

**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, members of the House Consumer Affairs Committee:

Good morning, and thank you for inviting me to comment on House Bill 1782.

My name is Mark Szybist and I am an attorney and policy advocate for the Natural Resources Defense Council (NRDC), a member-based non-profit environmental organization with more than 110,000 members and activists in Pennsylvania. NRDC works nationally and internationally to protect public health and natural resources. My job as NRDC's Pennsylvania advocate is to support state-level laws and policies that reduce emissions of greenhouse gases and other air pollutants and create an equitable and sustainable clean energy economy.

Since 2015, my work has included advocacy for revenue decoupling and performance incentives for electric utilities before the Pennsylvania Public Utility Commission (PUC). In the PUC's pending docket exploring revenue decoupling and other alternative ratemaking methodologies, NRDC has sponsored testimony by economist Mark Newton Lowry; commissioned a legal analysis of the PUC's existing legal authority by West Virginia University Law School professor Jamie Van Nostrand; and submitted substantive comments urging the PUC to make more robust use of its current alternative ratemaking authority – which is real, if limited – and to address consumer protection concerns in a policy guidance crafted through an inclusive stakeholder process.

NRDC supports House Bill 1782 insofar as it would clarify that the PUC has full authority, in base rate proceedings, to approve revenue decoupling, performance incentives, and multiyear rate plans. We do have some ideas for refinements, which I will discuss. First, however, I will briefly discuss why we need alternatives to traditional “cost-of-service” utility regulation, and discuss the relationship between alternative ratemaking and environmental protection, and the policy considerations that NRDC believes should guide the General Assembly and the PUC in determining whether particular alternative ratemaking approaches are in the public interest.

House Bill 1782 seeks to address the current, unprecedented uncertainty regarding electric utilities' recovery of prudently incurred authorized costs of service due to minimal growth in electricity sales. For most of the 20th century, electricity use in the U.S. increased consistently at a rate greater than the growth of the population. In recent years, however, electricity use has flattened, or even declined in some areas, as homes and appliances have become more efficient, distributed energy resources like rooftop solar panels have become more popular, and the economy has become less energy-intensive. This trend is likely to continue as our devices become more energy-efficient and distributed solar becomes widely affordable.

Flat or declining sales are a problem for Pennsylvania’s restructured utilities because under traditional “cost-of-service” regulation, utilities earn revenue mainly by delivering electricity and gas to consumers via the poles and wires that they own and maintain. Utilities are compensated for costs such as building and maintain the local energy distribution system, customer service, and meter reading and billing – through regulated rates set by the PUC. Much of the costs are recovered through volumetric (or per kilowatt-hour) charges, meaning the less electricity and gas they sell, the less money they make. If sales are lower than expected, a utility may not recover all of its prudent costs. On the other hand, a utility can increase its revenue and profits with greater sales and energy consumption. The incentive to do so is sometimes called the “throughput incentive.”

NRDC and other environmental organizations that work on utility issues find cost-of-service regulation problematic because the throughput incentive discourages utilities from embracing energy efficiency and “distributed energy resources” like rooftop solar, except to the extent that the law requires them to do so. Each unit of energy that the utility does not distribute thanks to energy efficiency or customer-owned generation is a lost sale.

This disincentive for the utility to promote cost-effective efficiency and distributed generation creates two main public policy problems. First, without utilities serving as trusted partners on clean energy, it is harder for consumers to take control of and lower their bills through conservation or self-generation. Second, from a climate perspective, it is absolutely critical that we increase our use of efficiency and distributed energy resources dramatically in order to reduce harmful, energy-related greenhouse gas pollution.

Because of greenhouse gases emitted by human activity, the earth is getting hotter, and according to the best current science, avoiding the worst effects of climate change means keeping the earth’s temperature from rising more than 2 degrees Celsius above pre-industrial levels.

To do that, both the United States (currently the world’s second-largest emitter of greenhouse gases) and other developed countries must cut their greenhouse gas pollution by at least 80 percent by 2050. By 2100, the entire world must be “net-zero” in carbon emissions.

Last month, NRDC released a report, *America’s Clean Energy Frontier: The Pathway to a Safer Climate Future*, explaining how we can achieve those reductions in a cost-effective way. NRDC’s modeling relies on four broad measures: energy efficiency, renewable energy, electrification, and decarbonized fuels. The first three strategies get us 90 percent of the way there. The most significant driver of reductions is energy efficiency improvements in buildings, factories, appliances, and vehicles. We must also significantly expand our use of renewable energy to generate electricity, both through large utility-scale power

facilities and through locally generated, or “distributed” sources like rooftop solar panels. We can then use this clean, renewable electricity to power many end-uses that currently run mostly on fossil fuels: cars, space heating, hot-water heaters, light industry, etc. In addition, we have to “decarbonize” uses that cannot be electrified at this point – things like airplanes, long-haul trucks, and heavy industry – by increasingly replacing fossil fuels with sustainable biomass, hydrogen-based fuels, and by using carbon capture technologies. In order to maintain the reliability and resiliency of our energy system during this low-carbon transition, it is essential that we modernize our electric grid – most of which was built more than 40 years ago, and needs to be updated anyway – to better accommodate 21st century technology and customer desires, such as large-scale and distributed renewable energy resources, “smart” appliances, and storage technologies.

Traditional cost-of-service utility ratemaking is a barrier to both greater efficiency and greater renewable generation, because it casts utilities in the role of reluctant gatekeeper, rather than helpful guide. And it leads to market failures. Pennsylvanians of all backgrounds and political tribes increasingly want clean and efficient energy, some because it lowers their bills, some because it brings them energy independence and self-reliance, some because of environmental and climate concern, most for some combination of these reasons. But under cost-of-service regulation, utilities resist satisfying this demand because the market signals are wrong.

You can think about alternative ratemaking as a set of strategies to send the right market signals, so that utilities develop business models and engage in business activities that are better aligned with and responsive to customer desires and demands. Imagine, for a moment, that the signals utilities are given to invest in efficiency and distributed energy resources were as strong as the signals they are given to invest in natural gas transmission pipelines. Under a tariff established by the Federal Energy Regulatory Commission in 1997, when interest rates were around double today’s average, investors in new interstate gas pipelines are allowed a 14 percent return on equity. Given the low interest rates that have prevailed for the last decade, this high return gives investors an exceptionally strong incentive to build new pipelines rather than use existing pipelines (which have already been depreciated) more efficiently. There are no remotely comparable price signals for utilities to help customers choose cleaner and more efficient ways of using energy.

Well-designed alternative ratemaking methodologies can help open the pathways of greater efficiency and greater renewable energy both by removing disincentives to the support of energy savings and distributed energy resources, and by providing additional, positive incentives for utilities to affirmatively support these resources.

Revenue decoupling, for example, uses periodic true-ups in electricity and natural gas rates to ensure that utilities cover their fixed costs – no more and no less. If the utility recovers more than its authorized costs, ratepayers receive a refund the next cycle; If the utility recovers less than its authorized costs, consumers will pay a small, capped surcharge to cover the previous shortfall. This symmetric approach benefits utilities, shareholders, and consumers: utilities maintain their financial integrity even if sales are lower than expected, which also reduces investor risk, while consumers are assured that the utility will not keep unwarranted profits if they over-recover due to higher than expected sales. This breaks the link between electricity and gas sales and recovery of costs, removing utilities’ disincentive to help customers save energy and reduce energy bills through efficiency.

Performance incentives can complement decoupling by giving utilities rewards for successfully promoting efficiency and distributed energy resources. Performance incentive mechanisms use quantitative targets and metrics to link a utility’s revenue to its performance in areas that stakeholders and regulators decide are in the public interest. They can – and should – involve both rewards and penalties, enabling utilities to earn enhanced returns based on their performance on things like verified energy savings, low-income programs, carbon reductions, and promotion and integration of distributed energy resources like solar panels and electric vehicles.

Decoupling and performance incentives are two of the five alternative ratemaking mechanisms that House Bill 1782 would explicitly allow the PUC to approve for electric and gas utilities. The other three are multiyear rates plans, formula rates, and “cost-recovery mechanisms and rates to support and fully recover the allocated costs to deploy infrastructure and distributed energy resources.” House Bill 1782 would also allow utilities to seek authorization for other types of “alternative ratemaking” mechanisms not specifically listed, as the term “alternative ratemaking” is not defined and the language in section 1330(b)(1) is non-exclusive.

The open-ended nature of House Bill 1782 raises the question of what alternative ratemaking should look like in practice, and what kinds of alternative ratemaking mechanisms we should want the PUC to approve, if the bill is enacted.

The kind of “alternative ratemaking” that NRDC supports is ratemaking that not only gives utilities an opportunity to recover their approved costs, but also aligns utilities’ business models with the expansion of energy efficiency, renewable energy, and distributed energy resources. Ratemaking largely determines whether and at what cost interested consumers can either choose to receive clean electricity or make their own clean energy investments, while also balancing potential impacts on other consumers, especially low-income consumers, and ensuring that utilities have a reasonable opportunity to recover their

authorized revenue on a timely basis, regardless of fluctuations in electricity use. Ratemaking also has a critical role in achieving other public policy objectives, such as minimizing customer fixed charges protects energy affordability for low-use low-income and fixed-income customers and implementing time-varying rates that promote customers to shift energy consumption to times of lower-cost service reduces total system costs and pollution.

Adhering to these public policy principles will allow for well-designed, consumer-protective revenue decoupling mechanisms, performance incentives, multiyear plans, and possibly formula rates – but will not accommodate some other types of methodologies that sometimes march under the banner of “alternative ratemaking,” such as Lost Revenue Adjustment Mechanisms (LRAM) and Straight-Fixed Variable (SFV) pricing.

House Bill 1782 could be drafted to proscribe certain alternative ratemaking methodologies, or to allow only those methodologies that are particularly identified. But in the interest of ensuring that both the PUC and Pennsylvania utilities have the flexibility to respond quickly to changing circumstances and technologies, we believe that most of the details concerning the implementation of this legislation would be best worked out in proceedings before the PUC, including the alternative ratemaking docket that the PUC opened in December, 2015.

NRDC’s most recent comments in that docket urged the PUC to develop policy guidance on alternative ratemaking authority through a stakeholder process where the Commission, utilities, and other stakeholders could reach as much consensus as possible and principles and standards. We believe that if House Bill 1782 becomes law, the benefits of a guidance or regulatory order that explains the standards the PUC will use to evaluate alternative ratemaking proposals – and to assess their effectiveness and impacts, after they are implemented – would be even greater, leading to more efficient rate cases when utilities make actual alternative ratemaking proposals.

We also believe that such a process is necessary to ensure consumer protection, and to conserve the limited resources of the Consumer Advocate and the low-income and small business advocates. All of these advocates have expressed serious concerns about revenue decoupling, performance incentives and other alternative ratemaking mechanisms, and while NRDC strongly believes that Pennsylvania must move forward with alternative ratemaking, we also believe that at a time of unprecedented financialization and market power in our economy, when every day brings new examples of corporate rent-seeking and self-dealing, and the benefits of economy activity are flowing increasingly to large investors, rather than Main Street, it is critical to ensure that ratemaking mechanisms are designed in a manner that protects all consumers, and especially low-income Pennsylvanians.

Finally, a brief comment on the final “alternative rate mechanism” listed in section 1330(b)(1) of House Bill 1782: “cost-recovery mechanisms and rates to support and fully recover the allocated costs to deploy infrastructure and distributed energy resources.” Essentially, this provision would give utilities license to collect greater revenue from customers who are taking advantage of distributed energy resources, such as net-metered rooftop solar panels. NRDC fully agrees that utilities should have a fair opportunity to recover the prudent and reasonable costs they incur in helping customers to implement distributed energy resources – for instance, through a mechanism such as a minimum bill. However, any determination of these costs must also account fully for the benefits that utilities realize when customers deploy distributed energy resources and so reduce load, such as the avoidance of capital costs for distribution system upgrades.

Chairman Godshall, Chairman Caltagirone, honorable members of the Committee, I thank you for the opportunity to comment today, and hope the Committee will continue its work on House Bill 1782, and take steps to ensure that the bill is passed in a manner that both aligns utility revenues with our urgent need to expand energy efficiency and renewable generation, and protects Pennsylvania’s consumers.