BEFORE THE PENNSYLVANIA
HOUSE CONSUMER AFFAIRS COMMITTEE

Testimony Of

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Regarding
House Bill 1782

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Chairman Godshall, Chairman Caltagirone
And Members of the House Consumer Affairs Committee

My name is Tanya McCloskey. I have been serving as the Acting Consumer Advocate of Pennsylvania since 2012 and have worked at the Office of Consumer Advocate since 1987 with a primary focus on energy issues. Thank you for inviting me to give comments before this Committee regarding House Bill 1782 regarding alternative ratemaking for natural gas and electric distribution companies in Pennsylvania. In my view, House Bill 1782 is not necessary and as constructed would result in increased rates to consumers with no discernible benefit being provided to consumers.

Alternative ratemaking methodologies can cover a broad spectrum of mechanisms and methodologies including those mechanisms identified in House Bill 1782. Pennsylvania law currently provides for many forms of alternative ratemaking and Pennsylvania utilities currently use a broad array of alternative ratemaking methodologies. In particular, the use of surcharges within the statutory requirements for such charges, the use of the fully forecasted test year, and the consideration of performance factors in setting rates are examples of alternative ratemaking mechanisms currently reflected in the Public Utility Code. *See*, 66 Pa.C.S. §§ 315(e), 523(b), 1307, 1319, 1351, 1505(b), 2806.1. Pennsylvania's current alternative ratemaking methodologies have been targeted to achieve specific purposes and objectives and seek to balance utility benefits and consumer protections.

Since Pennsylvania restructured its electric and natural gas industries, a substantial portion of the utility bill – the electric generation service and the natural gas commodity service – is subject to competition. It is the distribution/delivery portion of the bill that remains under regulation through the traditional ratemaking process. The ratemaking process for these monopoly services provides a balancing of stakeholder interests such that investors and shareholders are provided the opportunity to recover prudent and reasonable costs as well as the opportunity to earn a fair rate of return on investment dedicated to the public service. At the same time, this process provides ratepayers with just and reasonable rates that are easily understood and provides adequate price signals to utilize resources in an efficient manner.

Alternative ratemaking mechanisms, however, pose significant risks to Pennsylvania ratepayers by disrupting this careful balance. Alternative ratemaking mechanisms lower the risk a utility faces in providing utility services by guaranteeing at least a portion of revenue recovery which runs counter to the long accepted ratemaking principle that utilities are entitled to the <u>opportunity</u> to earn a fair rate of return. *See, e.g.*, <u>Federal Power Comm'n v. Hope Natural Gas Co.</u>, 320 U.S. 591 (1944); <u>Bluefield Water Works and Improvement Co. v. Public Serv. Comm'n of West Virginia</u>, 262 U.S. 679 (1923). The balance of interests established through the ratemaking process is tilted with alternative ratemaking by shifting business and financial risks of operating a public utility directly from shareholders to captive ratepayers. Captive ratepayers, however, are least able to bear or manage these risks.

The traditional ratemaking process, with some targeted adjustments along the way, has served Pennsylvania well over many decades and through many significant changes in the utility industry. Under our current regulatory framework, utility revenues are stable, specific automatic recovery mechanisms are in use to support the improvement of infrastructure necessary for the safety, reliability and efficiency of the system, the overall reliability of the system is trending in a positive direction, our universal service programs are expanding, access to a wide array of renewable resources is readily available, energy efficiency programs are robust, and the opportunity for utilities to earn a fair rate of return is more assured. In light of the effectiveness of the current regulatory framework, I question the need to further disassemble the traditional base rate process.

The traditional base rate process provides for a thorough review of utility operations, a review of the prudence of large capital improvements, an analysis of the fair rate of return on capital (*i.e.*, profit) as well as public input concerning the quality of service and the impact of rate increases on customers and communities. The base rate process also allows for the alignment of rates, rate design, and revenues and the consideration of measures that may be necessary to address the negative impacts of increasing rates on customers. These forms of review, and the public's input, are lost in alternative ratemaking processes that rely upon formulaic methods of setting rates.

On the other hand, guaranteed revenue recovery mechanisms that would be permitted under House Bill 1782 tend to promote the inefficient utilization of scarce resources, reduce the incentive for regulated monopoly public utilities to operate as efficiently as possible, shift unmanageable risks to ratepayers, and restrict the full review of a utility's operations that is necessary in setting just and reasonable rates. To give up the essential protections and efficiencies of the traditional ratemaking process would require clear and measurable goals beyond the statutory obligation to provide safe, adequate, reliable and continuous service, clear benefits to consumers, and necessary consumer protections.

As I mentioned, the General Assembly has provided for some alternative ratemaking mechanisms to achieve targeted objectives that improve utility service and has included consumer protections with these mechanisms. When I look at the stated purposes of House Bill 1782, I believe that these purposes are already being achieved in Pennsylvania. Some are supported by alternative ratemaking mechanisms that have been approved for the specific purpose and others are fully supported by current base rates.

For example, one purpose identified in House Bill 1782 is to facilitate customer access to new energy options. Customers in Pennsylvania already have access to a wide array of energy options through retail choice in the electric and natural gas industries as well as through the Alternative Energy Portfolio Standards Act. 66 Pa.C.S. §§ 2801 *et seq.*, 2201 *et seq.*; 73 P.S. § 1648.1 *et seq.* Energy options currently available include access to renewable energy, access to various rate options, and access to interconnection and net metering for solar energy installations. Customers also have broad access to energy efficiency and demand response programs through Act 129 of 2008. 66 Pa.C.S. § 2806.1. As I will discuss more below, alternative ratemaking methods that adjust based on sales or revenues, such as revenue decoupling, are particularly problematic in conjunction with net metering for solar installations and have already been rejected by the General Assembly in the context of energy efficiency programs.

Another stated purpose in House Bill 1782 is to sustain investment in infrastructure. In 2012, the General Assembly provided for the DSIC mechanism with the specific purpose of repairing, improving and replacing our utility infrastructure. 66 Pa.C.S. §§ 1351-1358. All EDCs and NGDCs have the option to recover the costs of the infrastructure repair and replacement between base rate cases. The DSIC also contains essential consumer protections that serve to retain the necessary balance between the utility's recovery of the infrastructure costs and just and reasonable rates for consumers. It is unclear to me what purpose is served by layering another alternative ratemaking mechanism as it concerns infrastructure over top of the DSIC, particularly one that contains no essential consumer protections.

A third purpose identified in House Bill 1782 is to reasonably allocate infrastructure costs to customers and market participants. Allocation of costs is exactly the type of complex issue that is handled through a base rate proceeding. Alternative ratemaking mechanisms do not allow for the detailed analysis necessary for such allocations, typically spread costs to all customers on a formula basis, and adjust automatically without consideration of changing factors. I would also note that alternative ratemaking methodologies do not assign costs to "market participants," only to customers.

I would like to turn to some of the specific provisions of House Bill 1782. I will not address each component of the alternative ratemaking mechanisms in detail here. My Office has filed extensive comments in the Commission's on-going proceeding that is examining alternative ratemaking methodologies. *See*, En Banc Hearing on Alternative Ratemaking Methodologies, Docket No. M-2015-2518883. Our Comments (filed March 16, 2016 and May 31, 2017) and Reply Comments (filed July 31, 2017) extensively consider the many alternative ratemaking mechanisms, identify the concerns with these mechanisms for consumers, and address the specific questions posed by the Commissioners on this topic. I will not repeat these comments here, but will be happy to make them available to the Committee at any time. I do wish to highlight here, some specific issues related to House Bill 1782.

House Bill 1782 is expansive in its authority, allowing the Commission to identify and implement any form of alternative ratemaking mechanism without standards, clear policy objectives, measurable outcomes, or consumer protections. While House Bill 1782 identifies five alternative ratemaking mechanisms as examples of those that can be considered by the Commission, the authority provided to the Commission is not limited to these five mechanisms.

Without guidance to the Commission as to what is to be achieved, it is not at all clear how the Bill would be implemented or would benefit consumers.

Each of the five mechanisms identified as alternative ratemaking mechanisms presents its own set of concerns for ratepayers. I will discuss revenue decoupling below as an example of some of the concerns presented. What these mechanisms have in common, though, is that they allow for little or no review of the expenditures of the utility and provide little to no incentive to the utility to operate efficiently. As to multi-year rate plans, Pennsylvania already uses a fully forecasted future test year that allows utilities to look two years out in determining their costs and revenues. Beyond that time frame, estimates become very unreliable and place customers at risk that future rates will not be just and reasonable.

House Bill 1782 also allows the utility to choose the mechanism, or mechanisms, that it wants to implement. Allowing the utility to choose the alternative ratemaking mechanism raises significant concerns. To use an example, some types of programs will benefit the shareholders of utilities whose sales are growing between rate cases, while other types of programs will benefit shareholders whose sales are declining. If left to the sole discretion of the utility, each utility will understandably select the type of program that most benefits shareholders, even if that program is not necessarily the most cost-effective or beneficial to customers. The Commission, on the other hand, is obligated to balance the interests of utility shareholders and consumers and to approve only those programs that the Commission determines best serves the overall public interest. The Commission's hands would be tied by the selection of the utility. If the point of the Bill is to address changes in the industry, then we should address those changes in a consistent manner for all utilities to keep all utilities and all ratepayers on equal footing.

I would also note that House Bill 1782 seems to go beyond alternative ratemaking mechanisms that address a utility's sales and revenues by allowing for the inclusion of capital investments, including a return on and a return of capital costs, to be included in the alternative ratemaking mechanism. Outside of the DSIC and advanced meter deployment, which have specific, limited identification of purpose and eligible facilities as well as consumer protections, surcharges and other alternative ratemaking mechanisms typically have not included the recovery of capital costs. Including capital costs and profit margin in alternative ratemaking mechanisms with their limited review and automatic adjustment guarantees profit to shareholders and disassembles the ratemaking process to the detriment of ratepayers. Widespread inclusion of capital costs in an automatic adjustment mechanism is a significant change in regulation in Pennsylvania that must be thoroughly considered.

While I have concern with other aspects of HB 1782 and with each of the alternative ratemaking mechanisms identified, I wanted to address both revenue decoupling and the implications of using the alternative ratemaking mechanisms to recover the costs of distributed energy resources. These aspects of House Bill 1782 serve to highlight the nature of the concerns for ratepayers and regulatory policy in Pennsylvania.

Revenue decoupling is often advanced as a tool to encourage energy efficiency investment by utilities. There are several forms of revenue decoupling but the two most often proposed are lost revenue adjustments and a revenue per customer approach. Under a lost revenue adjustment, only the revenues lost due to a specific energy efficiency program are recovered through the mechanism. Under a revenue per customer approach, the utility is insulated from any deviation in actual sales from expected sales. The change could be from anything, such as economic activity, weather, energy efficiency, change in building codes and the like. The reason for the change is irrelevant to the adjustment. Both methods present significant issues.

Proponents of revenue decoupling argue that it will remove the disincentive of the utility to implement energy efficiency programs. Through Act 129, Pennsylvania has achieved robust energy efficiency without revenue decoupling. Under Act 129, Pennsylvania's electric utilities spend approximately $240 million annually on energy efficiency and demand response programs. Our utilities have largely met or exceeded the mandated energy efficiency goals, recovered the costs of the programs on a full and current basis, and have done so within the spending cap provided under Act 129. Act 129 squarely spoke to the issue of reduced revenues from energy efficiency programs and found that decreased revenues from energy efficiency programs should be addressed in the context of a base rate case. Act 129 also established penalties for failure of the EDCs to meet the mandated energy efficiency and demand response goals. In essence, Act 129 contains both "carrots" and "sticks" to achieve the purpose of the Act within the spending limitations set forth by the General Assembly.

Given the ratemaking methodologies we have in place and the success with Act 129, revenue decoupling will not further advance goals that Pennsylvania is seeking to achieve. Revenue decoupling, however, will introduce other potential harms to consumers.

A great deal of focus in the revenue decoupling debate is put on the customer's total bill and the argument that the change in the usage rate occasioned by revenue decoupling is generally small when properly designed. A critical distinction is often lost in this argument, that is the distinction between those customers who can participate in energy efficiency programs and reduce their usage sufficiently to offset the increased usage rate and those customers who cannot participate (or cannot participate sufficiently) in energy efficiency programs. Not all customers are able to engage in energy efficiency due to the lack of financial means to pay for the necessary investment, the lack of ownership of their residence or business, or the inability to reduce energy usage any further due to health and safety concerns. These low to moderate income households and otherwise vulnerable households end up bearing the brunt of these increasing prices between base rate cases. In a base rate case, where offsets can be recognized and principles of affordability can be applied, these impacts can be better addressed.

Alternative ratemaking methodologies must also be considered in relationship to other utility operations and policies of the Commonwealth. One of the important policies that the Commission and the Commonwealth have sought to forward is the extension of natural gas service to unserved and underserved areas. Some forms of revenue decoupling could reduce the incentive for utilities to engage in timely main extensions as the benefit of adding new customers (and the associated revenue) is muted with some forms of revenue decoupling.

Revenue decoupling can also interact with the operations of the utility, particularly as it concerns storm restoration. Without proper protections, a utility could end up being compensated for revenues the utility would not otherwise have collected due to an outage. In other words, when the power is out to a home and the home is not able to consume electricity, this would ordinarily result in reduced revenue to the utility and a reduced bill to the customer. A decoupling mechanism will automatically "make up" this reduced revenue through the adjustment thus increasing utility revenues and customer bills due to the outage. Such a result could be particularly burdensome to customers who must pay for service they did not receive because of an outage.

I would also caution against consideration of revenue decoupling based only on past trends in usage or sales. Revenue decoupling, as well as other alternative ratemaking mechanisms, are most often introduced or proposed when a utility is experiencing declining sales. The energy industry continues to change as policies on both the state and federal level evolve. There may be new opportunities for the growth and development of the energy sector. We are already seeing a growth in the use of natural gas for heating, industrial processes, electric generation, and transportation. Similarly, there is a growing use of electric vehicles. Electrification, particularly with increased renewable production, is being viewed as a means of reducing emissions. Any policy based on the idea that energy industry sales will remain flat or continue to decline may quickly be out of date.

While revenue decoupling is typically thought of to address the impacts of energy efficiency, I would like to raise a concern about the use of revenue decoupling as a means to address distributed generation on the utility system. The question of reduced utility sales due to distributed generation, net metering and the proper payment for residential solar is an issue being considered by many states. One of the concerns with distributed generation is that as more customers install solar behind the utility meter, thereby reducing their purchases from the utility grid and avoiding some or all distribution charges, the costs to support the distribution system must be paid by other customers. The lost distribution revenues resulting from net metering fall on those customers who are unable to reduce their utility purchases through installation of distributed generation. Revenue decoupling does not address this fundamental issue with distributed generation and may even exacerbate the concerns. With decoupling, all of the foregone utility distribution revenue from reduced utility sales is automatically shifted to other customers through the decoupling mechanism.

That brings me to my concern with the inclusion of distributed energy resources in House Bill 1782. As I read House Bill 1782, it would allow an EDC or NGDC to own distributed generation resources and to receive traditional rate base/rate of return treatment for that generation resource by recovering a return of and a return on the distributed energy resources through an alternative ratemaking mechanism. It would also allow a utility to own alternative fuel vehicles and the associated infrastructure.

If it is the intent of House Bill 1782 to allow electric distribution companies, or even natural gas distribution companies, to own generation assets and receive rate base/rate of return cost recovery from ratepayers, this would move away from the policy of the Commonwealth declared in the Electricity Generation Customer Choice and Competition Act that competitive market forces were to be used to control the cost of generating electricity rather than economic regulation. While in my view the Restructuring Act did not preclude an electric distribution company from owning generation assets, the Act was clear that regulation which allowed a utility to recover a return on and return of the prudent cost of used and useful generating assets from ratepayers no longer applied. Economic competition through the wholesale markets and market price provides the cost recovery for generating assets, not regulated ratemaking cost recovery from captive ratepayers.

Monopoly distribution utility ownership of distributed generation assets as well as energy storage assets should also be carefully considered. Such ownership may impair or eliminate the benefits of innovation that could result from competition. Such ownership and regulated cost recovery treatment removes the incentive to pursue private investment and grants as it reduces the rate base value and the profit to shareholders from the project. Distributed generation assets and energy storage can be supported by grant funding as well as private investment where much of the risk of the investment is with the private entity and not ratepayers. Monopoly distribution utility ownership, along with recovery of and return on the plant through an alternative mechanism from ratepayers, would result in increased costs for ratepayers and limited benefit for any distributed energy resource.

The ownership of alternative fuel vehicles and the associated infrastructure presents a similar concern. The use of alternative fuel vehicles as fleet vehicles by the utility is already occurring and appropriate recovery of the costs of these alternative fuel vehicles as part of a utility fleet is being provided through base rates. There is no reason to single out these vehicles in use by utilities for any form of special treatment. The associated infrastructure, however, is a broad term that raises additional concern. This language could be read to suggest that monopoly distribution utilities should be in the business of owning and operating third party alternative fuel charging stations that are open to the public. This is a significant area of policy that requires much discussion and should not be decided at this juncture through a Bill that is addressing alternative ratemaking mechanisms.

If this Bill is to move forward in any form, I would strongly urge the Committee to limit its scope, provide clear, measurable objectives to achieve that will benefit consumers, and include necessary consumer protections. I have attached an Appendix with a list of consumer protections that I recommend be included in the Bill if it moves forward. I would also strongly urge that the provisions regarding distributed energy resources and infrastructure development be removed from House Bill 1782.

While I fully agree that the energy industry landscape continues to change and advance, I believe that our traditional regulatory system, with the targeted modifications that have been made along the way, has met these challenges and will continue to meet the challenges of the energy industry. For these reasons, I believe that House Bill 1782 is unnecessary and should not move forward. Thank you again for the opportunity to testify.

Appendix to Testimony of Tanya McCloskey

RE: House Bill 1782

Should the General Assembly determine to make changes to the current regulatory model to accommodate various forms of alternative ratemaking, the following consumer protections should accompany any change in the regulatory model:

- Any adjustment permitted between base rate cases should contain a hard cap, *i.e.*, with no exception to increase the cap.
- The utility should be required to achieve specific objectives, implement programs, or achieve specific metrics set forth in the legislation that are over and above the obligations already in place for regulated utilities in Pennsylvania.
- The utility must be able to demonstrate that the alternative ratemaking mechanism will result in clear, specific measures of success for incremental benefits to consumers that exceed the additional costs.
- The return on equity must be reduced to reflect the reduced risk to the utility from the alternative ratemaking mechanism.
- The utility should be required to submit periodic base rate filings such as every three to five years so that a complete review can be undertaken.
- Alternative ratemaking mechanisms should only be implemented as part of the completion of a full base rate proceeding.
- The underlying rate structures in base rates should be required to be aligned with the rate structures and rate designs of any alternative ratemaking mechanism before implementation.
- The alternative ratemaking mechanism should not include capital costs and should not be allowed to recover a profit margin for shareholders.
- The alternative ratemaking mechanism should apply to all customer classes.
- Alternative ratemaking that is intended to address changes within an industry should be applied as a comprehensive policy to all utilities within the industry.
- The utility should not be permitted to make the sole selection of the alternative ratemaking methodology that would be applied.
- The Commission should retain the authority to impose additional consumer protections as the Commission determines are necessary when reviewing any proposal.