

**FILED**

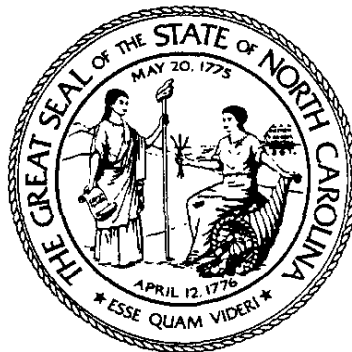
OCT 02 2008

Clerk's Office  
N.C. Utilities Commission

**REPORT OF THE  
NORTH CAROLINA UTILITIES COMMISSION  
TO  
THE JOINT LEGISLATIVE  
UTILITY REVIEW COMMITTEE**

**OFFICIAL COPY**

***Regarding  
Customer Usage Tracking  
Rate Adjustment Mechanisms for  
Natural Gas Local Distribution Companies***



**October 2, 2008**



**FILED**

**OCT 02 2008**

Clerk's Office  
N.C. Utilities Commission

# State of North Carolina Utilities Commission

4325 Mail Service Center  
Raleigh, NC 27699-4325

COMMISSIONERS  
EDWARD S. FINLEY, JR., Chairman  
ROBERT V. OWENS, JR.  
SAM J. ERVIN, IV

COMMISSIONERS  
LORINZO L. JOYNER  
HOWARD N. LEE  
WILLIAM T. CULPEPPER, III

October 2, 2008

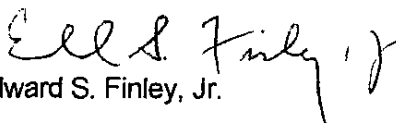
Senator David W. Hoyle, Co-Chair  
Representative Drew Paschal Saunders, Co-Chair  
Joint Legislative Utility Review Committee  
State Legislative Building  
Raleigh, North Carolina 27611

Dear Senator Hoyle and Representative Saunders:

Pursuant to the requirement of Section 2 of Session Law 2007-227, the North Carolina Utilities Commission (Commission) hereby submits for your consideration the *Report of the North Carolina Utilities Commission to the Joint Legislative Utility Review Committee Regarding Customer Usage Tracking Rate Adjustment Mechanisms for Natural Gas Local Distribution Companies*.

Section 2 requires that the Commission report on orders issued pursuant to G.S. 62-133.7 and the results obtained under those orders, as well as results obtained from the customer usage tracking component of the Commission's order issued in Docket No. G-9, Sub 499. As mandated by Section 2, the Commission's Report covers the period beginning July 18, 2007, the effective date of Session Law 2007-227, and ending June 1, 2008.

Respectfully submitted,

  
Edward S. Finley, Jr.

ESF:wrg

cc: Senator Charles W. Albertson  
Senator Stan W. Bingham  
Senator Charlie Smith Dannelly  
Senator R. C. Soles, Jr.  
Representative Harold J. Brubaker  
Representative Angela R. Bryant  
Representative Dale R. Folwell  
Representative Mary Price Taylor Harrison

430 North Salisbury Street • Raleigh, North Carolina 27603  
Telephone No: (919) 733-4249  
Facsimile No: (919) 733-7300  
www.ncuc.net

# THE CUSTOMER USAGE TRACKING RATE ADJUSTMENT MECHANISMS FOR NATURAL GAS LOCAL DISTRIBUTION COMPANIES

## A Report to the Joint Legislative Utility Review Committee

On July 18, 2007, Session Law 2007-227, *An Act Authorizing Customer Usage Tracking Rate Adjustment Mechanisms for Natural Gas Local Distribution Company Rates*, was signed into law, adding G.S. 62-133.7 to the General Statutes. This legislation clarifies that rate adjustments based on customer usage are allowed for natural gas local distribution companies (LDCs).

In Section 2, Session Law 2007-227 requires the North Carolina Utilities Commission (Commission) to report to the Joint Legislative Utility Review Committee (JLURC) on orders issued pursuant to G.S. 62-133.7 and the results of those orders, as well as the results obtained from the customer usage tracking component of the Commission's order in Docket No. G-9, Sub 499. This report is respectfully submitted in response to those requirements.

### Background

Traditionally, the rates set by the Commission to be charged by natural gas LDCs have included both a set monthly charge<sup>1</sup> and a rate per therm of natural gas consumed. The "per therm" or "volumetric" rates established in a general rate case consist of an estimate of the commodity cost of natural gas (called the "Benchmark Commodity Gas Cost" or "BCGC") and a certain margin per therm.<sup>2</sup> In order to set the margin per therm, the Commission must assign a total dollar margin to be collected in the volumetric portion of each rate schedule, and then estimate an annual sales volume for that rate schedule. Dividing the total dollar margin by the estimated sales volume yields an amount of margin per therm. The Commission estimates sales volumes by looking at the volumes actually sold in a "test year" period for each rate schedule. Those volumes are then adjusted for normal weather. The annual volume of natural gas sold by an LDC is very sensitive to weather. The purpose of the adjustment for normal weather is to allow the Commission to develop and prescribe a level of rates that will allow the LDC a reasonable opportunity to recover its total cost of service based

---

<sup>1</sup> This flat-rate monthly charge allows the LDC to recover a portion, but not all, of the fixed costs it incurs in providing natural gas distribution service. As the term "fixed" implies, the costs recovered through this charge are not a function of, and do not vary with, customer usage. However, it is important to note that the LDC's recovery of that portion of its fixed costs that are not included in this flat-rate monthly charge is a function of, and does vary with, customer usage (i.e., the number of therms consumed monthly), as such residual fixed costs, which are significant, are included in the development of the per therm charge that applies to each and every therm of natural gas consumed in any given billing period.

<sup>2</sup> The term "margin" as used in this context is the total costs expected to be incurred by the LDC in providing natural gas distribution service less: (1) that portion of the fixed costs to be recovered through the flat-rate monthly charge, as discussed in Footnote No. 1 above, and (2) the estimated commodity cost of natural gas.

upon weather conditions that the LDC can reasonably be expected to encounter into the reasonably foreseeable future.

Traditionally, once rates were set, the natural gas LDC was at risk for margin undercollections and the customers were at risk for margin overcollections depending upon whether actual weather turned out to be warmer or colder than normal. In a general rate case held in 1991, Piedmont Natural Gas Company, Inc. (Piedmont) requested and was allowed a Weather Normalization Adjustment (WNA). Prior to 1991, once the volumetric rates were set, Piedmont would under-collect its total dollar margin in warmer-than-normal weather and over-collect its total dollar margin in colder-than-normal weather. The WNA trued up margin recovery for each heat-sensitive customer each month, resulting in a surcharge to the bill if the weather was warmer than normal and a credit if the weather was colder than normal. Note that the WNA applied only to the margin per therm, and the cost of the commodity (the BCGC) was not affected by the WNA.

The WNA still left the LDC at risk for undercollection of its total margin if there was a decline in average annual customer usage by customer class unrelated to weather that resulted in actual sales volumes that were lower than the normalized test-year sales volumes, assuming the number of customers served remained constant. Arguably, the WNA also left the customer at risk for overcollections by the LDC in the event that the average annual usage by customer by rate schedule increased for reasons unrelated to weather. A reduction in average annual usage per customer could result from the installation of more efficient equipment, better insulation, and active conservation efforts. Increased consumption could result from the installation of more gas-fired appliances or a relaxation in conservation efforts. Under the traditional rate-making methodology, the LDC had an economic interest in increasing natural gas consumption per customer between rates cases and, arguably, had a disincentive for promoting conservation and energy efficiency during such intervals. Nationwide, the concern that traditional rate structures and rate design principles create a disincentive to LDC efforts to promote conservation and energy efficiency has led to proposals to "decouple" the LDC's sales volumes from the recovery of its total margin.

In Piedmont's last general rate case, Docket No. G-9, Sub 499, the Commission approved a Customer Utilization Tracker (CUT). This decision was embodied in an Order Approving Partial Rate Increase and Requiring Conservation Initiative issued on November 3, 2005. The CUT was a decoupling mechanism designed to allow the Company to track and true up variations in average customer usage from levels approved in that rate case. The CUT applied to certain residential, small general service, and medium general service rates schedules. Since the CUT trues up all variations in average customer usage, a separate true-up for variations in weather was no longer needed, and Piedmont's WNA was terminated.

In Docket No. G-9, Sub 499, Piedmont proposed to spend \$250,000 per year of shareholder money on conservation programs. In its November 3, 2005 order, the Commission ordered Piedmont to contribute \$500,000 per year toward conservation

programs and to work with the Attorney General and the Public Staff to develop appropriate and effective conservation programs to be submitted to the Commission for approval and annual review. While the Public Staff joined in a Stipulation that accepted the CUT, the Office of the Attorney General filed an appeal. The Attorney General argued that such a tracker was beyond the scope of the adjustments that North Carolina law authorized outside of a general rate case. In a July 18, 2006 settlement with the Attorney General, Piedmont agreed to contribute up to \$750,000 per year in additional conservation spending for a period of three years, as well as to accept up to a \$750,000 per year reduction in CUT collections from ratepayers.

As stated above, on July 18, 2007, Session Law 2007-227 was signed into law, adding G.S. 62-133.7 to the General Statutes and clarifying that customer usage trackers are allowed. Also, as stated above, Section 2 of Session Law 2007-227 requires the Commission to report to the JLURC on orders issued pursuant to G.S. 62-133.7 and the results of those orders, as well as the results obtained from the customer usage tracking component of the Commission's order in Docket No. G-9, Sub 499. Such matters are addressed below.

#### Orders Issued Pursuant to G.S. 62-133.7

No orders were issued pursuant to G.S. 62-133.7 from the effective date of Session Law 2007-227 to June 1, 2008, which is the period covered by this report. However, applications for general rate cases were filed by both Piedmont and Public Service Company of North Carolina, Inc. (PSNC), proposing customer usage rate tracking adjustments.

The Commission's November 3, 2005 order in Docket No. G-9, Sub 499 established a customer usage rate tracking adjustment, the CUT, for Piedmont as an experimental, three-year program. The CUT is set to expire on November 1, 2008. On March 31, 2008, Piedmont filed an application for a general rate increase in Docket No. G-9, Sub 550. Piedmont's application included a proposal to continue and make permanent its three-year experimental tracker, re-named the Margin Decoupling Mechanism.

On March 31, 2008, PSNC filed an application for a general rate increase in Docket No. G-5, Sub 495. PSNC's application included a Customer Usage Tracker or CUT. PSNC's proposed CUT is essentially the same mechanism as that which was approved for Piedmont in Docket No. G-9, Sub 499. A stipulation was reached in Docket No. G-5, Sub 495 between PSNC, the Public Staff, and the Carolina Utility Customers Association, Inc. (CUCA). Texican Horizon Energy Marketing, LLC (Texican) took no position regarding the stipulation. The Attorney General did not join in the stipulation and cross-examined PSNC witnesses at the hearing held on August 26, 2008. Briefs and proposed orders are due to be filed with the Commission in this docket on or before October 6, 2008. The Commission will consider the record and issue a decision shortly thereafter.

These general rate cases will be decided in the near future, and the Commission will report on them as directed by the JLURC.

Results Obtained from the Customer Usage Tracking Component  
of the Commission's Order Issued in Docket No. G-9, Sub 499

Piedmont's CUT as approved by the Commission in Docket No. G-9, Sub 499 was designed to allow the Company to track and true up variations in average customer usage from levels approved in that rate case. The CUT applies to certain residential, small general service, and medium general service rates schedules.

Every month, a CUT adjustment is calculated for each rate schedule and placed in a CUT deferred account. Interest is accrued on the balance. Every six months, in November and April, a rate increment or decrement -- as may be the case -- is calculated and put into effect for the purpose of recovering the then-existing balance in the CUT deferred account over the next twelve months. An increment is calculated if there is a balance owed to Piedmont, a decrement if there is a balance owed to the customers.

Piedmont has been filing monthly reports with the Commission since its CUT was approved in November 2005. These reports include -- for each rate schedule -- the monthly CUT adjustment, the amount collected or returned by the increment or decrement in place, the balance of the CUT deferred account, and the interest on the balance for the month.

In the eleven months ending May 31, 2008 (roughly, the period from the passage of HB 1086 on July 18, 2007, to June 1, 2008), Piedmont's CUT adjustments totaled \$34,827,793 from all classes of customers subject to the CUT. Actual amounts collected through increments in rates totaled \$29,529,475. The CUT deferred account at the end of May 2008 totaled \$41,389,241 owed to Piedmont by the customers. Table A below presents the eleven-month total results by customer class.

Table A

	Residential	Small General Service	Medium General Service	Total
CUT Adjustments	\$25,309,375	\$8,688,605	\$829,813	\$34,827,793
Increments /(Decrements)	\$21,771,596	\$7,230,952	\$526,927	\$29,529,475
Interest	\$2,054,716	\$653,501	\$60,296	\$2,768,513
Ending Deferred Account Balance	\$30,278,765	\$10,018,246	\$1,092,230	\$41,389,241

Since the CUT was implemented beginning November 1, 2005, Piedmont's CUT-related rate adjustments have totaled \$91,934,777 for all classes of customers subject to the CUT. Actual amounts collected through increments in rates totaled \$54,346,447. The CUT deferred account at the end of May 2008 totaled \$41,389,241 owed to Piedmont by customers. Interest of \$6,203,508 was accumulated. Table B below shows the totals by customer class since Piedmont's CUT was implemented to May 31, 2008, by customer class.

Table B

	Residential	Small General Service	Medium General Service	Total
CUT Adjustments	\$67,633,714	\$22,313,973	\$1,987,090	\$91,934,777
Increments / (Decrements)	\$40,630,758	\$12,765,348	\$950,341	\$54,346,447
Interest	\$4,650,385	\$1,428,053	\$125,070	\$6,203,508
Ending Deferred Account Balance	\$30,278,765	\$10,018,246	\$1,092,230	\$41,389,241

The total CUT adjustments, for both the eleven-month period ending May 31, 2008, and for the full time the CUT has been in effect, are both large debit amounts (amounts owed to Piedmont by the customers). However, there were a significant number of months for all three customer classes in which the CUT adjustment for that particular month yielded some generally smaller credit amounts (amounts due to the customers from Piedmont).

In considering the results obtained by Piedmont's CUT, there are several factors to consider in addition to the raw numbers. These include the impact of the weather, the price of natural gas, and the timing of general rate cases.

In Piedmont's pending rate case, Docket No. G-9, Sub 550, evidence was presented that a significant percentage of the CUT adjustments -- approximately half -- were weather-related and, therefore, would have been covered by the WNA. Attorney General Cross Examination Exhibit No. 5 showed that, for the first full year Piedmont's CUT was in effect (November 1, 2005 -- October 31, 2006), 39% of the CUT adjustments (of \$29,132,293) were weather-related. For the second year (November 1, 2006 -- October 31, 2007), 57% of the CUT adjustments (of \$29,921,669) were weather-related. And, for the period from November 1, 2007 to date, 48% of the CUT adjustments (of \$32,425,242) were weather-related.

The decrease in average customer consumption since the implementation of the CUT -- particularly among residential customers -- has been striking. In pre-filed testimony in Piedmont's pending rate case, Docket No. G-9, Sub 550, Piedmont witness Carpenter testified that the average residential customer's annual consumption declined 12.0%, that is, from 71.8 dekatherms per year in the 2005 rate case to 63.2 dekatherms

per year in the 2008 rate case. He further testified that the average small general service customer's annual consumption declined 6.3%, that is, from 375.5 dekatherms in the 2005 rate case to 351.7 dekatherms in the 2008 rate case, and the average medium general service customer's annual consumption declined 0.3%, that is, from 10,398.5 dekatherms in the 2005 rate case to 10,363.8 dekatherms in the 2008 rate case.

In addition to the warmer-than-normal weather, conservation due to high gas prices played a significant role in these decreases. Between the time that Piedmont filed its application for a general rate increase in Docket No. G-9, Sub 499, in which the CUT was proposed, and the time that the order was issued in that docket, Hurricanes Katrina and Rita struck the Gulf of Mexico. Those storms disrupted a significant amount of natural gas supply and resulted in an extreme increase in the wholesale price of natural gas. In the summer of 2005, the monthly average natural gas wholesale price at the Henry Hub in Louisiana was as low as \$7 per dekatherm in June. After the hurricanes, the price increased to over \$13 per dekatherm in October 2005, slipped to \$10 per dekatherm in November 2005, and then exceeded \$13 per dekatherm again in December 2005. The December 2005 average Henry Hub price was almost double what the average price had been in December 2004.

Piedmont responded to the increase in wholesale natural gas prices by increasing the Benchmark Commodity Gas Cost embedded in its volumetric sales rates to \$11.00 per dekatherm beginning October 1, 2005, and increasing the BCGC to \$13.00 per dekatherm beginning November 1, 2005. In comparison, Piedmont's embedded BCGC had been only \$6.25 per dekatherm in October 2004, and \$6.75 per dekatherm in November 2004. Obviously, the wholesale price run-up in the fall of 2005 prompted aggressive conservation measures by heat-sensitive residential and commercial ratepayers.

Without a CUT, the remedy available to an LDC if average annual customer usage drops and the LDC is under-recovering margin is to file a new general rate case. In doing so, the test year sales volumes per customer would decrease and that would tend to cause rates to increase.

The total impact of the CUT over the period in which it has been in effect is to increase the amount that will ultimately be collected from customers by about 4%. With interest, an additional \$99.1 million has been accrued so far, and \$54.3 million has actually been collected through increments in rates. However, approximately half of the CUT adjustments would have been collected by the WNA that Piedmont had in place before approval of the CUT. And, with the drastic decrease in average customer consumption, Piedmont would have had the option of coming in for another general rate increase if the CUT had not been in effect.

Piedmont's CUT was introduced at an extraordinary time. It is reasonable to assume that the 12.0% reduction in average annual residential consumption from the 2005 rate case to the current rate case is not a sustainable rate of decrease. In fact,



the 6.3% reduction in average annual small general service consumption is probably not indicative of what can be expected in the way of savings from normal conservation and efficiency improvements in that customer class.

Piedmont's latest general rate increase application, Docket No. G-9, Sub 550, is currently pending before the Commission and it would be inappropriate for the Commission to comment on how that case will be decided. However, it is reasonable to assume that whatever rates are adopted will be calculated using weather-normalized volumes that reflect dramatically lower average annual customer consumption than was used in the 2005 rate case. For that reason, if Piedmont's CUT mechanism (renamed the Margin Decoupling Mechanism) is renewed, it would be reasonable to expect a less-dramatic impact over the next three-year period.

A stipulation in Docket No. G-9, Sub 550 was reached between Piedmont, the Public Staff, CUCA, the United States Department of Defense and Texican. The Attorney General did not join in the stipulation and cross-examined Piedmont witnesses at the hearing held on September 9, 2008. Briefs and proposed orders are due to be filed with the Commission in this docket on or before October 2, 2008. The Commission will consider the record and issue a decision shortly thereafter.