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VIA eFILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Enclosed for filing in the above-referenced docket are the **Reply Comments of PECO Energy Company on Alternative Ratemaking Methodologies**.

If you have any questions regarding this filing, please do not hesitate to contact me at 215-841-5974.

Very truly yours,



W. Craig Williams

Enclosures

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

ALTERNATIVE RATEMAKING : DOCKET NO. M-2015-2518883
METHODOLOGIES :

**REPLY OF PECO ENERGY COMPANY TO
COMMENTS ON ALTERNATIVE RATEMAKING METHODOLOGIES**

I. INTRODUCTION

On May 31, 2017, in accordance with the procedural schedule established by the Pennsylvania Public Utility Commission (“the Commission”) in the above-referenced docket, PECO Energy Company (“PECO” or the “Company”) filed its comments in response to the Commission’s Tentative Order on Alternative Ratemaking Methodologies (the “Tentative Order”). In its comments (the “Initial Comments”), PECO provided detailed information on PECO’s current use of several ratemaking methodologies approved by the Commission as well as its perspective on the benefits and challenges associated with additional methodologies identified in the Tentative Order.

In discussing these various methodologies, PECO proposed several overarching considerations for use by the Commission in assessing the reasonableness and efficacy of different alternatives, as follows:

- **Rates Should Reflect Cost Causation.**
- **Customer Impacts Should Be Minimized.**
- **A Balanced Approach To Penalties And Incentives Should Be Taken.**
- **Utilities Should Be Given Flexibility.**
- **Legislation Should Be Pursued Where Commission Authority Is Unclear.**

Consistent with these principles, PECO offered its “Preferred Approach” in alternative ratemaking for both electric distribution companies (“EDCs”) and natural gas distribution companies (“NGDCs”) based upon a “revenue per customer” (“RPC”) decoupling model. Under this model, the Commission would establish an RPC value through a base rate proceeding, and utilities would use periodic true-up adjustments to refund or recover the difference between a utility’s actual revenue and its revenue threshold (calculated using the actual number of customers and the RPC value). When combined with a rate design incorporating fully cost-based fixed customer charges and a separate class for net metered customers to address intraclass cost shifting and other concerns, this model can mitigate the revenue losses, uncertainty and disincentives that utilities experience as increasing amounts of energy efficiency investments, distributed energy resources (“DERs”), and other new energy technologies are deployed.

Twenty-five organizations filed comments in response to the Tentative Order, including the Bureau of Investigation and Enforcement (“I&E”), the Office of Consumer Advocate (“OCA”), the Office of Small Business Administration (“OSBA”), EDCs, NGDCs, large industrial customers, low-income advocates, several energy policy organizations, and other advocacy groups. The comments provide a wide variety of perspectives, but also reveal an emerging consensus on several key issues.

First, several commenters emphasize that new technologies, shifting market conditions, and other changes in the utility industry are raising significant questions as to whether traditional ratemaking approaches and the associated incentives for both utilities and customers are adequate and properly aligned with goals of energy efficiency, conservation and facilitating the integration of DERs and the electric grid. While there is no broad agreement on the proper response to these changes and some commenters point to the Commonwealth’s success in

encouraging energy efficiency through Act 129 to assert that no additional ratemaking methodologies are necessary (or permitted), many join PECO in appreciation of the Commission's efforts to proactively address these general industry developments and continue to solicit stakeholder views on different methodologies.

Second, there is significant support for a flexible approach to the implementation of new ratemaking methodologies. Thus, EDCs, NGDCs, and numerous other commenters emphasize that a "one-size-fits-all" approach for utilities is not appropriate for many reasons, including differences in customer needs, utility service territories, and existing rate structures. PECO agrees wholeheartedly and believes that the ability of utilities to explore a range of Commission-approved methodologies will more likely result in effective "real world" rate designs that work.

Third, many commenters caution that any new ratemaking methodologies must take into account the particular needs of low-income customers. Thus, some assert that certain methodologies should be precluded from consideration because their use might adversely affect low-income customers, while others (including PECO) believe that new methodologies can build on existing customer assistance programs. Together, these perspectives demonstrate the importance of fully considering the effects of alternative rate designs on low-income customers.

In these Reply Comments, PECO first addresses flexibility for utilities seeking to implement new alternative ratemaking methodologies and the related recommendations of several commenters. PECO then discusses issues of rate fairness and the need to follow cost causation in rate design in the context of the Commission's consideration of alternative methodologies. Finally, PECO provides its perspective on the avoidance of overly complex performance incentive mechanisms ("PIMs") and time-of-use ("TOU") rates for both utilities and customers.

II. SPECIFIC COMMENTS

A. THE COMMISSION SHOULD ADOPT A FLEXIBLE, UTILITY-INITIATED PROCESS FOR ALTERNATIVE RATEMAKING METHODOLOGIES

In its Initial Comments, PECO urged the Commission to provide sufficient flexibility for individual utilities to develop innovative alternative ratemaking proposals. PECO explained that this flexibility is appropriate for individual companies seeking to meet the needs of customers, and that appropriate rate designs might well vary from one utility to the next as well as between different types of utilities.¹

Other utilities participating in this proceeding similarly emphasized the importance of such flexibility in their comments. For example, PPL Electric asserted that “the most prudent approach is to avoid a single, uniform methodology,”² and the UGI distribution companies (“UGI”) explained that “there is no ideal rate design,” so there “should be a bias towards permitting NGDCs and EDCs discretion in making initial rate proposals.”³ Duquesne Light Company (“Duquesne”), Columbia Gas, National Fuel Gas Distribution Corporation (“National Fuel”), the Philadelphia Gas Works (“PGW”), Peoples Natural Gas Company and Peoples TWP LLC (“Peoples”), Valley Energy, Citizens Electric Company of Lewisburg, PA, and Wellsboro Electric Company (“Citizens/Wellsboro/Valley”) also all stressed flexibility and opposed adoption of “prescriptive” approaches by the Commission.⁴ The Energy Association of

¹ Initial Comments, p. 3.

² PPL Electric Comments, p. 9.

³ UGI Comments, pp. 4-5.

⁴ See Duquesne Comments, pp. 5 & 8 (agreeing that “one-size-fits-all approach” for EDCs should be avoided and asserting that efforts to determine a “singular methodology” in the absence of actual information on customer and EDC effects is “ill-advised”); National Fuel Comments, pp. 5-6 (discussing weather normalization clauses and noting that “it is important to allow flexibility between the NGDCs in the implementation of the mechanism” in light of its experience in another jurisdiction); PGW Comments, pp. 1-2, 4 (methodologies should “be flexible and available to utilities to utilize as they need” and not prescriptive, with the advantages and disadvantages “best evaluated within the context of each NGDC’s needs”); Peoples Comments, pp. 3-4 (supporting the Commission’s

Pennsylvania (“EAP”) highlighted the likelihood of changing policy goals and the need for any framework for future action to incorporate a process that is initiated by individual utilities.⁵

Although the OCA generally opposes the adoption of alternative ratemaking methodologies at this time, the other statutory parties discussed consideration of decoupling mechanisms on a case-by-case basis. I&E explained that it “continues to believe revenue decoupling is unique to the particular circumstances of each utility” and that the “design and implementation of any revenue decoupling mechanism should take place in the context of individual base rate proceedings.”⁶ The OSBA observed that if the Commission “decides to take further regulatory action on this matter,” it should not impose “strict requirements” but rather “afford utilities the flexibility to propose any new methodologies that make sense taking into account their industry” and permit vetting by stakeholders on a case-by-case basis instead of “attempting to find a one-size-fits-all framework.”⁷

In light of these comments, as well as the comments of stakeholders who fully support or oppose decoupling or advocate for other alternative methodologies,⁸ PECO continues to recommend that the Commission ensure flexibility for those utilities that seek to offer new methodologies and rate designs. More specifically, PECO believes that the Commission should make clear that the decision to formally propose an alternative ratemaking methodology rests

authority to approve decoupling but asserting that decoupling should be “specific to the utility proposing such rates” and the Commission “should preserve ratemaking flexibility to best address company-specific facts and issues”); Citizens/Wellsboro/Valley Comments, p. 8 (requesting Commission flexibility for small utilities).

⁵ EAP Comments, p. 7.

⁶ I&E Comments, p. 9

⁷ OSBA Comments, p. 11.

⁸ See Advanced Energy Economy Institute (“AEEI”) Comments, p. 8 (advocating for a performance-based ratemaking but asserting that revenue decoupling can be a “foundational part of modern ratemaking”); Keystone Energy Efficiency Alliance Comments, pp. 6-9 (supporting existing alternative rate methodologies as well as full decoupling); Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Philadelphia Area Industrial Energy Users Group, PP&L Industrial Customer Alliance and West Penn Power Industrial Intervenors (“Industrials”) Comments, pp. 2-3 (opposing decoupling).

with a utility that, as an initial matter, is best situated to assess and determine how a particular methodology and associated rate designs can be implemented efficiently and at reasonable cost. Such an approach will help ensure that the use of alternative methodologies is fully explored in the context of actual operational facts and not resolved on a theoretical basis. The Commission should also underscore that utilities should not be penalized for developing alternative methodologies in an effort to further advance Commonwealth goals, as new disincentives (such as the imposition of a reduced return on equity as part of any decoupling mechanism) may limit the development of methodologies with real benefits for customers.

B. THE COMMISSION SHOULD EMPHASIZE THE NEED FOR RATE FAIRNESS AND THE CONSIDERATION OF COST CAUSATION IN ADOPTING ALTERNATIVE RATEMAKING METHODOLOGIES

In accordance with the Commission’s direction, most commenters offered their views on the specific alternative ratemaking methodologies highlighted in the Tentative Order and associated rate designs. Several utilities explained the reasonableness and benefits of increased fixed customer charges, as well as the need for standby charges to recover the costs of serving customers with self-supply when that self-supply fails.⁹ PECO’s Initial Comments also discussed the creation of a separate rate class for net metered customers with a three-part rate structure (fixed, volumetric, and demand components) and a reasonable phase-in period to minimize customer impacts.¹⁰ However, a number of non-utility stakeholders expressed their

⁹ *See, e.g.*, Duquesne Comments, p. 12 (explaining simplicity and predictability of fixed charges tied to actual costs to serve); PPL Electric Comments, p. 12 (noting that straight fixed/variable pricing “reflects cost of service and provides better revenue protection than a volumetric rate design”).

¹⁰ Initial Comments, p. 14.

opposition to higher fixed charges and any type of demand charge for residential customers, and several advocated against purportedly “excessive” standby charges.¹¹

As it proceeds with its consideration of alternative ratemaking methodologies, the Commission should make clear that rates must be fair and reflect cost causation. Such a clarification will help ensure that advocates for alternative methodologies demonstrate that a proposed methodology is consistent with sustainable funding of a reliable and universally available grid, and that all customers are expected to pay appropriately for the services they are receiving. PECO believes that clarification is particularly important with respect to fixed costs, demand charges, and standby rates, as explained below.

Fixed Costs and Demand Charges. Under traditional ratemaking principles, rates are designed to properly reflect the nature of the costs incurred in providing service to customers – i.e., fixed, variable, or demand-related costs. Fixed and demand-related costs (or costs that do not vary with the total amount of delivered electric energy or natural gas) should be recovered through fixed monthly rates and rates that reflect a customer’s demand on the system. Variable costs (or costs that increase or decrease as the total amount of delivered electric energy or natural gas changes) should be recovered through rates that can vary based on the amount of the commodity delivered to a customer.

Customers receive strong price signals from retail electric generation and natural gas rates that are based upon the actual per-unit commodity costs borne by suppliers. When customers reduce consumption, costs are reduced on a per-unit basis and customers save money.

¹¹ See, e.g., American Council for an Energy-Efficient Economy Comments, pp. 4-5 (opposing higher fixed customer charges and residential demand pricing); Pennsylvania Utility Law Project Comments, pp. 4-5 (asserting residential demand charges are “disproportionately harmful” to low-income households); AEEI Comments, pp. 10-12 (advocating for standby charge with mechanism to refund “potential overcharges” of customers who are more “reliable”); Alliance for Industrial Efficiency, p. 3 (proposing standby charge based on forced outage rate of customer’s combined heat and power (“CHP”) system).

In contrast, the costs to construct and maintain a utility's distribution system are generally fixed or a function of customer demand levels and not a function of the total amount of energy delivered to customers. All customers need a certain level of distribution service so that energy or natural gas is delivered to their premises, regardless of the level or source of the energy or natural gas, in a safe and reliable manner. Rate schedules that do not properly classify costs as fixed, demand-related or variable can create intraclass inequities that can be unfair and send incorrect price signals to customers.

The need for proper allocation of costs and appropriate cost recovery is essential for utilities to continue to build, maintain, operate and invest in distribution systems and to provide reliability, security, resiliency and new services at reasonable cost. The lack of an appropriate price signal arising from below-cost fixed charges or demand charges can result not only in unfair rates but also in economically inefficient results, including in the implementation of energy efficiency programs. Putting limits on customer charges or demand charges because of concerns that actual costs might not result in a particular level of desired energy efficiency will only result in higher costs for customers over time, and because energy efficiency generally reduces demand there is no reason to assume that higher fixed costs or demand charges must necessarily limit energy efficiency investment. Concerns regarding the effects of such charges on low-income customers should be addressed through customer assistance programs, consistent with other energy costs.

Notably, several comments also reflect a misconception that coincident peak load – when a customer's demand corresponds to overall system demand – drives the cost of an electric distribution system.¹² While this is true for generation and transmission systems, it is not true for

¹² See, e.g., AEEI Comments, p. 10 (“System costs, however, are rarely driven by any individual customer's non-coincident demand, and are instead dependent on aggregate peak demand.”).

distribution systems where non-coincident peak demand – the customer’s highest usage regardless of the timing of the system peak – is the cost driver. The distribution system is designed to meet the requirements of the customer peak demand as placed on the system, and a utility’s cost to serve a customer is related more to that peak demand (reflected in the peak demands of associated substations, feeders, and other distribution system components) than to the total amount of energy used by a customer over a period of time or to the coincident peak of the system. To the extent a demand charge is used in distribution rates, the non-coincident peak load (or customer maximum demand) will provide a more accurate price signal than coincident peak demand.¹³

Standby Charges. Standby charges are intended to recover the cost of providing instantaneous back-up service in the event that self-generating customers lose their source of supply unexpectedly. Several commenters propose that these charges be adjusted to encourage customer-owned CHP and other DER, and, in particular, contend that if a customer’s self-generation does not experience any outages, the standby rate for that customer should be reduced.¹⁴

As with other demand charges, standby charges should be designed to reflect the actual cost to serve the customer. While advocates of reduced standby charges argue that they do not rely upon the grid as anticipated (either through better self-generation performance or shifting scheduled or unscheduled outages to off-peak times), EDCs must nevertheless plan for unexpected contingences. Enhanced performance of a customer’s self-generation does not eliminate the need for EDCs to construct and maintain adequate distribution infrastructure to

¹³ Cf. Comments of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, and West Penn Power Company, pp. 16-17 (stating that non-coincident peak demand allocation methods should be utilized in demand-based rate design).

¹⁴ See *supra* n. 11.

serve a standby customer on a near-instantaneous basis. Moreover, PECO does not believe that reductions in standby charges should be used to encourage specific resources, as some commenters appear to suggest;¹⁵ encouraging a specific type of resource by discounting standby charges only for that resource could result in higher overall costs and unfair treatment of emerging DER that performs as well or better than the “preferred” resource.¹⁶

C. OVERLY COMPLEX ALTERNATIVE RATEMAKING METHODOLOGIES SHOULD BE AVOIDED

In response to the Tentative Order, several commenters emphasized the benefits of PIMs (referred to by some commenters as “performance-based regulation” or “performance-based rates”) intended to link financial rewards and penalties for utilities to specific performance metrics. Some commenters also proposed TOU rates as an alternative to increased customer charges or demand charges. While PECO believes that properly-designed PIMs and TOU rates can deliver significant benefits to customers and facilitate the achievement of broader policy objectives, PECO urges the Commission to keep several additional principles in mind as it considers such alternatives.

PIM goals must be clear and achievable. In its Initial Comments, PECO explained that PIMs can be used to integrate various policy objectives and incorporate shared savings for both utilities and customers to create a “continuous loop of improvement.”¹⁷ But PIMs are not yet sufficiently robust and developed to constitute an alternative “framework for utility regulation in

¹⁵ See, e.g., AIE Comments, pp. 2-3 (advocating revised standby charges for CHP and waste heat to power systems).

¹⁶ In their comments, AIE and a group of companies interested in CHP and waste heat to power systems refer to a consultant “analysis” of PECO and PPL Electric’s standby tariff charges. AIE Comments, p. 3. PECO provided tariff information to the consultant (who had not identified the purpose of its inquiry) but the analysis is incomplete and does not examine all of the underlying differences in large commercial customer rate structures between the companies. This type of incomplete analysis underscores why standby charges should be considered in the context of rate proceedings and not in a “model tariff” or rulemaking specific to standby charges, as AIE recommends. AIE Comments, p. 4.

¹⁷ Initial Comments, p. 12.

Pennsylvania,” as AEEI suggests,¹⁸ nor are utility PIMs the solution to every challenge of a modernizing distribution system given the large number of technological, financial and policy developments that are outside of utility control. A poorly designed PIM with inconsistent or contradictory goals or mismatched penalties and financial rewards can result in excessive spending and undermine other utility investment and operations. As with other alternative ratemaking methodologies, PECO believes that the decision to propose a PIM should rest with each utility and reflect an incremental approach, with the utility identifying discrete performance areas, clear metrics, and a balanced set of rewards and penalties for consideration by the Commission and other stakeholders.

TOU rates require careful design. With respect to TOU rates, the Commission should avoid rates with multiple periods and different seasonal pricing that can confuse customers and frustrate their ability to achieve savings. In addition, if not properly aligned with system costs, TOU rates can further exacerbate intraclass subsidization (i.e., in favor of customers with DER). Ideally, the Commission should encourage utilities to offer pilot TOU proposals that leverage AMI data and capabilities with flexibility to develop appropriate peak hours and on-peak/off-peak multipliers to maximize customer benefits. In particular, as customer adoption of electric vehicles increases, appropriately designed TOU rates provide an important tool to encourage electric vehicle charging behaviors that support efficient grid utilization and avoid additional congestion during peak periods. TOU rates can also be designed for net metered customers which address both the system costs associated with serving those customers and load-shifting benefits that net-metered DER systems may provide.

¹⁸ AEII Comments, p. 3.

Legislation providing Commission flexibility and statutory clarity would be beneficial. In the Tentative Order, the Commission suggests that legislative changes may be necessary to implement some alternative rate methodologies by some types of utilities.¹⁹ Consistent with its Initial Comments, PECO agrees that the best path for some methodologies may be through the enactment of legislation to remove any uncertainty regarding the Commission's authority. Legislation authorizing new methodologies should provide broad flexibility for the Commission to adapt such methodologies to support future technological developments and customer interests and avoid complex and prescriptive frameworks.

III. CONCLUSION

PECO appreciates the opportunity the Commission has provided to offer these Reply Comments on alternative ratemaking methodologies and looks forward to working with the Commission and interested stakeholders on this important initiative.

Respectfully submitted,



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¹⁹ See Tentative Order, p. 19.