

**BEFORE THE PENNSYLVANIA
HOUSE CONSUMER AFFAIRS COMMITTEE**

Testimony of

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**Regarding
House Bill 1294**

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Good afternoon Chairman Godshall, Chairman Preston, and members of the Committee. I am Terry Fitzpatrick, President & CEO of the Energy Association of Pennsylvania, a trade association whose members include electric and natural gas utilities operating in Pennsylvania. Thank you for this opportunity to testify in support of House Bill 1294, which would authorize the Public Utility Commission to consider alternative approaches to traditional ratemaking to provide more efficient and prompt recovery of investments in utility infrastructure.

In April 2007, when I was serving as a member of the Pennsylvania Public Utility Commission, I wrote a paper on improving utility and transportation infrastructure in the Commonwealth.¹ I did so because during my years on the PUC I became more concerned about infrastructure in Pennsylvania, and more conscious of the impact of the PUC's decisions on investments in infrastructure. The paper contained sections discussing infrastructure issues in a number of industries, including electricity, natural gas, water and wastewater, and transportation, among others.

I concluded that instead of viewing these infrastructure industries and their problems separately, as we have done in the past, we should view them comprehensively to identify common problems, and common solutions to these problems. Specifically, the paper recognized the legislation authorizing a distribution system improvement charge ("DSIC") for water utilities, which allowed those companies to collect their investments in new pipes more promptly and efficiently than under the traditional method of recovering the costs through base rates, and noted other utility industries were seeking legislation to use such a mechanism.

¹A *Comprehensive Approach to Improving Utility and Transportation Infrastructure in Pennsylvania* (April 2007), copies available upon request to tfitzpatrick@energypa.org. The views expressed in this paper are those of the author and do not reflect the positions of the Energy Association of Pennsylvania or its members.

The logic underlying the infrastructure paper I wrote while serving on the PUC supports passage of House Bill 1294. This legislation would authorize the PUC to extend to other utility industries innovative ratemaking mechanisms such as the one that has been used successfully in the water industry. This would benefit the public for the same reasons the water DSIC legislation has benefited the public. Like water utilities, electric and natural gas utilities operate critically important, capital-intensive distribution infrastructure. It would serve the public interest to allow for more prompt recovery of the costs incurred by electric and natural gas utilities in modernizing their distribution systems.

Modernizing electricity and natural gas infrastructure creates high-quality jobs for our citizens. In addition, while each utility faces different circumstances, much of our energy infrastructure is aging and is in need of replacing.² Encouraging modernization of utility infrastructure would enhance the quality, reliability, and safety of utility service, and would be in the public interest.

Currently, electric and natural gas utilities recover the cost of upgrading their infrastructure through base rates. This means they must file a rate case at the PUC before recovering these costs – an expensive, time-consuming litigation process that takes nine months to resolve in the absence of a settlement.³ Because of the time and expense required to prepare, file and litigate a rate case, most utilities do not file to increase base rates on an annual basis. Thus, the utility must wait as much as several

² There has been much discussion recently of the amount of cast iron and bare steel mains in the natural gas distribution system. A chart showing the amount of these types of mains in Pennsylvania is attached to this testimony.

³ The rate case expenses incurred by a utility are, in themselves, recoverable. For gas and electric utilities, rate case expenses can range from one to two million dollars.

years from the time it places new infrastructure in service to begin collecting that cost, a delay which contributes to what is commonly referred to as “regulatory lag.”

A utility that embarks upon an infrastructure replacement / modernization process experiences regulatory lag between the expenditure of capital and the filing and approval of new base rates through the rate case process. This may harm its financial condition, and increase its cost to borrow money. These negative financial consequences are an impediment to utilities modernizing their infrastructure. Such delay in the recovery of infrastructure costs is not in the interest of the utility, its customers, or the public.

A number of other states have recognized this dilemma and responded by moving toward alternative ratemaking approaches that allow prompt recovery of these costs. According to the American Gas Association, fifty utilities in nineteen states are recovering the costs of replacing their gas distribution mains through special rate mechanisms.⁴ In addition, twenty states have adopted alternative ratemaking approaches for electric utilities to achieve a number of goals, including encouraging investments in infrastructure.

Turning to the types of mechanisms identified in the legislation, House Bill 1294 authorizes the PUC to approve “additional procedures and mechanisms” including, but not limited to, a “fully projected test year” in a base rate proceeding, and an “automatic adjustment clause to recover capital costs and operating expenses related to capital costs.” Use of a fully projected test year would mean rates would be set based upon conditions expected to be in place at the time the rates take effect – after the nine month review process for setting the rates – as opposed to conditions that were in place

⁴ American Gas Association, *Natural Gas Rate Report: Infrastructure Cost Recovery Mechanisms* (April 2011)

in a past time period. Use of a fully projected test year would increase the ability of utilities to recover costs without incurring “regulatory lag.”

An “automatic adjustment clause” is a generic term used in Section 1307 of the Public Utility Code to describe mechanisms that allow a utility to recover the actual amount of certain categories of expenses - no more, and no less - without the requirement for review and approval through the rate case process. The language authorizing a DSIC for water companies is contained in Section 1307 (g). Accordingly, a DSIC is a particular type of automatic adjustment clause. House Bill 1294 would authorize the PUC to allow electric and gas utilities to use mechanisms similar to the water DSIC to recover the actual amount of their investments to replace their aging distribution systems, subject to oversight and auditing of costs by the PUC.

Authorizing the PUC to consider alternative ratemaking mechanisms would be fair to consumers. The issue here is not over whether these costs may be recovered; it is over the method for recovering them. Opponents of this legislation concede that infrastructure replacement costs are recoverable, but they insist that this must be accomplished only through the traditional, expensive rate case litigation process that takes nine months to resolve. In effect, these opponents are arguing to preserve the status quo.

This legislation authorizes the PUC to approve ratemaking mechanisms that allow more timely recovery of these costs without requiring expensive, time-consuming rate cases. Allowing more timely and certain recovery of these costs will make it easier to attract financing on reasonable terms. In addition, special rate mechanisms allow for a gradual inclusion of these costs in rates, as compared to recovery of the costs in base

rates, which may lead to the inclusion of a large amount of additional costs into rates all at once.

Pennsylvania was a leader when it passed the water DSIC legislation fifteen years ago. Passage of House Bill 1294 would add Pennsylvania to the growing list of states that are wisely allowing prompt recovery of infrastructure replacement costs for other utilities. I respectfully ask the Committee to approve House Bill 1294 because I believe that it is in the public interest.

Energy Association of Pennsylvania
Miles of Unprotected Bare Steel and Cast/Wrought Iron
Distribution Pipe in the Ground (*Year-end 2009*)

EAP Major Natural Gas Distribution Utility Member	Company's Total PA Distribution Pipeline	Miles of Total PA Distribution Pipeline Made of Unprotected Bare Steel & Cast/Wrought Iron	% of Total PA Distribution Pipeline Made of Unprotected Bare Steel & Cast/Wrought Iron
Columbia Gas of PA	7,363	1,990	27%
Equitable Gas Company	3,355	818	24%
National Fuel Gas Distribution Corp.	4,974	1,066	21%
PECO Energy Company	6,703	1,160	17%
Peoples Natural Gas Company	6,647	1,884	28%
Philadelphia Gas Works	3,029	1,582	52%
UGI Central Penn Gas, Inc.	3,704	641	17%
UGI Penn Natural Gas, Inc.	2,591	410	16%
UGI Gas Utilities, Inc.	5,322	671	13%
TOTAL	43,688	10,222	23%

Source: Individual EAP Member Companies' Reports filed year-end 2009 with the U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration).

