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American Gas Association

NATIONAL ACTION PLAN FOR ENERGY EFFICIENCY

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS SUMMER MEETING

San Francisco Marriott
Monday, July 31, 2006

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News Release – American Gas Association (AGA) Joins Industry and Energy Sector Leaders in Promotion of New National Action Plan for Energy Efficiency; "*Plan Could Save U.S. Energy Consumers Hundreds of Billions of Dollars.*"

American Gas Association

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July 31, 2006

American Gas Association Joins Industry and Energy Sector Leaders in Promotion of New National Action Plan for Energy Efficiency

Plan Could Save US Energy Consumers Hundreds of Billions of Dollars

Washington, D.C. – Savings of hundreds of billions of dollars during the next 10 to 15 years could be available to U.S. energy consumers as the result of the adoption today of a new National Action Plan for Energy Efficiency. More than 50 U.S. energy and industrial companies have signed on to support the plan and its objectives.

David N. Parker, president and CEO of the American Gas Association (AGA) said, "AGA is pleased to be a supporter of the Plan. Our 197 members serve more than 56 million natural gas consumers and know the importance of effective energy efficiency policies. This Plan has the potential to positively impact the energy consumption habits of every American, and we are pleased to take part in its adoption and promotion."

AGA noted the Plan holds the promise to defer the need for 40 new 500 Megawatt-power plants, avoid greenhouse gas emissions equivalent to approximately 35 million vehicles, lower the costs of air pollution controls and reduce prices for natural gas.

The Plan's recommendations include: making energy efficiency a high priority resource; aligning utility incentives and ratemaking processes to promote investments in efficiency; promoting long-term, stable program funding to deliver cost-effective efficiency to consumers; and broadly communicating the benefits of efficiency. These recommendations build upon successful efficiency programs already operating in many areas and remove barriers that have limited utilities and customers from pursuing cost-effective energy efficiency resources.

Two of the many AGA member companies that already offer energy efficiency programs, Vermont Gas Systems and KeySpan in Massachusetts, were highlighted in the Plan. The Plan also described the Integrated Resource Planning model for energy efficiency and conservation that is used by Minnesota members CenterPoint Energy and Xcel Energy.

Particularly noteworthy, said AGA, is the Plan's recommendation to align utility incentives with the delivery of cost-effective energy efficiency programs. The Plan, in further support of energy efficiency, encourages states to modify utility ratemaking practices in order to promote investments in energy efficiency technologies.

In a 2004 Joint Statement, AGA, the Natural Resources Defense Council, the Alliance to Save Energy and the American Council for an Energy-Efficient Economy urged state Public Utility Commissions to consider innovative programs that encourage increased total energy efficiency and conservation in ways that align the interests of state regulators, natural gas utility company customers, utility shareholders, and other stakeholders. The Plan recognizes that historically regulatory policies

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governing utilities have more commonly compensated utilities for selling energy rather than using energy more wisely.

AGA members who have implemented energy efficiency programs similar to ones described in the plan include NW Natural Gas in Oregon, Baltimore Gas and Electric and Washington Gas in Maryland, Southwest Gas in California, Piedmont Natural Gas in North Carolina and Cascade Natural Gas Corporation in Washington. Other AGA member companies have filed for permission to adopt such plans in additional states. The National Action Plan brings together leading energy sector organizations representing different stakeholder perspectives to determine how best to promote greater investment in energy efficiency by the customers of electric and gas utilities. This collaborative approach is essential as greater investment in energy efficiency requires a concerted effort by customers, utilities, regulators, states, and other stakeholders. The recommendations in the Plan provide support for the pending energy efficiency proposals of several AGA member companies. AGA member company Action Plan Participants include: Baltimore Gas and Electric, Duke Energy, Entergy, Exelon, New Jersey Natural Gas, Pacific Gas and Electric, PNM Resources, Vectren Corporation, and Xcel Energy.

For more information on the National Action Plan for Energy Efficiency, visit:
http://www.epa.gov/cleanenergy/eeactionplan.htm

The American Gas Association, founded in 1918, represents 197 local energy utility companies that deliver natural gas to more than 56 million homes, businesses and industries throughout the United States. Natural gas meets nearly one-fourth of the United States' energy needs. For more information, please visit www.aga.org.

- AGA -

AGA-NRDC-EEI Joint Statement Supporting New National Action Plan for Energy Efficiency

AGA American Gas Association

EEI EDISON ELECTRIC INSTITUTE

NRDC

To: NARUC Commissioners and Participants in the National Action Plan for Energy Efficiency

From: Roger Cooper, AGA

David Owens, EEI

Ralph Cavanagh, NRDC

Re: National Action Plan for Energy Efficiency

Date: July 10, 2006

The American Gas Association (AGA), the Edison Electric Institute (EEI) and the Natural Resources Defense Council (NRDC) join in commending all who contributed to the National Action Plan for Energy Efficiency. The National Action Plan demonstrates the depth and diversity of support for energy efficiency as a crucial part of the solution to volatile energy prices and formidable environmental challenges. The National Action Plan emphasizes the important role of utilities in promoting energy efficiency improvements and the need for regulators to ensure that cost-effective energy efficiency advances both customer and shareholder interests.

We agree with the National Action Plan's recommendations to recognize energy efficiency as a high priority energy resource; to communicate its benefits and opportunities broadly; to promote sufficient, timely and stable energy program funding where cost-effective; and to modify policies to align utility incentives with the delivery of cost-effective energy efficiency and modify ratemaking practices to promote energy efficiency investments. Our staffs have been working together in utility service territories across the nation to achieve these objectives. We commit ourselves now to redoubled joint efforts in support of the National Action Plan's worthy goals and recommendations. And we thank and congratulate all involved.

AGF *Rethinking Natural Gas Utility Rate Design:*
Press Release – *"Maintaining the status quo in natural gas utility rate design will be costly to consumers, utilities and society, according to a white paper from the American Gas Foundation (AGF)."*

American Gas Foundation

Contact: Daphne Magnuson
(202) 824-7205

July 21, 2006

Rethinking Natural Gas Utility Rate Design

Washington, D.C. – Maintaining the status quo in natural gas utility rate design will be costly to consumers, utilities and society, according to a white paper from the American Gas Foundation (AGF). AGF and the National Association of Regulatory Utility Commissioners (NARUC) Foundation sponsored an all-day executive forum at Ohio State University that brought together state regulatory officials, consumer advocates, financial analysts and executives from the natural gas utility industry to discuss the role of rate design in an era where utilities are increasingly encouraging energy efficiency at the expense of their economic livelihood.

The white paper, ***Rethinking Natural Gas Utility Rate Design***, examines traditional rate design, which links natural gas utility profits to the volume of gas transported, and concludes that with today's increasingly energy conscious environment and higher energy prices, traditional designs will not benefit the customer or the utility. According to ***Rethinking Natural Gas Utility Rate Design***, innovative rate designs and true-up mechanisms can break this cycle and align the interests of consumers, regulators, utilities and shareholders.

The white paper presents the views of a broad range of forum participants, including Ohio Public Utility Commissioner Don Mason, who also is chair of the NARUC gas committee; Wm. Michael Warren, Chairman of the AGF and Chairman and CEO of Energen Corp. of Birmingham, Ala.; Kenneth Costello, senior economist, National Regulatory Research Institute; and Russell Feingold of Navigant Consulting.

Among the white paper's highlights:

- Energy efficiency and conservation can provide relief for customers from high natural gas prices, and innovative rate designs such as the decoupling mechanism in place with NW Natural in Portland, Ore., can align the diverse interests of stakeholders.

- Consumers need to see clear benefits from new rate designs. Many customers seem to be price-sensitive, but most do not understand that natural gas utilities simply pass along the increases or decreases in gas commodity costs without any markup.

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- A critically important, but often underemphasized element of any ratemaking approach linked to a conservation initiative is consumer education. Consumers would benefit from better understanding of potential rate design changes and how these can serve the best interest of the consumer.

The white paper examined several rate designs that further addressed the need to educate consumers and other key groups about the benefits of innovative rate designs.

Rethinking Natural Gas Utility Rate Design is available on the ***American Gas Foundation web site***. The forum took place on May 23, 2006.

Founded in 1989, the American Gas Foundation (AGF) is a 501(c)(3) organization that focuses on being an independent source of information research and programs on energy and environmental issues that affect public policy, with a particular emphasis on natural gas. Recently, the AGF has delivered key public policy reports such as ***Fueling the Future: Meeting the Gas Supply Challenge of the Next 20 Years*** (2005); ***Safety Performance and Integrity of the Natural Gas Distribution Infrastructure*** (2005) and ***Public Policy and Real Energy Efficiency*** (2005).

- AGF -

Note to Journalists: *The American Gas Foundation plans to offer a briefing for journalists with some of the forum participants via audioconference in the August. If you are interested in being a part of this press briefing, please provide your name and contact information to Daphne Magnuson at dmagnuson@aga.org. Further details to follow.*

The American Gas Foundation
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American Gas Foundation (AGF) White Paper – *Rethinking Natural Gas Utility Rate Design*

"Rethinking Natural Gas Utility Rate Design"
May 23, 2006 – Columbus, Ohio

American Gas Foundation

The NARUC Foundation

Providing Education and Training Programs for the State Regulatory Community

Executive Summary

Maintaining the status quo in rate design will be very costly for utilities, consumers and society as a whole. Energy efficiency and conservation initiatives are essential in an era of high and volatile natural gas prices and concerns about supply. But traditional rate design, in which utility cost recovery is linked to the amount of gas customers consume, discourages utilities from promoting energy efficiency and conservation. Innovative rate designs and true-up mechanisms can break this link and align the interests of utilities, regulators, consumers and investors.

However, not all observers see every new rate mechanism as being in the consumers' interest. Consumers need to see clear benefits from new rate designs. Many customers seem to be price sensitive but most do not understand that gas utilities simply pass along, without any mark-up, the increases or decreases in gas commodity costs. Therefore, significantly higher bills puzzle them, particularly if they have heeded the price signal and actually used less gas. Consumer advocates don't necessarily oppose new rate mechanisms but they may often view utility-funded conservation programs as an essential part of any innovative rate concept.

Rate design changes aren't the complete answer. Traditional budget billing plans can be dusted off and updated. Weatherization programs can be particularly useful for low-income consumers. And a critically important, and often underemphasized element of any ratemaking approach linked to a conservation initiative is consumer education. Consumers need to understand what changes are being made and why those changes are in their best interest.

Introduction

On May 23, 2006, the American Gas Foundation and the National Association of Regulatory Utility Commissioners (NARUC) Education and Research Foundation sponsored "Rethinking Natural Gas Utility Rate Design," an executive forum designed to explore innovative approaches to rate design in an era of high natural gas prices and concerns about supply. The all-day event was held at Pfahl Executive Conference Center at The Ohio State University in Columbus.

The forum featured welcoming remarks by the chairman of the NARUC Gas Committee and the chairman of the American Gas Foundation, presentations on utility ratemaking by two individual speakers, and two panel discussions on current developments in innovative ratemaking and approaches for the future. Panelists included state utility commissioners, consultants, a Wall Street financial analyst, a consumer representative, representatives of natural gas distribution companies and an environmental organization. This paper summarizes the background of the issue, presented in the welcoming remarks and the ratemaking presentations, and then summarizes the two panel discussions.

Issues Background: Why Consider Changing Rate Design to Promote Energy Efficiency and Conservation?

Increasing the supply of natural gas has taken on global significance, Commissioner Don Mason of the Public Utilities Commission of Ohio said in his welcoming remarks. He noted that the status of efforts to open more OCS lands to energy development, build an Alaskan gas pipeline and open the Arctic National Wildlife Refuge to drilling is still unclear. LNG is a bright spot, he said, "but there are many negatives," because transportation and siting issues and the price of LNG are dependent not just on North American weather conditions but also on weather in Western Europe.

"Putting our home heating budgets into international energy markets places the American consumer at the same risk as we are presently facing with our crude oil markets," said Mason, who chairs the NARUC Gas Committee. "Therefore our options in controlling our home energy future are resting more and more on conservation and energy optimization."

While consumers are using less natural gas—the average residential customer today uses 25 percent less natural gas than the average customer used 25 years ago—the volatility of gas prices has shown no sign of diminishing. "I cannot stress strongly enough the need for teamwork and agreement as we move forward on alternative regulatory concepts," Mason said. "We must make sure there is the maximum possible alignment of interests. All stakeholders must be facing in the same direction, with the goal in mind."

In his opening remarks, American Gas Foundation Chairman Wm. Michael Warren Jr. said that since the establishment of the current regulatory compact for electric and gas utilities in the late nineteenth century, customers have been encouraged to use increasing amounts of these commodities. "Here we are, way over a century later, and our purpose today is to examine whether that model is still appropriate in today's world," said Warren, chairman and CEO of Energen Corporation.

Kenneth Costello, senior institute economist, National Regulatory Research Institute, told the forum that achieving the right level of conservation requires a combination of consumer and utility initiatives. Rate design is a "balancing act," he said, and rates that fail to give utilities an opportunity to earn adequate returns could have bad consequences for shareholders and consumers.

"If you look at a new rate design like revenue decoupling, it's intended to address that concern as well as the concern of utilities not having the right incentives to promote conservation," Costello said. Two additional examples of innovative rate concepts include the use of Straight Fixed-Variable (SFV) rate design by Atlanta Gas Light in Georgia and the use of a modified service charge by Xcel Energy in North Dakota, Costello said[1]. More typical is a compromise rate structure, he noted.

Conservation, revenue stability and concern for low-income consumers have become increasingly important factors in energy rate design, Costello said, but he added, "Reasonable people can disagree over the importance of each of those objectives." Staying with the status quo, though, "isn't doing consumers or society a favor," Costello said. There is a reluctance to change rate design because of regulatory inertia and uncertainty about outcomes, he said, so pressure needs to be placed on regulatory commissions to make the necessary changes to accommodate current realities.

Russell A. Feingold, managing director of Navigant Consulting, agreed that the utility ratemaking paradigm is shifting because of changing industry drivers and stakeholder policy objectives. But in his remarks, he stated that "there is no clear consensus among utility executives and regulators on what is most important" to achieve in designing rates. That's why the rate design process can often be adversarial and controversial, Feingold said. Utilities are proposing a number of innovative mechanisms to address specific business challenges, he noted, including SFV and mechanisms for revenue decoupling (e.g. conservation tariffs), bad-debt recovery, infrastructure replacement cost recovery, revenue stabilization and weather normalization adjustments.

Feingold said energy efficiency and conservation can provide relief for customers from high natural gas prices, and innovative rate designs such as the decoupling mechanism in place with NW Natural in Oregon can align stakeholders' diverse interests. A properly designed decoupling mechanism can have a number of benefits, he noted, including the potential for producing a gradual decline in gas commodity prices as overall demand is reduced.

[1] In late May Missouri Gas Energy and SEMCO Energy filed for a rate design similar to Xcel Energy's. In addition, Oklahoma Natural Gas offers a two-tier rate plan where customers choose between a rate design similar to Xcel Energy's or a rate design closer to a traditional plan. Kansas Gas Service has proposed a similar two-tier customer choice rate plan.

Today's Challenges and Solutions

Some panelists felt that not every new rate design proposal is aligned with ratepayers' interests. A utility that wants to redesign rates should do it in a way that offers value to its customers, not just the utility. Because ratepayers are not always rational, a mistake in communication or execution of a new rate design by utilities will be magnified in the current hyper-price-sensitive environment.

Adjust the Fixed Monthly Charge - One way to solve the problem of recovering the utility's approved level of fixed costs through a volumetric charge is to increase the monthly fixed charge and decrease the volumetric charge by an equivalent amount. While the percentage increase in the monthly fixed charge would be dramatic and the decrease of the volumetric charge on a percentage basis would be small, the total delivery rate charged to the average customer on an annual basis would be about the same. However, some speakers felt that reducing the volumetric charge, even by a small percentage, at a time when customers should be rewarded for saving energy, would send the wrong price signal to them at the worst possible time.

NRDC-AGA Proposal - The revenue decoupling method proposed by the Natural Resources Defense Council and the American Gas Association, solves the problem of recovering fixed costs volumetrically by making modest periodic adjustments to rates (both increases and decreases) based on whether utilities are under recovering or over recovering the fixed-costs that regulators have already said are reasonable. Revenue decoupling does not produce dramatic rate changes. On the other hand, if parties desire to have the revenue decoupling mechanism be more narrowly focused (i.e. a lost revenue adjustment) by basing it on an assessment of how much energy was actually saved and how much free-ridership there was, such an approach can be cumbersome and could result in ongoing disagreements between utilities and their stakeholders. Of note, revenue decoupling based on true-ups, per the NRDC-AGA Proposal, is an innovative modification that can work with whatever rate design is established.

A consensus is developing that one of the missions of utilities is to help customers use energy more efficiently. Even very modest reductions in use can have a big impact on wholesale gas costs when the supply and delivery systems are under stress. Customer education is essential. Customers already have experience with flat monthly rates, including those for trash collection, security services and Internet providers, as well as with fixed-variable charges, such as those for long-distance telephone service and water and sewer services. Those services might provide a basis for educating consumers about utility rate designs that encourage conservation by breaking the link between utility revenues and customers' energy use. But dramatic changes in rate structure may be unnecessarily controversial. In addition, in cases where revenue decoupling is being considered, it was noted that for now, regulators should not require downward adjustment to allowed returns on equity.

Traditional Approaches - Rate design isn't the only answer. Budget billing plans that require fixed monthly payments may need to be dusted off and updated. Shifting capital investment on the low-income side to weatherization and conservation programs is a way to permanently reduce low-income consumer bills and uncollectibles. But utility investment in weatherization of landlord-owned rental housing can result in unintended consequences, such as having the landlord raise the rent as a result of the weatherization.

Innovative Approaches for the Future

Customer Education - Those who are involved in rate design need to understand the objectives they are attempting to achieve and ensure that they are acting to achieve them in a consistent way. If substantial changes in gas rate design are attempted, customers need to understand what's being done and why. A rate design such as revenue decoupling, that could produce a slight per-unit increase in delivery rates, is completely counterintuitive for customers when presented the case by regulators and utilities that the new rate design is better for them in the long run. If utilities and regulators elect to decouple, there is a significant customer education role that must be played by someone.

Customers often complain about weather normalization adjustments because they don't understand what they are buying. Main replacements and other infrastructure improvements are also very important to the industry and must be taken into consideration as rate design evolves. But customers think they're buying gas, not infrastructure or delivery service, so once again, education and clarity about objectives is vitally important.

The Financial Community - Wall Street is very concerned about declining gas use per customer. Investors are giving a premium to companies with rate designs such as SFV, decoupling, and bad-debt recovery through tracking mechanisms, believing that regulators and LDCs must align customers' efficiency interests with companies' profit interests. Investors, consumers, managements and regulators will all benefit from innovative rate designs that promote customer efficiency and protect shareholder returns.

Consumer Advocates - Revenue decoupling can be a mechanism to address today's challenges, but concern exists that large fixed costs could send the wrong price signals to customers about conserving since they will not see the impact of their actions on their bills. Increasing the fixed-charge component might make Wall Street and utilities happy, but it can hurt lower-usage customers, some of whom are low-income. Support for revenue decoupling based on true-ups on the part of consumer advocates may hinge on utilities offering comprehensive conservation and energy efficiency programs. Costs for such programs could be recovered by a surcharge on delivery rates or by inclusion in the utility's overall

expenses. Customers should be offered practical programs they can readily take advantage of - a rebate for the purchase of energy-efficient appliances, for example. For low-income customers, the focus should be on weatherization.

In summary, innovative rate designs that address the realities of energy efficiency and resource conservation can serve the interests of all stakeholders: customers, utilities, regulators, and investors. The executive forum on "Rethinking Natural Gas Utility Rate Design" explored the issues, discussed today's challenges, and identified approaches for the future. Fortunately, many innovative rate design choices are available that meet society's needs.

Forum Speakers & Panelists

Ronald J. Barone
Managing Director, UBS Investment Research

Bryan Batson
Sr. Vice President, External Affairs,
AGL Resources

Ralph Cavanagh
Sr. Attorney & Co-Director, Energy Program, Natural Resources Defense Council

Kenneth Costello
Sr. Institute Economist, National Regulatory Research Institute

The Honorable Jeff Davis
Chairman, Missouri Public Service Commission

The Honorable Samuel J. Ervin
Commissioner, North Carolina Utilities Commission

Russell A. Feingold
Managing Director, Navigant Consulting

Conrad Gruber
Vice President, Strategic Planning, Atmos Energy

The Honorable Donald Mason
Commissioner, Public Utilities Commission of Ohio

Janine Migden-Ostrander
Consumers' Counsel, Office of Ohio Consumers' Counsel

Richard J. Rudden
Sr. Vice President & Managing Director, Black & Veatch Corporation

Branko Terzic
Global Regulatory Policy Leader, Deloitte Services LP

Wm. Michael Warren, Jr.
Chairman, American Gas Foundation
Chairman & CEO, Energen Corporation

American Gas Foundation (AGF) – Founded in 1989, the American Gas Foundation is a 501(c)(3) organization that focuses on being an independent source of information research and programs on energy and environmental issues that affect public policy, with a particular emphasis on natural gas. In 2005, AGF issued the studies *Natural Gas Outlook to 2020* and *Safety Performance and Integrity of the Natural Gas Distribution Infrastructure* and *Public Policy and Real Energy Efficiency*. In 2006, studies will be released on such topics as the future of research and development in the natural gas industry and the true impact of the Energy Policy Act of 2005. www.gasfoundation.org

The National Association of Regulatory Utility Commissioners (NARUC) Education and Research Foundation – The Foundation is a non-profit corporation established in 2000 that has a mission to conduct research and provide educational forums and conduct research for state regulatory commissioners and key staff on critical issues confronting consumers, shareholders and managers of regulated enterprises. www.narucfoundation.org

AGA Rate Round-Up: "Decoupling Mechanisms – July 2006 Update"

AGA
American Gas Association

NATURAL GAS RATE ROUND-UP

A Periodic Update on Innovative Rate Designs

July 2006

Decoupling Mechanisms – July 2006 Update

This is an updated and expanded edition of the *AGA Rate Roundup* that was previously issued in May 2006 and November of 2005. This issue describes a rate design method that helps utilities to promote energy efficiency while preventing the erosion of margins that is the usual outcome of customer conservation and utility energy efficiency.

DESCRIPTIONS AND COMPONENTS

Decoupling Programs

Traditional rate designs allow utilities to collect payments from consumers every month to cover the actual cost of natural gas (a pass-through cost, with no utility mark-up), as well as government taxes and the utility's fixed costs. After delivering a sufficient volume of natural gas to cover all of those items, a utility has the opportunity to earn its regulated profit. However, the traditional rate design ties a utility's profitability to the volume of natural gas that customers use. When the amount of gas consumed declines, as it does during periods of warmer than normal weather, and when natural gas consumers become more energy efficient, even a small reduction in natural gas consumption can significantly cut into a utility's profitability. This presents a strong financial disincentive for natural gas utilities to promote energy efficiency aggressively.

To remedy this situation, several natural gas utilities have worked with their state regulators to reform the way their rates are designed, by separating or "de-coupling" the utility's recovery of its fixed costs from the volume of natural gas delivered to customers. The impetus for this rate re-design has been, primarily, the problem of declining use per customer and the fact that weather has been consistently warmer than normal, on average, for many years. These decoupling mechanisms, or margin tracking mechanisms, use periodic adjustments called "true-ups" to move customers' rates up or down modestly to ensure that utilities recover their authorized fixed costs regardless of fluctuations in energy use.

Conservation Components

Regardless of the volumes of gas delivered by the utility, decoupling rate designs provide a better chance of recovery of the utility's fixed costs than do traditional rate designs. Decoupling rate designs remove the disincentives that utilities face in promoting energy efficiency. Conservation tariffs are the rate design components that give consumers an incentive to conserve

natural gas. Not all decoupling programs include a conservation component, and not all conservation tariffs also include a decoupling mechanism.

At least 29 natural gas utilities have tariff provisions that allow recovery of conservation and demand side management program costs, as well as recovery of lost net revenues caused by the reduction in sales. The programs differ in what costs are allowed recovery (e.g., program costs, administrative costs, lost margin costs) and who administers the program (e.g., company, state, or charitable organization). One example is NW Natural, which includes a conservation component in its current decoupling mechanism that is administered by an outside charitable foundation. Another example is Vermont Gas, which does not have a decoupling program, but does have a Demand Side Management and Energy Efficiency program, in which the utility funds a portion of customers' costs of purchasing new, more energy-efficient appliances. Vermont Gas defers the costs of the program until its next rate case and subsequently amortizes the costs over a three-year period and charges the costs to all ratepayers.

Computational Options

There are several options for calculating the revenue adjustment, or true-up, and while the results are approximately the same, the different options help companies meet unique regulatory preferences and circumstances. The use-per-customer basis makes a rate adjustment that is based on changes in average use per customer and then applies that adjustment factor against unit margins by customer class. The margin-per-customer rate adjustment is based on the change in baseline margin per customer compared to the actual margin per customer. The total margin revenue adjustment is based on comparison of total baseline margin revenues to actual margin revenues.

Variants –Fixed Variable Rate Design

More than one rate design method exists that will break the link between volumes of gas consumed and cost recovery for the utility. Fixed variable rate design places all of the utility's fixed costs, including a regulated profit on the value of the utility's investment in plant and equipment used to provide service to the customer, into a fixed monthly charge called a service charge or a demand charge. This charge is similar to the monthly fee charged by cable TV companies and is unrelated to the amount of gas (or number of TV programs) used by the customer. Several utilities currently utilize a fixed charge type of rate design for recovery of their costs. AGA will further discuss this rate design mechanism in the next *Rate Round-Up*.

Similar Mechanisms – Return Stabilization

Return stabilization, also known as rate stabilization and revenue stabilization, is another rate design mechanism that decouples a utility's profits from its gas throughput. The mechanism works by adjusting the utility's monthly revenues up or down to meet pre-established revenue and return targets. The amount calculated is added to or subtracted from the commodity charge of the utility in the next month and the utility files a revised rate schedule with the regulator. Several AGA members have received approval for these mechanisms. An upcoming *Rate Round-Up* will discuss these related mechanisms in more detail.

CURRENT DECOUPLING PROGRAMS

NW Natural - Oregon

The Public Utility Commission of Oregon approved a decoupling tariff for NW Natural in September of 2002. The PUC said the tariff was designed "to break the link between an energy utility's sales and its profitability, so that the utility can assist its customers with energy efficiency without conflict." The tariff was a partial decoupling mechanism that allowed NW Natural to defer and then amortize 90 percent of the margin differentials for the residential and commercial customer groups. The mechanism contained two components: 1) a "price elasticity" factor that adjusted for increases or decreases in consumption attributable to annual changes in commodity costs or periodic changes in the company's general rates; and 2) a decoupling adjustment calculated on a monthly basis that accounted for deviations in expected volumes. Weather related risks were not covered by the mechanism. The additional company revenues or credits to customers produced by the mechanism were booked to a deferral account that was reconciled as part of the company's annual purchased gas adjustment.

The NW Natural decoupling tariff was put in place for three years on a pilot basis and had a sunset date of September 30, 2005, unless extended by the PUC. In March of 2005, NW Natural asked the PUC to investigate whether the decoupling tariff should continue. As part of the petition, NW Natural submitted the results of an independent study that had been required under the original order.

In August 2005, the Oregon PUC extended NW Natural's partial decoupling mechanism for an additional four years. NW Natural revised the decoupling schedule to provide for 100 percent deferral and amortization of the margin differentials. This change eliminated the non-weather related margin variability related to distribution fixed costs. In addition to the decoupling provisions, NW Natural currently has in effect a weather-adjusted rate mechanism (WARM) that was adopted in an earlier rate case and that lasts until September 30, 2008. The WARM covers all residential and small commercial customers, unless the customers opt out. The 2005 decoupling case dictates that public purpose funding and low-income assistance programs will remain in effect throughout the life of the decoupling program. In addition, industrial customers will not be charged or be eligible for any of the assistance programs.

NW Natural has a conservation component to its decoupling program that provides an indirect efficiency incentive to its customers. The company collects from all of its residential and commercial customers a "public purpose" surcharge of 1.5 percent of their total monthly bills. The funds are then passed on to an independent, non-profit organization, the Energy Trust of Oregon. The Energy Trust, which also receives funding from public purposes surcharges from all of Oregon's electric utilities, then provides grants to promote energy-efficiency and renewable resources among homes and businesses.

The Energy Trust of Oregon disburses approximately $6 million each year to encourage more efficient use of natural gas. Incentives include: $450 - $825 per unit to builders of new home construction if natural gas service is installed; rebates for high-efficiency gas furnaces, water heaters (including tankless units) and other appliances in existing homes; rebates on insulation, new windows and other efforts to reduce home energy use; and rebates on the installation of tankless water heaters, efficient boilers, etc. in commercial buildings.

Baltimore Gas and Electric and Washington Gas Light - Maryland

BG&E's decoupling program began in 1998, while Washington Gas Light's mechanism began in October of 2005. The programs, which are similar in design, are "full decoupling" programs, in that they are designed to recover multiple sources of margin loss, including weather and price elasticity, as well as losses caused by customers' conservation and energy efficiency. The Maryland decoupling mechanism utilizes a balancing account that returns to customers excess margin when revenues exceed authorized levels.

The companies make adjustments to the delivery price of gas under the applicable schedules to reflect test year base rate revenues established in the latest base rate proceeding, after adjustment to recognize the subsequent change in the number of customers from the test year level. Test year average use per customer is multiplied by the net number of customers added since the like-month during the test year. The product is added to test year revenue to restate test year revenues for the month to include the revised values. Actual revenues collected for the month are compared to the restated test year revenues and any difference is divided by estimated sales for the second succeeding month to obtain the adjustment to the applicable delivery price. Any difference between actual and estimated sales is reconciled in the determination of the adjustment for a future month. Details of the calculation of the billing adjustment are filed monthly with the Public Service Commission.

Southwest Gas Co. - California

California has had some variation of a decoupling program in place for most of its utilities for nearly 30 years. The impetus for the program was the enactment of lifeline rates legislation, gas supply constraints, and the adoption of demand side management programs by the state. In its most recent general rate case order, effective April 15, 2004, Southwest was granted authority to implement a decoupling mechanism. The decoupling mechanism utilizes a balancing account to protect customers if base revenues exceed authorized levels, and to protect stockholders if base revenues are less than authorized levels. The program is firmly established and utilizes a long-standing regulatory construct that does not recognize an explicit reduction to ROE.

Future test year system annual revenue requirement (margin) is established in a rate case as a fixed dollar amount on a monthly and annual basis. The difference between billed margins and authorized margins, plus carrying costs, is recorded monthly in a deferred account. The account balance is amortized annually through a uniform cents-per-therm rate applicable to all schedules, except special contracts. The test year margin amount increases each January 1 (between rate cases) according to an established formula.

Piedmont Natural Gas – North Carolina

This decoupling tariff, approved by the North Carolina Utilities Commission in November 2005, gave Piedmont Natural Gas permission to implement a Customer Utilization Tracker (CUT). The mechanism was approved as an experimental, provisional tariff for a period of no more than three years and will automatically terminate on November 1, 2008, unless renewed in a general rate case. During the life of the CUT, Piedmont has agreed to contribute $500,000 per year toward conservation programs. Adoption of the CUT also resulted in the elimination of the company's existing weather normalization adjustment mechanism. In the 2005 ruling, the commission established an approved margin per customer per month for each residential and commercial rate class. Differences between the approved levels and the actual recovery are tracked monthly in a deferred account and trued-up twice a year.

The North Carolina attorney general appealed to the state Supreme Court to overturn the commission action. In July of 2006, Piedmont negotiated a settlement with the attorney general in which the company agreed to an additional contribution of up to $1,500,000 per year, dependent upon the level of conservation related revenues received by the company through the CUT mechanism. The (up to) $1,500,000 will be split 50/50 between a direct reduction in customer rates and further contributions to conservation programs, over and above the $500,000 per year contribution to conservation agreed to in the tariff.

Cascade Natural Gas – Oregon

The newest decoupling mechanism was approved by the Oregon Public Utility Commission on April 19, 2006, for Cascade Natural Gas. The decoupling mechanism, which was implemented outside of a rate case, applies to residential and commercial customers and mitigates demand reduction caused by conservation. The mechanism also adjusts symmetrically for deviations from normal weather. The Conservation Alliance Plan consists of two deferral accounts, one that tracks monthly weather-normalized usage impacts on margins and another that tracks monthly non-weather related changes in usage on margin. The deferral accounts will be maintained as regulatory assets or regulatory liabilities and will be amortized over the following year as increments to the commodity charge. The Cascade decoupling program includes a 0.75 percent public purpose surcharge to customers and a 0.75 percent of revenue contribution from the company to fund conservation programs for customers.

The Cascade Natural Gas decoupling mechanism imposes service quality requirements and includes a penalty provision for failing to perform below specified ratios on customer complaints. While there was no reduction to allowed ROE, Cascade's current earnings sharing mechanism was modified to reduce the threshold amount for earnings sharing from baseline ROE plus 300 basis points to baseline ROE plus 175 basis points. If requested by the commission, the company must file a general rate case in 2008. The plan will remain in effect until September of 2010 and an independent evaluation of the program will be conducted for the parties.

PENDING DECOUPLING MECHANISMS

- **Indiana** - In 2004, **Citizens Gas & Coke Utility** in Indianapolis, Ind., filed a general rate case with the Indiana Utility Regulatory Commission for the first time in 14 years. Citizens Gas proposed a Volume Variance and Conservation Adjustment (VVCA) mechanism that would adjust rates up or down on a monthly basis to allow the utility to recover its allowed revenue requirement, regardless of fluctuations in customer gas use caused primarily by the energy efficiency efforts of its customers and variations from normal weather. The proposed VVCA is an integral part of Citizens Gas' proposed comprehensive Energy Efficiency Program.
- **Indiana - Vectren Energy Delivery** has petitioned the Indiana Utility Regulatory Commission for permission to implement a conservation program, "in order to preserve its ability to provide reliable, low cost service, as well as create the financial stability required to position it to promote gas conservation on behalf of its customers." As proposed, the Conservation Adjustment will consist of two interrelated components: the conservation funding rider, and the decoupling mechanism. The company filed a petition rather than a new rate case for the conservation program and has reached a settlement with the office of the Utility Consumer Counselor.

- **Iowa** – On June 5, 2006, "Gas Utility Week" reported that Iowa regulators are considering decoupling rates for the state's local distribution companies. The report said that the Iowa Utilities Board opened a docket and will decide whether to issue a rule or allow the state's LDCs to propose their own rate decoupling mechanisms. According to the report, the goal is for commission staff to have a report ready for state regulators by the end of June. Previously, in its last rate case, Aquila asked the commission for a rate mechanism that would have decoupled a portion of its rates. While the Iowa Utilities Board denied Aquila's request, it stated that it is open to other decoupling proposals.
- **New Jersey** – In December of 2005, **New Jersey Natural Gas and South Jersey Gas** jointly filed proposals with the New Jersey Board of Public Utilities to implement a 5-year pilot program of decoupled rates. The current weather normalization clause would be replaced with a conservation and usage adjustment. The proposals also include new programs designed to further customer conservation efforts. The companies are in settlement discussions with commission staff and the ratepayer advocate.
- **New Mexico** – On May 30, 2006, **Public Service Company of New Mexico** filed a rate case in which it requested a decoupling mechanism that would be adjusted monthly, with an annual true-up, to allow the company to recover revenue lost due to conservation efforts. The monthly adjustment would be shown on the customer bill as a separate line item.
- **Ohio** – In late 2005, **Vectren Energy Delivery** petitioned the Ohio Public Utility Commission for authorization to implement a conservation tracking mechanism. Specifically, Vectren asked for two interrelated components to be approved. The conservation funding component would recover the costs of funding the design and implementation of conservation programs, and the decoupled sales component would recover the difference between actual revenues and revenues approved in the last rate case. Vectren, which is seeking approval for the proposal outside of a rate case, has reached a settlement with the Ohio Consumer Counsel.
- **Pennsylvania** – On May 31, 2006, **National Fuel Gas Distribution Co.** filed a rate case in its Pennsylvania jurisdiction in which it requested a decoupling mechanism. The Enhanced Energy Efficiency Rider compares actual usage to the amount of usage imputed in the rate case. The company also requested that the commission approve a rate redesign that incorporates rate block restructuring, in which a greater portion of company margin would be recovered through the lower-usage block rates as compared to the tailblock rates, and a seasonal PGA demand charge recovery mechanism.
- **Tennessee** – On June 30, 2006, **Chattanooga Gas** filed a general rate case in which it proposed to implement an energy conservation program and a conservation and usage adjustment mechanism to recover the revenues lost as a result of the conservation program.
- **Utah** - **Questar Gas** has petitioned the Utah Public Service Commission to implement a decoupling measure and to decrease rates. While the company has settled the rate reduction portion of the application, the decoupling filing will not be heard by the commission until June 26, 2006.
- **Washington** – Three LDCs in Washington state have proposals pending with the WUTC for approval of natural gas revenue decoupling mechanisms. In April, **Avista Corp.**, which recently completed a general rate case, filed a petition outside of a case for a partial decoupling mechanism that does not include losses related to weather. If approved as a three year pilot, the program would apply to most residential and commercial customer classes and to small industrial customers, and rate increases from the program would be capped at 2

percent per year. **Cascade Corp.** filed a general rate case in February and requested a mechanism that would adjust for weather changes on a monthly basis and for conservation induced consumption changes on an annual basis. **Puget Sound Energy's** revenue decoupling proposal is similar to the mechanisms in Maryland, except that it would be calculated on an annual basis rather than monthly. The mechanism would apply to residential and general service customers. Commission staff and intervenors are filing comments in July and the case is set for hearing in September.

PREVIOUSLY PROPOSED MECHANISMS

- **Arizona** – In December 2004, **Southwest Gas Corp.** filed to restructure their residential rates in order to separate the recovery of fixed operating costs from the volume of gas the utility sells. Southwest noted that while its residential customer growth rate exceeds 5 percent per year, it has experienced a decline in residential average use of approximately 2 percent per year, and has earned its authorized ROR in only one of the last 10 years. The filing was part of a general rate case. In Feb 2006, the Arizona Corporation Commission denied the request for a decoupling mechanism.
- **Arkansas** – **CenterPoint Southern Operations'** request in a rate case for a margin tracking mechanism was denied in 2005 by the Arkansas Public Service Commission.
- **Georgia** – A proposal by **Atmos Corporation** for a decoupling mechanism was denied by the Georgia Public Service Commission as part of a general rate case.
- **Minnesota - Xcel Energy's Northern States Power Co.** eliminated a decoupling proposal from its rate case settlement.
- **Montana - Montana-Dakota Utilities (MDU)** proposed a decoupling mechanism as part of a 2005 rate case but subsequently withdrew the entire case.
- **Nevada – Southwest Gas Corp.** In 2004, the company introduced a decoupling proposal after the initial filing of a rate case. The Nevada Public Service Commission said that the company's proposal came too late in the case and encouraged the company to refile at a later time.
- **Washington - NW Natural's** 2004 rate case settlement, in which their decoupling proposal was eliminated, authorized further study.
- **Washington - Cascade Natural Gas** - The Washington Utilities and Transportation Commission unveiled in May 2005 a proposal to decouple utilities' gas volume sales from their recovery of fixed costs. As part of the proceeding, the commission considered a decoupling petition by Cascade Natural Gas that was outside of a rate case. The commission ultimately denied the petition and said that the issues were better considered within a rate case.

HOW WELL HAVE THEY WORKED?

- **Decoupling programs, which have been accepted for many years in California and Maryland, have protected utilities from margin loss caused by declining use per customer.** These mechanisms compare recent base rate revenue targets against actual revenue, and usually adjust for growth. The use and acceptance of these programs appears to be growing.
- **An independent evaluation of NW Natural's decoupling and conservation tariffs, compiled in March 2005, found the programs to be worthwhile and in the public**

interest. Among the conclusions of the evaluators were that: the mechanism is effective in reducing the variability of utility revenues; the mechanism removes disincentives to promote energy efficiency; public purpose funding established in conjunction with the conservation component is beneficial to consumers; negative feedback was limited to complaints questioning the appropriateness and/or the legality of public purpose funding; and the mechanism does not reduce the incentive for good customer service.

- **Additional advantages of the program include: reduction of rate cases, reliance on basic rate formulas that have been utilized for decades, and the ease of audit.**
- **A disadvantage of decoupling is that utilities give up potential profits when customers consume more natural gas than was forecast when rates were set. Also, regulators and advocates may seek a reduced return or other concessions as a trade-off or as a bargaining chip.**

RESOURCES:
COMPANIES, RATE ORDERS, WEBSITES, CONTACTS, ETC.

- **Atmos Corp. – Georgia** – Denied - Docket No. 20298-U, December 20. 2005; *Contact Patricia Childers @ 615-771-8332*
- **Avista Corp. – Washington** – Petition Pending – April 4, 2006; *Contact Kelly Norwood @ 509-495-4267*
- **Baltimore Gas & Electric – Maryland** – Approved – Maryland Case No. 8780, Feb. 2005, http://webapp.psc.state.md.us/Intranet/CaseNum/NewIndex3_VOpenFile.cfm?ServerFilePath=C%3A%5CCasenum%5C8750%2D8799%5C8780%5C049%2Edoc, *Contact Laurie Duhan @ 410-265-4031*
- **Cascade Natural Gas – Oregon** – Approved - Docket No. UG 167, April 19, 2006, http://apps.puc.state.or.us/orders/2006ords/06-191.pdf, *Contact Jon Stoltz @206-624-3900*
- **Cascade Natural Gas – Washington** – Case Pending – *Contact Jon Stoltz @206-624-3900*
- **Cascade Natural Gas – Washington** – Petition Denied – , May 2005; http://www.wutc.wa.gov/webimage.nsf/34bbcde06f5ab31a88257044006e98f0/0e699dd89acd5b1888256fdd0068165f!OpenDocument, *Contact Jon Stoltz @206-624-3900*
- **CenterPoint Southern Operations – Arkansas** – Denied –Sep 2005; *Contact @ Chuck Harder @ 713-207-7273*
- **Chattanooga Gas – Tennessee** – Case Pending – June 30, 2006, http://www.state.tn.us/tra/orders/2006/0600175.pdf; *Contact Scott Carter @ 404-584-4136*
- **Citizens Gas & Coke Utility – Indiana** – Pending – December 9, 2004, http://www.citizensgas.com/pdf/NewsRelease/baserateincrease04.pdf; *Contact LaTona Prentice @ 317-927-4529*
- **Montana-Dakota Utilities – Montana** – Case Withdrawn; *Contact Don Ball @ 701-222-7630*
- **National Fuel Gas Distribution Co. – Pennsylvania** – Case Pending – May 31, 2006, Docket No. R-00061493; *contact Eric Meinl @ 716-857-7805*
- **New Jersey Natural Gas – New Jersey** – Petition Pending – December 5, 2005, http://www2.njresources.com/news/trans/newsrpt.asp?Year=2005; *Contact Annemarie Perachio @ 732-938-1129*
- **NW Natural – Oregon** – Approved - Order No. 05-1041, September 26, 2005; http://apps.puc.state.or.us/orders/2005ords/05-1041.pdf, *Contact C. Alex Miller @ 503-721-2487*

- **NW Natural – Washington** – Rate case settlement authorized further study - 2004; *Contact C. Alex Miller @ 503-721-2487*
- **Piedmont Natural Gas – North Carolina** – Approved – Dockets G-9, Sub 499, G-21 Sub 461, G-44 Sub 15, November 3, 2005; http://neuc.commerce.state.nc.us/docksrch.html, *Contact: David Carpenter @ 704-364-4242*
- **Public Service Company of New Mexico – New Mexico** – Case Pending – Docket No. 06-00210-UT, May 30, 2006; *Contact John Fernald @ 505-241-2879*
- **Puget Sound Energy – Washington** – Case Pending –Docket No. UG-060267, February 15, 2006; *Contact Tom DeBoer @ 425-462-3495*
- **Questar Gas – Utah** – Petition Pending –Docket No. 05-057-T01, December 15, 2005; http://www.questar.com/news/2006_news/01-27-06.pdf, *Contact Barrie McKay @ 801-324-5491*
- **South Jersey Gas – New Jersey** – Petition Pending – Docket No. GR05121020, Dec 5, 2005; *Contact Sam Pignatelli @ 609-561-9000 x4204*
- **Southwest Gas – Arizona** – Denied – Docket No. G-01551A-04-0876, February 15, 2006; *http://www.cc.state.az.us/news/pr02-16-06.htmY; Contact Roger Montgomery @ 702-876-7321*
- **Southwest Gas – California** – Approved – California Application No. 02-02-012, Decision No. 04-03-034; *Contact Roger Montgomery @ 702-876-7321*
- **Southwest Gas – Nevada** – Denied – Nevada, July 2004; *Contact Roger Montgomery @ 702-876-7321*
- **Vectren Energy Delivery – Indiana** – Petition Pending – Indiana URC Cause No. 42943, October 25, 2005; *Contact Scott Albertson @ 812-491-4682*
- **Vectren Energy Delivery – Ohio** – Petition Pending – Case No. 05-1444-GA-UNC, Nov. 28, 2005; *http://dis.puc.state.oh.us/DMPDFs/GWFLPPVGK@LU501L.pdf; Contact Scott Albertson @ 812-491-4682*
- **Washington Gas Light –Maryland** – Approved – Maryland Case No. 8990, October 1, 2005, *http://webapp.psc.state.md.us/Intranet/maillog/orders.cfm Contact Paul Buckley @ 703-750-5260*
- **Xcel Energy – Minnesota** – Eliminated from rate case settlement; *Contact Amy Liberkowski @ amy.a.Liberkowski@xcelenergy.com*

ADDITIONAL INFORMATION

If you would like more information about a particular program or would like to speak to another AGA member regarding the details of the program, please contact: *Cynthia Marple*, AGA director of rates and regulatory affairs, cmarple@aga.org or 202-824-7228.

Coming Up:

The next edition of the AGA Rate Roundup will cover rate and revenue stabilization mechanisms. If your company offers such a program, please contact Cynthia Marple.

Previous Edition:

The June 2006 *Rate Round-Up* focused on Innovative Rate Designs for Fixed Cost Recovery. Find this Round-Up by clicking here.

AGA Rate Round-Up: "Innovative Rate Designs for Fixed Cost Recovery"

American Gas Association

NATURAL GAS RATE ROUND-UP

A Periodic Update on Innovative Rate Designs

June 2006

Innovative Rate Designs for Fixed Cost Recovery

This issue of the *AGA Rate Roundup* describes four rate design methods that, when compared to traditional rate methods, increase the likelihood of recovery of the utility's fixed costs and send more accurate price signals to customers. Demand rates (also known as straight-fixed variable rates), single block rates, and flat monthly service charges all recover the utility's fixed distribution costs without regard to the amount of natural gas commodity used by the customer.

TYPES OF FIXED COST RECOVERY METHODS

Four innovative regulatory strategies help local natural gas distribution companies recover the fixed costs of distribution service.

1. Demand Rates (SFV Rates)
2. Block Rate Restructuring
3. Redesigned Service Charge
4. Two-Tier Customer Choice Option

CONCEPTS OF INNOVATIVE FIXED COST RECOVERY RATE DESIGNS

The traditional approach to fixed cost recovery for natural gas utilities is to volumetrically recover the costs of distribution service from each unit of gas sold. When more gas is sold than was predicted during the company's last rate case, the utility may earn more than its authorized return on equity. But as has happened all too frequently lately, when the utility sells less gas than was forecast at the time the rates were set, the utility does not recover its fixed costs of doing business and does not earn its authorized return. The primary causes of decreased natural gas sales are warmer than expected weather and increased appliance efficiency.

The more economically efficient approach to fixed cost recovery places all of the utility's fixed costs, including a regulated profit on the value of the utility's investment in plant and equipment used to provide service to the customer, into a fixed monthly fee. This charge is similar to the monthly fee charged by cable TV companies and is unrelated to the amount of gas (or number of TV programs) used by the customer. Several utilities currently utilize a fixed charge type of rate design for recovery of their fixed costs. For customers, the advantages of fixed charge recovery over volumetric cost recovery is that a flat monthly charge reduces monthly bill fluctuations, prevents overpayment of fixed costs during cold weather, and sends accurate price signals about

both the cost of the delivery service and the cost of the commodity. The advantages for the utility of this rate design is that a fixed monthly charge allows recovery of the distribution investment during the summer months as well as during the peak winter months, while it also reduces the frequency of future rate cases. Fixed charge recovery of fixed costs can be a win-win rate design mechanism for both utilities and their customers.

DESCRIPTIONS OF FIXED COST RECOVERY METHODS

1. Demand Rates (SFV Rates) – Atlanta Gas Light

Not really an innovation, demand rates are a fixture of traditional utility rate designs and are used by almost all FERC regulated interstate transmission pipelines[1]. Demand rates are rates that allocate fixed costs to each customer in proportion to how much usage or "demand" the customer places on the utility's delivery services. Although they are based on usage amounts, demand rates are not volumetric rates, because regardless of the amount of gas the customer has delivered, the utility receives a constant demand charge from that customer. The commodity cost of natural gas is not affected by this rate design.

Because a utility's fixed costs are largely driven by its design-day requirements, a demand rate recovers the common costs of delivering gas based on a customer's demand on the system on the coldest day for which the system is designed. Demand rates tie cost causation to cost recovery and allow the utility to ensure it has enough pipe and storage capacity to meet every customer's need in cold weather. Because the demand charge is calculated based on peak demand, weather volatility is removed from the charge.

Atlanta Gas Light (AGL) exited the merchant function in 1997 and simultaneously switched to the use of demand rates for the recovery of its fixed costs from residential and commercial customers. While AGL continues to provide distribution services (delivery, storage, meter reading, pipeline maintenance, etc.), marketers now provide AGL's customers with supply services (commodity, billing, and call center). AGL bills the marketers for the distribution services provided to customers, and marketers bills customers for services rendered by both AGL and themselves. The monthly gas bill from the customer's marketer contains a single line-item base charge from AGL, which continues to be regulated by the Georgia Public Service Commission. This single item is composed of AGL's demand rate, called the Dedicated Design Day Capacity charge (DDDC)[2], and AGL's other fees. The base charge does not vary if the customer chooses another marketer.

The base charge for each customer varies according to the size of the home or facility and the types of gas appliances or equipment used. DDDC charges are unique for each household or business and are based on how much gas is used (or demanded) during the coldest period of the prior year, adjusted for design day weather[3]. This allows AGL to ensure it has enough pipe and storage capacity to meet every customer's need in cold weather. Because AGL does not have 12 months of consumption history on a newly built structure, AGL gathers specific information on new buildings to calculate the DDDC. For residential premises, the charge is based on the square footage of the structure, the type of structure (single family residence, apartment or mobile home) and the gas equipment used. In theory, there could be as many individual DDDC

[1] FERC calls demand rates, "straight fixed variable" rates.

[2] The DDDC is also known as the maximum daily quantity demanded.

[3] DDDC's are calculated by adding individual customer summer base load to projected heat sensitive load on a design day, which is the customer's heat sensitive use per degree day multiplied by design day heating degree days.

charges as there are customers, but in actuality, each customer is assigned to the weighted average of one of 44 DDDC ranges.

In order to update usage patterns for each customer for the most recent year, a DDDC recalculation is required annually and is approved by the Georgia PSC. The DDDC is recalculated per premise, not per customer, with the result that changes in usage patterns and gas appliances can affect the DDDC. The updated DDDC factor is for the new year only and does not cause a refund or a surcharge to customers whose DDDC factor changes.

In February 2001, Atlanta Gas Light implemented a seasonal rate plan for DDDC charges for residential customers. The annual rate is sculpted on a monthly basis to more closely reflect typical summer and winter usage patterns. The seasonal rate plan results in higher base charges in winter (more gas use), and lower base charges in summer (less gas use). Although the base charges are billed on a sculpted basis, revenues are recognized on a flat basis on the income statement. Commercial customers' bills are not sculpted.

2. Block Rate Restructuring – Laclede Gas Co.

Block rates are volumetric rates that have two or more successive blocks of use with decreasing (or increasing) prices per unit of volume.[4] The customer is billed for use in each successive block at the rate applicable to that block. The charges calculated for each block are then added to determine the total volumetric monthly bill. The price for gas usage in each block can recover some or all of the fixed costs as well as the commodity costs. Declining block rates are a form of volume discount that recognizes that some cost elements decrease on a unit basis, as use increases. Declining block rates encourage additional gas usage and in the past helped gas compete with other fuels in energy markets. With the current emphasis on energy conservation, the usage and design of block rates are being reexamined.

In November 2002, Laclede Gas Co. implemented a Weather Mitigation Rate Design (WMRD) that attempts to recover most of the company's fixed distribution costs in the restructured first rate block of the rate schedule[5]. The WRMD applies to residential service and to certain types of commercial and industrial customers. The company designed the volumetric rate so that during the winter season (November – April) all of the company's non-gas distribution charges (other than the customer charge) are billed to customers based solely on their consumption in the first rate block. When customers' consumption is at least the level of the first rate block, as it usually is during the coldest winter months, all distribution costs other than those recovered through the monthly customer charge are recovered in the first rate block. However, in the shoulder months, warmer than normal weather may cause customers to consume less than the volume assumed in the first rate block and, therefore, the company remains at risk of under-recovering its fixed costs in those months. Significantly, because the amount of fixed cost recovery is greater in the restructured first block than it was in the first block of the old rate design, the amount of possible under-recovery of fixed costs in the shoulder months is greater with the new design than with the old block design.

Because Laclede wanted to avoid charging small volume users at a rate that was higher than it had been previously, the WMRD was designed to keep the rate in each block the same, while altering the sequence of the company's recovery of fixed distribution costs and gas commodity costs. To compensate for the increased fixed cost recovery in the first rate block, the Purchased

[4] Block rates with decreasing prices are called declining block rates and those with increasing prices are called inverted block rates.

[5] The rest of the fixed costs are included in the monthly customer charge of $12.00.

Gas Adjustment (PGA) was decreased in the first rate block and increased in the second rate block. To the extent that total gas commodity costs are not recovered in the winter months, the deferred gas cost adjustment component of the PGA records the differences and is reconciled the next year.

By restructuring the first and second blocks of the rate, the WMRD sends an accurate price signal to customers[6]. Gas costs account for two thirds of the customer's bill and it is the variable and volatile cost of the natural gas commodity to which customers should respond. The WMRD rate design gives consumers an incentive to conserve because for every therm conserved, customers avoid paying the PGA charge in the second rate block where the conservation would likely occur.

3. Redesigned Monthly Service Charge - Xcel Energy-Northern States Power Co.

The current rate design model, which was developed about 100 years ago, utilizes a monthly service charge that recovers only a fraction of fixed costs, plus a volumetric delivery fee that recovers the bulk of fixed costs on a usage basis. Because of the long history of this model, many customers and regulators are uncomfortable when changes to the traditional rate design model are proposed. However, the most straight forward technique of fixed cost recovery and the easiest method to explain to customers is a monthly service charge that recovers all of the utility's commission authorized cost of service in a flat monthly fee. Today's LDC customers are accustomed to this type of rate design when they pay a fixed monthly fee for their cable TV, local telephone, internet, and garbage pick-up services, among others. Many LDCs are now redesigning the monthly service charge to recover more of their fixed costs in the charge and some companies have begun to recover all of their costs in a flat monthly fee.

On June 1, 2005, the North Dakota Public Services Commission authorized Xcel Energy's Northern States Power Co. to change the way the company charges its residential natural gas customers for distribution and metering services. Residential customers no longer pay both a monthly fee and a usage-based rate for delivering natural gas to their homes. Instead, the rate plan allows the company to charge a flat monthly fee of $15.69 per month. The fee replaced a monthly basic service fee of $5.50 and a usage-based distribution charge that, when combined, had varied from $7 to $30 per month. Most customers did not see a large change in their overall bill, since the redesigned monthly service charge simply replaced two previous charges. A small number of high-usage customers received lower bills because the rate design eliminated the subsidy they had been paying, and a relatively few low-usage customers received a larger bill (around $4 to $6 per month) than they had paid on the traditional rate design.

The benefits of the redesigned, flat monthly charge include reduced monthly bill fluctuations, reduced frequency of rate cases (because of reduced revenue losses due to declining use per customer), reduced rate subsidies from high-usage customers to lower-usage customers, and more accurate matching of revenues with the associated distribution costs. Compared to the traditional rate design, the redesigned monthly service charge sends better economic signals to customers and helps customers better understand the separate charges on their bills. The new rate design helps customers distinguish between the costs for the consumed natural gas and the

[6] A correct price signal is one in which there is a correlation between the price of gas commodity (or the price of distribution service) and the reduction in cost that would occur if the quantity of gas commodity consumed (or the amount of distribution service received) is reduced. This is true with respect to gas commodity, where if the commodity price is too high, the gas remains unconsumed and the cost is avoided. However, this is not the case with respect to gas distribution service, where fixed distribution costs are not avoided when the amount of distribution service received is reduced.

costs for the delivered natural gas. Because consumption of natural gas comprises approximately 75 to 80 percent of each residential bill, a strong incentive remains for customers to seek ways to conserve energy. On the other hand, the redesigned monthly service charge eliminates the company's financial disincentives to promote energy conservation.

Xcel Energy believes that the redesigned monthly service charge concept is much easier to explain to customers than are other innovative rate mechanisms, such as decoupling, which results in regularly changing adjustments (positive and negative) that are not easily understood. The company used public input sessions, bill messages that included forecasted bill impacts, and press releases to communicate with customers. Xcel made presentations to the North Dakota PSC, demonstrating various billing scenarios and listing the benefits of the program for all customers, including the low-usage customers whose bills increased. The company's bill message to customers stated, "Your bill has been simplified. A fixed, monthly Delivery Services charge has replaced a more complicated two-part rate structure that typically varied between $7 and $30 per month. The new Delivery Services charge reflects our costs to distribute natural gas to you on the Xcel Energy system. The charge will be the same - $15.69 – each month for every residential customer we serve in North Dakota."

4. Two-Tier Customer Choice Rate Option – Oklahoma Natural Gas

Another innovative rate design offering is a new mechanism that combines the restructured rate block concept with the redesigned monthly service charge concept and offers customers a choice between two competing types of rate plans. Oklahoma Natural Gas Co. (ONG), a division of ONEOK, implemented a two-tier rate program in 2005 that allows residential customers to choose their rate design, either one where most fixed costs are recovered in the monthly service charge, or one where most fixed costs are recovered in a volumetric delivery charge. ONG believed that the previous rate design no longer reflected the underlying economics of providing natural gas service. ONG wanted a rate design that was simple, accurately reflected costs, moderated rate shocks, had a high probability of regulatory acceptance while delivering the maximum customer benefit, and would be complemented by ONG's other customer choice and fixed gas commodity programs.

The company's new two-tier customer choice rate plan eliminated the declining block rate structure and introduced a high usage option and a low usage option for certain residential classes. Those customers whose weather normalized annual consumption is greater than a specified level benefit by being billed under the high usage option, which features a higher monthly service charge and a lower volumetric delivery charge than the old rate offered. Customers with annual consumption less than the specified level are better off with the rate option that provides a lower monthly service charge and higher volumetric delivery charge. With the two-tier plan, lower usage customers are not over burdened by higher monthly service charges, while higher usage customers easily accommodate the higher monthly service charge because their volumetric delivery charge is reduced and their total bill is less likely to be affected. Customers may choose which rate plan they prefer at any time, but once chosen, customers must remain on that rate plan for 12 months.

ONG felt that customer education was critical to the success of the new rate design because the company did not want their call center to be overwhelmed and the commission did not want to hear from unhappy customers. The company determined customer perceptions from focus groups, created media opportunities, used billing inserts for customer specific communication, and carefully timed the implementation of the program.

PENDING FIXED COST RECOVERY MECHANISMS

Redesigned Monthly Service Charge

- **Missouri Gas Energy, a division of Southern Union Co.**, has petitioned the Missouri Public Service Commission as part of its rate case to replace the current $11.65 per month customer charge with a $27.50 per month basic service charge.
- **SEMCO Energy Gas Co.** has filed a rate case in Michigan that seeks to combine its flat monthly customer charge with its volumetric service charge into one flat monthly service fee. If lost and unaccounted for gas costs (LUAF) are tracked and recovered in the PGA, the proposed monthly fee will be $24.09. However, if lost and unaccounted for expenses are not tracked in the PGA, then the monthly service charge will include the LUAF costs and the fee will be $25.18 per month.

Two-Tier Customer Choice Rate Option

- **Kansas Gas Service, a division of ONEOK** – In a proposal similar to that approved for Oklahoma Natural Gas last year, Kansas Gas Service asked the Kansas Corporation Commission to approve a two-tier rate structure that will permit residential and general service customers to choose between rate plans, with a higher service charge and a lower delivery rate on the one hand, and a lower service charge and a higher delivery rate on the other hand. The plan is designed to promote informed conservation by allowing customers to choose the optimal rate offering based on a particular customer's usage pattern.

HOW WELL HAVE THEY WORKED?

- **Atlanta Gas Light** – As customers have benefited by having predictable and stable base charges that do not fluctuate with usage or weather, so too has the company benefited by having predictable and stable monthly revenue streams that do not vary seasonally. Base charges are easily explained and residential charges are sculpted to reflect seasonal usage patterns. Demand rate design aligns the interest of the customers and the company by decoupling the company's revenues from customer usage. This allows the company to encourage conservation, which lowers the customer's total bill without harming the company financially.

  Because of administrative difficulties with exiting the merchant function, the early years of the program were chaotic. Intervenors challenged the DDDC mechanism, while customers did not like having a monthly charge that did not vary by season. As a result, AGL "sculpted" the DDDC and held a rate design workshop.

- **Laclede Gas Co.** – Laclede chose to mitigate its weather risk and to recover its fixed costs by restructuring the first rate block because it felt that a 1979 Missouri Supreme Court decision disallowed the use of weather normalization-type adjustment clauses. However, Missouri Senate Bill 179 has since made it clear that weather normalized rates are not illegal under Missouri law. Because the first block of the rate is not particularly weather sensitive in most winter months, the amounts billed to customers to recover the company's fixed costs are relatively stable from one winter season to the next and are less sensitive to weather. Weather risk to both customers and utility is reduced. The rate design has successfully helped the company achieve a better matching of its revenues to the costs the company's rates were designed to cover. The restructured rate block has been in use for four years with little adverse reaction from customers.

- **Xcel Energy** – There have been very few customer questions or complaints concerning the redesigned, flat monthly service charge, probably because the change was easy to understand and the effect on most consumer bills was relatively small. Because residential revenues are now directly linked to the number of residential customers taking service from the company, the flat monthly fee makes it easier for the commission to audit the company's revenues and earnings. Members of the North Dakota PSC have spoken publicly in support of the new rate plan. In addition, because the information technology changes to the accounting and billing systems were less than would have been required for a partial decoupling or demand rate, the new rate design was less expensive to implement.
- **Oklahoma Natural Gas, A Division of ONEOK** – Under the former volumetric declining block rates, low volume load, such as water heater-only load, had been at risk. The two-tier customer choice program benefits both customers and company by keeping load on the system, thereby spreading fixed cost recovery over more volumes of gas. For customers, the new rate design program has the benefit of more easily understood bills and lower annual bills. The company benefits from more predictable and stable revenues and a significant improvement to cash flow. The program also benefits society by better matching the costs of providing service to the user of the service, by reducing intra-class and seasonal subsidies present in most rate structures, and by better accommodating conservation efforts.

RESOURCES: COMPANIES, RATE ORDERS, WEBSITES, CONTACTS, ETC.

- **Atlanta Gas Light – Georgia** – Approved – July 1998; View tariff provisions for Atlanta Gas Light.; http://www.aglc.com/rates_regulations/customer_charges.aspx; *Contact Scott Carter @ 404-584-4136*
- **Kansas Gas Service, a division of ONEOK – Kansas** – Proposed– Kansas Case No. 06-KGSC-1209-RTS, http://www.kcc.state.ks.us/scan200605/20060515150150.pdf; May 15, 2006; *Contact Larry Willer @ 913-319-8660*
- **Laclede Gas – Missouri** – Approved– Missouri Case No. GR-2002-356, November 2002; *Contact Mike Cline @ 314-342-0524*
- **Missouri Gas Energy, a division of Southern Union Co. – Missouri** – Proposed– Missouri Case No. GR-2006-0422, May 12, 2006; https://www.efis.psc.mo/mpsc/commoncomponents/view_itemno_details.asp?caseno=GR-2006-0422&attach_id=200620661; *Contact Mike Noack @ 816-360-5560*
- **Oklahoma Natural Gas, a division of ONEOK – Oklahoma** – Approved– Oklahoma Case No. PUD200400610; http://imaging.occeweb.com/AP/Orders/00135432.TIF; October 4, 2005; *Contact Jim Armstrong @ 405-551-6808*
- **SEMCO Energy Gas Co. – Michigan** – Proposed– Case No. U-14-893, Filed May 26, 2006; *Contact Annette Gardiner @ 810-887-4227*
- **Xcel Energy-Northern States Power – North Dakota** – Approved–North Dakota Case No. PU-04-578, June 1, 2005; *Contact David Sederquist @ 701-241-8632*

ADDITIONAL INFORMATION

If you would like more information about a particular program or would like to speak to another AGA member regarding the details of the program, please contact: *Cynthia Marple*, AGA director of rates and regulatory affairs, cmarple@aga.org or 202-824-7228.

Want to learn more? ***AGA hosted an audio conference for members on "Fixed Variable Rate Designs" on December 9, 2005. To see presentations, go to:***

http://www.aga.org/Template.cfm?Section=Audioconference_Series&Template=/MembersOnly.cfm&NavMenuID=828&ContentID=18609&DirectListComboInd=D

Previous Editions of Rate Round-Ups can be found on the AGA website at www.aga.org.
An updated, May 2006 *Rate Round-Up* on Decoupling Mechanisms can be found at: *http://www.aga.org/Template.cfm?Section=Rate_Round-Up&Template=/MembersOnly.cfm&ContentID=20169*

Coming Up: Rate Stabilization and Revenue Stabilization Clauses and Tariff Provisions
The next edition of the AGA Rate Round-Up will discuss rate stabilization and revenue stabilization tariff provisions. If your company offers a rate or revenue stabilization adjustment or tariff, please contact Cynthia Marple.

AGA-NRDC 2004 Joint Statement to NARUC on Energy Efficiency and Conservation – -- *"Environmental Group Teams with Natural Gas Utilities to Promote Innovative State Approach to Energy Efficiency"*

American Gas Association

NRDC
THE EARTH'S BEST DEFENSE

Joint Statement of the American Gas Association and the Natural Resources Defense Council

Submitted to the National Association of Regulatory Utility Commissioners
July 2004

The American Gas Association (AGA) and the Natural Resources Defense Council (NRDC) recognize the many benefits of using clean-burning natural gas efficiently to provide high quality energy services in all sectors of the economy. This statement identifies ways to promote both economic and environmental progress by removing barriers to natural gas distribution companies' investments in urgently needed and cost-effective resources and infrastructure.

NRDC and AGA agree on the importance of state Public Utility Commissions' consideration of innovative programs that encourage increased total energy efficiency and conservation in ways that will align the interests of state regulators, natural gas utility company customers, utility shareholders, and other stakeholders. Cost-effective opportunities abound to improve the efficiency of buildings and equipment in ways that promote the interests of both individual customers and entire utility systems, while improving environmental quality. For example, when energy supply and delivery systems are under stress, even relatively modest reductions in use can yield significant additional cost savings for all customers by relieving strong upward pressures on short-term prices.

NRDC and AGA also encourage state Commissions to support gas distribution company efforts to manage volatility in energy prices and reduce volatility risks for customers.

The Energy Efficiency Problem: Regulated Natural Gas Utilities are Penalized for Aggressively Promoting Energy Efficiency

Local natural gas distribution companies (gas utilities) have very high fixed costs. These fixed costs include the costs of maintaining system safety and reliability throughout the year, staffing customer service telephone lines 24 hours a day and doing what it takes each day of the year to ensure the safe and reliable delivery of natural gas to homes, schools, hospitals, retailers, factories and other customers.

Natural gas utilities typically purchase natural gas on behalf of their customers, and pass through the cost without markup. This means that natural gas utilities do not

profit from their acquisitions of natural gas to serve customer needs. The profit (authorized level of rate of return) comes from the rates utilities charge for transporting the natural gas to customers' homes and businesses.

The vast majority of the non-commodity costs of running a gas distribution utility are fixed and do not vary significantly from month to month. However, traditional utility rates do not reflect this reality. Traditional utility rates are designed to capture most of approved revenue requirements for fixed costs through volumetric retail sales of natural gas, so that a utility can recover these costs fully only if its customers consume a certain minimum amount of natural gas (these amounts are normally calculated in rate cases and generally are based on what customers consumed in the past). Thus, many states' rate structures offer – quite unintentionally – a significant financial disincentive for natural gas utilities to aggressively encourage their customers to use less natural gas, such as by providing financial incentives and education to promote energy-efficiency and conservation techniques.

When customers use less natural gas, utility profitability almost always suffers, because recovery of fixed costs is reduced in proportion to the reduction in sales. Thus, conservation may prevent the utility from recovering its authorized fixed costs and earning its state-allowed rate of return. In this important respect, traditional utility rate practices fail to align the interests of utility shareholders with those of utility customers and society as a whole. This need not be the case. Public utility commissions should consider utility rate proposals and other innovative programs that reward utilities for encouraging conservation and managing customer bills to avoid certain negative impacts associated with colder-than-normal weather. There are a number of ways to do this, and NRDC and AGA join in supporting mechanisms that use modest automatic rate true-ups to ensure that a utility's opportunity to recover authorized fixed costs is not held hostage to fluctuations in retail gas sales.[1] We also support performance-based incentives designed to allow utilities to share in independently verified savings associated with cost-effective energy efficiency programs.

Many states' rate structures also place utilities at risk for variations in customer usage based on variations in weather from a normal pattern. This variation can be both positive and negative. Utilities' allowed rate of return is premised on the

[1]For example, in 2003 the Oregon Public Utility Commission approved a "conservation tariff" for Northwest Natural Gas Company (NW Natural) "to break the link between an energy utility's sales and its profitability, so that the utility can assist its customers with energy efficiency without conflict." The conservation tariff seeks to do that by using modest periodic rate adjustments to "decouple" recovery of the utility's authorized fixed costs from unexpected fluctuations in retail sales. *See* Oregon PUC Order No. 02-634, *Stipulation Adopting Northwest Natural Gas Company Application for Public Purpose Funding and Distribution Margin Normalization* (Sept. 12, 2003). In California, PG&E and other gas utilities have a long tradition of investment in energy efficiency services, including those targeting low-income households, and the PUC is now considering further expansion of these investments along with the creation of performance-based incentives tied to verified net savings. California also pioneered the use of modest periodic true-ups in rates to break the linkage between utilities' financial health and their retail gas sales, and has now restored this policy in the aftermath of an ill-fated industry restructuring experiment. Thus, in March 2004, Southwest Gas Company received an order that authorizes it to establish a margin tracker that will balance actual margin revenues to authorized levels.

expectation that weather will be normal, on average, and that customer use of gas will maintain a predictable pattern going forward. Proposals by utilities to decouple revenues from both conservation-induced usage changes and variations in weather from normal have sometimes been characterized as attempts to reduce utilities' risk of earning their authorized return. The result of these rate reforms, in this regulatory view, should be a lowered authorized return. But reducing authorized returns would penalize utilities for socially beneficial advocacy and action, including efforts to create mechanisms that minimize the volatility of customer bills.

Our shared objective is to give utilities real incentives to encourage conservation and energy efficiency. With properly designed programs, the benefits could be significant and widespread:

- Customers could save money by using less natural gas;
- Reduced overall use will help push down short-term prices at times when markets are under stress, reducing costs for all customers (whether or not they participate in the utility programs);
- Utilities would recover their costs and have a fair opportunity to earn their allowed return;
- State policies to encourage economic development could be enhanced by increased energy efficiency and lower business energy costs;
- State PUCs would be able to support larger state policy objectives as well as programs that reflect the public's desire to use energy efficiently and wisely.

In today's climate of rapidly changing natural gas prices, such reforms make good sense for consumers, shareholders, state governments, and the environment.

Natural Gas Consumers, Price Volatility and Resource Portfolio Management. Another area of concern shared by NRDC and AGA is the impact of natural gas price volatility on natural gas consumers, which can be exacerbated by limited diversification of utilities' resource portfolios. Today many of the nation's natural gas utilities find themselves relying on short-term markets for most of their gas needs, with either the encouragement or the acquiescence of their regulators. During much of the 1990's this approach was typically advantageous to consumers, as the market price of natural gas was generally low and did not fluctuate dramatically. As wholesale natural gas prices have risen since 2000 and become more volatile, however, many utilities and commissions are reconsidering this emphasis on short-term market purchases.

While purchasing practices based on short-term supply contracts may offer consumers relatively low-cost natural gas, those consumers are also exposed to more volatile prices and natural gas bills that may rise and fall unpredictably. Public Utility Commissions should favorably consider gas distribution company proposals to manage volatility, such as through hedging, fixed-price contracts of various durations, energy-efficiency improvements in customers' buildings and equipment, and other measures designed to provide greater certainty about both supply

adequacy and price stability. Achieving these goals will sometimes require paying a premium over prevailing spot market prices. Like diversified investment portfolios that are designed to mitigate risk, prudent hedging plans should be encouraged as a way to help stabilize gas prices and ensure long-term access to affordable natural gas services.

This Joint Statement also has been reviewed and endorsed by:

ALLIANCE TO
SAVE ENERGY

Alliance to Save Energy

American Council for an Energy-Efficient Economy