National
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CASE STUDY: LITIGATED PROCEEDING FOR A RATE INCREASE REQUEST

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OUTLINE

- How was the NFG rate case initiated?
- How does a company demonstrate the need for a revenue increase?
- Why did NFG say it needs a revenue increase?
- How does a rate case proceed and what is the timeframe?
- What were the major issues addressed in testimony?
- What was the revenue increase recommended by the Staff?
- What was the recommendation of the ALJ?
- What was the final Commission decision?
- How was the approved revenue increase translated into customer rates?
- Has the case been concluded?

Case Initiation

- NFG filed a request to increase annual delivery revenues by $52 million or approximately 6.4%
- By regulation the rate increase request was suspended for 11 months and a proceeding was established to evaluate basis for the filing
- An Administrative Law Judge (ALJ) was assigned the case to prepare a recommended resolution including the level of the rate increase to be adopted and present it to the Commission for their final decision
- An Investigative Staff Team of engineers, accountants and other specialists was organized to analyze and audit the filing request and prepare a recommended rate increase and resolution to all issues in the filing
- The proceeding was noticed to the public so that interested parties, individual rate payers, large industrial customers and rate payer groups were able to participate by providing their input on various issues in the case

How does a company demonstrate the need for a revenue increase?

- Commission policy is to set rates based on a forecast of revenues and expenses expected in a future period with a demonstrated link to results from a recent historic period
  - NFG filed its revenue increase request in late January 2007 in order to set new rates for calendar 2008
  - The filing included a forecast income statement for calendar 2008, an actual income statement for the 12 months ended September 2006, and support for the forecast changes from the results of the historic actual income statement

What costs accounted for NFG's request for a revenue increase? (millions $)

Forecast Sales Decline	3.2
Labor and Benefits increases	4.6
Increased Uncollectible Accounts	8.2
Environmental Clean-Up – MGP Sites	2.3
Energy Efficiency/Conservation Incentive Program	12.7
Miscellaneous Other Expenses	-.5
Increased Depreciation Expense	8.5
Increased Gas Plant	2.7
Requested Rate of Return level & Capital Structure	10.3
Total	52.0

How does a rate case proceed and what is the timeframe?

- The ALJ sets a schedule for the case including the initial investigative phase, filing of testimony by Staff and other parties, filing of rebuttal testimony, public hearings and legal briefs of the case
- The Initial investigative phase generally covers the first four months of a rate proceeding
  - Staff and interested parties conduct discovery requesting supplemental filing support through requests for further information
  - Staff is also authorized by law to conduct on site inspection of NFG books and records and utility property

Rate case process (cont'd)

- Staff and other parties' prepare their positions on all issues including the recommended revenue increase and then present the results in written testimony by expert witnesses
  - Staff addresses the level of the revenue increase, etc. as well as, allocation of the revenue increase to service class rates and the design of final rate structure in those classes
  - Other parties testimony generally address selected issues frequently revenue allocation and rate design related (i.e. impacts on low income rates, large industrial rates, etc.)
- All parties allowed short period (2 -3 weeks) to file rebuttal testimony
- Hearing is held before the ALJ for purposes of cross-examination of the witnesses offering testimony in the case
  - All parties afforded opportunity to cross-examine all parties witnesses

What major issues were addressed in testimony?

- Allowed return on equity
  - NFG requested 11.65%, Staff recommended 8.85%
- Environmental clean-up of old manufactured gas plant sites
  - allocation of insurance recoveries among NFG affiliated companies
- Labor and benefits
  - reduced employee compliment and cost level of benefits
- Depreciation rates
  - NFG sought to accelerate depreciation of plant based on current mortality studies, Staff recommended that current rates are more representative
- Proposed energy efficiency program and an associated revenue decoupling mechanism
- Revenue allocation and rate design
  - concerns about cost responsibility and recovery, customer impacts and impacts on local economy

What adjustments did Staff recommend? (million$)

As requested by the NFG	52.0
Return on Equity and Capital Structure	-21.0
Energy Efficiency Program	-1.2
Labor and Benefits	-9.6
Environmental Clean-Up - MGP Sites	-2.8
Various Other O&M Expenses	-14.6
Depreciation Expense	-8.9
Rate Base - Pension Reserve	-3.5
Recommended Revenue Increase	-9.6

How does a rate case proceed and what is the timeframe? (cont'd)

- All parties prepare and submit initial and reply briefs to the ALJ summarizing their positions on all issues (approx. 1 month))
- ALJ prepares and issues his recommended decision to be presented to the Commission (approx. 1 month)
- All parties prepare and submit briefs on exceptions and reply briefs on exception to the ALJ recommendation (approx. 1 month)
- The Commission, in consultation with advisory staff, then evaluates the recommended decision by the ALJ and meets in public session to reach a final determination of all the issues in the case
- Before the end of the suspension period the Commission's determination is issued in the form of a written order
- NFG files new tariffs including appropriate rates to comply with the Commission's order

What did the ALJ recommend?

- The ALJ recommended a $2.5 million rate increase, or approximately 0.3% overall
  - Major change from the Staff position: recommended an allowed return on equity of 9.40% versus the Staff recommended 8.85%
  - The ALJ recommended a reduced $10.8 million energy efficiency program, the costs of which were to be recovered from a surcharge separate from standard delivery rates
  - The ALJ also adopted a revenue decoupling mechanism agreed to by all parties

What did the Commission decide?

- The Commission determined that a $1.8 million delivery rate increase was appropriate
  - Generally supported the ALJ recommendations (including the $10.8 million surcharge for the efficiency program)
  - Major difference: decreased the ALJ recommended return on equity from 9.40% to 9.10%
- NFG rates and tariffs filed in compliance with the Commission order were made effective with January 2008 bills

How was the approved revenue increase translated into customer rates?

- Revenue Allocation
  - The Commission gives consideration to various concerns regarding revenue allocation to service classes including:
    - cost of service study results
    - potential customer impact
    - competition from other fuels/value of service, and
    - ease of implementation

How was the approved revenue increase translated into customer rates?

- The Commission determined that the increase should be allocated to the individual service classes based on their historic proportion of delivery only (non-gas cost) revenue
  - This methodology fairly distributes the overall increase to all service classes
  - Although there was recognition of differences in individual class returns shown in the company's embedded cost of service study, the Commission determined that the potential additional rate impact of revenue reallocation to correct differences was not warranted at the time
  - Revenue allocation based on the proportion of non-gas delivery revenues will not aggravate any existing differences in the class to class returns

How was the approved revenue increase translated to customer rates?

- Rate Design
  - Similarly, rate design is determined based on consideration of many factors including cost of service, value of service, customer impact, character of service in a class, historic precedent, etc.
  - Residential
    - Commission decided to increase residential class minimum charge by $2/month (from $13.54 to $15.54), to move closer to actual costs of $19.12
    - Move the recovery of some fixed costs from the volatile tail-block to the less volatile penultimate block (Tail-block rate was reduced from current $.217/Ccf to $.102/Ccf)

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How was the approved revenue increase translated to customer rates?

- Small commercial
  - Commission decided to apply 50% of the allocated increase to the minimum charge and 50% to the volumetric rate block
- Large commercial and Industrial
  - Commission decided to increase the minimum charge of each sub-class up to the indicated cost per the cost of service studies and any remainder allocated to the volumetric rates
  - Large usage customers more sensitive to increases in volumetric usage rates than increases to monthly minimum charges because of cost control issues and competition from product rivals as well as alternate fuel options

How was the approved revenue increase translated to customer rates?

- Unbundling of Competitive Services - Merchant Function Charge (MFC)
  - Commission previously removed the costs of purchasing the commodity gas supply into a separate MFC which is only applied to the bills of customers which purchase their commodity supply from the utility
  - Allows customers to compare the costs of gas commodity service from an alternative energy provider versus the utility on an equivalent basis
  - Commission adopted refinements to the allocation of storage costs and records and collections costs to the NFG MFC which were previous included in the delivery rates charged to all customers

How was the approved revenue increase translated to customer rates?

- Billing Charges
  - The Commission previously separated the costs to issue bills to customers because this was considered a competitive service that could be provided by other entities and the charge was shown separately on bills provided by the utility
  - Commission adopted the Staff recommendation that the costs of preparing and issuing a bill should be reduced from the current $2.00 per month to $1.07 per month based on a review of the cost study results
  - Commission also rejected NFG current practice of applying the billing charge to the consolidated bills of customers receiving their gas supply from an alternative energy provider – instead NFG should charge the energy service provider directly for the cost of providing the billing function

Has the case been concluded?

- NFG had the option to request rehearing of the Commission order or choose to appeal the decision directly to the Judicial system
  - NFG filed a court appeal to overturn portions of the Commission decision which is currently pending