

# OBSTACLES TO REVENUE DECOUPLING FOR GAS UTILITIES

The National Regulatory Research Institute

Ken Costello  
Senior Institute Economist

prepared for

Workshop on Aligning Regulatory  
Incentives with Demand-Side  
Resources

San Francisco, CA.  
August 2, 2006



# Background

- Over the past few years, both conservationists and gas utilities have pushed aggressively for revenue decoupling (RD); also, the federal government has become active in reviewing RD (pursuant to EPA Act 2005) and other governmental entities (e.g., WGA) have endorsed or are reviewing RD
- 2004 and 2005 NARUC resolutions advise state commissions to consider RD for gas utilities
- Gas utilities and conservationists, while generally supportive of RD, have different objectives

# Background -- *continued*

- *Gas utilities with RD*
  - Baltimore G&E
  - Washington Gas Light (MD)
  - Southwest Gas (CA)
  - Northwest Natural (OR)
  - Piedmont Natural Gas (NC)
  - Cascade Natural Gas (OR)

# Background -- *continued*

- *Proposals for RD and investigations*
  - Washington (last year commission terminated rulemaking investigation, ruling that RD should be addressed in rate case filings)
  - Cascade Natural Gas (WA)
  - Puget Sound Energy (WA)
  - Puget Energy (WA)
  - Questar Gas (UT)
  - Citizens Gas & Coke Utility (IN)
  - Vectren Energy Delivery (IN, OH)
  - NJ Natural Gas
  - South Jersey Gas,
  - CT investigation with commission report to legislature in January 2006

# Background -- *continued*

- *Cases where RD was rejected, withdrawn or discontinued*
  - Southwest Gas (NV, AZ)
  - Xcel (MN, ND)
  - Maine (electric utilities)
  - New York (electric utilities)
  - Washington (electric utilities)
  - PacifiCorp (WA)
  - Portland GE (OR)
  - Northwest Natural (WA)

# Obstacles To RD

- **Inertia** (perception of RD as a radical change to ratemaking and not warranted by conditions)
- Political populism (“RD mostly protects the utility and passes risk to consumers without any apparent benefits to them”)
- **Competing ratemaking alternatives** (SFV, LRA, IBT)

# Bonbright's Eight Criteria for Ratemaking

1. **Simplicity, understandability, public acceptability and feasibility of implementation**
2. **Uncontroversial as to proper interpretation**
3. **Effectiveness in providing the utility with adequate revenues to recover costs**
4. Year-to-year revenue stability
5. **Rate stability**
6. Fairness among customer classes
7. Avoidance of undue price discrimination
8. Economically efficient in giving customers proper price signals, for example, in not over-consuming a utility's service

# Arguments against Revenue Decoupling

<b>Need to show special conditions for true-up recovery of revenues</b>	<b>Uncertainty over a future decline in use per customer</b>
<b>Inappropriate to single out revenues for true-up adjustments</b>	<b>Lower utility service quality</b>
<b>Less likelihood of addressing rate-design problem</b>	<b>More price volatility</b>
<b>More certainty of utility benefits than customer benefits</b>	<b>Reduced incentive for customer-initiated energy efficiency</b>
<b>Upward pressure on short-term prices, as a utility's average cost for delivery is likely to increase</b>	<b>Unequivocally increased customer risk</b>
<b>Incremental options should be considered</b>	<b>Preference for alternative ratemaking methods achieving similar objectives</b>
<b>Possible legal/policy precedent issues</b>	<b>Preference for lost revenue adjustment (LRA) mechanism</b>
<b>Overly broad in addressing the problem at hand</b>	



# State Commission Arguments Rejecting RD

- In the absence of extraordinary circumstances, RD runs afoul of acceptable ratemaking
- Other mechanisms more acceptable to stabilize the utility's earnings
- No evidence that past gas usage trends placed the utility in financial jeopardy
- Not sure that declining use per customer will continue and adversely affect a utility's future earnings

# State Commission Arguments Rejecting RD -- *continued*

- RD shields the utility from sales risk by passing it on to consumers
- Don't need RD to promote energy efficiency
- Need to explore fully, in a broader investigation, the issue of usage volatility and margin recovery
- Concern over the possible future magnitude of surcharges from RD

# Ex Post Evidence on RD: Generally Favorable

- Northwest Natural (OR)
- Baltimore G&E

August 2, 2006

# The Big Issues Being Fought in the Trenches

- Specification and prioritization of the objectives of ratemaking methods
- The merits of RD relative to other ratemaking methods in satisfying the same objectives
- The appropriateness of RD as a tracker
- Utility commitment to promoting energy efficiency

August 2, 2006



# The Big Issues -- *continued*

- The risk effect of RD on consumers and the utility
- The need for RD to promote utility-initiated energy efficiency
- The financial effect of declining usage per customer on a utility
- “Revenue assurance” effect versus conservation enhancement” effect of RD

# The Big Issues -- *continued*

- The assessment of RD outside the context of a rate case
- RD structure and implementation (e.g., need for a rate-adjustment cap, cost of capital effect, frequency of rate adjustments, pilot or permanent)
- Overall effect on consumers

# Stakeholder Process

- Stakeholders should work together to reach a consensus involving new ratemaking methods such as RD.
  - They need to agree on the objectives of ratemaking and the priority of those objectives
  - Parties should look at different ratemaking methods and assess their strengths and weaknesses
  - Important elements needed to get broad acceptance of RD: (1) commitment by a utility to promoting energy efficiency, (2) demonstration of benefits to consumers, or at least no harm to consumers, and (3) consumer/public education

# Contact

Ken Costello

[Costello.1@osu.edu](mailto:Costello.1@osu.edu)

NRRI Website: [www.nrri.ohio-state.edu](http://www.nrri.ohio-state.edu)

August 2, 2006

