

**BEFORE THE PENNSYLVANIA
HOUSE CONSUMER AFFAIRS COMMITTEE**

Comments of

**SONNY POPOWSKY
CONSUMER ADVOCATE**

Regarding

House Bill 1294

**Harrisburg, Pennsylvania
April 28, 2011**

**Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923
(717) 783-5048 - Office
(717) 783-7152 - Fax
Email: spopowsky@paoca.org
141799**

**Chairman Godshall, Chairman Preston
and Members of the House Consumer Affairs Committee**

My name is Sonny Popowsky. I have served as the Consumer Advocate of Pennsylvania since 1990, and I have worked at the Office of Consumer Advocate since 1979. Thank you for permitting me to testify before this Committee at this Hearing regarding House Bill 1294.

Let me state at the outset that I agree that public safety is paramount and that it is essential that our Commonwealth's public utilities are able to provide safe and adequate service. I also understand the concerns of many members of the General Assembly that safety-related improvements are needed to much of our utility infrastructure – particularly to our underground natural gas infrastructure – and that there is a public need to accelerate these improvements.

In my view, the General Assembly's valid concerns about public safety and the need to accelerate certain natural gas infrastructure improvements can be met in a manner that is fair to both consumers and to the utilities that serve them. I would respectfully submit, however, that House Bill 1294 goes far beyond addressing those concerns and would effectively eliminate many of the fundamental statutory ratemaking requirements that have protected Pennsylvania utility consumers for decades.

There are reasons that monopoly utility distribution companies are regulated in every state and there are reasons that those utilities generally are not permitted to raise their rates automatically between rate cases. Unlike competitive products, and even unlike the less regulated aspects of utility service such as electric generation and natural gas commodity service, consumers have no place else to go for their monopoly utility distribution service. Pennsylvania consumers must rely on the provisions of the Public Utility Code to ensure that they receive safe and adequate service at just and reasonable rates.

The major substantive provisions of House Bill 1294 start by stating that “Notwithstanding any other provision of this title, including but not limited to, sections 315 (relating to burden of proof), 1307 (relating to sliding scale of rates; adjustments), 1308 (relating to voluntary changes in rates) and 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission shall have the authority to approve, but shall not require, additional regulatory procedures and mechanisms proposed by a fixed utility or a city natural gas distribution operation to provide for timely recovery of reasonable and prudently incurred costs.” The Bill then goes on to state that “The additional procedures and mechanisms under paragraph (1) shall include, but are not limited to ... An automatic adjustment clause to recover capital costs and operating expenses related to the capital costs.”

The sweep of this provision is extraordinary in its scope and its potential impact on Pennsylvania utility consumers. First of all, House Bill 1294 applies to all fixed public utilities, including electric, natural gas, water and wastewater companies. Second, the Bill applies to all utility capital costs, not just costs that are needed to improve the safety and reliability of our infrastructure. At the same time, however, there is nothing in House Bill 1294 that requires the utilities to do anything more than “business as usual” with respect to their infrastructure improvement programs.

The reference to “this title” in the portion of House Bill 1294 quoted above is Title 66 of the Pennsylvania Consolidated Statutes which contains the entirety of the Public Utility Code. Thus, under the “notwithstanding” clause of House Bill 1294, every other provision of the Public Utility Code could be “trumped” by the subsequent language in the Bill. That is, even if a long-standing ratemaking principle is required under the existing Code, that principle will not apply if it is inconsistent with any new ratemaking mechanism proposed by a utility under House Bill

1294. Among the Public Utility Code provisions that could be specifically overridden by House Bill 1294 are Section 315, which requires utilities to bear the burden of proof that any proposed rate increases are just and reasonable; Section 1308, which requires that utility ratepayers be given notice and an opportunity to be heard before rate increases that exceed a certain level are imposed upon them; and Section 1315, which requires that electric utility facilities must be “used and useful in service to the public” in order for their costs to be charged to ratepayers. It should be noted that this last provision was upheld in the landmark case that I had the honor of arguing on behalf of Pennsylvania consumers before the United States Supreme Court in 1988. Yet, this provision – and for that matter every other provision in the Public Utility Code – could be disregarded under the terms of House Bill 1294.

The proponents of this legislation will undoubtedly argue that the Bill itself does not overturn these statutory protections. Rather, it only “authorizes” the Public Utility Commission to disregard them. It is important again, however, to look at the language of House Bill 1294 quoted above. Specifically, the Bill states that the Public Utility Commission “shall have the authority to approve, but shall not require, additional regulatory procedures and mechanisms proposed by a fixed utility.” In other words, the Commission can only consider alternative ratemaking proposals that are made by the utility – not proposals made by consumer representatives or by the Commission itself. And the Commission can approve the proposals made by a utility, but the Commission cannot require the utility to accept any alternative ratemaking method that is different from the one proposed by the utility.

As noted above, House Bill 1294 permits the PUC to approve an “automatic adjustment clause to recover capital costs and operating expenses related to the capital costs.” That may sound reasonable, but that is not the way utility rates are traditionally set. In a traditional base

rate case, the PUC looks at all costs and all revenues that go up and down between rate cases, not just at the additional new capital costs that are inevitably incurred between rate cases.

An illustration of this point here would be helpful. In 2010, PECO Electric filed a request for its first electric distribution base rate case since 1989, that is, its first base rate increase request in 21 years. As stated by PECO in its filing in that case: “During the intervening 21 years, PECO has invested \$2.9 billion in new and replacement electric-distribution plant.” To its credit, PECO was able to manage its operations in such a way that it was able to invest \$2.9 billion in capital additions over a 21-year period without raising its regulated distribution rates by a single penny.

Similarly, PECO Gas went from 1988 to 2008 without filing a base rate increase for the Company’s natural gas division. In November 2007, PECO Gas issued a press release announcing that it had just completed \$12.3 million in upgrades to its suburban Philadelphia natural gas facilities, including the replacement of 58,000 feet of cast iron and bare steel mains. In the press release announcing the system improvements that PECO issued on November 6, 2007, the Company stated:

During the past 20 years, PECO has made significant upgrades to its natural gas delivery system and expanded capacity, serving about 7,000 new customers each year – all without an increase in the company’s delivery and service charges since 1988. By saving customers money through the use of new technologies, increasing sales, operational mergers and other efficiencies PECO charges remain among the lowest in Pennsylvania.

That is how ratemaking is supposed to work. Between base rate cases, a utility makes needed investments that increase certain costs, but the utility may also add customers who provide more revenues, or it may operate more efficiently to reduce costs in other areas.

A major reason that utilities are able to make new plant additions between rate cases without having to increase their rates is that traditional base ratemaking is a two-way street. That is, between rate cases, while a utility is adding new capital investments to the “rate base” on which it is allowed to earn a return, the utility’s existing plant is depreciating, which has the effect of reducing the utility’s rate base. In a rate case, the Commission looks at both the additions and the subtractions, and establishes a net rate base on which prospective rates are set.

Under a distribution system improvement charge (DSIC), such as would be permitted under HB 1294, however, the Commission looks only at plant additions, without considering the offsetting plant reductions. The DSIC thus becomes a one-way street, rather than a two-way street, and allows rate increases even if the utility’s overall plant investment is actually declining over time. That is why last year, when the issue of a natural gas DSIC came before this Committee, my Office and the Industrial Energy Consumers of Pennsylvania (IECPA) proposed a number of amendments to that legislation, including an amendment that would require the PUC to establish such charges on a “net” basis that is fair to both utilities and ratepayers, rather than on a “capital addition only” basis that increases rates automatically even if the utility is doing little to improve its distribution system.

To the extent that the General Assembly concludes it is necessary to develop legislation that allows for accelerated rate recovery for natural gas safety improvements between base rate cases, I would urge you to limit such recovery to net increases in capital investments, to limit the overall size of those increases to a reasonable percentage, and to permit utilities to implement such a cost recovery mechanism only after their baseline rates and infrastructure plans have been reviewed by the Commission. I would be pleased to work with the Chairmen, Members and Staff of this Committee to develop such legislation for natural gas infrastructure that I believe

could accomplish the improvements to infrastructure and safety that the General Assembly seeks, while still treating ratepayers fairly.

As to electric utilities, I would note that PECO is not the only utility that managed to operate for many years without the need for a base rate increase. Pennsylvania Power Company has not filed for a base rate increase since 1988, while West Penn (Allegheny) Power has not filed a rate increase request since 1994. Metropolitan Edison Company has requested only one base rate increase case since 1994 and Pennsylvania Electric Company has filed only one case since 1986. I do not see a benefit to consumers in allowing electric utilities to obtain automatic quarterly rate increases for capital additions, when many of those companies have managed to operate for decades without requesting any increases in their monopoly distribution rates.

Before closing I would like to address two other provisions contained in House Bill 1294. First is the provision in the Bill to allow the use of a “fully projected future test year in a general rate proceeding.” A “test year” is the 12-month period over which a utility’s costs and revenues are measured as the basis for setting prospective base rates. The Public Utility Code already permits the use of a future test year for setting rates under Section 315(e). Under current PUC regulations, however, the future test year is essentially completed by the end of the nine-month period in which the rate case is considered by the Commission under Section 1308(d) of the Code. House Bill 1294 would explicitly permit a utility to propose, and the Commission to approve, a future test year that begins after the rate case is completed and after the new rates go into effect. In contrast to a one-sided DSIC, there is nothing inherently unfair or biased against consumers in the use of a fully projected future test year. The problem, and the reason I believe that such test years have not been approved in Pennsylvania in the past, is that they are highly speculative and difficult to predict. Under the current PUC methodology, if a utility files a rate

case, for example, on April 1, 2011, the future test year in that case may end on December 31, 2011, and the utility's rate base will be measured as of that December 31, 2011 test-year-end date. Under the fully projected future test year set forth in House Bill 1294, however, the future test year would end on December 31, 2012, and the parties to the rate case would have to predict what the utility's plant in service (and many other factors) would be as of December 31, 2012. In my view, the use of a fully projected future test year will raise the level of complexity and controversy in a base rate case. This will make rate cases more complicated, time-consuming, and expensive, not less.

Finally, I will address the wholly independent provision of HB 1294 that would repeal for water and wastewater utilities the long-standing requirement that utilities providing more than one type of utility service must segregate the property used to provide one service from the property used to provide the other service, and that such utilities may not combine the costs of those different types of property in setting rates for those services. I assume that this provision was drafted to address valid concerns over the high rate increases that have been required for customers of small private and municipal wastewater companies that have recently been acquired by major water utilities such as Pennsylvania American Water Company (PAWC) and Aqua Pennsylvania, Inc. (Aqua PA). As I testified at this Committee's recent Informational Meeting on water and wastewater utilities, my Office has long supported the concept of "single tariff pricing" as a means of sharing costs equitably among all of a large water utility's customers. To my knowledge, however, this is the first time in Pennsylvania that it has been suggested that rates of two completely different utility service divisions be combined as a means of reducing one division's rates by raising the other's. I share the concerns about high wastewater rates that I believe are the basis for this proposal and I would note that my Office represents both water and

wastewater customers. The problem, however, is that the water and wastewater customers of the companies at issue here are not the same people. PAWC, for example, has over 635,000 water customers and only 17,500 wastewater customers. Even assuming that all of the wastewater customers also receive water service from PAWC, the remaining more than 600,000 water customers are already paying for their own wastewater service either through a municipally-owned or authority waste water system or their own on-lot system. Similarly, Aqua PA has more than 400,000 water customers and only about 8,500 wastewater customers. If this provision of House Bill 1294 is passed, it is important for the General Assembly to realize that the great majority of PAWC and Aqua PA water customers could end up paying a portion of the cost of someone else's wastewater service as well as their own.

Thank you again for the opportunity to testify at this hearing. As I stated above, I would be pleased to work with Chairmen Godshall and Preston and all the Members and Staff of this Committee as the issues raised by this legislation are addressed in the General Assembly.

141799

