

**PENNSYLVANIA HOUSE OF REPRESENTATIVES
HOUSE CONSUMER AFFAIRS COMMITTEE**

HEARING - HOUSE BILL 1782

**TESTIMONY OF
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Good morning, Chairman Godshall, Chairman Caítagirone, and distinguished members of the House Consumer Affairs Committee. And, good morning as well, to my esteemed colleagues from the Office of Consumer Advocate (“OCA”), the Public Utility Commission (“PUC”), the participating utility companies, and other interested stakeholders.

As many of you know, my name is John Evans, and I am the Small Business Advocate for the Office of Small Business Advocate (“OSBA”). Here with me today is Elizabeth Rose Triscari, Deputy Small Business Advocate. Thank you for inviting us to testify before this Committee regarding House Bill 1782. The OSBA is charged with representing the interests of Pennsylvania’s small business consumer class in proceedings that come before the Pennsylvania Public Utility Commission (“PUC”), any comparable federal regulatory agencies, and in the courts.

Part of the OSBA’s ongoing mission is to ensure that our small businesses, so crucial to the Commonwealth’s economy, pay reasonable rates for safe and reliable utility service. As such, the OSBA has significant concerns with HB 1782 in its current form, and the effect it will have on utility rates.

The OSBA agrees with HB 1782’s declaration of policy in that it recognizes that it is in the public interest for the PUC to approve “just and reasonable rates and rate mechanisms” and “that utility ratemaking should encourage and sustain investment in natural gas and electric distribution systems through appropriate cost-recovery mechanisms to enhance the safety, security, reliability or availability of natural gas and electric infrastructure.”

However, the OSBA notes that the alternative rates and rate mechanisms proposed appear to be intended to provide utilities with greater revenue stability and/or an enhanced revenue stream between base rate proceedings. While the formal adoption of such alternatives would

provide obvious benefits to utilities, it is unclear how ratepayers might benefit from such proposals. Pennsylvania utilities already receive significant revenue stability and/or cost recovery benefits from the Commonwealth's existing regulatory paradigm. As such, the General Assembly should carefully weigh the potential benefits to be received by utilities versus ratepayers before adopting changes to that paradigm. In the OSBA's view, HB 1782's ratemaking alternatives are deficient in that they would provide only one-sided benefits to utilities at the expense of ratepayers. We will discuss each mechanism below.

1) Decoupling Mechanisms

a. Revenue Decoupling Shifts Risk to Consumers

The OSBA has concerns with granting broad authority to the PUC to establish alternative rates and rate mechanisms, in addition to those already enjoyed by utility companies.

Pennsylvania utilities already benefit from many alternative ratemaking approaches including:

1) guaranteed cost recovery associated with any number of approved cost tracking / recovery mechanisms; 2) the ability to employ a distribution system improvement charge ("DSIC") between base rate cases; and 3) permission to use a fully projected future test year in a base rate proceeding. All of these ratemaking approaches act to reduce a utility's earnings risk. However, certain alternative rate mechanisms, such as revenue decoupling, would further reduce risk by eliminating perhaps the single largest risk that remains for a utility, namely, the business risk associated with sales variability. In simplest terms, a revenue decoupling mechanism tracks actual versus authorized revenue collections between base rates cases and adjusts rates, as needed, so as to ensure a utility fully recovers its authorized revenue requirement.

A utility's sales will vary between base rate cases due to a number of factors, such as: 1) consumers' conservation efforts; 2) weather; 3) changes in economic conditions and technology;

and 4) changes in the price of electricity/natural gas. If utility margins are fully decoupled from sales, the utility will be insulated from the impact of *all* of the above sources of sales (revenue) variability between base rate cases. Put simply, revenue decoupling would eliminate a utility's business risk as it relates to revenue variability and shift that risk to consumers.

Moreover, because the underlying long-term trend in average use per customer, even independent of conservation, is generally considered to be flat (at best) or declining, revenue decoupling will produce more rate increases than decreases for ratepayers between base rate cases. Therefore, the OSBA recommends that if the PUC is statutorily granted the authority to approve revenue decoupling for any of Pennsylvania's fixed utilities, such grant of authority should also include a directive to implement a commensurate reduction in a utility's allowed return on equity ("ROE") due to the fact that revenue decoupling would completely eliminate the business risk associated with sales variability. Even PECO has acknowledged that revenue decoupling protects utilities against revenue losses.¹ The OSBA maintains that any protection against revenue losses is equivalent to a reduction in a utility's business risk and should be paired with a commensurate reduction in a utility's allowed ROE.

b. Revenue Decoupling and Energy Efficiency

Revenue decoupling not only eliminates risk for the utility, it shifts that risk to and among ratepayers. The primary focus of alternative ratemaking mechanisms such as revenue decoupling is the "throughput incentive" inherent in "standard" utility ratemaking practices. To the extent that a utility's margins are positively related to sales volumes (or throughput), a utility has an incentive to promote additional sales or, equivalently, to oppose implementation of energy

¹ *Comments of PECO Energy Company on Alternative Ratemaking Methodologies*, Pa. P.U.C. Docket No. M-2015-2518883 at p. 7.

efficiency or conservation programs. A primary purpose of revenue decoupling is to break the “link” between throughput and margins, so that a utility no longer has a reason to promote sales and/or oppose conservation programs.

In the OSBA’s view, a relevant question when considering alternative ratemaking is whether utility incentives are misaligned (vis-à-vis the implementation of energy efficiency programs) in Pennsylvania? At least with respect to electric distribution companies (“EDCs”), the OSBA submits the answer is “no.”

Act 129 requires EDCs to develop a comprehensive energy efficiency/conservation plan to meet Pennsylvania’s conservation goals. That plan must include specific programs for each rate class. Moreover, EDCs are subject to significant penalties if conservation goals are not met, which provide powerful motivation to implement energy efficiency programs.

According to the Energy Association of Pennsylvania (“EAP”), total EDC spending on Act 129 energy efficiency programs makes Pennsylvania rank as the fifth largest state in energy efficiency spending in the nation.² In short, Act 129 effectively aligns electric utility incentives so as to meet the Commonwealth’s energy efficiency goals. PECO has admitted that “a decoupling mechanism [or lost revenue adjustment mechanism] would likely not affect existing EE&C plans” since an EDC’s mandatory targets and spending limitations would remain in place.³ An equivalent statutory requirement could be developed for Pennsylvania’s gas industry, if deemed appropriate.

² Testimony of T. Fitzpatrick before the Pennsylvania House Consumer Affairs Committee on September 1, 2015, on behalf of EAP.

³ *Comments of PECO Energy Company on Alternative Ratemaking Methodologies*, Pa. P.U.C. Docket No. M-2015-2518883 at p. 8.

In addition, the OSBA is concerned that HB 1782, at least with respect to EDCs, is inconsistent with Sections (K)(2) and (K)(3) of Act 129, which read as follows:

- (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).

Act 129 clearly prohibits an EDC from recovering decreased revenues on a retroactive basis via any reconcilable automatic adjustment clause, such as a revenue decoupling mechanism. Therefore, in order to implement revenue decoupling in Pennsylvania, Section (K)(2) of Act 129 must be amended or superseded. It is unclear whether the current language of HB 1782 intends to accomplish that.

Regardless, even if statutory barriers are removed, revenue decoupling is not effective in increasing incentives for customers to participate in energy efficiency programs. Under the revenue-per-customer decoupling model, all required rate adjustments are typically made on a rate class basis. In other words, there is no shifting of revenue responsibility between rate classes. However, intraclass cost shifting will occur. From a rate class perspective, there are no truly avoidable distribution service charges under revenue decoupling, *i.e.*, a class's distribution service revenue requirement is a zero-sum game. Therefore, by definition, revenue decoupling will shift revenue/cost responsibility among customers in a given rate class.

To the extent that a revenue decoupling based rate design incorporates higher kWh (avoidable) charges and lower fixed (unavoidable) charges than otherwise in place, customers would see an apparent increase in the monthly payback associated with adopting energy

efficiency measures. All else equal, therefore, one would expect customers to have a greater incentive to participate in conservation programs. However, as discussed above, there are no truly avoidable distribution service charges under revenue decoupling. Therefore, one must conclude any such distribution-related incentive effects are illusory and misplaced, since they are only made possible from the cross-subsidies provided by other ratepayers in a given rate class.

2) Performance-Based Rates

Similar to revenue decoupling, performance incentive mechanisms are unnecessary with respect to the electric industry where Act 129 already creates utility incentives to implement energy efficiency programs in Pennsylvania and imposes strict penalties for not meeting conservation goals. Such mechanisms are perhaps more appropriately considered in the natural gas arena. However, any implementation of a performance-based rate should be coupled with a PUC-approved, utility specific, energy efficiency or conservation program/plan so as to facilitate an after-the-fact evaluation of whether a utility has performed in a manner that warrants a higher allowed ROE.

With regard to select performance incentives, the OSBA also recommends that such incentives be symmetric in nature, *i.e.*, utilities should be subject to an equivalent penalty for failure to attain a specific performance target, not just rewarded for exceeding that target.

3) Formula Rates

An expansion in the use of formula-based ratemaking, like that used by FERC, to distribution service would undermine the Commonwealth's traditional ratemaking review process, which is essential for determining whether a utility's distribution rates are just and reasonable. As such, the OSBA recommends that the General Assembly reject any expansion in the use of formula ratemaking.

4) Multi-Year Rate Plans

All else equal, multi-year rate plans will reduce the frequency of rate case filings.

However, the DSIC, in combination with authorization to choose a fully projected future test year ("FPFTY"), has effectively eliminated the need for "annual" rate filings in the Commonwealth. With Act 11 and the implementation of the DSIC, Pennsylvania utilities are effectively already permitted to implement, and benefit from, a multi-year rate plan. The DSIC allows a utility to automatically adjust rates to recover the cost of DSIC-eligible capital improvements between base rate cases, or beyond the end of the FPFTY period. This extension of cost recovery beyond the future test year period is equivalent to a multiyear rate plan that permits the recovery of certain anticipated costs not recovered in current rates.

As such, utilities now typically file rate cases on a three-year (or longer) cycle. While it may be possible to extend that cycle to five years, it is far from clear that the cost to achieve such an extension, in the form of pre-approved annual rate increases, presents a worthwhile tradeoff for ratepayers.

5) Cost-Recovery Mechanisms And Rates To Support and Fully Recover The Allocated Costs To Deploy Infrastructure And Distributed Energy Resources

The Commonwealth already permits electric and natural gas utilities a return on (and of) their prudently incurred costs of providing safe and reliable distribution service. In addition, Act 129 permits electric utilities to recover 100% of the costs of their Commission-approved energy efficiency programs. To the extent that Act 129 does not expressly authorize natural gas utilities to recover the costs of any Commission-approved energy efficiency programs, the OSBA agrees that such formal authorization should be granted.

The OSBA notes, however, that HB 1782 goes much further by broadly defining "distributed energy resources" to include energy storage and alternative fuel technologies. As

such, HB 1782 would appear to authorize utilities to recover the full cost of their investment in, say, alternative fueling stations or battery technology. The OSBA respectfully submits that the Commonwealth should rely upon the private sector, rather than public utilities, to develop and implement such technologies. Regulatory policy should focus on ensuring that public utilities provide safe and reliable distribution service to ratepayers at the lowest possible cost. Any authorized change to utilities' underlying business model, such as that contained in HB 1782, could hinder the achievement of that outcome.

Thank you for your time and attention. The OSBA appreciates this opportunity to testify today on the impact House Bill 1782 will have on Pennsylvania's small business ratepayers. We welcome any questions or comments you may have.

Respectfully submitted,

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