

# Regulatory Analysis Form

(Completed by Promulgating Agency)

INDEPENDENT REGULATORY  
REVIEW COMMISSION

(All Comments submitted on this regulation will appear on IRRRC's website)

(1) Agency  
Public Utility Commission

(2) Agency Number: L-2014-2421001  
Identification Number: 57-307

IRRC Number: 3088

(3) PA Code Cite: 52 Pa. Code §§ 54.187 and 54.190.

(4) Short Title: Automatic Adjustment Clauses Related to Electric Default Service

(5) Agency Contacts (List Telephone Number and Email Address):

Primary Contact: Krystle Sacavage (717) 787-5262 [ksacavage@pa.gov](mailto:ksacavage@pa.gov)

Secondary Contact: Robert Young (717) 787-4945 [rfyoung@pa.gov](mailto:rfyoung@pa.gov)

(6) Type of Rulemaking (check applicable box):

- Proposed Regulation  
 Final Regulation  
 Final Omitted Regulation

- Emergency Certification Regulation;  
 Certification by the Governor  
 Certification by the Attorney General

(7) Briefly explain the regulation in clear and nontechnical language. (100 words or less)

The Commission proposes to establish a symmetrical rate of interest which will be applicable to both over and under collections resulting from the reconciliation of utilities' actual costs and revenue collected through automatic adjustment clauses regarding electric default service. In order to fully recover the cost of providing service, public utilities are permitted to utilize automatic adjustment clauses to increase or decrease rates to reflect changes in certain costs.

(8) State the statutory authority for the regulation. Include specific statutory citation.

66 Pa. C.S. §§ 501, 1301, 1307 and 2804; Sections 201 and 202 of the Act of July 31, 1968, P.L. 769 No. 240, 45 P.S. §§ 1201-1202; 1 Pa. Code §§ 7.1, 7.2, and 7.5; Section 204(b) of the Commonwealth Attorneys Act, 71 P.S. § 732.204(b); Section 745.5 of the Regulatory Review Act, 71 P.S. § 745.5; Section 612 of the Administrative Code of 1929, 71 P.S. § 232.

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(9) Is the regulation mandated by any federal or state law or court order, or federal regulation? Are there any relevant state or federal court decisions? If yes, cite the specific law, case or regulation as well as, any deadlines for action.

The proposed regulations are not mandated by any federal or state law or court order, or federal regulation.

(10) State why the regulation is needed. Explain the compelling public interest that justifies the regulation. Describe who will benefit from the regulation. Quantify the benefits as completely as possible and approximate the number of people who will benefit.

In order to fully recover the cost of providing service, public utilities are permitted to utilize automatic adjustment clauses to increase or decrease rates to reflect changes in certain costs. Ideally, utilities would reasonably forecast and match expenses to sales, resulting in only minor over or under collections. Unfortunately, this may not always be the case going forward. Traditional methods of reconciliation accounting and of allocating costs to rate classes could cause a great deal of volatility, especially in the electric default service market.

In addition, the rules vary as to whether interest is paid or collected on over and under collections and also as to the rate of interest that is paid or collected. Further, these interest rates are often not reflective of current market conditions. As a result, utilities may have little or no incentive to accurately forecast expenses and sales and the amount of costs that are over-collected or under-collected could potentially be significant. In order to alleviate these concerns, the regulations proposed by the Commission create uniformity as to whether interest is to be paid or collected on over or under collections and the rate of interest that is paid or collected (interest at prime rate).

Applying a uniform and symmetrical rate of interest to both over and under collections resulting from automatic adjustment clauses related to electric default service will benefit and provide equity for both customers and electric distribution companies (EDCs) as each would be compensated at the true cost of money. Additionally, establishing symmetrical interest rates for over and under collections is equitable to both customers and EDCs because it allows for identical treatment. Therefore, not only will electric default service customers benefit from the Commission's proposed symmetrical rate of interest, but also EDCs providing electric default service.

Currently, the Commission regulates 11 EDCs which provide electric default service, called "default service providers" (DSPs), throughout the Commonwealth. The Commission also estimates that there are 3.6 million total customers receiving default electric service within the Commonwealth. The exact benefits to customers and EDCs/DSPs cannot be quantified as the Commission cannot predict the exact amount of over and under collections resulting from automatic adjustment clauses related to electric default service at any given time.

(11) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulations.

These proposed regulations do not contain any provisions that are more stringent than federal standards.

(12) How does this regulation compare with those of the other states? How will this affect Pennsylvania's ability to compete with other states?

The Commission recognizes that several other states utilize a symmetrical rate of interest applicable to both over and under collections resulting from automatic adjustment clauses. However, these proposed regulations do not affect the ability of Pennsylvania to compete with other states.

(13) Will the regulation affect any other regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

The proposed regulations will not affect any other regulations of the Commission or other state agencies.

(14) Describe the communications with and solicitation of input from the public, any advisory council/group, small businesses and groups representing small businesses in the development and drafting of the regulation. List the specific persons and/or groups who were involved. ("Small business" is defined in Section 3 of the Regulatory Review Act, Act 76 of 2012.)

On May 22, 2014, the Commission issued an Advance Notice of Proposed Rulemaking Order (ANOPR Order) proposing to establish a symmetrical rate of interest which will be applicable to both over and under collections resulting from the reconciliation of utilities' actual costs and revenue collected through automatic adjustment clauses regarding electric default service. In response to the May 22, 2014 ANOPR Order, the Commission received comments generally supporting such a proposal from the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), the Energy

Association of Pennsylvania (EAP), PPL Electric Utilities Corporation (PPL), PECO Energy Company (PECO), and the Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company (collectively, the First Energy Companies). The Commission reviewed and considered these comments in the Proposed Rulemaking Order and in connection with drafting the proposed regulations.

(15) Identify the types and number of persons, businesses, small businesses (as defined in Section 3 of the Regulatory Review Act, Act 76 of 2012) and organizations which will be affected by the regulation. How are they affected?

The proposed regulations to establish a symmetrical rate of interest for both over and under collections resulting from automatic adjustment clauses related to electric default service will impact both EDCs providing electric default service and customers receiving electric default service. Currently, the Commission regulates 11 electric default service providers (DSPs) throughout the Commonwealth, which include:

1. Citizens' Electric of Lewisburg
2. Duquesne Light Company
3. Metropolitan Edison Company (Met-Ed)
4. PECO Energy Company
5. Pennsylvania Electric Company (Penelec)
6. Pennsylvania Power Company (Penn Power)
7. Pike County Light & Power Company
8. PPL Electric Utilities, Inc.
9. UGI Utilities, Inc.
10. Wellsboro Electric Company
11. West Penn Power

These DSPs will be required to revise their default service tariffs filed with the Commission (beginning with the first reconciliation after any of the proposed regulations take effect) to comply with the proposed symmetrical interest rate structure. As further explained below, some of these DSPs would be considered "small businesses." These DSPs will be benefited as the proposed regulations will allow DSPs to be compensated for their over and under collections resulting from automatic adjustment clauses related to electric default service at the true cost of money.

Currently, the Commission estimates that there are 3.6 million total customers receiving default electric service within the Commonwealth. The Commission notes that the number of customers affected by these regulations will constantly change due to customer "shopping" and the number of customers who chose to receive electric default service. These customers will be benefited as the proposed regulations will prevent significant over and/or under collections from customers and will allow customers to be compensated at the true cost of money.

As previously explained, applying a uniform and symmetrical rate of interest to both over and under collections resulting from automatic adjustment clauses related to electric default service will benefit both DSPs and customers. Specifically, establishing symmetrical interest rates for over and under collections is equitable to both DSPs and customers because it allows for identical treatment.

(16) List the persons, groups or entities, including small businesses, that will be required to comply with the regulation. Approximate the number that will be required to comply.

These regulations will require compliance by DSPs as they will be required to revise their default service tariffs filed with the Commission (beginning with the first reconciliation after any of the proposed regulations take effect) to comply with the proposed symmetrical interest rate structure. Currently, 8 of the 11 DSPs regulated by the Commission would be considered “small businesses.”

The Commission reviewed the standards set forth by 13 CFR § 121.201 and the U.S. Small Business Administration Table of Small Business Size Standards Matched to North American Industry Classification System (NAICS) Codes to determine the applicability of this rulemaking to small businesses. The standards for small business classification for DSPs are as follows:

**Sector 22 – Utilities**

Subsector 221 – Utilities	Size Standards - # of Employees
221122      Electric Power Distribution	1,000

As per these standards, Electric Power Distribution entities (#221122) with 1,000 employees or less qualify as “small businesses.” Currently, 8 of the 11 DSPs regulated by the Commission have 1,000 employees or less and thus qualify as “small businesses.”

(17) Identify the financial, economic and social impact of the regulation on individuals, small businesses, businesses and labor communities and other public and private organizations. Evaluate the benefits expected as a result of the regulation.

The DSPs regulated by the Commission will be benefited as the proposed regulations will allow DSPs to be compensated for their over and under collections resulting from automatic adjustment clauses related to electric default service at the true cost of money. Additionally, the 3.6 million total customers receiving default electric service within the Commonwealth will be benefited as the proposed regulations will prevent significant over and/or under collections from customers and will also allow customers to be compensated at the true cost of money. Accordingly, establishing symmetrical interest rates for over and under collections is equitable to both DSPs and customers because it allows for identical treatment.

(18) Explain how the benefits of the regulation outweigh any cost and adverse effects.

Although DSPs will be required to revise their default service tariffs filed with the Commission (beginning with the first reconciliation after any of the proposed regulations take effect) to comply with the proposed symmetrical interest rate structure, these DSPs will be benefited as the proposed regulations will allow DSPs to be compensated for their over and under collections resulting from automatic adjustment clauses related to electric default service at the true cost of money.

The Commission is not aware of any added adverse effects or costs to customers receiving electric default service.

(19) Provide a specific estimate of the costs and/or savings to the **regulated community** associated with compliance, including any legal, accounting or consulting procedures which may be required. Explain how the dollar estimates were derived.

DSPs will be required to revise their default service tariffs filed with the Commission (beginning with the first reconciliation after any of the proposed regulations take effect) to comply with the proposed symmetrical interest rate structure. The Commission is not able to estimate the cost of this revision. However, these DSPs will be benefited as the proposed regulations will allow DSPs to be compensated for their over and under collections resulting from automatic adjustment clauses related to electric default service at the true cost of money. The Commission is not able to estimate the exact amount of savings to DSPs that will result from the proposed interest rate structure as the Commission cannot predict the amount of over or under collections that will occur at any given time.

(20) Provide a specific estimate of the costs and/or savings to the **local governments** associated with compliance, including any legal, accounting or consulting procedures which may be required. Explain how the dollar estimates were derived.

The Commission is not aware of any costs and/or savings to local governments resulting from the proposed regulations.

(21) Provide a specific estimate of the costs and/or savings to the **state government** associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required. Explain how the dollar estimates were derived.

The Commission is not aware of any costs and/or savings to state governments resulting from the proposed regulations.

(22) For each of the groups and entities identified in items (19)-(21) above, submit a statement of legal, accounting or consulting procedures and additional reporting, recordkeeping or other paperwork, including copies of forms or reports, which will be required for implementation of the regulation and an explanation of measures which have been taken to minimize these requirements.

There are no legal, accounting or consulting procedures, or additional reporting, recordkeeping or other paperwork imposed by the proposed regulations.

(23) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years. N/A

	<b>Current FY Year</b>	<b>FY +1 Year</b>	<b>FY +2 Year</b>	<b>FY +3 Year</b>	<b>FY +4 Year</b>	<b>FY +5 Year</b>
<b>SAVINGS:</b>	\$ N/A	\$ N/A	\$ N/A	\$ N/A	\$ N/A	\$ N/A
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Savings</b>						
<b>COSTS:</b>						
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Costs</b>						
<b>REVENUE LOSSES:</b>						
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Revenue Losses</b>						

(23a) Provide the past three year expenditure history for programs affected by the regulation. N/A

Program	FY -3	FY -2	FY -1	Current FY
N/A	N/A	N/A	N/A	N/A

(24) For any regulation that may have an adverse impact on small businesses (as defined in Section 3 of the Regulatory Review Act, Act 76 of 2012), provide an economic impact statement that includes the following:

- (a) An identification and estimate of the number of small businesses subject to the regulation.
- (b) The projected reporting, recordkeeping and other administrative costs required for compliance with the proposed regulation, including the type of professional skills necessary for preparation of the report or record.
- (c) A statement of probable effect on impacted small businesses.
- (d) A description of any less intrusive or less costly alternative methods of achieving the purpose of the proposed regulation.

(a) Currently, 8 of the 11 DSPs subject to the proposed regulations are considered “small businesses.”

(b) These 8 DSPs will be required to revise their default service tariffs filed with the Commission (beginning with the first reconciliation after any of the proposed regulations take effect) to comply with the proposed symmetrical interest rate structure.

(c) The Commission is not able to estimate the cost of revising default service tariffs to comply with the proposed regulations. However, the Commission notes that DSPs are not required to revise their current tariffs on file with the Commission. Rather, DSPs would only be required to change the interest rate structure to comply with the proposed regulations in their first reconciliation after any of the proposed regulations take effect.

(d) The Commission is not aware of any less intrusive or less costly alternative methods.



(25) List any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, the elderly, small businesses, and farmers.

There are no special provisions that were considered.

(26) Include a description of any alternative regulatory provisions which have been considered and rejected and a statement that the least burdensome acceptable alternative has been selected.

There are no less burdensome alternatives that were considered.

(27) In conducting a regulatory flexibility analysis, explain whether regulatory methods were considered that will minimize any adverse impact on small businesses (as defined in Section 3 of the Regulatory Review Act, Act 76 of 2012), including:

- a) The establishment of less stringent compliance or reporting requirements for small businesses;
- b) The establishment of less stringent schedules or deadlines for compliance or reporting requirements for small businesses;
- c) The consolidation or simplification of compliance or reporting requirements for small businesses;
- d) The establishment of performing standards for small businesses to replace design or operational standards required in the regulation; and
- e) The exemption of small businesses from all or any part of the requirements contained in the regulation.

There are no other regulatory methods that were considered.

(28) If data is the basis for this regulation, please provide a description of the data, explain in detail how the data was obtained, and how it meets the acceptability standard for empirical, replicable and testable data that is supported by documentation, statistics, reports, studies or research. Please submit data or supporting materials with the regulatory package. If the material exceeds 50 pages, please provide it in a searchable electronic format or provide a list of citations and internet links that, where possible, can be accessed in a searchable format in lieu of the actual material. If other data was considered but not used, please explain why that data was determined not to be acceptable.

Data is not the basis for these proposed regulations.

(29) Include a schedule for review of the regulation including:

- |   |                              |
|---|------------------------------|
| A. The date by which the agency must receive public comments:                               | 30 days after publication    |
| B. The date or dates on which public meetings or hearings will be held:                     | as needed                    |
| C. The expected date of promulgation of the proposed regulation as a final-form regulation: | 1 <sup>st</sup> quarter 2016 |
| D. The expected effective date of the final-form regulation:                                | upon publication as final    |
| E. The date by which compliance with the final-form regulation will be required:            | upon publication as final    |
| F. The date by which required permits, licenses or other approvals must be obtained:        | <u>N/A</u>                   |

(30) Describe the plan developed for evaluating the continuing effectiveness of the regulations after its implementation.

The Commission will continue to monitor over and under collections resulting from automatic adjustment clauses related to electric default service to determine whether further regulations are required to avoid significant over and under collections by DSPs.

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WITH THE LEGISLATIVE REFERENCE BUREAU

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Copy below is hereby approved as to form and legality. Attorney General.

*Angela M. Elliott*

BY \_\_\_\_\_  
(DEPUTY ATTORNEY GENERAL)

DEC 02 2014

DATE OF APPROVAL

Check if applicable  
Copy not approved. Objections attached

Copy below is hereby certified to be true and correct copy of a document issued, prescribed or promulgated by:

Pennsylvania Public Utility Commission  
(AGENCY)

DOCUMENT/FISCAL NOTE NO. L-2014-2421001/57-307

DATE OF ADOPTION October 2, 2014

*Rosemary Chiavetta*

BY \_\_\_\_\_  
Rosemary Chiavetta

TITLE Secy  
(SECRETARY)

Copy below is hereby approved as to form and legality. Executive or independent Agencies.

BY *Bohdan R. Pankiw*

Bohdan R. Pankiw  
Chief Counsel

10-2-2014

DATE OF APPROVAL

Check if applicable. No Attorney General approval or objection within 30 days after submission.

L-2014-2421001/57-307  
Proposed Rulemaking  
Automatic Adjustment Clauses  
Related to Electric Default Service  
52 Pa Code, Chapter 54

The Pennsylvania Public Utility Commission on October 2, 2014, adopted a proposed rulemaking order establishing a symmetrical rate of interest which will be applicable to both over and under collections resulting from the reconciliation of utilities' actual costs and revenue collected through automatic adjustment clauses regarding electric default service. The contact person is Assistant Counsel Krystle Sacavage, Law Bureau, 717 787-5262.

## **EXECUTIVE SUMMARY**

**L-2014-2421001/57-307**

Proposed Rulemaking

### Automatic Adjustment Clauses Related to Electric Default Service

On May 22, 2014, the Pennsylvania Public Utility Commission (Commission) issued an Advance Notice of Proposed Rulemaking Order (ANOPR Order) proposing to establish a symmetrical rate of interest which will be applicable to both over and under collections resulting from the reconciliation of utilities' actual costs and revenue collected through automatic adjustment clauses regarding electric default service. In order to fully recover the cost of providing service, public utilities are permitted to utilize automatic adjustment clauses to increase or decrease rates to reflect changes in certain costs. The Commission received comments in response to the May 22, 2014 ANOPR Order from the Office of Consumer Advocate, the Office of Small Business Advocate, the Energy Association of Pennsylvania, PPL Electric Utilities Corporation (PPL), PECO Energy Company, and the Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company.

The Commission proposed to establish a symmetrical rate of interest applicable to over and under collections resulting from reconciliation of automatic adjustment clause costs and revenues related to electric default service to better ensure that utilities' current prices reflect current costs as accurately as is feasible. Based upon our review and consideration of the comments filed in response to our May 22, 2014 ANOPR Order, the Commission proposes the regulations as set forth in Annex A of the Proposed Rulemaking Order.

The contact persons for this Proposed Rulemaking are Assistant Counsel Krystle Sacavage (717) 787-5262 and Deputy Chief Counsel Robert Young (717) 787-4945.

**PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17105-3265**

Public Meeting held October 2, 2014

Commissioners Present:

Robert F. Powelson, Chairman  
John F. Coleman, Jr., Vice Chairman  
James H. Cawley  
Pamela A. Witmer  
Gladys M. Brown

Automatic Adjustment Clauses  
Related to Electric Default Service

Docket No. L-2014-2421001

**PROPOSED RULEMAKING ORDER**

**BY THE COMMISSION:**

On May 22, 2014, the Pennsylvania Public Utility Commission (Commission) issued an Advance Notice of Proposed Rulemaking Order (ANOPR Order) proposing to establish a symmetrical rate of interest which will be applicable to both over and under collections resulting from the reconciliation of default service providers' (DSPs) actual costs and revenue collected through automatic adjustment clauses regarding electric default service. In order to fully recover the cost of providing service, DSPs, which currently are electric distribution companies (EDCs), are permitted to utilize automatic adjustment clauses to increase or decrease rates to reflect changes in certain costs. The Commission has identified that traditional methods of reconciliation accounting could, however, cause a great deal of volatility in default service rates associated with the recovery of revenue and cost imbalances created by the use of these automatic adjustment clauses. In order to alleviate these concerns, the Commission proposes to establish a

uniform policy regarding whether interest is recoverable when reconciling costs through automatic adjustment clauses and the rate of interest that is paid or collected. Based upon our review and consideration of the comments filed in response to the May 22, 2014 ANOPR Order by the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), the Energy Association of Pennsylvania (EAP), PPL Electric Utilities Corporation (PPL), PECO Energy Company (PECO), and the Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company (collectively, the FirstEnergy Companies), we propose the regulations as set forth in Annex A to this Order.

## **BACKGROUND**

Section 1307(a) of the Public Utility Code, 66 Pa. C.S. § 1307(a), generally provides that public utilities may establish automatic adjustment clauses. Automatic adjustment clauses allow utilities to increase or decrease rates to reflect changes in specific costs without the extensive filing requirements and review process of a traditional base rate case. 66 Pa. C.S. § 1307(a). Some examples of costs that are recovered through automatic adjustment clauses include, but are not limited to: Electric Default Service, Act 129 Energy Efficiency and Conservation Programs, Smart Meter, Universal Service, Distribution System Improvement Charges and the Alternative Energy Portfolio.

Before implementing an automatic adjustment clause, public utilities must file a tariff, or tariff rider, for the Commission's approval. *Id.* The tariff or tariff rider will outline the specifics of each automatic adjustment clause, including: to which customers the rate applies, how often the rate is adjusted (i.e. monthly, quarterly, semi-annually, or annually), which costs are recoverable and the reconciliation period.

Within thirty days following the end of the reconciliation period set forth in the

tariff, each public utility using an automatic adjustment clause must file with the Commission a statement specifying the total revenues received pursuant to the adjustment clause, the total amount of expenses incurred pursuant to the adjustment clause and the difference between the total revenues received and the total expenses incurred. 66 Pa. C.S. § 1307(e). The difference between the total revenues received and the total expenses incurred is referred to as the over or under collection. After reconciling their actual costs with what was recovered from consumers, utilities then make adjustments to their rates to either refund over-collected amounts to customers or collect under-collected amounts from customers.

Ideally, utilities would reasonably forecast and match expenses to sales, resulting in only minor over or under collections. Unfortunately, this may not always be the case going forward. Traditional methods of reconciliation accounting and of allocating costs to rate classes could cause a great deal of volatility, especially in the electric default service market. In addition, the rules vary as to whether interest is paid or collected on over and under collections and also as to the rate of interest that is paid or collected. Further, these interest rates are often not reflective of current market conditions. As a result, utilities may have little or no incentive to accurately forecast expenses and sales and the amount of costs that are over-collected or under-collected could potentially be significant.

The Commission believes that many of the utilities' costs are currently being forecasted accurately. However, in order to specifically meet the Commission's objective that utilities' current prices reflect current costs as accurately as is feasible, the Commission desires to set forth uniform rules regarding default service related automatic adjustment clauses. Specifically, the Commission desires to create uniformity as to whether interest is to be paid or collected on over or under collections and the rate of interest that is paid or collected.

## DISCUSSION

### A. Current Varying Interest Rate Structure

By way of background, the Public Utility Code (Code) and the Commission's Regulations expressly permit reconciliation by DSPs for default service costs through automatic adjustment clauses. 66 Pa. C.S. § 2807(e)(3.9); 52 Pa. Code § 54.187(b). Section 2807(e)(3.9) of the Code specifically provides that DSPs may recover all costs incurred under a Commission-approved competitive procurement plan pursuant to a reconcilable automatic adjustment clause under 66 Pa. C.S. § 1307 (relating to sliding scale of rates; adjustments). 66 Pa. C.S. § 2807(e)(3.9). As previously stated, however, the rules vary as to whether interest is paid or collected on over and under collections and also as to the rate of interest that is paid or collected.

The guiding principal of any adjustable rate approved under Section 1307 of the Code, in addition to its being in the public interest, is that it comply with the just and reasonable mandate of 66 Pa. C.S. § 1301 (relating to just and reasonable rates). Section 1307 specifically seeks to ensure that qualifying rates provide utilities with the opportunity to achieve a just and reasonable return. Thus, a primary purpose of Section 1307 is to provide qualified adjustable rate relief to utilities that may be subject to significant expense swings.

The adjustable expense recovery permitted under Section 1307 of the Code is limited to those expenses expressly authorized, or those easily identifiable, variable and beyond a utility's control. In the wake of electric restructuring, the Commission has approved a host of automatic adjustment clauses for EDCs to recover, including default service expenses related to their role as DSPs. Costs recoverable through automatic adjustment clauses related to electric default service include, but are not limited to, the costs to procure energy, capacity, ancillary services, Federal Energy Regulatory



Commission approved transmission charges and administrative costs associated with portfolio procurements for the default services supply.

This Order focuses only on those automatic adjustment clauses related to electric default service as bulleted below. The Commission has limited the proposed application of a uniform interest rate paid or collected on over or under collections resulting from reconciliation of automatic adjustment clauses to electric default service for several reasons. First, all EDCs, as DSPs, use automatic adjustment clauses related to electric default service. Second, default service represents the largest dollar amount on most default service customers' electric bills and invoices (other than distribution). Third, default service is still the electric service used by a majority of customers in Pennsylvania. Accordingly, the proposals set forth herein regarding the uniform interest rates applicable to over and under collections are limited to the following automatic adjustment clauses related to electric default service filed with the Commission pursuant to 52 Pa. Code § 54.187(b) (relating to default service rate design and the recovery of reasonable costs):

- Price-to-Compare (PTC)
- Hourly Pricing Default Service Rider (HPDSR)
- Transmission Service Charge (TSC)
- Generation Supply Charges 1 & 2 (GSC-1 & GSC-2)
- Generation Supply Adjustment 1, 2, 3, 4 (GSA 1, 2, 3, 4)
- Generation Supply Service Rate (GSSR)
- Default Service (DS)
- Default Service Supply (DSS)

To provide an example of varying interest rates set forth in these automatic adjustment clauses, PPL, an EDC acting as a DSP within its service territory, utilizes the

following automatic adjustment clauses related to electric default service: a Transmission Service Charge (TSC), a Generation Supply Charge-1 (GSC-1) and a Generation Supply Charge-2 (GSC-2). PPL's TSC is computed separately for each of the following four customer classes: (1) residential, (2) small commercial and industrial, (3) large commercial and industrial-primary and (4) large commercial and industrial-transmission. PPL's GSC-1 applies to residential and small commercial and industrial customers. PPL's GSC-2 applies to large commercial and industrial customers.

For the TSC, interest is calculated at an "appropriate rate" under Section 1308(d) of the Code. 66 Pa. C.S. § 1308(d). Section 1308(d) defines interest as "the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L. 13, No. 6), referred to as the Loan Interest and Protection Law." 66 Pa. C.S. § 1308(d). This Residential Mortgage Interest Rate is based on the monthly index of long term United States Government Bond Yields. Loan Interest and Protection Law, Act of Jan. 30, 1974, P.L. 13, No. 6. (Loan Interest Act). The Pennsylvania Residential Mortgage Interest Rate changes monthly. In 2013, the Residential Mortgage Interest Rate ranged from a low of 4.5% to a high of 6.0%.

For the Generation Supply Charges, interest on under collections is calculated at the legal rate of interest, and interest on over collections is calculated at the legal rate of interest plus two percent annual interest. The legal rate of interest was also defined by the Loan Interest Act and codified at 41 P.S. § 202. Section 202 reads, in pertinent part, "[r]eference in any law or document...to 'legal rate of interest'...shall be construed to refer to the rate of interest of six per cent per annum." 41 P.S. § 202. Under this statutory definition of legal interest, PPL recovers under collections of its Generation Supply Charges with six percent (6%) interest. PPL refunds over collections of its Generation Supply Charges with eight percent (8%) interest. 52 Pa. Code § 54.187(g).

In addition to the residential mortgage interest rate and the legal interest rate, there

is also the prime interest rate. The prime interest rate is the interest rate charged by banks to their most creditworthy customers. The prime interest rate is almost always the same amongst major banks, and adjustments to the prime interest rate are made by banks at the same time. The prime interest rate is usually adjusted at the same time and in correlation to the adjustments of the Federal Funds Rate (the interest rate that banks charge each other for overnight loans made to fulfill reserve funding requirements). As of September 2014, the prime interest rate is 3.25% in the United States.<sup>1</sup>

As exemplified by PPL's Generation Supply Charges, interest rates on under and over collections are often asymmetrical. Asymmetrical interest rates create an incentive for the DSPs to under project or under collect in order to avoid over collection penalties and to receive an interest rate higher than that which can be found in the market. This practice can lead to an understated price-to-compare (PTC). An understated PTC undermines the competitive market because electric generation suppliers (EGSs) cannot under collect and then make-up that under collection later as can the utilities. This Order will recommend the use of symmetrical interest rates for both under and over collections.<sup>2</sup>

The Commission's current use of the legal rate of interest for under collections and the legal rate of interest plus 2% for over collections, used for most electric default service automatic adjustment clauses, results in interest rates that are well above current market-based rates. This Order will recommend the use of the prime interest rate for the calculation of interest on both over and under collections resulting from automatic adjustment clauses related to electric default service.<sup>3</sup> The Commission believes that

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<sup>1</sup> The Wall Street Journal, Market Data Center, [http://online.wsj.com/mdc/public/page/2\\_3020-moneyrate.html](http://online.wsj.com/mdc/public/page/2_3020-moneyrate.html) (September 10, 2014).

<sup>2</sup> The proposals set forth herein are supported by the comments filed in response to the Commission's Default Service Reconciliation Interim Guidelines at Docket No. M-2012-2314313 (Order entered August 14, 2012).

<sup>3</sup> As additional support for the proposals contained in this Order, the Commission analyzed House Bill 1188. H.R. 1188, Printer's No. 1484 (Pa. 2013). House Bill 1188, currently under consideration by the

using the prime interest rate is most appropriate here as this rate is most commensurate with market rates. Additionally, the prime interest rate is publicly known and available, and transparent. Further, the prime interest rate also reflects the terms and risks inherent in the utility reconciliation process.

At this time the Commission is not aware of any intentional over or under collecting being done by DSPs in order to earn more interest. However, in addition to the volatility of rates caused by unpredictable weather and shopping patterns of customers, there is the widely-recognized possibility that a DSP could attempt to use the automatic adjustment clause methodology related to electric default service to increase interest earnings. In general, DSPs have a 50/50 split in over collections versus under collections relating to electric default service. Additionally, the over and under collections by month are well within a reasonable percentage of allowable costs in the associated months. However, in order to ensure accurate projections and to create uniformity, the Commission proposes to apply a symmetrical interest rate, reflective of market conditions, to under and over collections as set forth below.

## **B. Proposed Uniform Interest Rate Structure**

By way of this Order, the Commission proposes to establish a symmetrical rate of interest which will be applicable to over and under collections resulting from the reconciliation of DSPs' costs and revenues resulting from automatic adjustment clauses related to electric default service. The proposed applicable rate of interest on over and under collections would be interest at the prime rate for commercial borrowing in effect on the last day of the month the over or under collection occurred, as reported in the Wall

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General Assembly,<sup>3</sup> would amend the Gas Choice Act, 66 Pa. C.S. §1307(f), to change the interest rate from the legal rate of interest to the prime interest rate for both over and under collections. The proposed language specifically states that “[r]efunds to customers shall be made with and recoveries from customers shall include interest at the prime rate for commercial borrowing in effect 60 days prior to the tariff filing made under paragraph (1) [relating to the filing of tariffs by natural gas distribution companies] and as reported in a publicly available source identified by the commission or at an interest rate which may be established by the commission by regulation.” *Id.*

Street Journal. For example, the interest rate applied to over or under collections in the month of March would be the prime rate that was in effect on March 31 as reported in the Wall Street Journal. This rate of interest will be computed monthly from the month the over collection or under collection occurs to the effective month that the over collection is refunded to customers or the under collection is collected from customers.

Additionally, this rate of interest will apply universally to all over and under collections reconciled through the automatic adjustment clauses related to electric default service, as bulleted in Part A of this Order.

The Commission recognizes that the interest rate structure proposed herein does not currently comply with the Commission's regulations, 52 Pa. Code §§1.1-111.14, and/or public utilities' current tariffs regarding electric default service. As such, the Commission's Final Rulemaking Order may direct DSPs to revise their tariffs and tariff riders to reflect this proposed interest rate structure.

Although the Commission cannot completely eradicate all imbalances in the amount of costs that are over and under collected, the proposed symmetrical interest rate structure set forth herein will deter DSPs from inaccurately forecasting costs and sales to improperly increase interest earnings. This symmetrical application of interest to over and under collections uses the prime rate of interest which is not only commensurate with market rates, but is also publicly known, available and transparent. Overall, application of the symmetrical rate of interest, at prime rate, to over and under collections reflects the terms and risks inherent in the utility reconciliation process.

In addition to the proposed interest rate structure set forth herein, the Commission reminds DSPs to consider filing an interim rate adjustment and/or cost reconciliation when the DSP anticipates substantial over or under collections. In fact, the Commission recognizes that such interim rate adjustments and cost reconciliations are in the public interest as they provide DSPs with a mechanism to reduce significant imbalances in over

and under collections. For example, Section 69.1809(c) of the Commission's regulations regarding default service provide in relevant part that:

It may be in the public interest to reconcile default service costs more frequently than at each PTC [price-to-compare] adjustment interval. The DSP [default service provider] should propose interim reconciliation prior to the next subsequent PTC adjustment interval when current monthly revenues have diverged from current monthly costs, plus any cumulative over/under recoveries, by greater than 4% since the last rate adjustment. . . . Interim reconciliation proposals should result in a PTC adjustment that will resolve cumulative under or over recoveries by the time of the next PTC adjustment interval.

52 Pa. Code § 69.1809(c).

### **C. Comments**

All of the commentators to the May 22, 2014 ANOPR Order generally support the Commission's proposal to establish a symmetrical rate of interest which will be applicable to over and under collections resulting from the reconciliation of electric default service rates. Specifically, PECO provided that using a symmetrical rate of interest "will provide equity for both customers and EDCs as each would be compensated at the true cost of money." PECO Comments at 2. Similarly, the FirstEnergy Companies noted in their comments that "[e]stablishing symmetrical interest rates for over and under collections is equitable to both customers and EDCs because it allows for identical treatment." FirstEnergy Companies Comments at 2. Additionally, the OCA commented that a "symmetric market-based approach to the application of interest might make some EDCs more amenable to reconciliation periods which will better serve customers and make price comparisons easier." OCA Comments at 3.

Additionally, all of the commentators agree that the proposed prime rate of interest is the appropriate interest rate to apply when reconciling over and under collections

through automatic adjustment clauses related to electric default service. In their comments, EAP noted that “making interest rates market-based makes sense because it more accurately reflects the true time value of money.” EAP Comments at 3. The OCA also commented that they agree with the Commission “that the interest rate should be more closely aligned with current market rates,” as the prime rate of interest is the rate most reflective of market conditions. OCA Comments at 3. Further, the OSBA commented that the prime rate of interest is “market-based and much more reflective of DSP [Default Service Provider] costs than is the current mechanism.” OSBA Comments at 2.

In the May 22, 2014 ANOPR Order, the Commission proposed that the applicable rate of interest on over and under collections would be interest at the prime rate for commercial borrowing “as reported in the Wall Street Journal or other publically available source identified by the Commission.” In their comments, PECO requests that the Commission state with specificity which market based index will be used when determining the prime rate of interest. PECO Comments at 3. PECO specifically asks that the Commission determine whether it will use the Wall Street Journal index or reserve the right to switch to a different index in the future. Because the Commission cannot predict whether the Wall Street Journal will continue to be the most appropriate market index for purposes of determining the prime rate of interest, the Commission will continue to reserve the right to switch to a more appropriate market index in the future. If the Commission is required to switch to a different index in the future, the Commission will ensure that proper notification of such switch is provided to all interested parties.

PECO also comments that the adoption of the Commission’s proposed symmetrical interest rate should be structured to not conflict with an EDC’s currently approved default service plan. PECO Comments at 2. Specifically, PECO requests that the Commission allow EDCs to implement the proposed interest rate method

commencing with the first reconciliation filing after the effective date of any regulations adopted pursuant to this rulemaking process. In order to maintain the integrity of these default service plans, the Commission intends to require DSPs to implement these proposed interest rates with the first reconciliation filing after the effective date of any new regulations adopted pursuant to this Order. As such, if the proposed regulations set forth herein are approved, the Final Rulemaking Order will specifically direct DSPs to implement this proposed interest rate structure commencing with the first reconciliation filing after the effective date of such regulations.

In the May 22, 2014 ANOPR Order, the Commission proposed that the interest applicable to over and under collections would be computed monthly from the month the over collection or under collection occurs to the effective month that the over collection is refunded to customers or the under collection is collected from customers. In their comments, the FirstEnergy Companies request that the Commission permit an alternative interest calculation currently being used by the companies. Specifically, the FirstEnergy Companies request that interest be calculated monthly using the average opening and closing default service balance. FirstEnergy Companies Comments at 3. Alternatively, the FirstEnergy Companies request that the proposed interest methodology be “phased-in” so that the companies can “changeover” their practices.

At this point in time, all electric default service providers, other than the FirstEnergy Companies, are using the interest calculation proposed by the Commission in Part B of this Order for purposes of their automatic adjustment clauses related to electric default service. For consistency purposes, the Commission does not intend to propose an alternative interest rate computation that would only apply to the FirstEnergy Companies’ automatic adjustment clauses related to electric default service. Additionally, as previously set forth, the Commission will only require DSPs to implement the proposed interest rate methodology commencing with the first reconciliation filing after the effective date of any regulations adopted pursuant to this



rulemaking process. As such, the FirstEnergy Companies will have a reasonable amount of time to “changeover” their current interest calculation practices.

In the May 22, 2014 ANOPR Order, the Commission proposed that in the event the Commission finds that the application of the symmetrical rate of interest does not adequately prevent DSPs from using automatic adjustment clause methodology related to electric default service to increase interest earnings, the Commission may consider the application of a modified interest rate applicable to “excessive” portions<sup>4</sup> of over and under collections. Specifically, the Commission proposed that in addition to the prime rate of interest applicable to the “non-excessive” portion of all over and under collections, the Commission may consider applying a modified interest rate of prime rate plus 100 basis points on the “excessive” portion of all over collections and a modified interest rate of prime rate minus 100 basis points on the “excessive” portion of all under collections.<sup>5</sup>

All of the commentators to the May 22, 2014 ANOPR Order generally agree that this proposed application of a modified interest rate to “excessive” portions of over and under collections may not be necessary at this time. As previously mentioned, the Commission recognizes that we are not aware of any intentional over or under collecting being done by DSPs in order to earn more interest. Additionally, the commentators have provided that significant over and under collections may occur due to circumstances outside of the DSPs’ control.<sup>6</sup> Specifically, the FirstEnergy Companies noted that “the Companies have occasionally experienced under-collections as a result of unpredictable weather and default service sales which cannot be forecasted when rates are initially

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<sup>4</sup> The Commission proposed that when determining whether a portion of an over or under collection is “excessive,” the Commission would use a threshold equal to a percentage of certain costs of the EDC related to the relevant automatic adjustment clause.

<sup>5</sup> This modified interest rate, adjusted up or down by 100 basis points, would only apply to the “excessive portion” of the over or under collection. This modified rate of interest would not apply to the “non-excessive” portion of the over or under collection.

<sup>6</sup> These circumstances may include billing lag, unpredictable weather, customer shopping rates, default service sales and unforeseen price spikes in energy costs at the wholesale level. PPL Comments at 2; PECO Comments at 5; FirstEnergy Companies Comments at 4; EAP Comments at 5.

established” (for example, experiencing considerable under-collections during the “polar vortex”). FirstEnergy Companies Comments at 4. Similarly, PPL commented that “there are numerous factors that contribute to over or under collections, many of which are not within the Company’s control.” PPL Comments at 4. Based upon our review and consideration of these comments, the Commission will not propose the application of a modified interest rate to “excessive” portions of over or under collections at this time.

## CONCLUSION

Establishing a symmetrical rate of interest applicable to over and under collections resulting from reconciliation of automatic adjustment clause costs and revenues will better ensure that DSPs’ current prices reflect current costs as accurately as is feasible. By this Proposed Rulemaking Order, the Commission proposes to implement the foregoing regulations. The Commission, therefore, formally commences its rulemaking process to implement proposed regulations consistent with Annex A to this Proposed Rulemaking Order.

Accordingly, pursuant to its authority under Sections 501, 1301, 1307 and 2804 of the Public Utility Code, 66 Pa.C.S. §§ 501, 1301, 1307 and 2804, and Sections 201 and 202 of the Act of July 31, 1968, P.L. 769 No. 240, 45 P.S. §§ 1201-1202, and the regulations promulgated thereunder at 1 Pa. Code §§ 7.1, 7.2, and 7.5; Section 204(b) of the Commonwealth Attorneys Act, 71 P.S. § 732.204(b); Section 745.5 of the Regulatory Review Act, 71 P.S. § 745.5; and Section 612 of the Administrative Code of 1929, 71 P.S. § 232, and the regulations promulgated thereunder at 4 Pa. Code §§ 7.231-7.234, we are considering adopting the proposed regulations as set forth in Annex A, attached hereto; **THEREFORE**

**IT IS ORDERED:**

1. That a proposed rulemaking be opened to consider the regulations set forth in Annex A.
2. That the Secretary shall submit this Proposed Rulemaking Order and Annex A to the Office of Attorney General for review as to form and legality and to the Governor's Budget Office for review of fiscal impact.
3. That the Secretary shall submit this Proposed Rulemaking Order and Annex A for review and comments to the Independent Regulatory Review Commission and the Legislative Standing Committees.
4. That the Secretary shall certify this Proposed Rulemaking Order and Annex A and deposit them with the Legislative Reference Bureau to be published in the *Pennsylvania Bulletin*.
5. That an original of any written comments referencing the docket number of the proposed regulations be submitted within 30 days of publication in the *Pennsylvania Bulletin* to the Pennsylvania Public Utility Commission, Attn: Secretary, P.O. Box 3265, Harrisburg, PA 17105-3265.
6. That a copy of this Proposed Rulemaking Order and Annex A shall be served on the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, all jurisdictional electric distribution companies and all parties who commented on the May 22, 2014 Advance Notice of Proposed Rulemaking Order .

7. That the contact person for legal matters for this proposed rulemaking is Krystle J. Sacavage, Assistant Counsel, Law Bureau, (717) 787-5000. Alternate formats of this document are available to persons with disabilities and may be obtained by contacting Sherri DelBiondo, Regulatory Coordinator, Law Bureau, 717-772-4597.

**BY THE COMMISSION,**



Rosemary Chiavetta  
Secretary

(SEAL)

ORDER ADOPTED: October 2, 2014

ORDER ENTERED: October 2, 2014

**Annex A**  
**TITLE 52. PUBLIC UTILITIES**  
**PART I. PUBLIC UTILITY COMMISSION**  
**Subpart C. FIXED SERVICE UTILITIES**  
**CHAPTER 54. ELECTRICITY GENERATION CUSTOMER CHOICE**  
**Subchapter G. DEFAULT SERVICE**

**§ 54.187. Default service rate design and the recovery of reasonable costs.**

\* \* \* \* \*

[(g) A DSP may collect interest from retail customers on the recoveries of under collection of default service costs at the legal rate of interest. Refunds to customers for over recoveries shall be made with interest, at the legal rate of interest plus 2%.]

[(h)] (g) \*\*\*

[(i)] (h) \*\*\*

[(j)] (i) \*\*\*

[(k)] (j) \*\*\*

[(l)] (k) \*\*\*

**§ 54.190. Universal interest applicable to over collections and under collections resulting from reconciliation of automatic adjustment clauses costs and revenues related to electric default service.**

(a) General rule. This section applies to automatic adjustment clauses related to electric default service filed with the Commission by a DSP under § 54.187(b) (relating to default service rate design and the recovery of reasonable costs).

(b) Definitions. The following words and terms, when used in this section, have the following meaning, unless the context clearly indicates otherwise:

Commission – The Pennsylvania Public Utility Commission.

Costs – The total amount of expenses, or class of expenses incurred, which is the basis of the automatic adjustment clause.

Revenue – The total proceeds received pursuant to the automatic adjustment clause.

Over collection – The amount equal to revenues received pursuant to an automatic adjustment clause which exceeds the amount of costs incurred.

Under collection – The amount equal to costs incurred pursuant to an automatic adjustment clause which exceeds the amount of revenues received.

(c) Interest collectible on over collections and under collections. When revenues exceed costs, the over collections shall be refunded to customers with interest. When costs exceed revenues, the under collections shall be collected from customers with interest. Interest on over collections and under collections shall be computed at the prime rate of interest for commercial banking in effect on the last day of the month the over or under collection occurs, as reported in the Wall Street Journal or other publically available source identified by the Commission. Interest shall be computed monthly from the month the over collection or under collection occurs to the effective month that the over collection is refunded or the under collection is collected.



COMMONWEALTH OF PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
400 NORTH STREET  
HARRISBURG, PA 17120

ROBERT F. POWELSON  
CHAIRMAN

February 27, 2015

The Honorable John F. Mizner  
Chairman, Independent Regulatory Review Commission  
14th Floor, Harristown II  
333 Market Street  
Harrisburg, PA 17101

**Re: L-2014-2421001/57-307; Automatic Adjustment Clauses Related to Electric Default Service,  
52 Pa. Code, Chapter 54**

Dear Chairman Mizner:

Enclosed please find one copy of the proposed rulemaking and the Regulatory Analysis Form prepared in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." Pursuant to Section 5(a) of the Regulatory Review Act of June 30, 1989 (P.L. 73, No. 19) (71 P.S. §§745.1-745.15), the Commission is submitting today a copy of the proposed rulemaking and Regulatory Analysis Form to the Chairman of the House Committee on Consumer Affairs and to the Chairman of the Senate Committee on Consumer Protection and Professional Licensure.

The purpose of this proposal is to establish a symmetrical rate of interest which will be applicable to both over and under collections resulting from the reconciliation of utilities' actual costs and revenue collected through automatic adjustment clauses regarding electric default service. The contact person is Assistant Counsel Krystle Sacavage, Law Bureau, 717 787-5262.

The proposal has been deposited for publication with the Legislative Reference Bureau.

Sincerely,

A handwritten signature in black ink that reads "Robert F. Powelson".

Robert F. Powelson

Enclosures

CC: The Honorable Robert M. Tomlinson  
The Honorable Lisa Boscola  
The Honorable Robert Godshall  
The Honorable Peter J. Daley, II  
Legislative Affairs Director Perry  
Chief Counsel Pankiw  
Assistant Counsel Sacavage  
Regulatory Coordinator DelBiondo

TRANSMITTAL SHEET FOR REGULATIONS SUBJECT  
TO THE REGULATORY REVIEW ACT

ID Number: L-2014-2421001/57-307

Subject: Proposed Rulemaking Re Automatic Adjustment Clauses  
Related to Electric Default Service  
52 Pa. Code Chapter 54

Pennsylvania Public Utility Commission




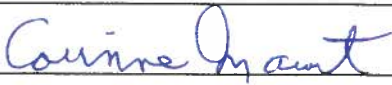
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RECEIVED  
IRRC

TYPE OF REGULATION

- Proposed Regulation
- Final Regulation with Notice of Proposed Rulemaking Omitted.
- Final Regulation
- 120-day Emergency Certification of the Attorney General
- 120-day Emergency Certification of the Governor

FILING OF REPORT

<u>Date</u>	<u>Signature</u>	<u>Designation</u>
2/27/15		<u>HOUSE COMMITTEE</u> (Godshall) Consumer Affairs
2/27/15		<u>SENATE COMMITTEE</u> (Tomlinson) Consumer Protection and Professional Licensure
2/27/15		Independent Regulatory Review Commission
		Attorney General
2/27/15		Legislative Reference Bureau