

REVENUE DECOUPLING FOR GAS UTILITIES: KNOW YOUR OBJECTIVES

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Background and Context

- Lot of activity on the natural gas side for revenue decoupling (RD) and other revenue stabilization mechanisms
- Beginning to see renewed interest in the electricity sector
- Increased emphasis on energy efficiency by policymakers (e.g., National Action Plan for Energy Efficiency)
- Revenue stabilization has become important for gas utilities

Background and Context -- *continued*

- Conservation advocates see RD as essential for utility-initiated conservation activities
- Several RD proposals for gas utilities approved in the past year
- Rejections of RD by some state commissions
- Gas utilities have proposed revenue stabilization mechanisms other than RD (e.g., SFV rate design, earnings sharing, higher customer charges, declining block rate)

Background and Context -- *continued*

- Debate still focused on policy and fundamental issues on the merits of RD as a ratemaking mechanism advancing specified regulatory and policy objectives
- Implementation issues have gotten increased attention – “the devil is in the details” (e.g., rate collar, demand factors considered in rate adjustment, cost-of-capital effect, accounting for overall utility earnings, utility commitment to promoting EE, baseline level of sales, frequency of rate adjustment)

Arguments for Revenue Decoupling

- No other ratemaking method achieves the dual objectives of revenue stability and stimulation of energy efficiency
- Without RD, a utility would not have a reasonable opportunity to earn its authorized rate of return
- Prevailing implementation of two-part tariff is flawed in recovering most of a utility's fixed costs in the volumetric charge

Arguments for Revenue Decoupling

-- *continued*

- How can regulators expect a utility to promote energy efficiency when it would be contrary to shareholders' interest?
- RD satisfies the customary 3-part regulatory test for the approval of trackers
- RD would reduce the frequency of future rate cases

Arguments for Revenue Decoupling

-- *continued*

- RD would assist in stabilizing winter gas bills
- Evidence so far point to generally favorable outcomes from RD for gas utilities
- RD does not affect rate design and would have only an incremental effect on rates
- RD preferred to SFV rate design and other approaches for producing revenue stability

Arguments against Revenue Decoupling

- Even with declining average gas usage, a utility can earn its authorized rate of return between rate cases by adding new customers and improving its productivity
- RD makes a utility less aggressive in controlling its costs
- RD is not needed to get a utility seriously involved in promoting energy efficiency
- No convincing rationale for utility involvement in promoting energy efficiency

Arguments against Revenue Decoupling -- *continued*

- Declining average gas usage has not substantially affect a utility's past earnings
- Question of whether declining average gas usage will continue in the future
- Adjusting rates for other than conservation improvements is unreasonable and imposes excessive risk on customers

Arguments against Revenue Decoupling -- *continued*

- Reducing future rate cases could cause a utility to over-earn in the future from a mismatch of revenues with costs
- Alternatives to RD are superior for addressing the downward trend of gas usage per customer
- Revenue stabilization is not a legitimate ratemaking objective

Arguments against Revenue Decoupling -- *continued*

- Instead of just focusing on revenues and declining average gas usage – which represents a form of “piecemeal regulation” – state commissions should place their emphasis on the overall profitability of a utility
- RD shifts business risk to consumers without any apparent benefits to them
- From an pure economics perspective, SFV is preferred to RD

The Challenge for Regulators: What's in the Public Interest?

- Cogent arguments, in support of advancing specific regulatory objectives, presented before state commissions on both sides of the RD debate
- Some of the arguments, however, are feeble (or even foolish), and state commissions should immediately weed them out
- Regulators should articulate their ratemaking objectives and the relative importance of each one (i.e., place weights on the different objectives, which requires judgment by regulators)

The Challenge for Regulators --

continued

- The tough task for regulators is to reconcile the conflicting objectives of ratemaking (e.g., revenue stability and minimal shifting of business risk to customers)
- Ratemaking has always entailed the compromise of different regulatory objectives
- Regulators need to understand the tradeoffs involved – no single ratemaking mechanism most effectively satisfies all regulatory objectives

The Challenge for Regulators --

continued

- Regulators should look at an individual utility's circumstances to assess the merits of RD and other ratemaking mechanisms
- RD scores well in advancing some longstanding ratemaking principles and objectives, but not so well for others
- Regulators, in one way or another, need to account for the effect of declining gas usage per customer in setting rates

The Challenge for Regulators -- *continued*

- In the end, regulators will need to address the following questions:
 - What are the objectives of ratemaking and their relative importance?
 - What ratemaking mechanism or group of mechanisms would *be most effective* in achieving those objectives?
 - Most essential, what ratemaking mechanism would be both fair to the utility and most beneficial to customers?

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