

SUBJECT: Allowing interim adjustments in gas utility rates for investment recovery

COMMITTEE: Regulated Industries — committee substitute recommended

VOTE: 4 ayes — King, Hunter, Baxter, Guillen

0 nays

3 absent — Turner, Crabb, Wolens

SENATE VOTE: On final passage, April 25 — 31-0

WITNESSES: *(On House companion bill, HB 1942:)*

For — Ann Coffin, Texas Intrastate Pipeline Association; Tom Hawkins, Atmos Energy Corp.; Bob Rima, Texas Association of Builders; Curtis Seidlits, Texas Utilities; *(Registered, but did not testify:)* David Gill, TXU Gas; Don Leverty, CoServ Gas; Scott Norman, Texas Association of Builders; Patrick Nugent, Texas Pipeline Association; Rick Grundman, Texas Gas Service Co.; Harry Savio, Home Builders Association of Greater Austin

Against — Geoffrey Gay, Texas Coalition of Cities for Utility Issues; Daniel Lawton, City of Denton, City of Greenville, and City of Gatesville; Matthew Wojnowski, City of Temple; *(Registered, but did not testify:)* Tom “Smitty” Smith, Public Citizen

On — Karl Nalepa, Texas Railroad Commission

BACKGROUND: The Gas Utilities Regulatory Act provides for regulation of natural gas utilities to ensure that rates, operations, and services are just and reasonable. A municipality has jurisdiction over a gas utility providing service within the municipality, while the Texas Railroad Commission has jurisdiction over a utility that distributes gas to areas outside a municipality, or in a municipality that has surrendered its jurisdiction to the commission, and that transports gas to utilities that distribute the gas to the public. The commission also has appellate jurisdiction to review an order or ordinance of a municipality exercising original jurisdiction over a utility.

The regulatory authority may establish and regulate rates of a gas utility. Under regulated rates, utilities may earn a reasonable return on invested capital, in excess of reasonable and necessary operating expenses. Utilities Code, ch. 104 establishes procedures to calculate rates.

DIGEST:

CSSB 1271 would allow a gas utility that had filed a rate case within the previous two years to file a tariff or rate schedule containing an interim adjustment in the utility's monthly customer charge, or initial block rate, to recover the cost of changes to the utility's capital investment in providing gas service. An adjustment would have to be allocated among customer classes in the same manner as the utility's cost of service.

A utility would have to file a tariff or rate schedule containing an adjustment at least 60 days before its proposed implementation and would have to notify customers within 45 days after filing the tariff. Within the 60-day period, the regulatory authority could suspend implementation of the tariff, rate schedule, or annual adjustment. A change in investment included in an interim adjustment could not be reviewed for reasonableness or prudence after a final order was issued in a rate case filed after implementation of the tariff or rate schedule. Money collected under the tariff or rate schedule would be subject to refund until the issuance of a final order.

A utility could adjust rates under the tariff or rate schedule for each calendar year to account for the difference in the value of capital investment between the preceding calendar and the year before that. The value of capital investment would equal the original investment cost at the time it was put into service, minus depreciation.

An interim adjustment would have to be recalculated annually. A utility could ask the regulatory authority to suspend the tariff or rate schedule for any year by stating the reasons for suspension in a written request, and the regulatory body could grant the suspension if the utility showed reasonable justification.

A utility could adjust rates under the tariff or rate schedule only for return on investment, depreciation expense, ad valorem taxes, revenue-related taxes, or federal taxes. The return on investment, depreciation, and federal tax factors would have to be the same as those approved by the regulatory authority that established the utility's latest effective rates for the area.

A utility would have to file an annual report with the regulatory authority describing the investment projects completed and operating in the preceding year and any investments that were retired or abandoned during the year. The report also would have to include the cost, need, and customers benefitted by the capital investment.

A utility also would have to file an annual earnings monitoring report. If a utility earned a return on invested capital of more than 75 basis points above the return established in the rates approved by the regulatory authority, the utility would have to file a statement on why the rates were not unreasonable or did not violate the law.

If a utility did not file a rate case within five years of implementing a tariff or rate schedule that included an interim adjustment, the utility would have to file a rate case within 180 days of the fifth anniversary date.

The bill would not limit a regulatory authority's power to establish just and reasonable rates after finding that existing rates were unreasonable or in violation of the law.

A utility that included an interim adjustment in a tariff or rate schedule would have to pay annually its proportionate share of the regulatory authority's costs to implement the interim rate adjustment mechanism that the bill would establish.

The bill would take effect September 1, 2003.

**SUPPORTERS
SAY:**

CSSB 1271 would allow a natural gas utility to implement an interim rate adjustment to recover capital investment costs. Currently, a utility seeking to adjust rates must file a rate case proceeding with a municipality or with the Railroad Commission. Completing a rate case is a lengthy and costly process, requiring months or years of litigation, preparation of detailed technical documentation, expert witness testimony, and legal expenses. Because of this requirement, utilities have had difficulty gaining access to capital, especially in the current economic environment, because lenders want greater assurance that a utility can recover a project's investment costs in a timely manner. This bill would streamline the regulatory process, allowing utilities to begin recovering their investments without lengthy and expensive rate cases.

The bill would encourage investment in Texas' gas pipeline infrastructure. Under current law, utilities may have to wait years before they can begin recovering capital investment costs, hindering new investment. However, new investment is needed to replace Texas' aging gas infrastructure and to keep up with increasing demand. By allowing a utility to begin recovering its investment immediately, the bill would create an incentive for investment in the state's gas pipeline infrastructure. An analysis by economist Ray Perryman indicates that such an incentive would stimulate about \$25 million per year in new investment, providing about \$23 million in additional personal income and \$11 million in revenue to the state.

The bill would improve regulatory oversight and would benefit consumers. Cities and the Railroad Commission would retain all their existing regulatory powers. In addition, utilities would have to file an annual report detailing their earnings over the past year and would have to undergo a rate case every five years. Nothing in the bill would prohibit a regulatory authority from opening a utility rate case at any time. Consumers also would benefit from lower rates. The streamlined process would allow utilities to adjust rates without participating in full-blown rate cases, thereby saving expenses that otherwise would be passed on to customers.

Rate adjustments would be implemented only on an interim basis. A utility would have to undergo a full rate review every five years, in which all amounts collected under the tariff would be subject to refund. If a regulatory authority found that a utility had overcollected for an investment, it could reduce rates to compensate. Moreover, the bill would specify that a utility could adjust rates upward or downward according to net capital investment in the previous two years.

The bill is necessary to help utilities keep up with the needs of Texas' gas infrastructure. Some pipeline distribution systems already are decades old. Replacing aging pipeline improves reliability and safety. Installing new pipeline serves the increased demand from population growth, increased gas usage per person, and the shift toward cleaner-burning fuels.

The bill would require that rates be adjusted equitably. An interim adjustment would be allocated among customer classes according to a ratio allocating costs of service to customer classes under the utility's already approved rate

schedule. Industrial customers pay the largest share of costs, subsidizing investment in residential gas service.

**OPPONENTS
SAY:**

CSSB 1271 would create a piecemeal ratemaking approach contrary to the traditional standard of regulation. Rate regulation is based on a regulatory body's comprehensively reviewing a utility's costs and allowing the utility to earn a fair rate of return on its reasonable and necessary expenses. This bill would circumvent this process by allowing a utility to begin recovering for one rate component without full review of the utility's costs. Adjusting a rate to account for a single component would not take into account other factors that might be changing, such as a decrease in labor costs or an increase in revenues. The bill would allow a utility to adjust rates to account for a rate component that benefits shareholders, but it would not allow a comparable adjustment for other components that could benefit consumers.

The bill is unnecessary. The Railroad Commission already allows accelerated depreciation in ratemaking to give utilities an incentive to replace pipeline promptly. Customers pay for the cost of rapid depreciation in their gas rates. The commission also has been generous in approving a fair rate of return for utilities, well above the cost of capital in most cases. Moreover, industry consolidation has allowed utilities to benefit from synergies and reduced overhead, lowering their overall costs. Also, utilities already can recover capital costs for building new pipeline through the increased revenue they receive from serving more customers. Utilities do not need additional incentives for investment.

**OTHER
OPPONENTS
SAY:**

The bill would impose a rate adjustment in an inequitable manner by allowing a utility to adjust its monthly customer charge to recover capital costs. This portion of a residential utility bill is the same for all customers, regardless of how much gas they use. It would be better to adjust usage charges on utility bills to recover capital investment costs, so that customers would pay for capital cost recovery according to their gas consumption.

NOTES:

The committee substitute modified the Senate engrossed version of SB 1271 by adding the requirement that a utility pay the regulatory authority's cost of administering the interim rate adjustment mechanism.