

**PENNSYLVANIA HOUSE OF REPRESENTATIVES  
HOUSE CONSUMER AFFAIRS COMMITTEE**

**HEARING - HOUSE BILL 107**

**WEDNESDAY, APRIL 26, 2017 (9:30 AM)  
HARRISBURG, PA**

**TESTIMONY OF  
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Good morning, Chairman Godshall, Chairman Caltagirone, and distinguished members of the House Consumer Affairs Committee. And, good morning as well, to my esteemed colleagues from the Office of Consumer Advocate (“OCA”), the Public Utility Commission (“PUC”), the participating utility companies, and other interested stakeholders.

As many of you know, my name is John Evans, and I am the Small Business Advocate for the Office of Small Business Advocate (“OSBA”). Here with me today is Elizabeth Rose Triscari, Deputy Small Business Advocate. Thank you for inviting us to testify before this Committee regarding House Bill 107. The OSBA is charged with representing the interests of Pennsylvania’s small business consumer class in proceedings that come before the Pennsylvania Public Utility Commission (“PUC”), any comparable federal regulatory agencies, and in the courts.

**Small Businesses remain critical to the state and national economy:**

- According to the latest data available from the federal Office of Advocacy at the Small Business Administration (“SBA”), in 2015, there were 28.4 million small businesses in the United States - representing 99.7% of all employer firms.
- Here in Pennsylvania, small businesses are paramount to our Commonwealth’s continued well-being – accounting for a significant share of the state’s economic production and hiring.
- Pennsylvania’s small businesses represent 98.2% of the Commonwealth’s employers.

Part of the OSBA’s ongoing mission is to ensure that our small businesses, so crucial to the Commonwealth’s economy, pay reasonable rates for safe and reliable utility service. As such, the OSBA strongly supports the *economically feasible* expansion and extension of natural gas distribution service to unserved and under-served areas.

The OSBA agrees that traditional utility regulatory practices that are designed to protect existing ratepayers from economically unattractive extensions can serve to deter system expansions that may, in the longer term, prove to be economic. The OSBA has supported, and will continue to support, innovative efforts by natural gas distribution companies (“NGDCs”) to adopt alternatives to the traditional approaches.

However, with respect to the proposed legislation, the OSBA has significant concerns, both at a policy and a detail level. The policy concerns are:

First, from our experience with these programs, we observe that the idea of a distribution system *extension* charge (“DSEC”) is a more complicated issue than the distribution system *improvement* charge (“DSIC”) that was adopted in Act 11. A DSIC applies only to the replacement of obsolescent equipment that serves existing customers. It does not involve the additional costs or revenues associated with serving new customers. System expansions, in contrast, serve new customers, and necessarily involve additional costs and revenues. These additional costs and revenues will vary substantially from project to project, dependent on the nature of the geographical area of the expansion (*i.e.*, number and type of customers to be served). Due to the wide variance in incremental costs and revenues across potential expansion projects, a DSEC must be structured to reasonably balance the interests of existing ratepayers and new ratepayers. The DSIC, by contrast, need not address that balance.<sup>1</sup>

The OSBA respectfully submits that, because of these complexities, a one-size-fits-all DSEC mechanism mandated by statute is not a workable strategy for achieving the goals we all share. The OSBA recommends continuing the current approach of implementing a variety of programs to promote economically feasible service expansions at different NGDCs on a pilot basis, with the ability to evaluate what works and what doesn’t over time.

However, if a DSEC is deemed necessary, at a minimum, the OSBA strongly encourages the legislature to ensure that the NGDCs are not being compensated twice for system expansion costs (from base rates and the DSEC), and to establish specific protections that insulate existing customers from the costs of excessive or uneconomic expansions to serve new customers.

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<sup>1</sup> All policies related to the expansion of an existing network to new customers must necessarily involve some balancing of the costs and risks between existing customers and new customers. How this balance is achieved is determined both by the general method used to determine who is responsible for the additional costs and by the specific assumptions in the calculations. Questions include: Who is responsible for the risk that new customers will not produce as much revenue as expected, after the investments have been made? What contribution should be required from new customers with respect to their use of the existing system? How many years of revenue (from new customers) should the utility use to determine required contributions in aid of construction (“CIAC”)? A DSIC, on the other hand, is nothing more than a mechanism to allow utilities to recover asset replacement costs up to a reasonable level without a base rates case, and it therefore does not need to address these more complex questions.

Second, the OSBA questions whether this is the appropriate time to adopt a DSEC mechanism. Currently, the Pennsylvania NGDCs are aggressively replacing obsolescent equipment, and they have substantially ramped up their capital spending with the aid of the DSIC mechanism. This effort appears to be creating a strain on existing resources, such that competent contractors and skilled labor can only be obtained at a significant price premium. For example, PECO has recently indicated to the PUC in its Petition for Approval of a Second Modified Long-Term Infrastructure Improvement Plan (at PUC Docket No. P-2013-2347340):

*Market conditions have driven up the costs associated with construction activities, such as the installation of mains. As a result, PECO's main installation costs increased from \$1 million per mile to \$1.5 million per mile. The market conditions that have increased PECO's costs include:*

- *Shortage of qualified labor personnel in the industry that perform gas construction work;*
- *Limited number of reputable contractors that can complete gas construction projects according to PECO's requirements for quality and safety; and*
- *Increased amount of LTIIIP programs being implemented concurrently by other Pennsylvania NGDCs combined with limited qualified contracting resources.*

The OSBA respectfully submits that implementing a DSEC mechanism at the current time will exacerbate these problems. Furthermore, implementing a DSEC mechanism at this time may cause the NGDCs to divert attention away from replacing aging infrastructure and onto system expansions. Simply put, the DSEC may serve to reduce the effectiveness of the DSIC.

Third, in the OSBA's experience with the innovative programs being developed to encourage economically sensible expansions, we note that the NGDCs have generally only been interested in participating in these expansions if they face no risk. The current cost-recovery mechanisms are generally structured such that the costs for the system expansion are *fully* recovered from the new customers served by the expansion, or are *eventually* rolled into utility rate base, regardless of the efficacy of the expansion. The DSEC mechanism proposed in HB 107 follows this pattern, and in fact exacerbates it by "socializing" all of the expansion costs for recovery from *all* ratepayers, not just new ratepayers

benefiting from the expansion. To the extent a legislative solution is deemed necessary, the OSBA respectfully requests that the legislature consider options in which some of the risk of the expansion is borne by the NGDCs, rather than simply shifting all of the risk to ratepayers as is proposed in HB 107.

Fourth, as noted earlier, OSBA strongly supports the legislation's focus on *economically feasible* expansions. In our view, that means that the revenues from the new customers served by the system expansions will, over the longer term, recover the additional costs of the expansion. Thus, to the extent up-front help from existing ratepayers (or the utility) is needed to meet near-term revenue requirements of the expansion, the longer-term benefits in the form of revenues from new customers will eventually offset those costs. We recommend that NGDCs be required to demonstrate this long-term economic feasibility as a condition for obtaining any DSEC funding from all ratepayers.

Fifth, the OSBA expects that system expansion spending will primarily focus on residential customers. The OSBA strongly opposes imposing costs on small business customers in order to subsidize expansions serving other customer classes, or even requiring small businesses to absorb risks associated with such expansions. Like the electric industry energy efficiency programs, the OSBA supports a careful assignment of costs and revenues associated with the expansions to the customer classes that are served by the expansion. Rolling all of the costs into a single pool will simply be one more way of taxing small businesses to support residential customers.

As to the more specific concerns that we have regarding the legislation:

1. Section 1330(a)(2) contemplates utility investment in in-house piping and possibly other equipment. As the DSEC is designed to recover costs associated with investment ("depreciation and pretax return"), it appears that any utility which finances in-house equipment will have those assets on its books. The OSBA recommends that the legislature and, of course, the NGDCs, carefully examine the legal and insurance implications of such ownership.
2. Section 1330(b)(3)(i) contemplates establishing a "... customer contribution amount above which some or all of the costs are to be recovered through the distribution system extension charge." We are unsure how to interpret this provision. When a utility extends its distribution

system, it expects to earn a certain amount of revenues from the new customers. These revenues serve to justify a certain investment level that can be made by the utility without harming existing customers. Costs in excess of this “maximum investment” level are typically required from the new customers in the form of a contribution in aid of construction (“CIAC”).

As we understand this legislation, the DSEC might be used to absorb some of the costs above the maximum investment level, with the balance being required from all new customers served by the expansion. As noted earlier, we strongly support the requirement that new customers benefiting from the expansion make a contribution to excess costs above the maximum investment level, and a careful balance must be struck between existing and new customers. Unfortunately, as currently written, HB 107 is unclear in this respect, which we expect will lead to endless argument before the PUC. We request that the legislature clarify its intent.

3. Section 1330(b)(3)(ii) contemplates structuring the DSEC such that it pays for unusually expensive line extensions. While the OSBA is unsure that we understand the purpose of this provision, we observe that this would appear to encourage uneconomic system extensions, rather than the economically feasible extensions that are the object of the legislation.
4. Section 1330(c) provides for a cap on the DSEC. The OSBA strongly supports the efforts in the legislation to avoid unreasonably burdening existing customers, and to establish a cap on the overall level of recovery. With respect to the cap, however, we have two concerns. First, the language should be clarified to apply the 2.5 percent limit to “distribution” rates and not all rates, consistent with the language in the DSIC. A 2.5 percent limit based on all rates including gas costs would be excessive, and it would create an incentive for NGDCs to try to retain gas sales customers to the detriment of independent natural gas suppliers (“NGSs”). Second, the legislation contemplates the possibility of a waiver of the cap, on public interest grounds. Based on our experience with the DSIC cap waiver, the OSBA believes that this provision would be an invitation for endless litigation before the PUC and dilutes the consumer protection it intends to afford. We recommend against the imposition of a cap waiver.

Thank you for your time and attention. The OSBA appreciates this opportunity to testify today on the impact House Bill 107 will have on Pennsylvania's small business ratepayers. We welcome any questions or comments you may have.

Respectfully submitted,

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Elizabeth Rose Triscari, Pennsylvania Deputy Small Business Advocate