Natural Gas Decoupling Rulemaking
WUTC Docket No. UG-050369

Summary, Analysis of Comments
and Decision to Close Docket
without Action

Background

On March 31, 2005, the Washington Utilities and Transportation Commission (Commission) issued a CR-101 Preproposal Statement of Inquiry concerning the possible issuance of administrative rules for natural gas companies pertaining to rate and accounting methods to separate or "decouple" utility recovery of fixed costs from the volume of its commodity sales.

On May 12, 2005, the Commission held a workshop to receive input from interested stakeholders on natural gas decoupling. The workshop was intended as a forum for open discussion of alternative approaches to natural gas decoupling, as well as an opportunity for parties to identify potential issues or concerns associated with use of various types of decoupling methodologies. The workshop included a presentation pertaining to a decoupling concept that Cascade Natural Gas has developed and discussion of an existing mechanism being used by Northwest Natural Gas in Oregon.

Following the workshop, on May 16, 2005, the Commission issued a Notice of Opportunity to File Written Comments. This notice included a series of questions pertaining to the specific mechanisms discussed during the workshop and sought input on other alternative approaches to decoupling. The notice also requested that interested parties identify specific interests and objectives that they wanted to see addressed by any decoupling proposal. Comments were due June 10, 2005.

Written comments were received by the Commission from Cascade Natural Gas, Avista, Northwest Industrial Gas Users, Public Counsel, Cost Management Services, Inc., Northwest Natural Gas and Puget Sound Energy. This paper is the Commission's summary of the comments organized by core issues. It also identifies outstanding questions and unresolved issues pertaining to the various decoupling methodologies that have been considered and concludes that a rulemaking on this subject is not appropriate at this time and this docket should be closed.

Summary of Comments and Associated Open Questions by General Issue Groupings

The following is the Commission's distillation of the comments received from stakeholders into general subject categories and to identify key issues and questions arising within each category. This summary includes oral comments made at the May 12 workshop and written comments submitted in response to the Commission's post workshop request. While a significant amount of overlap exists between categories, the Commission feels it is helpful, given the exploratory nature of the decoupling rule making process, to identify general issue groups for the limited purpose of facilitating analysis and supporting its decision on how to proceed.

A. Scope of Events Covered by Decoupling

The comments focus on two fundamental classes of events or circumstances that would trigger or drive a decoupling mechanism. The first is reduction in commodity consumption due to conservation and/or improvements in appliance efficiency. The second is variations in consumption caused by weather, primarily driven by changes in heating demands during the winter months.

A third possible approach would be to rely on a recovery mechanism that was designed to recover all fixed costs. This approach would effectively separate fixed cost recovery from all possible factors that could influence commodity sales volumes, including weather, conservation, economic fluctuations and population trends. No party has proposed a mechanism based on this more comprehensive and inclusive approach, so it is not discussed in this paper.

Most parties seem to agree that encouraging conservation and energy efficiency is a laudable goal. Some comments suggest, however, that the economic impact of weather variations may overwhelm the commodity usage reduction caused by conservation and efficiency. As a result, when weather adjustments are included it becomes difficult to accurately segregate and identify conservation and efficiency impacts so as to target, promote and encourage those types of energy savings through a decoupling mechanism. On the other hand, some comments suggest that because of relative magnitude of weather impacts, not much would be accomplished in terms of assuring fixed cost recovery (an objective of the utilities) by trying to devise a decoupling mechanism that sought to eliminate weather variability.

In Oregon, the Northwest Natural decoupling methodology has two separate elements; one for conservation and efficiency improvements and other non-weather induced variations (Distribution Margin Normalization), and one for weather driven usage impacts (WARM). Several parties have commented on the complexity of this two-track decoupling mechanism and questions have been raised about whether it actually achieves any measurable benefits for conservation and efficiency programs by virtue of its two-tier approach. In general, there does not seem to be much support for duplicating the Oregon system in Washington.

- Should a Washington decoupling mechanism be all-inclusive in terms of the reasons why commodity consumption per customer declines?
- If some reasons for decline should be excluded from operation of the mechanism, which are they and how would we isolate them for purposes of exclusion?
- As an alternative to exclusion, does it make sense to treat any causes of decline differently? For example, would we want one mechanism or formula for weather-related impacts and a different mechanism for tracking non-weather impacts?

B. Scope of Customer Classes Included

Another question relating to the scope of any decoupling mechanism is which customer classes are included. Most proposals focus on residential customer usage, although some would extend application to commercial or even light industrial customers. To the extent that variations in gas consumption are driven by weather, the main usage at issue is space heating. While classes in addition to residential may use gas to heat their facilities, the relative relationship between heating demand and total customer usage is generally less significant as you move from residential to commercial and into industrial customers. With regard to conservation and efficiency impacts, however, it seems that opportunities for reductions in consumption apply throughout the principal customer classes.

- Is there a sufficient volume of commodity sales and/or types of usage among classes other than residential to merit inclusion of those classes in any type of decoupling mechanism? If so, which classes?
- Does the answer to the preceding question change if the decoupling mechanism is limited to non-weather related impacts?

C. Scope of the Measurement and Subsequent Rate Impacts

Cascade's Conservation Rewards proposal would adjust rates on an individual customer basis based on that customer's usage history. Using that historical usage level as a baseline, individual Cascade customers would be able to reduce their share of the company's fixed costs by reducing their consumption below their baseline. Other approaches would adjust the fixed cost component of rates for an entire customer class based on class-wide usage data. Cascade's customer specific approach arguably sends a more direct signal and potential benefit to individual customers based on changes in their personal usage patterns. It may, as a result, allow customers to see a more direct impact from installation of conservation measures that they undertake (under similar weather conditions), whereas such changes would probably be lost in the noise of a class-based adjustment.

- Should any decoupling mechanism be applied on an individual customer basis, using their specific usage data (history)?
- Is it a problem that individual usage tracking and associated rate adjustments will have the affect of shifting fixed costs to other customers who don't reduce consumption? (For example under the Cascade model, if company fixed costs are a set amount and my share of those costs goes down because I reduce my consumption, my neighbor, who didn't change his usage pattern, must see an increase in order to keep the total fixed cost recovery level constant.)
- Does spreading fixed cost recovery impacts proportionately over an entire class do much, if anything, to encourage individual customers to conserve or otherwise reduce consumption?

D. Timing of Adjustments: Deferral with Annual True-up vs. Monthly Adjustments

With regard to the timing of rate changes for recovery of fixed costs, two general approaches seem to be used in decoupling mechanisms suggested by stakeholders.

The first involves use of a tracking mechanism that records variations above or below a determined baseline for the period in question, usually a year. While the nature and method of calculating the baseline varies significantly among the proposals, the common element is that the rates are only changed (up or down) at the end of the specified period through some type of "true-up" mechanism that utilizes the data that was tracked throughout the measurement period. Usually, the resulting fixed cost recovery rate impact/adjustment is then applied throughout the next period (until the next true-up occurs). This process would be somewhat similar

that currently used to adjust natural gas commodity prices through the Purchased Gas Adjustment (PGA) mechanism. In general terms this can be described as a deferred cost recovery approach. Proposals by Avista and PSE essentially use this method. Cascade's approach is also annual in terms of timing adjustments but it doesn't utilize a deferral or true-up mechanism for annual corrections.

The other approach tries to tie rate adjustments more closely in time to customer usage. The idea is that when changes in usage occur due to, for example, unusually warm or cold weather or installation of energy efficiency measures, the fixed cost recovery rate component for the affected customer class is adjusted as soon as practical. Under the mechanism being used in Maryland by Baltimore Gas & Electric, the adjustment is monthly, occurring about 30 days after the end of the month during which the change was measured. In other words, if usage changed in January, the rates would reflect that change beginning the first of March (February being the month in which the data is evaluated and the changes calculated). This mechanism is applied to the customer class, not individual customers, based on month-to-month changes in usage across the entire class.

One possible advantage of the second approach is that it creates a stronger temporal link between rate adjustments and events causing changes in consumption. This may serve to give customers, at least as a class, a price signal closer to real-time that ties a portion of their price to near term usage patterns. This may make it easier for customers to understand the basis for the changes than would be the case with an annual deferral and true-up system that doesn't result in any rate changes until many months after occurrence of the triggering events. On the other hand, this method might cause considerable customer confusion because rates are constantly in flux. There would also be a fair amount of administrative complexity associated with monthly calculations and rate changes.

- How important is it to tie fixed cost rate impacts temporally to the events that caused the impacts? Do customers need to see rate changes within 30-60 days or is it OK if they only see changes once a year?
- Is the overall financial impact on customers of any fixed cost recovery adjustment mechanism (decoupling) significant enough compared with commodity costs to merit the complexity, expense and possible confusion of a monthly adjustment process?
- Are there significant system limitations for the companies associated with one approach versus the other?

E. New Customer Impacts

Ongoing customer growth has been identified as a factor that needs to be considered under some of the proposed decoupling methods because it increases the base of customers over which fixed costs are spread. When fixed costs are allocated among a class consisting of X number of customers and the decoupling recovery mechanism is calculated, the company may end up over recovering to the extent that subsequent new customers also pay a portion of the fixed costs through their rates. Ideas for addressing this include use of an escalator that adjusts the fixed cost recover charge mechanism based on some type of average or actual customer growth data, with a true-up of the numbers and resetting of the growth index in the next general rate case.

- Do new customers have a material impact on the fixed cost recovery for any Washington gas company that could lead to over recovery of those costs?
- If so, what is the best way to mitigate that impact?

F. Rate of Return Implications

The rate of return that a regulated utility is authorized to earn, especially with regard to its return on equity, is generally considered to be a measure of the relative risk perceived by investors. Some parties, including NWIGU and Public Counsel, suggest that a decoupling mechanism reduces the investors' risk by essentially guaranteeing recovery of fixed costs. Because of that risk reduction, they argue that the company does not need to earn as high a return in order to attract sufficient capital investment. The companies challenge that logic.

- Does a decoupling mechanism materially reduce the risk associated with investment in a gas utility?
- Does the degree of reduction vary with the different decoupling mechanisms that parties have proposed? More specifically, is there a difference in the risk effect between decoupling mechanisms that cover weather effects versus those that cover only programmatic conservation effects?
- If a decoupling mechanism does materially reduce risk, should the Commission try to expressly quantify the magnitude of that reduction or should it simply "take it into consideration" in setting ROE?

G. Low Income Customer Considerations

Any mechanism that seeks to assure recovery of fixed costs from a class of customers without regard for consumption rates will have a disproportionate impact on customers who are historically low volume consumers. In many instances this would include low income customers, who have the least financial ability to absorb the increase. Consequently, some stakeholders believe that any decoupling mechanism must be accompanied with new low income support programs or increases in existing programs to offset this impact.

- Are low income customers disproportionately impacted by any of the decoupling mechanisms that have been proposed?
- How much low income assistance is needed to offset the adverse impact?

H. Pilot Project Implementation Approach

As a general consideration, several parties suggest that any decoupling approach in Washington be adopted initially as a pilot project with both limited scope and duration. Such a pilot would also include specific review criteria and timelines.

- Should any decoupling mechanism that the Commission adopts be setup initially as a pilot program?
- If so, what would be an appropriate duration and what types of reviews or studies should be incorporated into the program to facilitate evaluation?

I. Basic Charge Increase Alternative

The debate about use of a basic customer service charge to recover fixed costs as an alternative to a more complex decoupling mechanism appears to be a debate about what we are trying to accomplish. On one hand, we are trying to assure that customers who cause the company to incur fixed costs are the ones who pay for those costs. On the other hand, simply spreading fixed costs without any relationship to consumption volumes doesn't send a signal that encourages conservation and energy efficiency. Customer charges that are high enough to recover all fixed cost may also have a disproportionately adverse impact on low income and low volume users. They would, however, eliminate the need for any sort of complex weather variable. Setting fixed costs would simply occur as the result of a general rate case, with the exception of the need for some type of "new customer" adjustment to protect against over recovery and appropriate line extension policies for new customers.

- Should the Commission be open to covering all fixed costs through a uniformly applied customer charge?
- Is there a compromise position between full recovery of fixed costs through a customer charge and use of a relatively complex, dynamic decoupling mechanism addressing weather and conservation impacts?

J. Earnings Cap or Other Mechanism to Avoid Windfalls

One of the concerns voiced by stakeholders, most notably in comments by NWIGU, is the risk that any decoupling mechanism the Commission might accept could result in "windfall" earnings if the actual circumstances vary from anticipated circumstances in ways that are not adjusted for by the decoupling mechanism. NWIGU suggests that any decoupling mechanism include some type of cap on company earnings, such as a limitation that any earnings that exceed the company's authorized ROR by 3% or more would result in an automatic rate reduction.

In a similar vein, NWIGU also suggests that any decoupling plan should include some type of sharing mechanism that would serve as an incentive for the company to operate below its most recent general rate case expense levels and, at the same time, give the company an opportunity to share in a portion of any efficiency gain achieved by its customers.

- Should measures be built into any decoupling mechanism to protect against windfall recoveries caused by operation of the mechanism?
- Should there be some type of sharing mechanism built into a decoupling mechanism to encourage the companies to manage as efficiently as possible? If so, how should it be structured?

K. Need to Set Fixed Cost Level in General Rate Case

NWIGU recommends that the Commission should not adopt any form of decoupling except in the context of a general rate case or an equivalent cost review in order to give all parties a full and fair opportunity to review and understand the financial basis for the proposal. Support for this position is based on the anticipated need to understand the company's overall revenue requirement, including its general expenses, its capital structure and the way rates will be allocated to various classes. It is asserted that such data is necessary in order to craft appropriate sharing incentives and caps, as discussed above, and to make sure that the mechanism is based on current income and expense data. Some of the company stakeholders

believe that a decoupling proposal can be fairly processed as a standalone filing that provides key data updates and a detailed explanation of the proposed mechanism.

- How much data does the Commission need to make an informed decision on any decoupling proposal?
- Is it practical to obtain and analyze that data in any context other than a general rate case?

L. Proper Way to Measure Weather Impacts

If weather impacts are included in a decoupling mechanism, questions arise concerning how those impacts are measured. One approach is to use heating degree days and measure the annual deviation from normal. This in turn raises the question of how you measure normal weather. Several different proposals concerning the best method for calculating normalized weather have arisen in the context of recent general rate cases and the Commission has not endorsed any specific method as its preferred approach. Another measurement tool that combines weather, conservation, efficiency and other usage impacts, such as price elasticity, uses customer usage history. Cascade's model looks at individual customer history over a three-year period, selecting the lowest consumption year as the baseline for that customer. Other models, such as that used in Maryland by Baltimore Gas & Electric, look at customers as a class and compare the most recent month's usage to a baseline for that month derived from a normalization calculation.

- If weather impacts are included, what is the best means of measuring deviations from normal for rate adjustment purposes?
- How should the Commission define normal? Is it necessary or appropriate to use the same definition of normal for all decoupling mechanisms?

Decision to Close Docket

One thing that is clear to the Commission from the ideas and comments generated by this process is that there are many different factors that bear on the appropriateness of the various draft decoupling proposals that have been reviewed and discussed to date. These include defining the scope of the proposal in terms of the inclusion or exclusion of customer classes, different consumption impacts, company data and billing system capability, program scope and objectives, low income impacts and other financial and practical effects on both customers and the companies.

This rulemaking was initiated to assess whether it made sense for the Commission to craft a general rule or policy outlining an approach to decoupling. Given the wide variety of alternative approaches to the various issues that have been identified and the significant geographic, economic and technological differences between the four natural gas companies doing business in Washington and the populations they serve, the Commission is of the opinion that it does not make sense to pursue a rulemaking addressing this subject, at least at the present time. Accordingly, the Commission has decided to close this docket without taking any further action.

The Commission's decision is not intended as a comment on the viability of any specific decoupling proposal that has been discussed and considered in this docket. As a matter of policy, the Commission favors utility efforts to accomplish cost-effective conservation that reduces both the utility's costs and enables consumers to manage their natural gas bills. Companies that perceive that a decoupling mechanism would overcome disincentives to their offering such conservation programs should include a decoupling mechanism in a future general rate case filing. Any such proposal would necessarily be designed to fit with the utility's particular circumstances and needs and be accompanied by sufficient financial information to allow the Commission to thoroughly analyze its implications for customers and the utility. The Commission presumes that the most efficient way to fully assess these effects would be through a general rate case filing.