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MONTANA NATURAL GAS RATES

PSC Rejects Requested Increase, Orders Decrease Instead

The Montana Public Service Commission (PSC) has denied in its entirety a natural gas local distribution company's (LDC's) petition for rate relief, finding instead that the utility's revenue requirement was already too high and must be reduced. The company, Energy West Montana, had originally sought \$362,316 in additional revenues, although it subsequently adjusted that amount downward to \$200,795. The commission, however, determined that the company's rates should be lowered by almost that same amount, ruling that Energy West's allocated cost of service should be reduced from \$8,891,397 to \$8,651,327. The commission explained that the company's rate increase application had been overstated due to an unreasonable hypothetical capital structure and improvident special rate contracts with certain large-consumption customers. Interestingly, neither the commission nor the Montana Consumer Counsel (MCC) raised any issue as to the utility's claimed rate base and operating expenses.

(See page 2)

VIRGINIA ELECTRIC RATES

Dominion Virginia Power Directed to Refund Customers

In its first-ever biennial review of an electric utility's revenues pursuant to a new state statutory mandate, the Virginia State Corporation Commission has determined that the utility, Virginia Electric & Power Company d/b/a Dominion Virginia Power, had excess earnings in the 2009 and 2010 rate years and must return such overearnings to ratepayers. The commission said that the record showed that the utility had earned more than 50 basis points above its authorized rate of return for the two-year period. The commission noted that the state law governing the biennial earnings review process provides that if a utility is found to have earned more than 50 basis points above its authorized rate of return for two consecutive biennial reviews, the commission is empowered to order reductions in the utility's rates. The commission thus placed the utility on notice that its base rates could be lowered if the same overearnings are found after its next biennial review.

(See page 3)

TABLE OF CONTENTS

Montana Natural Gas Rates	1
Virginia Electric Rates	1
Indiana Demand-Side Management	4
Pennsylvania Natural Gas Gathering Service	6
In Brief	7
◆ Electric Procurement Plan	
◆ Water Utilities	

MONTANA NATURAL GAS RATES *(Continued from page 1)*

In its rate filing, Energy West pointed out that its last general rate case had been in 2004, when, based on its parent company's financials, a capital structure of 42.35% equity and 57.65% debt had been adopted for the LDC, translating into a rate of return on common equity (ROE) of 10.27%. According to Energy West, its parent company's structure continues to be an appropriate model for the LDC, even though the parent's capital structure has changed significantly since 2004. The company noted that its parent had sold off certain assets, paid off debt, and then acquired several new groups of assets, resulting in the parent now having an actual capital structure of 72.9% equity and 27.1% debt. Energy West asserted that because it is not a stand-alone company and has no capital structure of its own, its parent's capital structure is a valid substitute. The LDC also argued that given the higher equity ratio, it was deserving of a higher ROE as well, which it recommended be set at 10.67%.

The commission agreed in principle that in the case of a wholly owned subsidiary with no capital structure of its own, it is instructive to look at the parent company's capital structure. However, in the specific case of Energy West, the commission found that such an approach would yield an unreason-

able rate level that would unjustly enrich the parent company's stockholders to the detriment of the subsidiary's ratepayers. While the commission commended the parent company for vastly improving its financial situation and building its equity portfolio, the commission held that a capital structure composed of almost 73% equity would be too costly for rate-making purposes, especially when combined

The commission observed that it has traditionally treated a 50/50 ratio of debt and equity as a theoretical ideal capital structure.

with an increased ROE allowance. The commission said that the company's proffered capital structure would produce a nearly 80% increase in shareholder compensation at the expense of LDC customers, an absurdly unfair result. The commission noted that the MCC's research had turned up no examples in any jurisdiction where a regulatory agency had ever

approved such a high equity percentage.

In considering just what Energy West's capital structure should be for rate-making purposes, the commission observed that it has traditionally treated a 50/50 ratio of debt and equity as a theoretical ideal capital structure, and that was the structure propounded by the MCC. However, concurring with the LDC that a company of its small size faces greater financial risks than larger companies, the commission boosted the equity portion to 55%. Although conceding that 55% equity was at the high end of the range of reasonableness, the commission deemed it appropriate in this case.

The additional financial risk underlying its capital structure decision also accounted for the commission's authorization of a 10.5% ROE for the utility. The commission said that while the LDC's requested 10.67% ROE was clearly too high in light of the capital structure actually adopted, the MCC's suggested ROE of 9.25% was inexplicably low, especially given MCC testimony that the average ROE for utilities comparable to Energy West was 10.56%. The commission also noted that the MCC had supported a higher ROE of 9.5% in another rate case for a much larger utility, NorthWestern Energy (NWE), and the PSC found it difficult to recon-

(See page 3)



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Public Utilities Reports, Inc.

8229 Boone Boulevard
Suite 400
Vienna, VA 22182
Phone: 703-847-7720
800-368-5001
Fax: 703-847-0683
<http://www.pur.com>

Editorial Staff

Diane S. Boiler
dboiler@pur.com
Phillip S. Cross
pcross@pur.com
Production: Francisco R. Fernandez

One year of weekly service:
\$595. Call: 800-368-5001

*For e-mail address changes
or other information, contact
jcole@pur.com
or 800-368-5001.*

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MONTANA NATURAL GAS RATES *(Continued from page 2)*

cile that discrepancy. Noting that it had ultimately permitted a 10.25% ROE for NWE, the commission said it could understand why Energy West would think that it would be entitled to a higher ROE than NWE. The commission therefore settled on a 10.5% ROE, which was predicated on the 10.56% average quoted by the MCC, but reduced slightly for an acknowledged downward trend in ROEs.

Turning to Energy West's proposed special rate contracts, the commission directed the company to revise the language contained in its tariff governing the offering of such contracts. The commission explained that the company's present terms make negotiated rates available to any customer who "may

have the opportunity" to bypass the LDC's system. Deeming such words to be overly broad and too permissive, the commission ordered the company to limit special contract rates to only those customers with a demonstrable, credible threat of bypass.

On that basis, the commission found that the LDC's current contracts with two customers – an Air Force base and a refining company – could continue, as both customers had been shown to be capable of switching to alternative fuels and/or suppliers. However, the commission nixed certain other special contracts, including those with a hospital, a pasta maker, and a concrete mix manufacturer. According to the commission, those customers had not

proven a near-term credible ability to bypass the LDC and thus must be returned to standard rate tariffs.

After factoring in the effect on the company's overall revenue requirement of those now-disapproved rate concessions as well as the changes in the LDC's capital structure and ROE, the commission concluded that rather than an increase in rates, Energy West instead had shown a need for the exact opposite. The commission calculated that the company's new revenue requirement should be \$28,490,584, as compared to its present authorized revenue level of \$28,699,506. *Re Energy West Montana, Docket No. D2010.9.90, Order No. 7132c, Nov. 17, 2011 (Mont.P.S.C.).* ■

VIRGINIA ELECTRIC RATES *(Continued from page 1)*

In Dominion Virginia Power's last general rate case in 2009, a target rate of return on common equity (ROE) of 11.9% had been approved, meaning that the company could earn up to a 12.4% ROE without running afoul of the ratepayer refund requirements. Although the utility maintained that its revenues did not produce a ROE above the 12.4% limit, the commission said that its calculations demonstrated that the utility had, on average, earned a 13.31% return over the two-year period. Under the earnings-sharing formula provided in the state code, the company was entitled to retain those earnings that were above 11.9% but below 12.4%, with the revenues received in excess of the 12.4% ceiling being divided between the company and its customers on a 40/60 basis, respectively. According to the commission, Dominion Virginia Power was there-

fore allowed to keep \$71.5 million, representing revenues collected between 11.9% and 12.4%, as well as another \$52 million representing 40% of the earnings in excess of 12.4%. Ratepayers, however, were found to be deserving of \$78.3 million, reflecting their 60% share of those excess earnings.

The utility protested that in reaching its conclusion on the company's actual earned ROE, the commission had disallowed certain costs and expenses that would have reduced those ROE computations. Among the items that had been excluded by the commission were certain incentive compensation packages for executives. The commission explained that such bonuses and extra pay had been tied to the achievement of financial goals as opposed to service or performance goals. As such, the commission said, attainment of those objectives was

far more beneficial to shareholders than to ratepayers and thus should not be used as a decremental factor when quantifying the utility's ROE. The utility likewise challenged the commission's elimination of certain of Dominion Virginia Power's advertising expenses, but the commission countered that the advertising campaigns had been instituted for goodwill or image-building purposes rather than a public interest purpose, such as enhancing awareness about conservation or energy efficiency.

The commission conceded that there are many approaches to determining what an entity's actual earned return is. Reiterating that this was a "first-of-its-kind" proceeding, the commission acknowledged that it had no direct prior precedent for this type of review. Nevertheless, the commission expressed confidence in the methods it used to

(See page 4)

VIRGINIA ELECTRIC RATES *(Continued from page 3)*

ascertain the company's revenues, and it refused to lower its ROE findings for the utility.

As to how the refunds are to be returned to customers, the commission declined to require a direct monetary refund, opting instead for a series of rate credits. The commission ruled that the credits should

appear on monthly bills over a six-month period, with the credits proportional to each customer's usage during the 2009/2010 earnings period. The commission also reset the company's ROE for purposes of its next biennial review. Although Dominion Virginia Power had sought a new ROE of 12.5%, the

commission found that a ROE of 10.9% would be more appropriate, inclusive of an adder of 50 basis points for meeting certain renewable energy targets. *Re Virginia Electric & Power Co. d/b/a Dominion Virginia Power, Case No. PUE-2011-00027, Nov. 30, 2011 (Va.S.C.C.).* ■

DEMAND-SIDE MANAGEMENT

Indiana Approves New DSM Plan for IPL

The Indiana Utility Regulatory Commission has adopted a settlement agreement that outlines an electric utility's planned steps for implementing demand-side management (DSM) and energy-efficiency programs in compliance with a December 2009 commission order. As originally proposed by the utility, Indianapolis Power & Light Company (IPL), its DSM program would cover a three-year period and would be supported by virtually unlimited ratepayer-provided funds. Upon objection to such uncapped funds by the Office of Utility Consumer Counselor (OUCC), however, the parties met to negotiate various program components, ultimately reaching agreement as to what elements to retain, eliminate, or defer.

In the commission's December 2009 decision, referred to as its generic DSM order, the commission had directed all electric utilities subject to its jurisdiction to develop DSM and energy-efficiency initiatives, with an eye toward achieving a certain percentage of energy savings each year. The commission specified five core program components which it considered essential to reducing consumption. However, it conceded that its energy savings

goals were unlikely to be met solely through the five defined core program offerings the commission had listed. The commission therefore expressed an expectation that each utility would supplement its DSM plans with more individually tailored "core plus" programs. The commission's generic DSM order requires all core program components to be instituted through a third-party program administrator, rather than the utilities themselves, and to be subject to independent verification and evaluation.

The five core DSM elements include four programs exclusive to residential customers and one to commercial and industrial (C&I) customers. First and foremost on the residential side is a lighting program, which focuses on the offering of incentives for the installation of Energy Star-rated lighting equipment. Second is a home energy audit service, under which on-premises walk-through inspections would be conducted, with customers then advised of energy-saving measures they could utilize, such as additional insulation, low-flow showerheads, compact fluorescent bulbs, and the like. The third feature, weatherization upgrades, is limited to qualifying low-income households. The

final residential DSM measure is actually targeted at schools and includes on-site energy audits and the availability of energy-efficiency kits and associated educational materials for students from kindergarten through high school. For the C&I sector, the lone core DSM program encompasses an array of energy-saving offerings, from high-efficiency motors to upgraded lighting to the installation of high-technology heating, ventilation, and air conditioning (HVAC) systems.

The initial DSM portfolio put forth by the utility incorporated all five of the core elements noted above, as well as several additional "core plus" measures, for both residential and C&I ratepayers. For residential customers, the core plus features included a program for the removal and recycling of both second refrigerators and window air conditioning units, the offering of load management service for air conditioning systems, and incentives for purchasing renewable-based energy. In addition, IPL proposed to expand its high-efficiency HVAC rebate incentives to residential customers and to make available to them a customized energy management service. The company stated that the customized energy manage-

(See page 5)

DEMAND-SIDE MANAGEMENT *(Continued from page 4)*

ment service, the incentive for renewables, and the air conditioning load management option also would be offered to C&I customers. The utility said it envisioned its C&I core plus measures as likewise producing incentives for both energy-efficient new construction and high-efficiency retrofit projects.

The utility further declared that it considers the development of electric vehicle-related services to be appropriate for inclusion in its DSM and energy-efficiency plans. Explaining that it anticipates steady growth in the sale and use of electric vehicles within its service territory, IPL said that it felt it was incumbent upon it to provide the infrastructure to accommodate such vehicles. It therefore set forth a schedule for deploying electric vehicle supply equipment, such as plug-in recharging systems, throughout its service area. The company related that special time-of-use (TOU) rates would be applicable to the recharging equipment.

While the OUCC agreed with most of the program elements selected by the utility for its core plus offerings, the OUCC disagreed with some of IPL's associated budget plans and its inclusion of renewable-based rate offerings as an energy-saving measure. The OUCC also voiced skepticism about the propriety of treating electric vehicle support functions as a DSM protocol. According to the OUCC, although the utility had tendered proposed annual budgets for its various core and core plus programs, those budgets were presented more as recommendations than as hard-and-fast budgets. The OUCC asserted that without more definitive

spending limits, the cost-effectiveness of any of the DSM measures could be significantly compromised. The OUCC thus suggested that the utility be required to petition the commission before exceeding its proposed budgets in either of the first two years of the three-year plan, but that it be allowed to spend up to 110% of its budget for the third year of the plan. The OUCC also posited that a customer's election to pay a premium for green energy does not affect the level of the customer's usage, but only the

The OUCC also voiced skepticism about the propriety of treating electric vehicle support functions as a DSM protocol.

price paid. Consequently, the OUCC argued that renewable rate options should not be counted as a formal component of DSM programs.

As to the electric vehicle matter, the OUCC found conflicting data regarding the growth of the electric vehicle industry within IPL's service area. Moreover, the OUCC said that the utility's electric vehicle program proposal lacked detail, especially as to how potential cybersecurity issues would be handled. In addition, the OUCC questioned the need for TOU rates for recharging services, noting that there undoubtedly will be many times when an electric vehicle

owner simply must recharge immediately and will not have the luxury of deferring the service to an off-peak time. The OUCC concluded that because IPL would not be able to have any direct impact on electric vehicle load, the electric vehicle components should not be considered DSM elements.

Upon learning of the OUCC's misgivings, the utility agreed to settlement discussions, during which a number of changes were made to the utility's original DSM proposal. For one, the company's electric vehicle support project will no longer be considered a DSM measure per se. However, the stipulation provides that IPL may still pursue electric vehicle initiatives and defer associated costs for future recovery from its customers via a separate rate rider. Similarly, the utility withdrew its renewable rate option from its DSM portfolio, conceding that customer participation in renewable programs does not necessarily have any direct bearing on reductions in consumption. The settlement also makes certain adjustments to IPL's proposed annual budgets, eliminating certain features and reallocating monies from those offerings to other program components. As an example, the stipulation removes a smart appliance subcomponent as well as a proposed energy consumer behavior study from the DSM portfolio and reassigns their respective recommended funding levels to the utility's residential high-efficiency HVAC program instead.

In reviewing the settlement, the commission determined that its provisions reflected a reasonable resolution of the disputed issues and provided a DSM plan in compart-

(See page 6)

DEMAND-SIDE MANAGEMENT (Continued from page 5)

ment with the commission's 2009 order. Looking more specifically at DSM budget matters, the commission said that although utilities need some flexibility in administering their programs from year to year, IPL's third-year budget as first pro-

posed could have produced an increase of more than 25%, a level deemed excessive by the commission. Citing another case in which the commission had authorized a third-year budget increase of no more than 10%, the commission

held that the OUCC's proposed spending limit of 110% for core programs in the last year of the three-year DSM plan should be adopted. *Re Indianapolis Power & Light Co., Cause No. 43960, Nov. 22, 2011 (Ind.U.R.C.).* ■

NATURAL GAS GATHERING SERVICE

PA OKs Withdrawal of Shale Gas Pipeline Project

The Pennsylvania Public Utility Commission (PUC) has granted a request by Laser Northeast Gathering Co. to withdraw its application to become a public utility, certified to provide regulated natural gas services in the state on a contract basis. It left in place, however, legal findings detailed in earlier orders concerning applications by shale gas gathering and transportation entities for certificates to provide public service. The ruling was appealed by other companies engaged in the shale gas gathering, processing and transportation business. Laser said that it withdrew the application due to a change in its business plans and that it no longer planned to offer service to the public.

The company had proposed to build a natural-gas gathering and transportation pipeline to carry shale gas from fields in Pennsylvania that would extend into Broome County, New York, to a tie-in with an interstate pipeline called the Millennium Pipeline. In a June

2011 order, the PUC determined that Laser's proposed service was a "public utility" service subject to regulation under the state's public utility code. (For more on the PUC's initial ruling, *see Letter Nos. 4025 and 4036.*) The grant of utility status would have subjected Laser to safety standards, and in some instances rate regulation, but would also have made it easier to acquire private property using powers of eminent domain.

In granting Laser public utility status and paving the way to begin construction of its facilities, the commission said that whether an enterprise is private or public does not depend on the number or types of persons served but upon whether or not it is open to all members of the public who may require the offered service. It explained that offering service only to a customer group limited by its business characteristics, such as natural gas producers, can be service for the public as long as the service provider holds itself out as offering service to all

members of that group. In its initial ruling, the commission stressed that its decision on public utility status was specific to Laser Northeast and should not be interpreted as a conclusion that all natural gas gathering service providers will be treated as public utilities and it said, it "has no intention of seeking to impose economic regulation" on gathering and transportation service providers "as a general matter."

The commission's affirmation of public utility status for Laser Northeast came despite a strongly worded dissent from Commissioner James H. Cawley. In that order, Commissioner Cawley said that he saw no indication that the company intends to hold itself out to serve any producer that desires its services. Rather, he opined, it seemed that Laser Northeast would be using individually negotiated contracts to enable it to pick and choose its customers. *Re Laser Northeast Gathering Co., LLC, Docket No. A-2010-2153371, Nov. 10, 2011 (Pa.P.U.C.).* ■

In Brief

Electric Procurement Plan

The Idaho Public Utilities Commission announced that Avista Utilities has submitted a plan to add about 1,000 megawatts (MW) of capacity and reducing another 447 MW through energy efficiency savings to meet an expected 1.6% annual growth in electrical load over the next 20 years. The Spokane-based utility serves customers in both Washington state and northern Idaho. Most of the planned added generation, about 760 MWs, would come from natural gas plants, while another 240 MWs would come from wind sources. According to the commission, major changes from the utility's 2009 plan include reduced amounts of wind and the introduction of natural gas-fired generation to meet demand during periods of peak use. It said that, according to the resource documents submitted by the company, "the plan includes less wind

because of lower expected retail loads resulting from the present economic downturn and increased conservation acquisition." The company also states that it selected gas-fired peaking resources because of a lower natural gas price forecast, lower retail loads and the need to acquire more flexible generation as a back-up when wind output is low. (*Case No. AVU-E-11-04, Order No. 32377*) ■

Water Utilities

The Arizona Corporation Commission approved a proposal by American Water Works Company Inc. (parent company of Arizona-American Water Co.) to sell to EPCOR USA all of the issued and outstanding shares of Arizona-American's common stock. In addition, EPCOR USA's parent, EPCOR Utilities Inc (EPCOR), will replace the existing Arizona-American debt extended by American Water with debt extended by EPCOR under

comparable terms. EPCOR's primary operating utility subsidiaries are EPCOR Water, EPCOR Distribution & Transmission, Inc., and EPCOR Energy Alberta, Inc. EPCOR Water provides water and wastewater services to over one million people in more than 70 communities and counties across western Canada. According to the commission, EPCOR USA intends generally to adopt American Water's projected capital budget plan for Arizona-American for the years 2011 through 2013. Under that plan, capital projects totaling approximately \$36.8 million would be constructed over the next three years. In approving the plan, the commission noted that EPCOR maintains a Standard & Poor's credit rating of BBB+ stable for long-term unsecured debt and DBRS Ltd. affirmed its credit rating for EPCOR's long-term unsecured debt at A (low) stable. (*Docket No. W-01303A-11-0101, Decision No. 72668*) ■