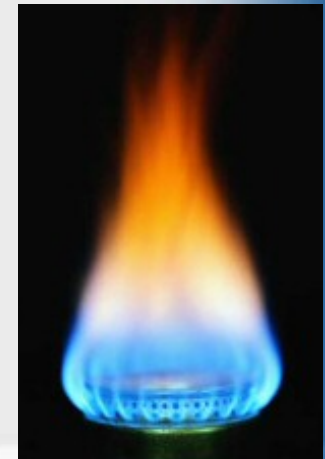


Gas Distribution System Pricing

AERS and Pennsylvania PUC Partnership

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Pricing Methodologies and Tariff Systems

- The pricing methodology for natural gas service regulated by the Pennsylvania Public Utility Commission is focused on costs related to the NGDC/TSO distribution system, not the cost of the commodity.
- The NGDC/TSO may only charge those rates published in its PUC approved, publicly filed tariff.



Pricing Methodologies and Tariff Systems

- Tariffed rates are established as the result of a base rate case filed with the Commission.
- Typically, the effect of the rate increase is suspended while the Commission holds public hearings to determine the justness and reasonableness of the proposed rates.
- The Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), and the PUC Office of Trial Staff all represent the “public interest” in these cases.



Pricing Methodologies and Tariff Systems

- The NGDC/TSO, which files the case and the related tariff, is represented by its own counsel.
- Large industrial customers typically join together to hire counsel.
- “Public input hearings” are held at various locations to allow members of the public to express their opinion about the proposed rates.



Definition of Customer Groups (Classes)

- Different customers are grouped together based on similar demand characteristics.
- Customer classes tend to impose similar costs on the utility system.
- While customer classes may vary by utility, typical customer classes include: the residential class, the commercial class, and the industrial class. The latter may include “firm” and “interruptible” customers, each with distinct tariff provisions.



Definition of Customer Groups

Tariffed rates vary for each customer class:

- Rate R – General Service Residential
- Rate RT – General Service – Residential Transportation
- Rate N – Non-Residential
- Rate CIAC – General Service – Commercial and Industrial Air Conditioning
- Rate SS – Storage Service
- Rate IS – Interruptible Service



Definition of Customer Groups (cont.)

- Rate MBS – Monthly Balancing Service
- Rate LFD – Large Firm Delivery Service
- Rate BD – Business Development



Capacity Charges and Cost Allocation

- For natural gas, “capacity” is the maximum quantity of gas that can be moved through a pipeline system, or a specific component thereof, at any given time based on operational conditions.
- A capacity charge, sometimes called a Demand Charge, or a System Use Charge, is assessed on the amount of capacity being purchased.
- Cost allocation is the identification of costs with cost objectives, also called *cost apportionment*, *cost assignment*, *cost distribution*, and *cost reapportionment*.
- In a rate-making sense, cost allocation is the allocation of the non-direct costs of furnishing utility service among classes of customers in a cost of service study.



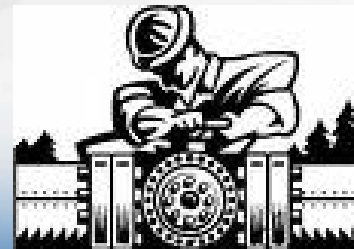
Relation Between Capacity and Commodity Charges

- Capacity charges and commodity charges are “decoupled,” in the sense that natural gas as a commodity is price deregulated at the well-head.
- Commodity charges account for 60-70% of a natural gas bill, while 30-40% of a bill is for distribution costs.
- The NGDC/TSO (or a competitive supplier) purchases the gas, and the end-use customer pays the commodity cost which (in the case of the NGDC/TSO is “trued up” annually in a PUC proceeding. 66 Pa. Code §1307(f)



Treatment of Interruptible Services

- Interruptible service offers qualified customers the opportunity for more attractive rates if the customer can operate equipment using either natural gas or an alternative fuel.
- Interruptible customers must be able to switch from natural gas to the alternative fuel whenever the utility announces a temporary curtailment of gas service (interruption).
- The number of customers to obtain service under an interruptible rate may be limited in order to maintain adequate and efficient supply for the utility's firm service customers.



Treatment of Interruptible Services

When is “interruptible service” *really* interruptible?

- “Burn-throughs”
- Reliability issues
- *Post facto* unwillingness to pay penalties



Duration of Regulatory Period

- For purposes of the “true-up” or reconciliation of natural gas (commodity) costs, the regulatory period is one year.
- Base rate cases are filed at the discretion of the NGDC/TSO. Given the time and expense of base rate cases, utilities generally do not file these until compelled by economic necessity. This can lead to “rate shock,” for consumers.



Treatment of Investments (cont.)

Regulatory role in approving investments in new or existing infrastructure: investments in facilities are included in the “rate base.”

- The cost of operating and maintaining the NGDC’s distribution system is decided in a base rate case.
- “Investments” in infrastructure are addressed in this proceeding.



Treatment of Investments

The base rate case (or general rate case) focuses on a period of time called a “test year,” which is a 12 month period used to calculate the revenue requirements to cover the utility’s distribution system non-gas costs. In essence, the case:

- Establishes the Revenue Requirement
- Assigns Costs to Customer Classes
- Designs Rates to Collect Revenue Requirement by Class



Treatment of Investments

- Traditionally, regulators have adopted rules to prevent *over investment* in capital.
- Key rule is that only the prudently incurred cost of assets that are used and useful in serving the public are included in rate base.
- Arguably, the theory of preventing over investment in classical ratemaking continues to be applied despite the reality of underinvestment.
- Utilities are urged to update and replace infrastructure while the rules restrict replacement.



Treatment of Investments

- Ratemaking can influence a utility's decision to invest by making the recovery of construction costs more uncertain than the recovery of fuel and other operating costs.
- Charges for construction work in progress are often held in a separate account rather than immediately entered into the rate base and reflected in the price of electricity.
- Only when the plant is placed in service is the accumulated amount, together with a return earned on it, entered into the rate base for recovery of the investment.



Treatment of Investments

Distribution System Improvement Charge

- The DSIC blends the concepts of a surcharge and an automatic adjustment charge. A surcharge establishes a mechanism for cost recovery outside of the utility's basic revenue requirement. In other words, a surcharge will allow recovery of a cost that was not previously included in the utility's rates.
- The DSIC is a surcharge that allows the recovery of costs related specifically to distribution system improvement projects designed to enhance reliability and long term system viability. The projects are typically ongoing, but short-term in nature.



QUESTIONS?

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