Before the House Consumer Affairs Committee

Hearing on House Bill 1782--
Alternative Ratemaking for Electric And Natural Gas Distribution Companies

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Testimony of

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Good morning Chairman Godshall, Chairman Caltagirone and members of the House Consumer Affairs Committee. I am Terry Fitzpatrick, President and CEO of the Energy Association of Pennsylvania ("EAP" or "Association"), a trade association comprised of electric and natural gas utilities—also known as distribution companies—operating in Pennsylvania. Thank you for this opportunity to appear on behalf of our members[1] and testify regarding House Bill 1782, which addresses alternative ratemaking for electric and natural gas utilities.

House Bill 1782 would clarify the authority of the Public Utility Commission ("PUC") to approve proposals by electric and gas utilities to establish alternative forms of rates. Currently, utilities recover a majority of the costs of their distribution systems through usage-based (aka, "volumetric") charges even though most of the costs of these systems are fixed—that is, they do not vary with usage. This longstanding, traditional method of cost recovery came into use in the previous century at a time when energy usage grew along with the economy. The growth in energy usage coupled with volumetric rates helped to maintain stable funding for electric and gas distribution systems and minimized the need for utilities to file frequent, time-consuming, costly general rate increases.

Over the past few decades, however, the link between growth of the economy and energy usage has weakened. Changes in the economy, technology, and government policy have contributed to this trend. In the home, improved insulation and more efficient appliances have reduced energy use even as the size of homes and the number of electronic devices used in them has increased. To cite two examples, since 1980 the energy use of new clothes washers has declined by more than 70% and the energy use of new homes per square foot has

[1] EAP members include: Citizens' Electric Company; Columbia Gas of Pennsylvania, Inc.; Duquesne Light Company; Leatherstocking Gas Company, LLC; Metropolitan Edison Company; National Fuel Gas Distribution Corp.; PECO Energy Company; Pennsylvania Electric Company; Pennsylvania Power Company; Peoples Natural Gas Company LLC; Peoples Gas Company (formerly Peoples TWP); Philadelphia Gas Works; Pike County Light & Power Company; PPL Electric Utilities; UGI Central Penn Gas; UGI Penn Natural Gas; UGI Utilities, Inc.; Valley Energy Inc.; Wellsboro Electric Company; and West Penn Power Company.

declined by nearly 20%.[2] In the electric industry, the development of new technologies along with government policies mandating and subsidizing energy efficiency and subsidizing the growth of customer-owned generation have further contributed to the trend.

The impact of all of these changes has been to reduce sales of electricity and natural gas. Data compiled by the federal Energy Information Administration supports this claim:

- The amount of natural gas used per customer fell in sixteen of nineteen years between 1990 and 2009; the total reduction in usage during that time was 22%.[3]
- Electricity sales fell 1.1% in 2015, marking the fifth time in the past six years that these sales have fallen.[4]

Here in Pennsylvania, the PUC projects that total electricity usage will decline at an annual rate of .1% over the next few years.[5]

Clearly, circumstances have changed and electric and natural gas utilities can no longer count on growth in sales to help maintain stable revenue to cover the costs of their distribution systems. These changed circumstances call for changed policies.

House Bill 1782 answers this need by authorizing utilities to seek PUC approval of alternative rates and rate mechanisms, including:

- Decoupling mechanisms, which adjust or reconcile distribution rates for differences between sales projections used to set rates and actual sales.
- Performance-based rates, under which rates are set or adjusted based upon a utility's operating or financial performance.
- Formula rates, which are adjusted periodically based upon a predetermined formula without the need for a full base rate proceeding.

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2 American Council for an Energy Efficient Economy, *Energy Efficiency in the United States: 35 Years and Counting* (2015), p. vi.
3 *Trends in U.S. Residential Natural Gas Consumption*. Energy Information Administration, Office of Oil and Gas, June 2010.
4 EIA, *Today in Energy*, March 14, 2016.
5 *Electric Power Outlook for Pennsylvania 2015-2020.*

- Multi-year rate plans, under which rates are set for a multi-year period and which may include an adjustment for inflation.
- Mechanisms and rates to recover costs to deploy infrastructure and distributed energy resources, which would allow utilities to respond to new technologies that impact their distributions systems.

These innovative mechanisms are in use in many other states and they address the problem of over-reliance on volumetric rates. Pennsylvania is in the minority in that it has not applied any of these methods. For example, Pennsylvania is one of only fourteen states that has not approved revenue decoupling or another form of non-volumetric rate design for the natural gas industry.[6] Alternative ratemaking can also remove the current financial disincentive for utilities to promote energy conservation among customers.

Pennsylvania has enacted other policies to modernize the utility ratemaking process. In particular, Act 11 of 2012 authorized utilities to implement a distribution system improvement charge and make use of a fully projected future test year in rate cases. These innovative policies have been successful and stimulated greater investment in utility distribution systems. House Bill 1782 would build on this previous work and further modernize ratemaking in Pennsylvania by lowering reliance on volumetric rates to recover costs of utility distribution systems.

There are three other points I wish to make regarding this legislation. First, I have characterized the bill as "clarifying" the authority of the PUC to approve alternative rates and mechanisms. That's because I view the Commission's current authority to set "just and reasonable" rates[7] as a flexible standard that allows new ratemaking methods as circumstances change. Some other parties view the issue differently. The PUC has opened a proceeding to

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[6] *Innovative Rates, Non-Volumetric Rates, and Tracking Mechanisms: Current List.* American Gas Association. December 2016.

[7] 66 PaCS Sec. 1301

examine its policies on alternative ratemaking,[8] and some parties have filed comments arguing that court decisions interpreting the current statute preclude the PUC from approving new mechanisms such as decoupling. Accordingly, even if the PUC were to authorize alternative rate mechanisms, its decisions could be subjected to legal challenges that may take years to resolve. This creates financial uncertainty that undermines the goal of securing stable funding for utility distribution systems. Passage of HB 1782 would eliminate this uncertainty.

Related to the above point, subsection (c) of HB 1782 is entitled "Construction" and provides that nothing in the section should be construed as limiting the PUC's current authority or as invalidating any rate mechanisms approved previously. This is important language as the PUC has approved some mechanisms, such as weather normalization adjustments for certain gas utilities, and this legislation should not be viewed as calling the legality of these mechanisms into question.

Second, the process in the legislation for consideration of applications for alternative ratemaking is designed to assure that all affected parties will have an opportunity to be heard and that decisions on the applications will be in the public interest. Under the process set forth in the bill, utilities must initiate consideration of alternative rates and mechanisms by filing an application in the context of a base rate proceeding. This process involves formal hearings before an administrative law judge and parties have the right to conduct discovery, submit testimony, cross-examine witnesses, and file briefs. At the end of the process, the PUC "may approve" alternative rates and mechanisms only if the evidence supports that determination.

Finally, it is important that HB 1782 does not mandate any form of alternative ratemaking; instead, it provides utilities with the flexibility to seek alternative rates and mechanisms that are appropriate in light of their circumstances. Pennsylvania is a diverse state containing rural and urban areas, differing economic circumstances, and customer bases

[8] *Alternative Ratemaking Methodologies*, Docket No. M-2015-2518883.

reflecting different demographics. The utilities that serve customers here reflect that diversity, and a one-size-fits-all policy on alternative ratemaking would not serve the public interest. Several parties made this point in the PUC's alternative ratemaking proceeding and supported providing flexibility to utilities to make proposals that reflected their individual circumstances.

Thank you for the opportunity to testify, and I would be happy to answer your questions.