Prepared Testimony of

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Introduction

Good morning Chairman Godshall, Chairman Caltagirone, and members of the House Consumer Affairs Committee. I am Vice Chairman Andrew Place of the Public Utility Commission (Commission or PUC). I am here today, on behalf of the Commission, to offer testimony concerning House Bill No. 1782 (HB 1782), which amends Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, providing for alternative ratemaking for natural gas distribution companies (NGDCs) and electric distribution companies (EDCs). It should be noted that this legislation also expands utility investment and cost recovery authority for Distributed Energy Resources (DER) – i.e. electricity generation.

Overall, the Commission is neutral on the bill and is supportive of efforts to clarify its jurisdiction regarding flexibility to approve alternative ratemaking and rate design methodologies – in particular, decoupling filings. Nonetheless, the Commission is concerned with provisions within the bill that may be inconsistent with basic public utility ratemaking principles and with the DER portion of the legislation, as that language is contrary to the intent and purpose of the current Electricity Generation Customer Choice and Competition Act (Electric Competition Act) and the Natural Gas Choice and Competition Act (collectively, Competition Acts).

<u>Alternative ratemaking and rate design methodologies</u>:

The legislation proposes to provide clear authority for the Commission to approve alternative ratemaking and rate design methodologies, including (1) decoupling mechanisms, (2) performance-based rates; (3) formula rates; (4) multiyear rate plans, (5) cost-recovery mechanisms and rates to support, and fully recover the allocated costs to deploy infrastructure and distributed energy resources or (6) any combination of these five mechanisms.

The issue of alternative ratemaking and rate design is actively being studied by the Commission. On December 31, 2015, the Commission issued a Secretarial Letter opening a docket and scheduling an *en banc* hearing to be held on March 3, 2016. The purpose of the hearing was to consider the efficacy, appropriateness and value of alternative ratemaking methodologies, such as revenue decoupling, which have the potential to mitigate disincentives that may presently exist for energy utilities to pursue aggressive energy conservation and efficiency initiatives. The hearing provided participants a forum in which to inform the Commission on the following rate issues: (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. Consequent to the hearing, a comment period was provided for interested parties to offer subsequent responses.

The Commission issued a Tentative Order on March 2, 2017 at the same docket seeking further comments on, and potential processes to advance, rate designs and alternative rate methodologies. The Tentative Order specifically addressed decoupling mechanisms generically, including Lost Revenue Adjustment Mechanisms (LRAs) and Straight Fixed / Variable (SFV) Pricing, as well as Cost Trackers (also known as Surcharges or Riders), Choice of Test Years, Multiyear Rate Plans, Demand Charges, Standby and Backup Charges, and Demand Side Management Performance Incentive Mechanisms. The Tentative Order solicited additional comments and reply comments on specific questions for electric, gas and water utilities.

Comments and reply comments are being reviewed to determine whether certain orders, policies and/or regulations need to be issued as appropriate and consistent with our current statutory authority.

Many stakeholders believe that the Commission has existing authority to approve various alternative rate designs, including Straight Fixed Variable (SFV) rate designs, demand charges, standby and backup charges, Performance Incentive Mechanisms (PIMs), and Performance Based Rate (PBR) mechanisms, including Multiyear Rate Plans, within the context of a base rate case, and more limited statutory authority to approve cost trackers.[1] However, commenters to our docket were significantly divided on the efficacy and legality of decoupling mechanisms under current statutes, regulations and case law. As defined in HB 1782, decoupling is a rate mechanism that adjusts or reconciles authorized distribution rates or revenues for differences between sales used to set rates and actual sales, including, but not limited to, customer adjustments or other adjustments deemed appropriate by the Commission. The Commission has some experience with *partial* decoupling

[1] Cost trackers are often used synonymously with a section 1307 mechanism, where cost recovery is specifically permitted by statute, or where specific costs, for example natural gas or electric supply, low income, or transmission costs, are easily identifiable and beyond the utilities' control. Under such a mechanism, the specifically-identified reasonable costs can be separately tracked, periodically reconciled, and recovered.

mechanisms for natural gas companies through implementation of weather normalization adjustments (WNAs).[2]

To the extent the Legislature believes *full* decoupling for all utility companies, which would allow all projected sales revenues to be reconciled against actual revenues, should be among the regulatory tools available to the Commission for its consideration, this draft legislation could remove potential statutory and legal barriers to effectuating various alternative ratemaking mechanisms, including decoupling. Nevertheless, this legislation stands in direct conflict with existing provisions of the Public Utility Code. These challenges include arguments that raise improper single-issue ratemaking, retroactive ratemaking, and violation of the just and reasonable rate standard under 66 Pa. C.S. § 1301. Many commentators have noted that Act 129 prohibits an EDC from recovering decreased revenues on a retroactive basis via a reconcilable automatic adjustment clause such as through a decoupling mechanism. Specifically, Section 2806.1(k)(2) of the Electric Competition Act provides that "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." Also, the section of Act 129 addressing smart meter technology states that "lost or decreased revenue by an electric distribution company due to reduced electricity consumption or shifting energy demand" shall in no event be considered a "recoverable cost" associated with smart meter technology.

While this conflict may be intended to remove potential statutory and legal barriers to adoption of these decoupling mechanisms in the Commonwealth, the intent should be made clear.

In terms of implementation of the various alternative rates and rate mechanisms included in this bill, the Commission recommends that its authority to develop parameters and standards for any particular alternative rate or rate mechanism, where it deems appropriate and after due process, be made clear and express.

<u>Cost Recovery for Distributed Energy Resources:</u>

The draft legislation proposes cost-recovery mechanisms and rates to support, and fully recover the allocated costs to deploy infrastructure and DER, as well as returns

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[2] Columbia Gas of Pennsylvania, Inc. and Philadelphia Gas Works have implemented WNAs. A WNA allows the companies to "recalculate and recover/refund" sales revenues based on actual experienced weather, allowing for more revenue recovery from customers if sales were lower than projected due to warmer weather actually experienced or a refund to customers if sales were higher than projected due to colder than expected weather.

on that capital investment. DER is very broadly defined as a distributed generation resource, energy efficiency, energy storage, alternative fuel vehicles and associated infrastructure, and demand response technology.

To date, the Commission has engaged in rate design methodologies for narrowly defined infrastructure investments. For example, through authority granted to it by the General Assembly in Act 11 of 2012, the Commission has reviewed and approved utilities' petitions for distribution system improvement charges (DSICs).[3] See 66 Pa. C.S. §1353. The DSIC allows for the recovery of prudently incurred costs related to the repair, improvement and replacement of eligible utility infrastructure through a surcharge that is subject to reconciliation, audit and other consumer protections. A precondition to obtaining Commission approval of a DSIC is the filing and approval of a long-term infrastructure improvement plan (LTIIP). 66 Pa. C.S. § 1352. DSIC charges are capped at 5% of the amount billed to customers under the applicable distribution rates of the EDC or NGDC unless the Commission grants a waiver, upon petition, for a higher amount. 66 Pa. C.S. § 1358. Currently, except for National Fuel Gas Distribution Corporation, all large EDCs and NGDCs have filed LTIIPs and sought cost recovery through a DSIC mechanism.[4]

Specific to generation assets, the Electricity Generation Customer Choice and Competition Act resulted in EDCs divesting their generation assets – in order to create a competitive retail energy market. Thus, under this draft legislation, current statutory directives and policy as to utility ownership and cost recovery for generation resources would be implicitly reversed, or at a minimum conflicted.

There are, however, narrow instances where EDCs and NGDCs own generation assets; though to date EDC recovery for distributed generation resources has largely been limited to facilities used to provide back-up power to company-owned facilities.

Distributed generation, particularly solar, is increasingly commonplace in the Commonwealth and EDCs are increasingly experiencing an acceleration in requests for interconnection for customer/third party owned distributed solar installations at residential and commercial customer sites.[5] In response to this increase in development activity, the Commission has held a series of stakeholder meetings,

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[3] Docket No. L-2012-2317274. The Final Rulemaking Order on Act 11 was finalized by the Commission on May 23, 2014.
[4] UGI Utilities Inc., Electric Division has recently filed an LTIIP with the Commission, but has not filed a base rate case, and therefore does not qualify for a DSIC.
[5] For the 12 months ended May 31, 2016 and May 31, 2017, annual interconnects of distributed solar resources in Pennsylvania have increased from 1,411 per year to 5,478 per year, which was a 53% increase in Pennsylvania solar DER resources.

technical conferences and collaboratives to identify best practices and any amendments to our interconnect processes that may be necessary to more effectively implement customer generator interconnections. Staff has held meetings with DER service providers and EDCs, completed an internal report on its findings, and is continuing this collaboration by holding future joint meetings with stakeholders.

The Commission also has been actively working to remove barriers to Combined Heat and Power (CHP) technologies. At our February 25, 2016, Public Meeting, the Commission issued a proposed policy statement that would establish a biennial reporting requirement for EDCs and NGDCs regarding their efforts to eliminate obstacles to the development of CHP in the Commonwealth, encourage these companies to design interconnection and standby rates for owners and operators of CHP facilities, and promote the consideration of special natural gas rates for owners and operators of CHP facilities.

As to distributed energy resources in the form of energy efficiency and demand response programs, the Commission's large electric utility activities are driven by the statutory requirements of Act 129 of 2008 (Act 129). Under Act 129, each EDC with at least 100,000 customers must develop a plan to reduce energy demand and consumption within its service territory. Spending on these plans is capped at an annual spending ceiling of 2% of each EDC's 2006 annual revenue. Costs for these Act 129 energy efficiency and conservation (EE&C) programs are recovered through a section 1307 (relating to sliding scale of rates and adjustments) non-bypassable surcharge to customers. EDCs have successfully implemented these programs, and are currently executing their third phase of planned energy efficiency and demand response reductions.

For smaller electric utilities and all natural gas utilities, the Commission has broad energy efficiency and demand response authority pursuant to Section 1505 of Title 66, which provides authority to order conservation and load management programs. This section permits the Commission to order a utility to establish a conservation and load management program as part of determining or prescribing safe, adequate and sufficient service. The plan must be "prudent and cost-effective." Pursuant to this authority, the Commission has approved, on a voluntary basis, a number of energy efficiency programs for small electric utilities and NGDCs.[6]

[6] The following utilities have filed, and had approved by the Commission, voluntary energy efficiency programs: Philadelphia Gas Works, PECO Energy Company – Gas Division, UGI Utilities, Inc. – Gas Division, UGI Utilities, Inc. – Electric Division, UGI Central Penn Gas, Inc., UGI Penn Natural Gas, Inc., and Leatherstocking Gas Company.

As to alternative fuel vehicles (AFVs) and associated infrastructure, EDCs and NGDCs have developed programs to facilitate the introduction of these technologies into the marketplace. For example, compressed natural gas (CNG) technology has been part of PECO's fleet since the 1980s. PECO operates six CNG fueling stations in Chester, Delaware and Montgomery Counties – five of these are open to the public, and owns a fleet of 13 Natural Gas Vehicles. As of today, PECO has transitioned the operation of five of six stations to a private company, Clean Energy, and the stations have been upgraded with new equipment and are available to the public. The remaining station is located within a secure area and not readily available to the public. PECO has acted as a resource for customers interested in CNG technology and is working with several companies to support the planning and construction of fueling stations by building the infrastructure needed to support increased gas use across the region. PECO's programs have supported the expansion of public CNG fueling access across its service territory with five new non-utility owned stations.

Likewise, Peoples Natural Gas Company LLC, Peoples Division and Equitable Division (Peoples) have focused on informing and educating customers on CNG vehicles, station equipment and economics, assisting customers with CNG funding opportunities, and participating in CNG committees and events. Peoples provides pipeline extensions and meter sets for CNG stations, and currently owns and operates two private CNG fueling stations,[7] , and operates 50 CNG vehicles[8] used for company operations. These types of investments, which mainly support third party development of AFV infrastructure, but also support company operations, are typical of the NGDC AFV activities today. Peoples currently has 24 customers using CNG as a transportation fuel.

Similarly, EDCs have taken steps to promote the development of electric vehicles (EVs) and associated EV infrastructure. PECO's EV fleet currently consists of 26 plug-in vehicles[9] and PECO has invested in a total of 52 charging stations (61 total charging ports) for company fleet and employee use, of which 22 charging stations have been installed (representing 22 ports) for company fleet truck use only.

[7] Peoples currently owns 10 private CNG stations but only 2 are operational at this point. The two functional CNG stations are at Ginger Hill and Pitt Street. As part of People's NGV plan, there are major upgrades planned at these two locations. The others stations are in Johnstown, Altoona, Hopewell, Grove City, Greensburg, Gibsonia, Kiski, and Butler.

[8] 34 company-owned AFVs are dedicated CNG units, and the other 16 are bi-fuel units. Peoples has plans to add another 17 bi-fuel units into the fleet in 2018.

[9] 22 Hybrid bucket trucks, 1 Heavy duty truck, 1 Splicer truck, and 2 Chevy Volts.

Employee workplace charging facilities include 30 charging stations at eight different worksites.[10]

Likewise, energy storage facilities have proliferated at the wholesale level. Pennsylvania currently has 92 Megawatts (MWs) of energy storage systems in service, an additional 20 MWs under construction and 96 MWs in the development queue.

The purpose of the Electric Competition Act was to unbundle generation, transmission and distribution functional areas to allow competition in the electricity generation markets that could lead to customer savings. The Electric Competition Act was clear in its purpose that competitive market forces were to be used to control the cost of generating electricity, rather than economic regulation. 66 Pa. C.S. § 2802(5). As I read the intent of the Electric Competition Act and the phrase "no longer regulated as a public utility function," it conveys that this form of rate base/rate of return economic regulation will no longer apply to generation assets. One of the principles of restructuring was that company shareholders, not customers, would be at risk for recovery of generation costs. This conflict makes it unclear whether the draft legislation intends customers again to be responsible for risks associated with investments by EDCs and NGDCs in generation, energy storage and CHP facilities.

To date, the Competition Acts have been very effective in helping to moderate basic electricity costs to customers. Over the period 2007-2017, average electricity generation costs have <u>decreased</u> an average of 0.3% per year for non-heating residential customers and increased 2.2% per year for residential heating customers. During this same period, electric distribution rates for these two customer groups increased 5.3% and 7.5% per year, respectively. In a similar manner, NGDC supply costs have <u>decreased</u> an average of 8.7% and 8.6% per year, respectively, while distribution costs have increased an average of 2.8% and 3.4% per year, respectively. The benefits of the Competition Act have even been more dramatic for large industrial customers. While distribution rates have increased an average of 4.4% per year, generation supply costs have <u>decreased</u> an average of 1.9% per year.

The draft legislation also appears to promote further utility spending for service not related to distribution. It does this by providing for cost recovery of non-basic service costs, including distributed generation resources such as distributed solar facilities, CHP facilities, as well as electric vehicles, CNG vehicles, liquefied natural gas (LNG)

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[10] 10 level 2 charging stations installed (representing 19 charging ports), and 20 level 1 outlet ports installed at main office parking lots for employee use.

vehicles, and related charging facilities and energy storage facilities,[11] without including any limitations on the size, location of interconnection, fuel source or purpose of the resource that would qualify as a "distributed energy resource." The proposals to allow for cost recovery of DER projects necessarily raise important issues as to which consumers should pay for such localized facilities in the utility's rate structure. The draft legislation could also expand utility spending on additional energy efficiency and demand response programs beyond the spending limits imposed under Act 129. Similarly, additional infrastructure spending could be enabled beyond the DSIC cost recovery caps contained under Act 11.

As noted during recent testimony provided by the PUC on microgrids (HB1412), the Commission continues to encourage innovation, especially involving matters that could enhance reliability; increase resilience during large-scale electric disruption events; and increase the integration of renewable and highly-efficient DER. Nonetheless, because this draft legislation changes policy regarding EDC and NGDC ownership and operation of generation, energy storage equipment, AFVs and associated infrastructure, it raises concerns similar to those noted by the PUC with respect to EDCs in the microgrid legislation.

<u>Conflicts with existing ratemaking principles and statutes:</u>

The Commission is also concerned about conflicts with basic ratemaking principles in the draft legislation. First, as it relates to cost recovery, all recoverable costs must be prudently incurred and reasonable, and all assets must be used and useful, to ensure just and reasonable rates. In short, any investment must be proven to be cost effective. Secondly, utilities are provided a reasonable opportunity to recover their costs and return on their investments. They are not entitled to fully recover their costs as proposed in Section 1330(b)(1)(v) and § 1330(b)(2). Lastly, Section 1330(a)(1) proposes a new standard for distribution cost recovery, proposing that infrastructure costs are reasonably allocated to and *recovered from customers* and market participants *consistent with the use of the infrastructure*. Ratemaking is a complex process. The rate design portion of the ratemaking equation itself is based on a number of diverse considerations, including revenue recovery for the utility, efficient resource use, fairness in cost allocation, practicality, interpretability (non-controversial), revenue stability for the utility, and rate stability for the ratepayer, among others. While this draft legislation expands the Commission's ratemaking authority, it is important that these fundamental ratemaking principles are be

[11] As HB 1782 does not define energy storage, nor limit it to electric energy storage, it could include batteries, flywheels, among others, as well as LNG facilities.

undermined, limited, or replaced. The Commission must retain all discretion under its existing ratemaking that currently exists under its jurisdiction to consider all factors when rendering decisions on proposed rate designs.

The proposed legislation also creates potential conflicts with important consumer protection provisions related to cost caps under recent statutes. It is not clear whether the intent of this legislation is designed to remove the cost recovery caps currently in place. For example, EDC cost recovery on energy EE&C plans is capped at 2% of each EDC's 2006 annual revenue. In another example, DSIC charges are capped at 5% of amounts billed under distributed rates of the EDC or NGDC unless the Commission grants a waiver, upon petition, for a higher amount. It is unclear if Section 1330(b)(1)(v) cost recovery provisions supersede these EE&C and DSIC cost recovery cap provisions.

Closing

The practical impact of this draft legislation is that it would:

1. Remove potential statutory and legal barriers to adoption of these decoupling mechanisms and other alternative ratemaking in the Commonwealth.
2. Expand utility investment and cost recovery on infrastructure and DER, including distributed generation resource, energy efficiency, energy storage, alternative fuel vehicles and associated infrastructure, and demand response technology. Cost recovery under such provisions may not be subject to the consumer protection provisions of Act 129, and Act 11, which provide for caps on spending for energy efficiency, demand response, and infrastructure spending.
3. Potentially modify basic ratemaking principles associated with just and reasonable rates.

The Commission is supportive of efforts to clarify its jurisdiction regarding flexibility to approve alternative ratemaking and rate design methodologies, and, in particular, decoupling filings. Nevertheless, the Commission is concerned about certain provisions that may be inconsistent with basic principles of public utility ratemaking. In addition, the Commission is concerned about potential conflicts with other existing provisions of law, including the DER portion of the legislation.

The Commission is receptive to working to address concerns regarding legislative language to remove conflicts with existing ratemaking principles and other statutory obligations.

We commend the Committee for the discussion on this important topic. We are at your service and happy to answer any questions you may have.