



COMMONWEALTH OF PENNSYLVANIA

May 31, 2017

E-FILED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
PO Box 3265
Harrisburg, PA 17105-3265

**Re: Alternative Ratemaking Methodologies
Docket No. M-2015-2518883**

Dear Secretary Chiavetta:

I am delivering today for filing the Comments of the Office of Small Business Advocate to the March 2, 2017 Tentative Order on Alternative Ratemaking Methodologies, at the above-docketed proceeding.

If you have any questions, please feel free to contact me directly.

Sincerely,

A handwritten signature in blue ink, appearing to read "Elizabeth Rose Triscari".

Elizabeth Rose Triscari
Deputy Small Business Advocate
Attorney ID #306921

Enclosures:

Cc: Mr. Brian Kalcic
Kriss Brown, PUC Law Bureau
Marissa Boyle, PUC Bureau of Technical Utility Services
Andrew Herster, PUC Bureau of Technical Utility Services

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Alternative Ratemaking Methodologies : Docket No. M-2015-2518883

COMMENTS OF THE OFFICE OF SMALL BUSINESS ADVOCATE
ON TENTATIVE ORDER

I. INTRODUCTION

On December 31, 2015, the Secretary of the Pennsylvania Public Utility Commission (“Commission”) issued a Secretarial Letter noticing an *En Banc* Hearing on Alternative Ratemaking Methodologies on March 3, 2016 (“Secretarial Letter”). The Secretarial Letter outlined three rate issues to be covered at the hearing: (1) whether revenue decoupling or other similar rate mechanisms encourage energy utilities to better implement energy efficiency and conservation programs; (2) whether such rate mechanisms are just and reasonable and in the public interest; and (3) whether the benefits of implementing such rate mechanisms outweigh any costs associated with implementing the rate mechanisms. The Secretarial Letter also listed several topics to guide this discussion.

The following persons and/or organizations were invited to submit written testimony and appear at the *en banc* hearing: Eric Ackerman of Edison Electric Institute, Mark Newton Lowry, PhD of Pacific Economics Group, Peter H. Kind of Energy Infrastructure Advocates LLC, Richard Sedano of the Regulatory Assistance Project, Kyle Rogers of the American Gas Association, Maureen Mulligan of the Keystone Energy Efficiency Alliance, Scott R. Koch of PPL Electric Utilities Corporation, Mark Balmert of NiSource Corporate Services Company, Tanya J. McCloskey of the Pennsylvania Office of Consumer Advocate, Frances

Mansberger of the Industrial Energy Consumers of Pennsylvania, and Hugh Gilbert Peach, PhD of H. Gil Peach and Associates.

The Secretarial Letter also provided for other interested parties to submit written comments following the *en banc* hearing. The OSBA and many other interested stakeholders submitted comments on March 16, 2016.

On March 2, 2017, the Commission issued a Tentative Order continuing and expanding the investigation by seeking comments on specific alternative ratemaking (and rate design) methodologies for the electric, natural gas, and water and wastewater utility industries. The OSBA thanks the Commission for the opportunity to submit the following comments.

II. COMMENTS

The utility ratemaking process typically involves three distinct phases: Phase 1) the determination of the utility's overall (allowed) revenue requirement; Phase 2) the allocation of the allowed revenue requirement to the utility's individual rate classes; and Phase 3) the implementation of the approved class revenue allocation, *i.e.*, designing a set of rates that recover assigned class revenues. Correspondingly, each phase of the utility ratemaking process presents a unique set of questions and/or issues.

Upon review, the alternative rate methodologies discussed in the Tentative Order fall into two distinct groups: 1) those related to the revenue requirement phase of the ratemaking process ("Phase 1")¹; and those related to the rate design phase of the ratemaking process ("Phase 3")².

¹ In order of appearance in the Tentative Order, the Phase 1 alternatives include: A. Revenue Decoupling; B. Lost Revenue Adjustment Mechanism (LRA); D. Cost Trackers; E. Choice of Test Years; F. Multiyear Rate Plans; and I. DSM Performance Incentive Mechanism.

² The Phase 3 alternatives include: C. Straight Fixed/Variable (SFV) Pricing; G. Demand Charges; and H. Standby and Backup Charges.

In the discussion that follows, the OSBA will first comment on the (Phase 1) *ratemaking* alternatives contained in the Tentative Order, followed by a discussion of suggested (Phase 3) *rate design* alternatives.

A. Ratemaking Alternatives

1. Revenue Decoupling

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 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.

Revenue decoupling may be implemented on a limited, full or partial basis. *Limited* decoupling permits rate adjustments for one or more (but not all factors) that may impact utility sales between base rate cases. *Full* decoupling permits rate adjustments for all factors that impact utility sales, and *partial* decoupling limits a utility’s permissible rate adjustment to something less than 100% of the otherwise permissible limited or full rate adjustment. Limited decoupling necessitates that utilities isolate the impact of permissible sales adjustments from non-permissible factors, which greatly complicates the calculations needed to adjust rates. In the OSBA’s view, some level of partial decoupling would be preferable to limited decoupling as the rate adjustment process would be much more transparent.

As the OSBA explained in its previous comments at this docket, when considering revenue decoupling, a relevant question 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. Such penalties act as a significant incentive to implement energy efficiency programs. According to the Energy Association of Pennsylvania (“EAP”), as a result of EDC spending on Act 129 energy efficiency programs, Pennsylvania rank as the fifth largest state in energy efficiency spending in the nation.³ In short, Act 129 effectively aligns utility incentives so as to meet the Commonwealth’s energy efficiency goals.

Revenue decoupling could be deemed appropriate in Pennsylvania’s natural gas and/or water and wastewater industries, which do not have an equivalent statutory requirement. With respect to natural gas and water/wastewater, there also does not exist the statutory barrier to revenue decoupling that exists under Act 129 for the electric industry. 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.⁴ Therefore, in order to

³ Testimony of T. Fitzpatrick before the Pennsylvania House Consumer Affairs Committee on September 1, 2015, on behalf of EAP.

⁴ 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. However, Sections (K)(2) and (K)(3) of Act 129 reads 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).

implement revenue decoupling in Pennsylvania for the electric industry, Act 129 would need to be amended.

However, if full revenue decoupling were to be approved for any of Pennsylvania's fixed utility industries, the Commission should implement a commensurate reduction in each utilities' allowed return on equity ("ROE"), because it would completely eliminate perhaps the single largest risk that remains for a utility, namely, the business risk associated with sales variability. 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 4) changes in the price of electricity. If 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.

Revenue decoupling not only eliminates risk for the utility, it shifts that risk to and among ratepayers. If the underlying long-term trend in average use per customer, independent of conservation, is declining, then revenue decoupling would produce more rate increases than decreases for ratepayers between base rate cases. Since the long-term trend in electricity sales is generally considered to be flat (at best) or declining, the OSBA concludes that revenue decoupling will produce more rate increases than decreases for ratepayers between base rate cases.

Moreover, 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.

From a public policy perspective, such a shifting of risk from utilities to ratepayers could potentially be offset by the benefits of conservation. However, revenue decoupling is not

effective in promoting conservation, at least with respect to the restructured electric and gas industries, where revenue decoupling only addresses the distribution service portion of a customer's bill. To the extent that a revenue decoupling based rate design incorporates higher commodity (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 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.

In summary, the statutory barrier of Act 129 prevents revenue decoupling from being appropriate in the electric industry. Full or partial revenue decoupling are not statutorily barred from being implemented in the natural gas and water/wastewater industries. However, either form of decoupling would shift significant risk from utilities to ratepayers and should result in the Commission's commensurate reduction in a utilities' allowed return on equity.

2. Lost Revenue Adjustment (LRA) Mechanism

Similar to limited revenue decoupling, the LRA mechanism compensates a utility for revenue loss from specific causes. However, as discussed above, Act 129 specifically prohibits an LRA in the case of lost revenues that result from required energy efficiency and conservation measures in the electric industry. Moreover, as in the case of limited revenue decoupling, the LRA calculations required to isolate the revenue impact associated with specific (permissible) causes are likely to be controversial. Consequently, the OSBA does not support the

implementation of an LRA mechanism. However, as with revenue decoupling, if implemented, the LRA mechanism should be coupled with a commensurate reduction in allowed ROE.

3. Cost Trackers

Cost trackers, commonly called surcharges or riders, provide for guaranteed cost recovery for specific expenses incurred between base rate cases. Cost trackers are already used extensively by utilities in the Commonwealth and are just one of the many alternative ratemaking approaches Pennsylvania utilities employ to reduce earnings risk. For example, EDCs commonly employ the following margin (as opposed to default service) related cost trackers: 1) State Tax Adjustment Surcharge (“STAS”); 2) Universal Service Cost (“USC”) Rider; 3) Transmission Service Charge (“TSC”); 4) Energy Efficiency and Conservation Charge Rider; 5) Smart Meter Technology Cost Rider; 6) Consumer Education Cost Rider; and 7) Distribution Service Improvement Charge Rider (“DSIC”). Natural gas distribution company tariffs typically include a STAS, USC, DSIC and consumer education cost riders. Finally, water utility tariffs may include a Pennvest Surcharge cost tracker, in addition to the STAS and DSIC riders. In addition, Act 11 permits a combined water and wastewater utility to recover a portion of its claimed wastewater revenue requirement from water customers.

Given the extensive list of cost trackers currently employed by Pennsylvania utilities, it is unclear what additional cost trackers or recovery mechanisms may be necessary and/or appropriate in the Commonwealth.

4. Choice of Test Years

Like cost trackers, utilities in Pennsylvania already have a choice of whether to use a historic, future, or a fully projected future test year (“FPFTY”) to determine what rate base items and expenses are allowed to be included in base rates. Using a FPFTY permits a utility to

recover the cost of plant not yet in service (at the time rates go into effect), and provides another example of an alternative ratemaking approach that currently benefits utilities in the Commonwealth.

5. Multiyear Rate Plans

With Act 11 and the implementation of the DSIC, Pennsylvania utilities are also already able to benefit, effectively, 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.

6. DSM Performance Incentive Mechanism ("PIM")

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 PIMs are perhaps more appropriately considered in the natural gas and water/wastewater arenas. However, any implementation of a PIM should be coupled with a Commission 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.

B. Rate Design Alternatives

The Tentative Order discusses three rate design alternatives, which, if implemented, would reduce the reliance on volumetric charges to recover a utility's allowed revenue

requirement. Accordingly, such alternatives may be expected to provide greater revenue stability for a utility between base rate proceedings, compared to existing volumetric-based rate designs.

All utility base rate proceedings include a rate design phase in which the utility is permitted to propose changes to its existing rate structure. At the same time, the utility retains the burden of proof that its proposed rate structure is just, reasonable and cost based. As such, the OSBA would suggest that it is not necessary for the Commission to include specific rate design alternatives in any formal policy statement or rulemaking procedure.

1. Straight Fixed/Variable (SFV) Pricing

Fixed costs are defined as costs that do not vary with the level of consumption of a commodity, while variable costs are defined as costs that do vary with changes in consumption levels. Under SFV pricing, all of a utility's fixed costs are recovered via a fixed charge(s), while only variable costs are recovered in usage charges. Since most distribution or delivery costs are considered fixed in the short run, a SFV price structure effectively decouples a utility's revenue stream from usage levels.

The revenue stability provided by SFV pricing stems from the fact that the fixed charges employed in that pricing scheme, unlike, say, demand charges, are not "actionable" or avoidable in any way. In the OSBA's view, the level of such fixed charges are likely not supportable from a cost-of-service perspective, and would violate the Commonwealth Court's decision in *Lloyd*.⁵

2. Demand Charges

Unlike volumetric charges, demand charges apply to a customer's maximum *rate of use* of a commodity in a given time period. Historically, demand charges have been used more

⁵ The Commonwealth Court has unambiguously decided that cost of service should be the "polestar" criterion for rate-setting. In *Lloyd v. Pa. PUC*, the Court held that other rate-making concerns could not trump cost of providing service. *Lloyd v. Pa. PUC*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006).

extensively in the electric than gas industry, with very limited use in the water industry. In all cases, utilities have, to date, limited demand charges to non-residential rate classes.

In the case of electricity, demand charges apply to kilowatts (kW) rather than energy (kWh). As such, demand charges send a different price signal to customers than energy charges. Assuming a customer has a complete understanding of, and the ability to react (*i.e.*, shift load in response) to demand charges, such charges incent a customer to use energy more evenly throughout a billing period (*i.e.*, at a higher load factor), rather than as an incentive to use fewer kWh in a billing period. In other words, customers will not see any reduction in their assessed demand (kW), or total billed demand charges, simply from using fewer kWh in a given month. Instead, customers must reduce their maximum demand (kW) in order to realize demand charge savings. By their nature, therefore, demand charges may be expected to provide greater revenue stability to the utility than energy charges.

The vast majority of small business customers in the Commonwealth are currently served on electric rate schedules that include a demand charge. The OSBA has supported, and will continue to support, the use of demand charges for electric service for small business customers, as long as such charges are cost based. Given an appropriate phase-in period and an adequate customer education program, the OSBA could also support the expanded use of cost-based demand charges for small business customers in the gas and water industries.

3. Standby and Backup Charges

Standby service is generally available to utility customers that provide their own generation to protect the customer from loss of service in the event of an *unanticipated* outage of the customer's self-generation equipment. Backup service is similar except that it is intended to apply to a *planned* outage of the customer's generation equipment and, therefore, may not be

available on an instantaneous basis. Historically, utilities have made standby service available only to large non-utility generators (*e.g.*, to combined heat and power, or CHP customers), and have recovered the cost of standby service via demand charges.

With the possible exception of distributed generation customers, the OSBA does not view Standby and/or Backup Charges as applicable to the general population of utility customers. Stated differently, such charges have limited application as a cost-based rate design option.

C. Next Steps: Policy Statement vs. Rulemaking

The OSBA respectfully submits that if the Commission decides to take further regulatory action on this matter, a policy statement on alternative ratemaking and rate design approaches that offers guidance, but does not impose strict requirements, is the preferred course of action. Such a policy statement will afford utilities the flexibility to propose any new methodologies that make sense taking into account their industry and other individual circumstances, including existing alternative ratemaking approaches already employed. Furthermore, any proposed ratemaking changes can then be vetted by interested stakeholders and the Commission on a case-by-case basis rather than attempting to find a one-size-fits all framework.

III. CONCLUSION

The OSBA respectfully requests that the Commission consider its comments above in reviewing the efficacy and appropriateness of alternative ratemaking and rate design methodologies.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Elizabeth Rose Triscari".

**Elizabeth Rose Triscari
Deputy Small Business Advocate
Attorney ID No. 306921**

For:

**John R. Evans
Small Business Advocate**

Office of Small Business Advocate
300 North Second Street, Suite 202
Harrisburg, PA 17101

Dated: May 31, 2017