

**Comments of the Consumers' Utility Counsel Division  
of the Office of Consumer Affairs**

On June 5, 1997, the Georgia Public Service Commission (Commission) issued a Notice of Inquiry in preparation for a rulemaking proceeding concerning Section 46-4-154 of the new natural gas statute (SB215). This provision allows a local distribution company to file a notice of election to be regulated under a new statutory article and imposes several requirements on the Commission. In its Notice, the Commission posed several questions and invited interested parties to file comments on issues raised by this new statutory provision. The Consumers' Utility Counsel Division (CUC) appreciates the opportunity to respond to issues raised in the Notice. We expect to develop our ideas further in reply comments in this docket and in any future rulemaking proceeding.

**Overview**

The Natural Gas Competition and Deregulation Act provides a set of criteria and a series of steps through which today's local distribution gas companies may elect to exit the retail sales function. In this circumstance, retail natural gas consumers will receive natural gas commodity service and firm distribution service from a natural gas marketer certified to provide service by the Commission. The familiar gas utility will evolve into a "pipes" company that provides transportation services to gas marketers. These changes in industry structure are sweeping and will require careful implementation of the new statute by the Commission in order to protect the interests of consumers during the transition to a fully competitive market.

The Commission is correct to investigate the issues raised by the new statute before a gas utility files a notice of election to be regulated under the new regulatory scheme. CUC thinks that it is prudent to begin grappling with issues such as the required Straight-Fixed-Variable cost methodology, gas service unbundling and market-based rates before the clock starts to run on a utility's filing. Similarly, it makes good sense to determine beforehand the types and format of information that must be provided by an electing company as part of its filing.

On the other hand, it is not clear that the Commission should attempt to adopt detailed rules on all these subjects at this time. Rather than applying to numerous companies, the election provision of the new statute will likely be invoked by only one company in Georgia. This suggests that the Commission's policies should be tailored to the circumstances presented by that single company, and need not be generic. Further, it is much easier, and more productive, for parties like CUC to react to specific proposals and deal with actual data presented in a filing than to formulate analyses in the abstract. In view of these considerations, CUC suggests that the Commission should consider adopting a general policy statement, rather than detailed rules, on such subjects as the costing methodology and the treatment of rate riders. However, because of the substantial challenge facing the Commission and all parties to such upcoming cases, it is reasonable for the Commission to adopt specific filing requirements for any gas company that chooses to file an election under the new statute.

CUC's comments are organized in the same format as the Commission's NOI.

1. Notice of Election

If a gas utility elects to be regulated under the new article in the statute, the Commission is required to undertake certain actions. CUC comments briefly on the issues raised by each requirement.

**Maintain rates for interruptible service** This provision apparently freezes the rates charged to industrial customers of the utility that take service under interruptible tariffs. The rates charged these customers are either fixed by tariff or involve negotiated discounts from tariffed rates. Obviously, the Commission is directed to keep tariff rates at current levels, even if rates for firm customers are changed as a result of a rate case filed at the same time as the filing of election. It is unclear whether the electing gas company could negotiate lower rates (such as additional discounts) beyond those in effect at the time of the filing of election.

**Establish firm rates using SFV method** Establishing rates, through cost allocation and rate design, using the Straight-Fixed-Variable (SFV) costing methodology clearly will require that the utility file a rate case. Moreover, the rate case must entail both a revenue requirements determination and rate design phase. CUC expects that the use of the SFV methodology will substantially shift costs among customer classes and within elements of customers' bills.

But this revenue shift also has implications that the Commission may not have considered before. The revenue requirement will be affected by the substantial structural and rate design changes that the electing company will be experiencing due to the change to the SFV method and other transformations of the company. There are at least three major effects that the Commission will

need to consider when determining the costs of capital and setting the revenue requirements for an electing company:

- 1) The use of an SFV rate methodology will greatly reduce the risk and variability in the revenue flow of the electing company. As cost recovery is shifted from variable elements to fixed elements, the likelihood that a utility will fail to collect its revenue requirement is greatly reduced. For the electing company, this translates into lower risk and lower costs of capital.
- 2) An electing company will gradually exit the retail sales function. It will become a "pipes" business in Georgia, with many fewer customers: an electing company will serve a handful of gas marketers, not millions of end-users. Many of its gas commodity-related costs will be eliminated from costs and the expenses for its retail functions must be eliminated from rates. This transformation will also reduce the volatility of revenues and the risk faced by investors in the company.
- 3) The electing company might also propose an alternative form of regulation whose ingredients will affect investors' view of the company. The Commission must also consider the interplay between the form of regulation and the revenue requirement.

**Establish rates for unbundled services** Georgia will be among the first states to undertake a determination of the prices for unbundled gas distribution services. There is not much precedent available from other states in this matter. Nevertheless, this is a very important element of the transition to a competitive market. The Commission must simultaneously ensure that the sum of the prices of the parts equals the revenue requirement of the utility and ensure that the prices for unbundled services are competitively neutral. Until the gas company exits the retail function, it will be competing with gas marketers who purchase these unbundled services.

**Provide for recovery of prudently incurred costs** In CUC's opinion, this statutory requirement restates the current commission practice so that no special Commission action is needed here. The current ratemaking standard in Georgia is that a utility should have an opportunity to recover

prudently incurred costs.

**Provide for recovery of stranded costs** CUC offers several observations about stranded costs. First, stranded costs should be limited to those costs that are “stranded” as a result of a changed regulatory/competitive structure, not past management errors. Second, the Commission should permit only a one-time claim by the utility of stranded costs; this should not be an ongoing opportunity to collect costs that, in the future, may become more difficult to collect because of competition. Third, the Commission should clarify that investments made after passage of the new natural gas statute cannot qualify for stranded cost treatment since Georgia natural gas companies have been put on notice that competition is coming to all gas markets.

**Riders** The Commission has enquired about the treatment of existing riders. CUC believes that the Commission should use the occasion of the notice of election and the rate case to review the status of rate riders and the Commission’s policy toward them. In many ways, rate recovery riders are antithetical to performance-based regulation since they shield the utility from risk and tend to blunt incentives of regulation (such as regulatory lag) that would otherwise make the utility more efficient. CUC believes that rate recovery riders should be used only when the cost element being recovered is 1) volatile; 2) significant; and 3) beyond the utility’s control. Rate riders were developed during a period of time when fuel costs and gas costs were changing rapidly; their use has persisted (usually advocated by utilities) essentially as a revenue guarantee mechanism.

CUC welcomes the opportunity to consider whether some of the rate riders applied to gas companies in Georgia should be eliminated. When considering how to treat these riders, CUC urges the Commission to consider that the riders have functioned consistently to the benefit of the gas utilities. The timing of their elimination (and the terms under which they may be eliminated) should not work to the further disadvantage of ratepayers.

## 2. Straight Fixed Variable (SFV) Pricing

The Commission has posed numerous questions about the application of the SFV costing methodology. CUC responds at this time with some general observations about the issues.

**Fixed and Variable Costs** In cost theory, there is a distinction between the short run (in which very few costs are variable) and the long run (in which all inputs are variable). For a given run, fixed costs are those that do not vary with the volume of gas delivered; variable costs are those that vary with the volume of gas delivered. Under this definition, many distribution plant accounts will represent fixed costs. Most gas production, storage and acquisition expenses will be variable. In this usage, fixed costs are demand-related or customer-related; variable costs are commodity-related. The SFV cost methodology specifies how apportionment and assignment of these costs is made.

In the case of an electing gas company, the balance between fixed and variable costs will tend to change as the Company exits the commodity business. Since the overhead costs of a gas utility are related to utility operations that entail both fixed and variable costs, allocations of overhead

costs can be made on the basis of some relative weighting of fixed and variable costs. This means that rates will require a transition as an electing company moves toward a delivery-only operation. CUC expects that overhead cost sharing could become a significant issue.

**Criteria or standards for classifying costs** Unfortunately, there is not a distinction between plant costs and labor expenses that equates to the fixed/variable distinction. Gas processing plant and storage-related plant costs tend to be variable should probably be allocated mainly on the basis of commodity. Labor costs for employees involved in billing would tend not to vary with the amount of gas purchased in the short run, and so would not be candidates for classification as variable costs. Other labor costs are related to operation and maintenance expenses which are, in turn, partially related to the amount of gas delivered.

**Fixed and variable component of a rate form** On customers' bills, the fixed components of a rate form will be the customer charge and the demand charge. Variable components will be those that are billed on a per-therm basis. Since residential and small commercial gas customers do not have meters capable of measuring instantaneous demand, uniform demand charges actually assume that all customers in a given usage strata have the same load factors. In other words, the demand charge could actually be set on the basis of annual or monthly gas *volumes* and not actual design day demand.

**Components subject to change** Both the fixed and variable portions of tariffs are prices specified by Commission. Neither should be subject to change except by approval of the

Commission. In other words, "fixed" does not mean "set" and "variable" does not mean "flexible" in the context of regulatory methods.

### 3. Proposed Minimum Filing Requirements

**General requirements** CUC agrees with the suggestions in the NOI concerning the general filing requirements for a gas company filing a rate case that accompanies a notice of election.

CUC and likely other parties should receive a copy of the filing at the same time it is filed with the Commission. Because of the substantial cost allocation issues raised by the requirements of the new statute, the electing company should be required to provide all supporting costs studies at the same time. Such cost studies should be provided in electronic form, to the extent available.

**Specific filing requirements -- detailed schedules** CUC endorses the Commission's suggested requirement that the electing company provide a schedule showing each existing rate, proposed rate and methodology for determining the proposed rate. This last requirement is especially important, given the large changes in rate methodologies that will follow from the new statute. Again, the applicant should be required to furnish this information in an electronic format as well as in a print format.

**Description of ancillary services for which market-based rates are proposed** CUC agrees that ancillary services proposed for market-based treatment should be identified in the filing. The electing company should be required to compute "cost-based" prices for these services as well.

The Commission should consider setting guidelines for what will be considered to be possible candidates for market-based treatment.

**Detailed description of stranded costs** CUC agrees that the electing company should identify those costs that are considered to be stranded, along with a description of the company's mitigation efforts. CUC wishes to emphasize its belief that the level of stranded costs should be very small. Further, a utility should have the same opportunity (not guarantee) of recovering these costs as any other cost.

**Specify how SFV rate design affects consumer rates** This is a very important requirement. The new statute provides for the phase-in of SFV-based rates when the effect of the change to SFV increases rates more than 10%. The electing company should be required to compute the effect of a change to SFV-based rates on annual bills, monthly bills and seasonal bills for customers in each existing rate class. The electing company should also be required to determine the effect separately on typical high- and low-load factor customers within each rate class. CUC expects that, in many cases, low-load factor customer within a rate class may experience very large fluctuations in rates even when the entire rate class does not experience a large fluctuation. These differences may also be geographic-related and should be considered by the Commission in determining whether to phase-in the transition to SFV rate design.

**Other filing requirements** CUC agrees that an electing company should file rate base calculation and other supporting schedules calculated in conformity with existing Commission

precedent. Further, CUC agrees that the filing should identify separately the elements of unbundled gas service and provide cost study support for proposed prices for each element. As mentioned previously, these cost studies should be available at the time the filing is made.