

BUILDING A WORLD OF DIFFERENCE

State Regulatory & Legislative Issues Affecting Utilities

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Today's discussion

- State regulatory issues affecting utilities
- Federal and state legislative issues affecting utilities
- Future directions

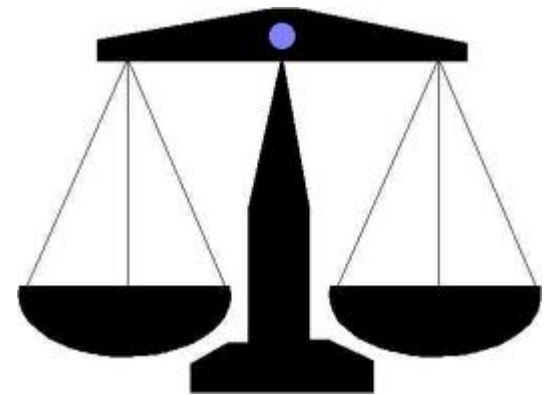


State Regulatory Issues Affecting Utilities



The “hot” state regulatory issues...

- Increased number of rate case filings and the magnitude of the proposed rate increases
- Ratemaking for distribution utilities
- Energy efficiency and conservation initiatives

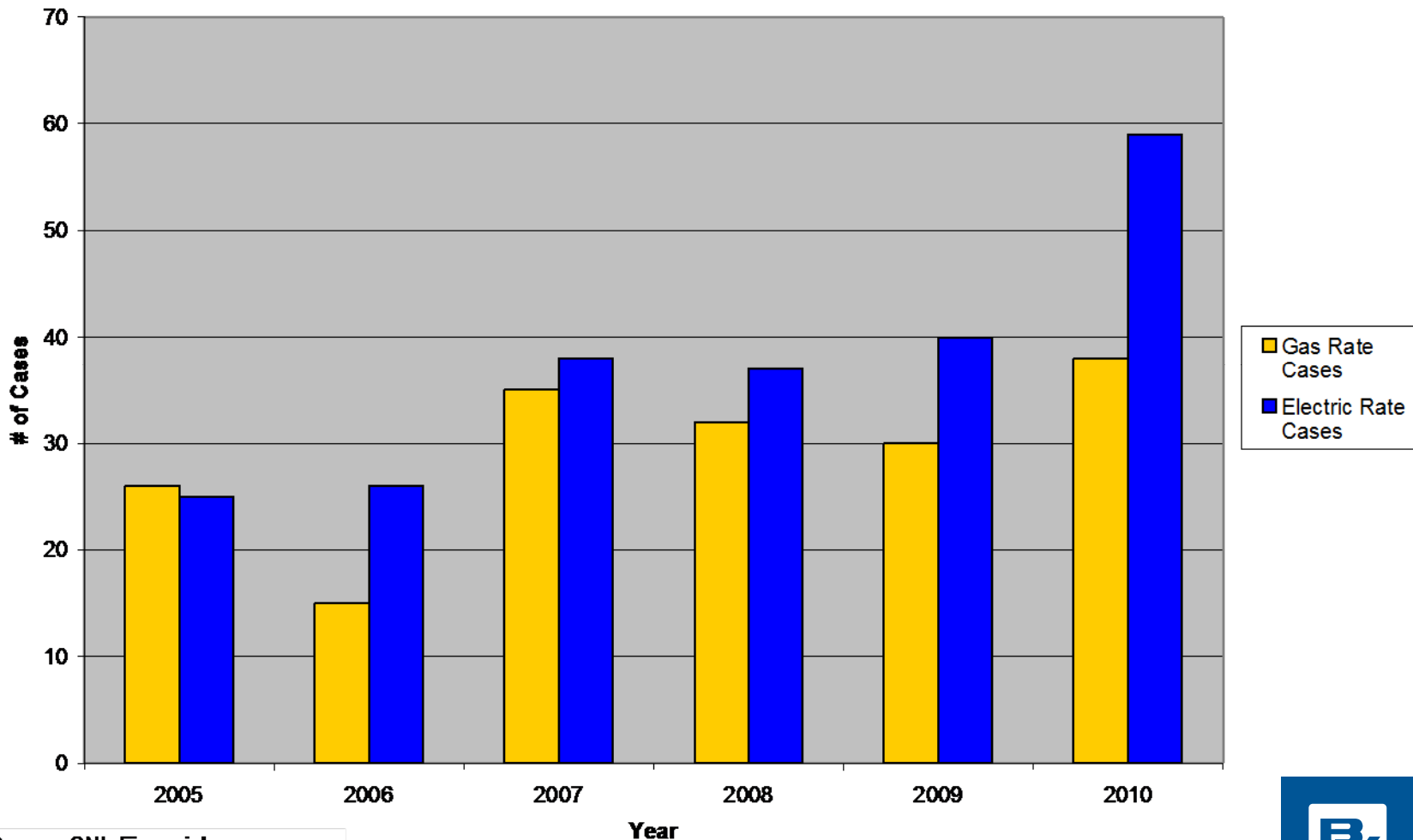


For many utilities, their major business challenges have prompted the filing of base rate cases

- Unstable margins – leading to earnings stress
- Uncontrollable and unpredictable costs
- Continued declining use per customer
- Challenges to achieving customer growth
- Regulatory “lag” (process can be slow costly, inefficient)
- Aging infrastructure and focus on system reliability
- Regulatory uncertainty

Rate Case Trends – Gas and Electric Utilities

Completed Utility Rate Cases
2005-2010

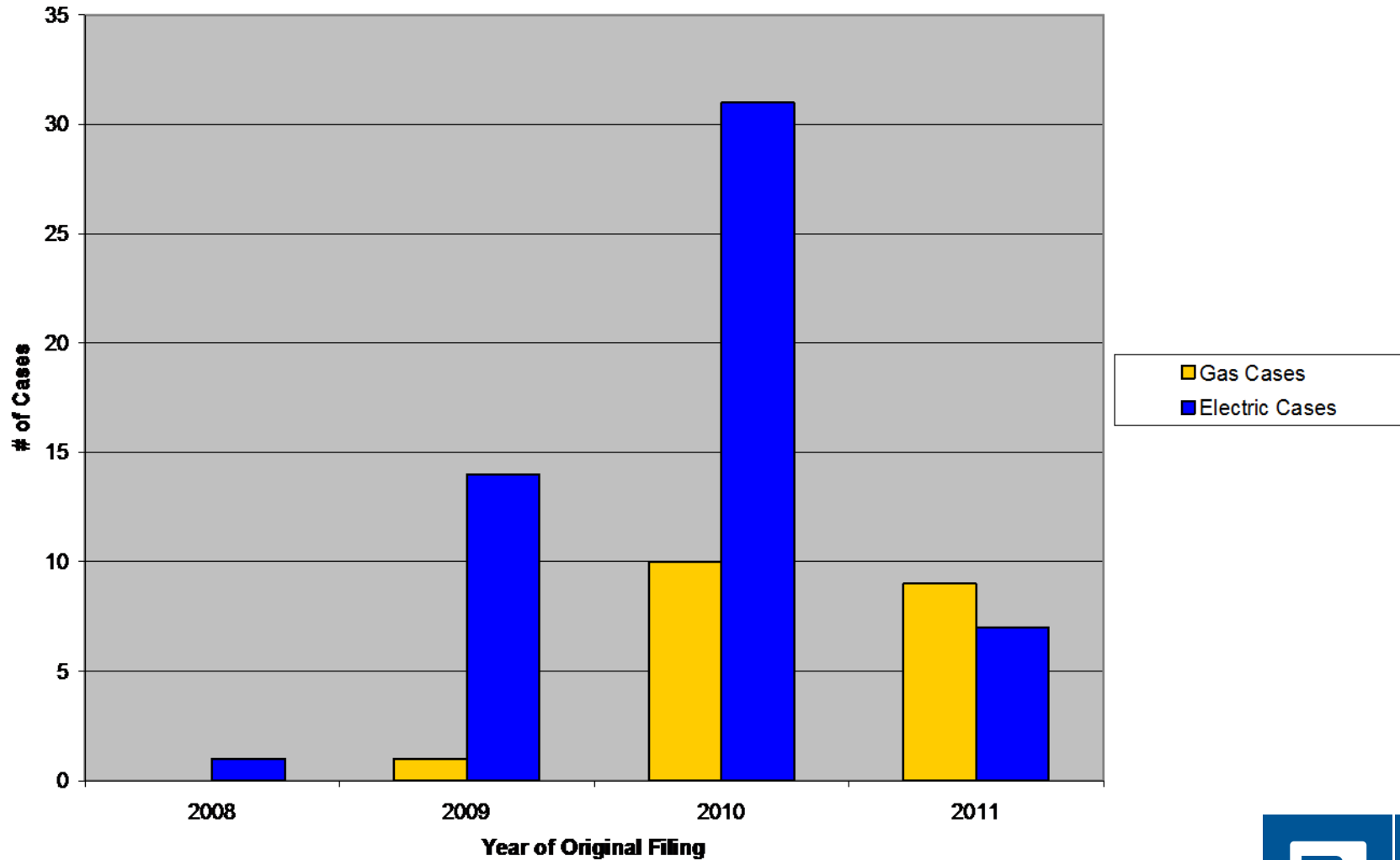


Source: SNL Financial



Rate Case Trends – Gas and Electric Utilities

Pending Rate Cases



Source: SNL Financial

Many innovative ratemaking mechanisms are being proposed by utilities in their rate cases to address specific business challenges

- Revenue decoupling mechanisms
- Rate design utilizing a single, fixed monthly charge
- Automatic adjustment rate mechanisms or rate trackers to address:
 - » Bad debt expenses
 - » Infrastructure replacement cost
 - » Energy efficiency program costs
 - » Margin revenue losses due to warmer-than-normal weather
- Revenue (return) stabilization mechanisms

When does it make sense to utilize an automatic rate adjustment mechanism?

An automatic adjustment mechanism should be considered as an appropriate cost recovery method when it addresses costs and/or business factors (e.g., weather, gas usage) that are:

- Uncontrollable by the utility.
- Variable and Unpredictable.
- Material and of a Recurring nature.



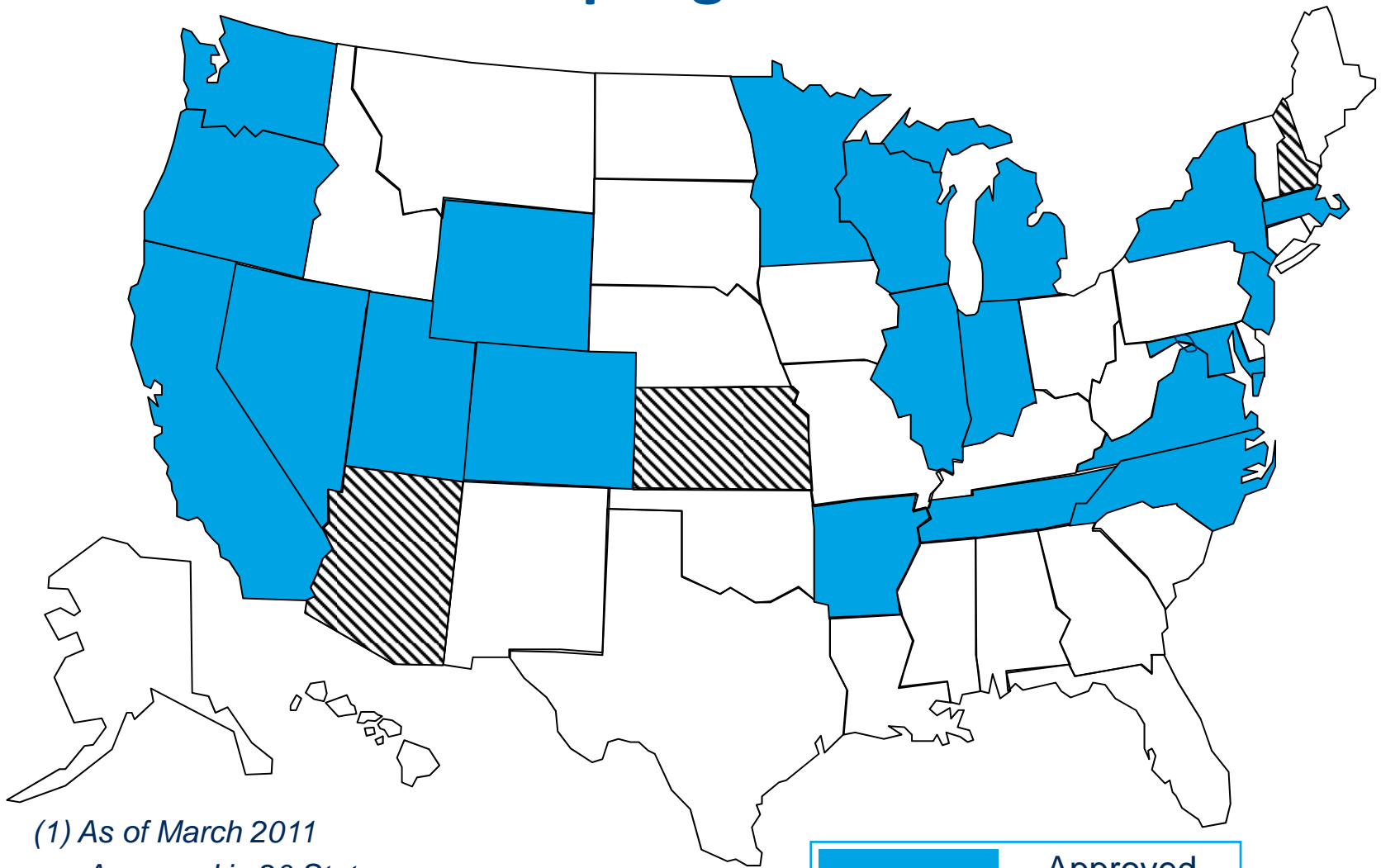
How are gas utilities addressing the under-recovery of fixed costs due to declining gas use?

1. Revenue Decoupling Mechanisms
2. Straight Fixed-Variable (“SFV”) Rate Design
3. Weather Normalization Adjustment (“WNA”) mechanisms that adjust rates for changes in usage caused by weather
4. Monthly customer charges that more fully reflect the gas utility’s fixed costs of providing delivery service; and
5. A measure of “normal weather” (other than the 30-year measure of normal weather) that is an accurate predictor of the weather expected by the utility in future years

Breaking the link between a utility's earnings (revenues) and sales through revenue decoupling

- Decoupling is a ratemaking and regulatory tool that is designed to break the link between a utility's profits and the energy consumption of its customers.
- It removes the inherent economic disincentive that a utility has under traditional ratemaking to promote energy conservation
- Replaces traditional regulation with a formula that determines how revenues change over time.
- The utility, knowing what revenue level to expect, is then free to take cost management actions to improve its profitability under this revenue level.

Revenue Decoupling – Gas Utilities (1)



(1) As of March 2011

Approved in 20 States

Pending in 3 Additional States



Decoupling can align stakeholders' diverse interests

- **A properly designed decoupling mechanism can achieve significant benefits for the utility and its customers:**
 1. Mitigates the utility's disincentives to promote energy efficiency;
 2. Removes the relationship between the utility's sales volume levels and profits (margin revenues); and
 3. Provides increased opportunities to customers to reduce energy consumption, and to reduce energy bills, created by the various energy efficiency and conservation initiatives supported by the utility.

Decoupling can align stakeholders' diverse interests (continued)

- **A properly designed decoupling mechanism can achieve significant benefits for the utility and its customers:**
 4. Customers' bills will more accurately reflect the margin recovery amounts approved by the regulator.
 5. Improves the ability of the utility to recover its fixed costs of providing service.
 6. Potential for gradual decline in gas commodity prices as overall demand is reduced (e.g., ACEEE estimates)

But, revenue decoupling works both ways

If sales increase, any incremental revenues will be credited to customers, as a result...



Absent a Revenue Growth Factor to *replace* growth in sales, revenue decoupling will not address a utility's need for incremental revenue to fund:

- Utility infrastructure investments.
- Increases in utility operating expenses (beyond the level approved in the utility's last rate case).

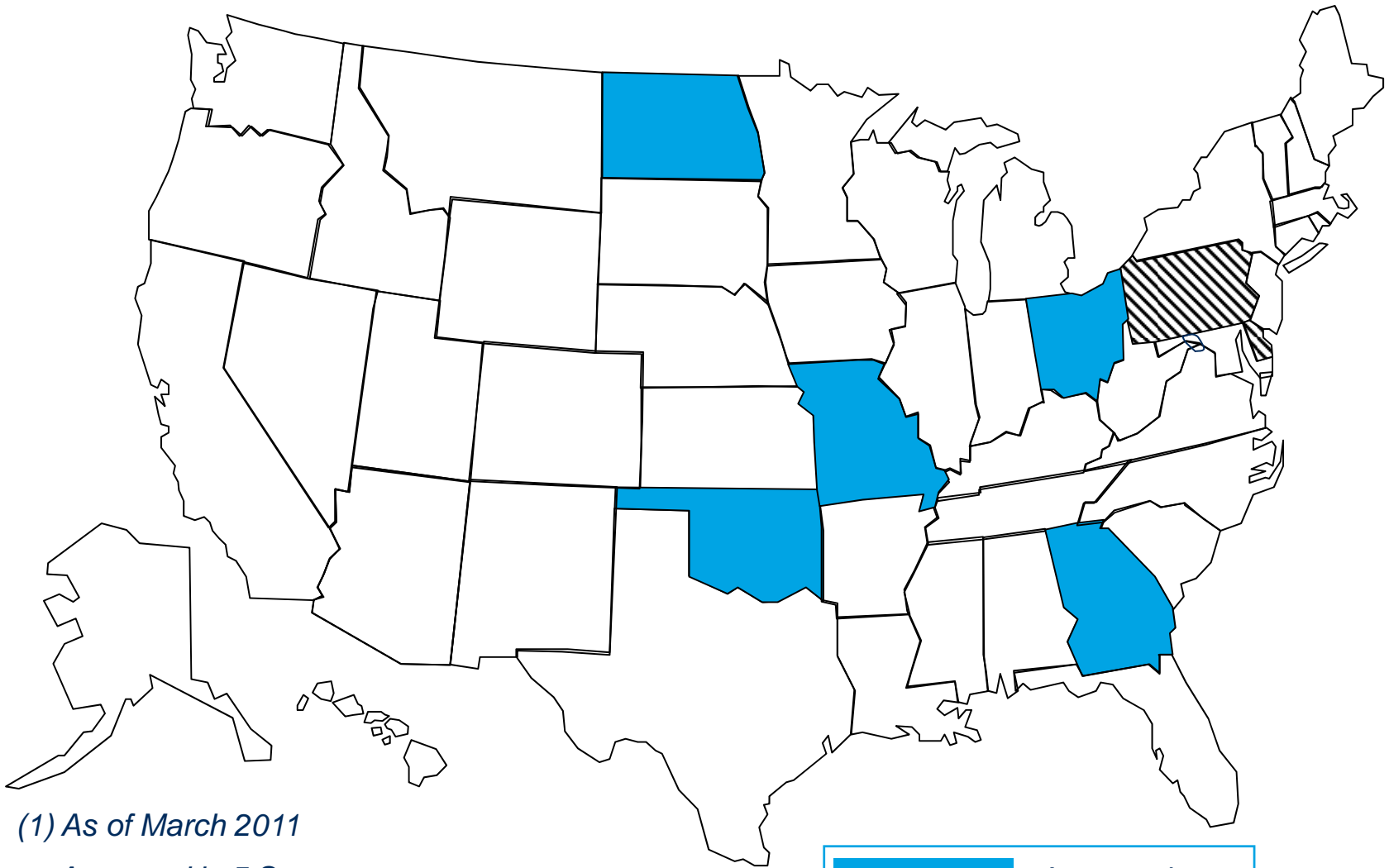
A Straight Fixed-Variable (“SFV”) rate structure can achieve some of the same outcomes as under revenue decoupling

- A SFV rate structure effectively breaks the link between a utility’s profits and the energy consumption of its customers by matching the rate structure to the cost structure
- It also removes the inherent disincentive that a utility has under traditional ratemaking to promote energy conservation
- There are numerous other benefits to the utility and its customers with a single, fixed monthly bill concept under a SFV rate structure
 - Customers don’t overpay or underpay each month
 - Minimizes cross-subsidies between and within customer classes
 - Improves bill stability
 - Similar pricing to other consumer services
 - Achieves bill simplicity and promotes understandability

Attributes of SFV rate design

- Flat monthly fee places all of the utility's fixed costs, including a regulated profit, into a fixed monthly charge called a service or delivery charge
- Similar to monthly fee charged by cable, internet, cellular service, trash services, etc.
- The “variable” portion of the tariff refers to variable commodity-related charges (i.e., related to purchased gas costs)

SFV Rate Design – Gas Utilities (1)



(1) As of March 2011

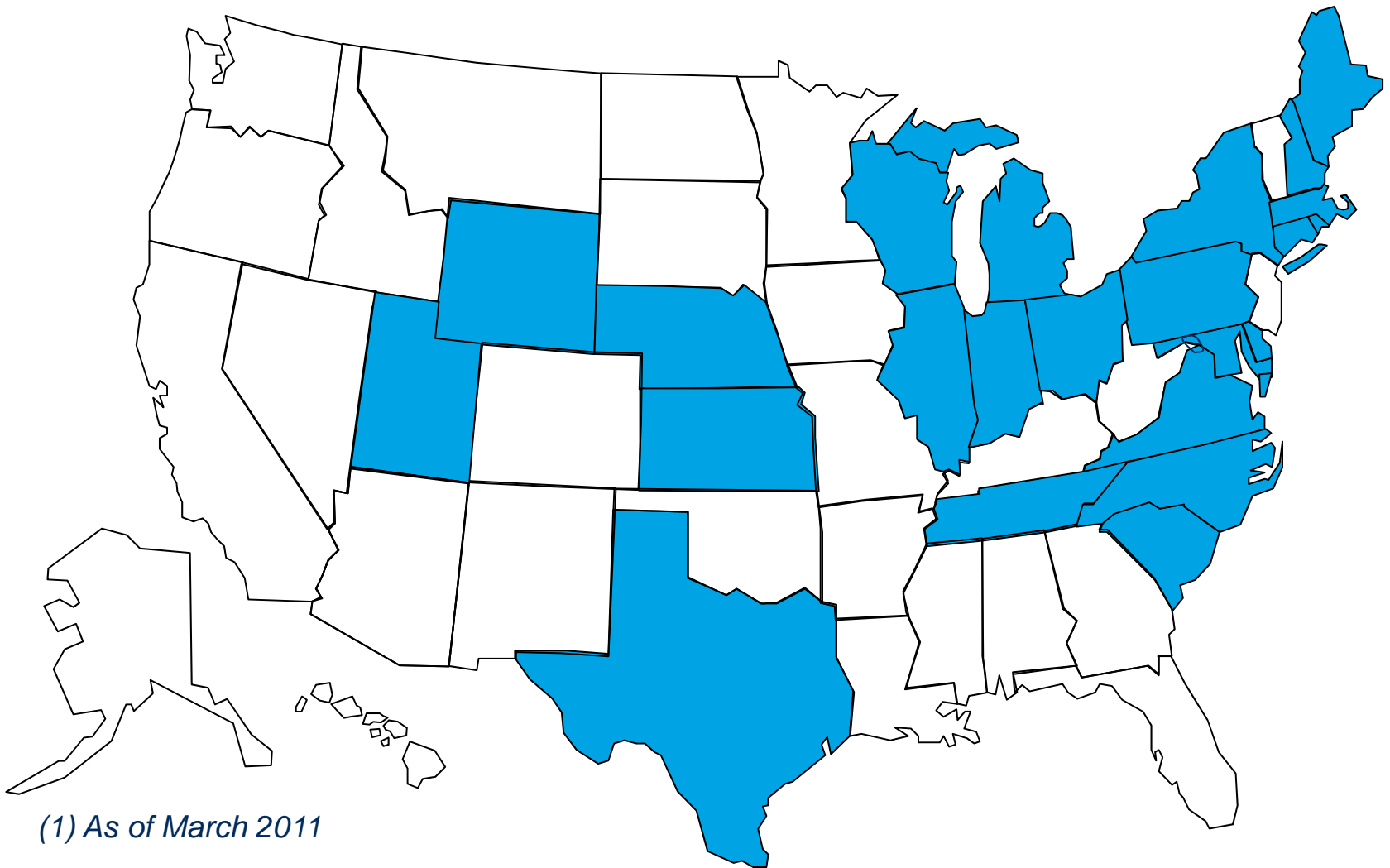
Approved in 5 States



Bad debt recovery mechanisms

- An alternative to recovery as a fixed expense in base rates set in a rate case
- The tracker permits recovery of actual bad debt expense through a deferral account - periodically is “zeroed out” through the application of surcharges or credits to base rates.
- Recognizes the uncontrollable/unpredictable nature of such costs and close correlation with changes in the price of natural gas
- In some states, base rates reflect a “baseline” level of bad debt expense, with variations from baseline used to adjust rate
- Others permit separate treatment of gas commodity-related bad debt expense through the Purchased Gas Adjustment (“PGA”) mechanism

Bad Debt Recovery Mechanisms – Gas Utilities⁽¹⁾



(1) As of March 2011

Approved in 23 States

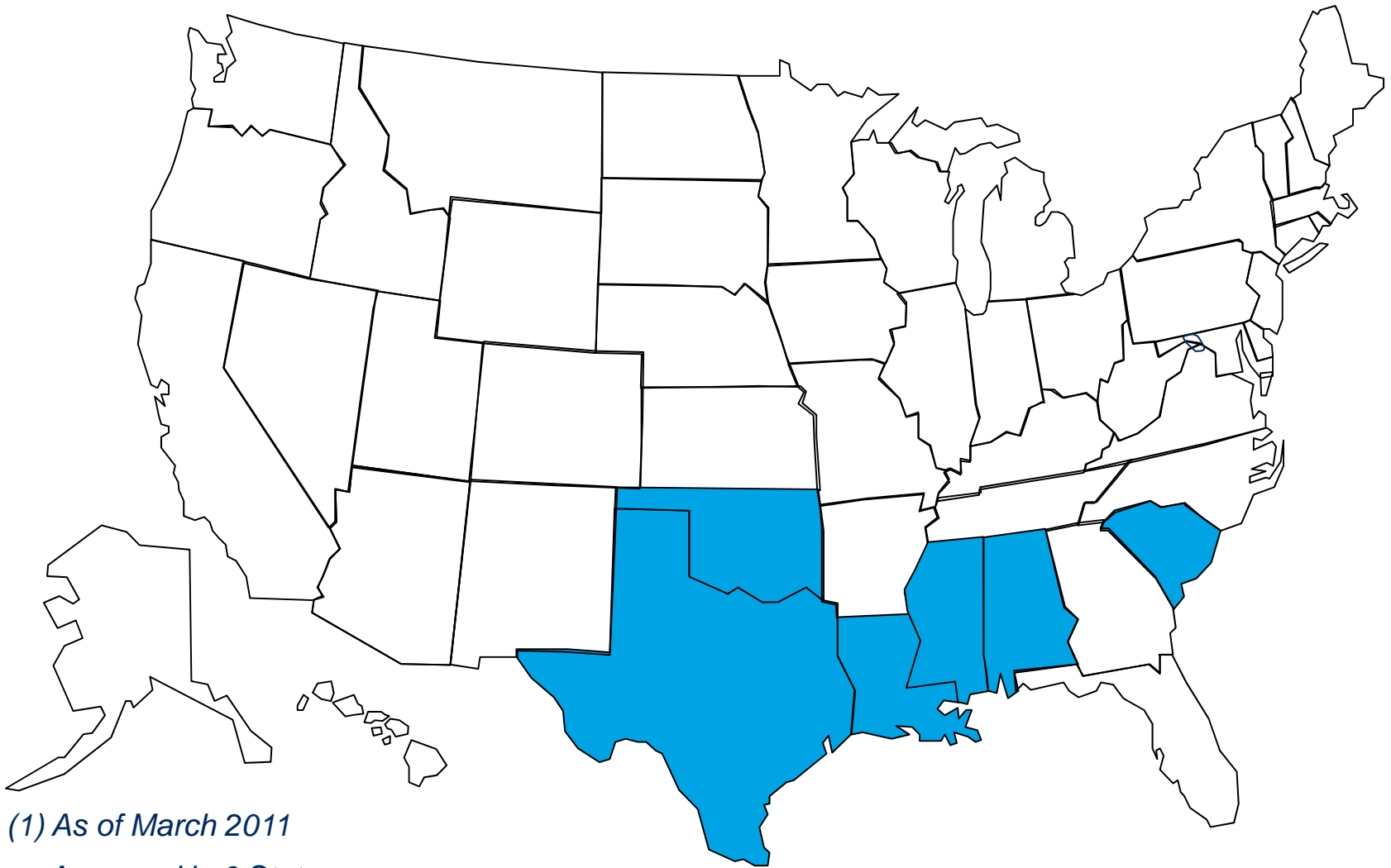
Infrastructure replacement cost recovery mechanisms

- An alternative to recovery as a fixed expense in base rates set in a rate case, or through deferred accounting treatment.
- Integrity management costs
 - ✓ Tracker
 - ✓ Deferred accounting
 - ✓ Capitalized asset
- Pipeline replacement program costs
 - ✓ Tracker
 - ✓ Surcharge

Revenue (return) stabilization mechanisms

- Periodic rate adjustments are made based on a comparison of achieved vs. approved rate of return, without the need for a full rate case
- Can reflect Performance-Based Ratemaking (“PBR”) concepts
 - Some of the mechanisms are based on an “earnings sharing” approach – utility and customers share any increase or decrease in achieved earnings relative to a target earnings level.
 - Other mechanisms reflect a performance adjustment to the computed earnings based on the utility’s performance against pre-defined operational benchmarks.

Revenue (Return) Stabilization Mechanisms⁽¹⁾

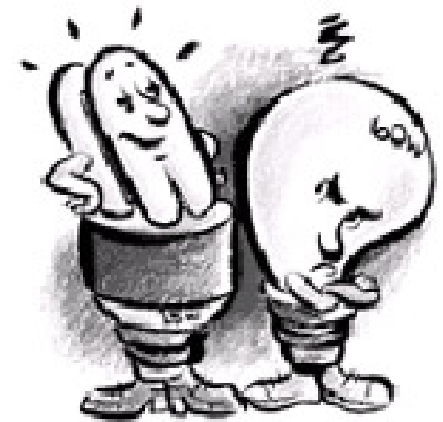


(1) As of March 2011

Approved in 6 States

The regulatory platforms for energy efficiency programs

- Utility rate cases
- Integrated Resource Planning (“IRP”) proceedings
- Renewable Portfolio Standard (“RPS”) proceedings
- Energy Efficiency Portfolio Standard (“EEPS”) proceedings
- Generic/rulemaking proceedings
 - » EE initiatives and savings standards for utilities
 - » AMI inquiries
 - » Dynamic pricing concepts



Key regulatory objectives of energy efficiency

- Establish a reasonable and achievable savings standard
- Select EE programs that are cost-effective for the utility and its customers
- Establish sufficient funding levels and a stable recovery mechanism
- Set expectations for periodic reporting, measurement and verification of EE program results (i.e., impact evaluations)
- Ensure that EE initiatives as a business activity are fully embraced by the utility
- Take a multi-year view of the process

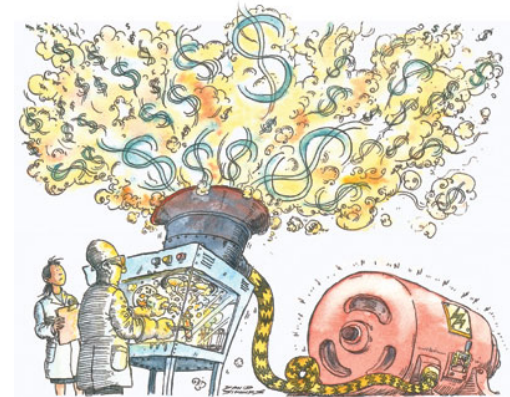
The challenge of creating the right incentives

- How do you make energy efficiency a profitable undertaking as opposed to simply a breakeven business initiative?
- How do you achieve equality for a utility between supply-side and demand-side alternatives?



The regulatory incentives offered to utilities to actively promote energy efficiency

- Providing an opportunity for shareholder earnings from superior performance in providing programs and services for customer energy efficiency



<i>Type of Incentive</i>	<i>States Where Approved</i>
Performance Targets	CT, MA, RI
Shared Savings	AZ, CA, CO, GA, HI, MN, NH, VT
Rate of Return Adder	IN, KS, MO, MT, NM, NV

Federal and State Legislative Issues Affecting Utilities



The Federal legislative agenda...

- Energy policy
- Clean energy standard
- Pipeline safety
- LIHEAP funding



Energy policy legislation – *not on the radar screen right now...*

- Congress preoccupied with work on a long-term federal budget and raising the federal debt ceiling
- Individual measures may be possible
 - For example - a bill to amend the Energy Policy and Conservation Act to improve energy efficiency of certain appliances and equipment, and for other purposes (S. 398)
- Majority of action is likely to be at the state and local level
- More federal activity expected by the Fall

Clean Energy Standard

- In January 2011, the Obama Administration proposed a Federal Clean Energy Standard (CES) as part of a broad program of energy innovation and job creation
- A flexible mechanism to ensure utilities meet an increasing percentage of their electricity sales using *clean* sources.
- Prompted by the lack of success in efforts to enact climate change legislation
- White paper on CES – issued in March 2011 by Senators Jeff Bingaman and Lisa Murkowski; Committee on Energy and Natural Gas Resources – U.S. Senate

Key elements of a CES

- Designed to promote more efficient and lower carbon electricity generating options
- A CES would incent wind, solar, other renewable resources, possibly nuclear and gas-based generation, and possibly discourage coal-based generation.
- Under the Obama Administration's concept of a CES, the amount of *clean energy* would double by 2035 – to 80% of domestic electricity production.

Key questions associated with a CES

- What should be the threshold for inclusion in the program?
- What resources should qualify as “clean energy”?
- How should the crediting system and timetables be designed?
- How will a CES affect the deployment of specific technologies?
- How should Alternative Compliance Payments, regional costs, and consumer protections be addressed?
- How would the CES interact with other policies?

Pipeline safety – the Pipeline Transportation Safety Improvement Act of 2011

- **Recently introduced in the Senate (S. 275 – Lautenberg and Rockefeller)**
- **Key provisions**
 - Require the installation of automatic/remote-control shutoff valves on new transmission pipelines
 - Expand excess flow valve requirements
 - Increase civil penalties for violators of pipeline regulations; add civil penalties for obstructing investigations
 - Require the Secretary of Transportation to evaluate whether integrity management system requirements should be expanded
 - Set minimum standards for state one-call programs
 - Make pipeline information available to the public
 - Require the Department of Transportation to establish time limits for accident and leak notification by pipelines

LIHEAP funding

- **FY2011 - \$4.71 billion**

- \$5.1 billion in FY2009 and FY2010
- Sets the state income eligibility level back to 60% of the state median income (In both the FY2009 and FY2010 appropriations acts, Congress gave states the authority to raise their LIHEAP eligibility standards to 75% of state median income).

- **FY2012 - \$2.57 billion**

- As per Obama Administration's proposed budget for FY2012
- Funding cut justified based on the expectation of relatively lower energy prices (i.e., moderation in the spot prices for crude oil and natural gas)
- Proposed funding rolled back to FY2008 levels

The recent “hot” topics at the State level...

- Net metering
- Clean coal technology
- Carbon capture
- Electric vehicles
- Energy efficiency
- Fossil fuels
- Solar
- Wind
- Renewable portfolio standards



Plenty of activity at the state level in recently enacted or introduced legislation

- Net metering (*115 bills in 23 states in 2010*)
- Clean coal technology (*65 bills in 18 states in 2010*)
- Carbon capture (*72 bills in 19 states in 2010*)
- Electric vehicles (*91 bills in 19 states in 2010*)
- Fossil fuels (*155 bills in 33 states in 2010*)
- Solar (*915 bills in 45 states in 2010*)
- Wind (*1,029 bills in 26 states in 2010*)
- Renewable portfolio standards (*38 states have some type of renewable portfolio standard, with 7 states that considered legislation in 2010*)

Examples of recently enacted or introduced state legislation

- **Net metering**

- New Hampshire requires net metering tariffs to be made available to eligible customer-generators by each electric distribution utility

- **Clean coal technology**

- Illinois established a “clean coal portfolio standard” requiring that 25% of electricity used in the state be generated by “cost-effective clean coal facilities” by 2025

- **Electric vehicles**

- Arizona provides a business investment tax credit for the installation of an electric vehicle charging station
- California and Florida allow energy efficient vehicles to use all highway HOV lanes, regardless of occupancy

Examples of recently enacted or introduced state legislation

- **Solar**

- Hawaii requires solar water heater systems in the construction of all new single-family dwellings

- **Wind**

- Louisiana, Minnesota, and Nebraska provides for the leasing of state-owned lands for the construction and development of wind energy systems
- Nebraska also exempts any land used for wind energy systems from state property tax
- New Jersey established an offshore wind renewable energy certificate program to take advantage of offshore opportunities within the state

Future Directions

The expected future trends in utility regulatory and ratemaking activities

- A number of revenue decoupling mechanisms were approved by regulators as “pilot programs” – will require a revisiting of structure and benefits of programs (e.g., North Carolina, New Jersey, Oregon, Washington)
- An increased recognition of the uncontrollability, variability, and unpredictability of a utility’s costs, and its customers’ usage levels will lead to the greater use of automatic adjustment ratemaking mechanisms

The expected future trends in utility regulatory and ratemaking activities (cont.)

- To meet increasing annual EEPS targets, utilities will have to offer a growing array of EE programs, with more aggressive expectations for participation levels and energy savings
- Financial incentives for utilities to aggressively pursue and promote energy efficiency will become more prevalent as the EE bar is raised
- More focus on EM&V activities to ensure energy efficiency programs are cost-effective and result in the energy savings promised by the utility

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