers as being particularly generous. A rate case is actually a straightforward matter of totaling assets, expenses and customers, setting a fair return on the assets and allocating the costs among the customers. The great complexity of most rate cases can be directly related to the passage of long periods of time since the last rate case. We contend that more frequent rate cases would result in less complex, less onerous and less costly rate cases. Further, with respect to the cost of rate cases, the utilities' complaints are empty because, in the end, it is only the customers who bear those costs. As the largest customers and, hence, the largest bearer of those costs, IECPA believes that the transparency and discipline imposed upon a utility by an appropriately skeptical PUC is well worth the cost of the routine rate case every few years or so. On the other hand, our experience has shown that a utility that believes it is under-earning its allowed rate of return is most eager to file a new rate case.

It is for these reasons that the General Assembly should resist HB1782 and the insufficiently controlled utility rates that would be the inevitable consequence of incorporating such loosely defined ratemaking mechanisms into statute.

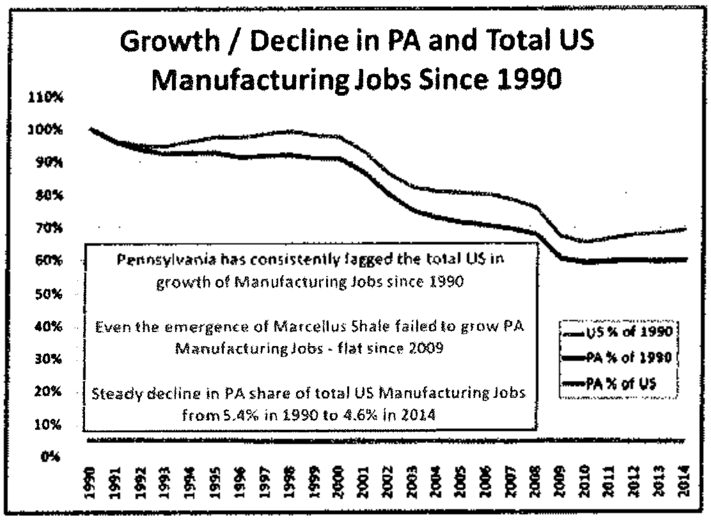
3. The Bill Aims to Protect the Utility at the Expense of its Customers

If passed into law, HB1782 would be one more step down the path leading away from the basic social compact of utility regulation. Public utilities are created and authorized as state-sanctioned monopolies to provide a service that a market cannot efficiently provide. The role of regulation and state regulatory commissions is to protect the customers (ratepayers) from the monopoly. Too often, in recent years, legislative assemblies in many states have passed well-intended laws that function to protect the utility from the ratepayer. With its focus on the wellbeing of the utility, HB1728 represents a continuation of this trend.

Our policy principle of "Sustainability" (described above) drives IECPA to ensure that all our suppliers – including our utilities – operate businesses with returns sufficient to assure their efficient operation far into the future. We seek only a fair bargain. We believe that our utilities should recover all their prudently incurred costs while earning a fair return on their invested capital, but not one dollar more. The vague language of HB1782 does not give ratepayers the tools we need at the PUC keep the bargain fair.

Some Alternative Suggestions

It is beyond debate that growth manufacturing and advanced manufacturing jobs is essential to a widely shared, sustained prosperity. Leaders across the country repeat this fact so frequently that it is almost a mantra. As the National Association of Manufacturing (NAM) statistics shared above prove, a Pennsylvanian with a manufacturing job will, on average, earn over 39% more than his or her neighbor in a non-manufacturing job.



Yet, despite Pennsylvania's heritage as the cradle of the steel, aluminum and many other industries, and despite our leading role in advanced manufacturing R&D, manufacturing job growth in our state has consistently lagged the rest of the country. As the chart shows[7], since 1990, Pennsylvania's decline in manufacturing jobs is 10% greater than the United States as a whole. Even as the "shale boom"

[7] This chart, which was provided as part of the above cited testimony to the PUC, as well as previous testimony to this Committee, is based upon data from the US Bureau of Labor Statistics.

has been driving manufacturing growth elsewhere, manufacturing jobs in the state that is literally sitting on top of the Marcellus have been flat since 2009.

It is also beyond debate that energy costs have a huge impact on how effectively EITE businesses, like ours, can compete in national and global markets. Pennsylvania manufacturing, like all of US manufacturing, faces global competition that does not always share the same commitment to fair labor, safety and environmental compliance that increase our costs. Energy is often the only large production input capable of creating a competitive advantage strong enough to counter some of these headwinds. This underscores the care that the Commonwealth must take in shaping policies that determine how we allocate energy costs, particularly to our EITE businesses.

Hence, it is regrettable that there are so many examples of these considerations being overlooked by those shaping Pennsylvania's energy policy. According to US Department of Energy data, Pennsylvania ranked an undistinguished 26th in average industrial electricity rates in 2016[8]. (Ranking among 50 states and D.C.)

It is even more regrettable because this does not need to be so. Pennsylvania burdens, or threatens to burden, its industrial customers with many significant, extra charges:

- PA Act 129 (2008) compels utilities to include all customers, even large industrial customers with sophisticated, mature energy efficiency programs, in their Energy Efficiency and Conservation Programs[9].
- Distribution System Improvement Charges (DSIC) are multiplying despite the controls and caps imposed upon them by PA Act 11[10] of 2012.
- Gross Receipts Taxes, collected on the energy bill, is a threat that is often seen looming on the horizon when people seek new sources of revenue.
- Microgrids and similar initiatives, which could be beneficial, appear in legislation that does not specify scope or cost.
- Nuclear price supports (subsidies or bailouts depending upon one's perspective) now comprise the latest and largest threat to energy costs that will be paid by Pennsylvania's manufacturers. If the goal is saving a few thousand good jobs we should not put 566,000 equally good jobs at risk.

Higher costs and/or the threat of higher costs, as advanced by HB1782, discourage the investment needed to grow manufacturing jobs. The aggregate data is clear enough. Businesses that can grow elsewhere have and will continue to elect to do so. They will do so quietly, and we may not know until it is too late.

[8] US Energy Information Administration, Electricity Data Browser, October 2017.
[9] PA Senate Bill 805 (Boscola), Introduced October 19, 2017 seeks to mitigate this burden.
[10] PA Act 11 (2012)

It is not wrong for HB1782 to focus on the health of utilities, but healthy utilities require successful industrial customers. The uncertainty introduced by HB1782 is counterproductive. If Pennsylvania is serious about retaining and growing jobs in manufacturing and advanced manufacturing, we need to stop pancaking additional costs on industrial rates that are already uncompetitive.

Therefore, we suggest that when HB1782 is re-drafted, we re-balance its impact to better serve Pennsylvania's broader aspirations by adding a new public interest finding and a new policy statement.

- In addition to a finding that it is in the public interest to safeguard the utilities, we suggest a finding that it is in the public interest to foster widespread prosperity with an expanding middle class by actively encouraging the growth of family-sustaining jobs in manufacturing and advance manufacturing.

- In addition to a policy statement narrowly focused on energy infrastructure, which is needed, we suggest a more expansive policy to ensure that Pennsylvania's industrial energy rates are at par of better than the country's top manufacturing states with whom we intend to compete and surpass.

Conclusion

We respectfully request that this Committee not move this bill from Committee for consideration by the entire House.

We again express our appreciation for the opportunity to share our views and we look forward to our continued engagement with this Committee in developing innovative energy policy solutions for Pennsylvania that helps grow the sustainably prosperous economy that we all want.

Thank you for your time and consideration. We look forward to answering any questions you may have.