STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: INQUIRY INTO THE EFFECT OF REDUCED USAGE ON RATE-REGULATED NATURAL GAS UTILITIES	DOCKET NO. NOI-06-1

ORDER ADDRESSING ISSUES AND CLOSING DOCKET

(Issued December 18, 2006)

On February 9, 2006, the Utilities Board (Board) initiated an inquiry into the effect of reduced natural gas usage resulting from increased energy efficiency and other factors over the next five years on the non-gas revenues of Iowa's rate-regulated natural gas utilities. The Board indicated that Iowa had joined with seven other states, Michigan, Minnesota, Missouri, Wisconsin, Ohio, Illinois, and Indiana, to form the Joint Natural Gas Price Reduction Initiative (JNGPRI) to support regional and individual state actions to create downward pressure on natural gas prices by reducing demand for natural gas by 5 percent over the next five years. The Board indicated that the states recognized that the high cost of natural gas created a financial hardship on many consumers and represented millions of dollars exported from these state economies.

The Board stated that the inquiry would investigate the potential effects of this initiative and other factors in reducing natural gas usage, the resulting effect on regulated non-gas utility revenues, and would consider whether traditional regulation is flexible enough to address these effects or whether alternative mechanisms or approaches, such as a decoupling mechanism to reduce the influence of sales volumes on utility earnings, might be appropriate. The Board presented a set of initial questions in the February 9, 2006, order for participants to address. Responses to the questions were filed by the Consumer Advocate Division of the Department of Justice (Consumer Advocate), Atmos Energy Corporation (Atmos), the Iowa Environmental Council (IEC), Interstate Power and Light Company (IPL), MidAmerican Energy Company (MidAmerican), Ag Processing Inc (AGP), the Iowa Industrial Energy Group (IIEG), and Aquila, Inc., d/b/a Aquila Networks (Aquila). As part of the inquiry, the Board contracted with the Regulatory Assistance Project (RAP) to conduct a workshop on May 10, 2006, addressing mechanisms considered in other jurisdictions to resolve these issues.

On July 11, 2006, the Board issued an order requesting responses to additional questions. The Board indicated that it had reviewed the initial comments, RAP presentation, and the discussions at the workshop and, based upon that information, the Board had questions about some of the mechanisms that were discussed. AGP, Consumer Advocate, MidAmerican, IPL, IIEG, and Aquila filed additional comments.

In considering whether a decoupling mechanism or similar system should be adopted in Iowa, the Board is faced with two important public policy concerns. First, there is the public policy goal of reducing usage of natural gas by individual customers with the result that overall usage in Iowa, and nationally, is reduced.

Second, there is the requirement under public utility regulation that a utility be given a reasonable opportunity to earn the return authorized by the regulatory agency. In many states these two public policy concerns have been found to be in conflict and various mechanisms to decouple sales of natural gas from a utility's revenues have been proposed to alleviate the tension between the two policies.

Based upon the information reviewed by the Board in this docket, the tension between energy efficiency and Iowa natural gas utilities' opportunity to earn their authorized rate of return does not appear to be a substantial problem in Iowa. Iowa utilities have been participating in energy efficiency plans since before 1990 without substantial adverse effects on earnings. In that year, Iowa established a statutory goal in Iowa Code § 473.3 to “more efficiently utilize energy resources . . . to decrease the state's dependence on energy resources from outside the state by reducing the amount of energy used." This goal was to be implemented through the development of programs that promote energy efficiency and energy conservation by all Iowans.

To meet this statutory goal, the Board developed rules and procedures for planning and implementing energy efficiency programs by Iowa public utilities and has approved several rounds of energy efficiency plans for rate-regulated utilities, most recently in 2003. The energy and peak capacity saved by investor-owned utility energy efficiency programs over the past 15 years have resulted in a cumulative reduction in natural gas usage through 2005 of about 7 million MCF, or about 6.6 percent of annual retail natural gas sales. By 2005, total customer retail cost savings resulting from these cumulative changes in energy use amounted in 2005 to about $80 million in natural gas costs. From this, the Board concludes that Iowa utilities have not been unable to engage in meaningful energy efficiency programs because of concern about their earnings.

The Board is committed to the continuation of the aggressive energy efficiency programs already in place and to the development of new plans to further increase savings to customers and reduced natural gas consumption from increased energy efficiency. This increase in energy efficiency programs by utilities and their customers may have an adverse effect on the ability of rate-regulated utilities to have a reasonable opportunity to earn their authorized rates of return, potentially creating a disincentive to utility participation in these programs.

Other jurisdictions that lack the energy efficiency mandate and history of Iowa have adopted decoupling mechanisms. The Board believes this may be appropriate in situations where reduced natural gas usage resulting from energy efficiency programs may aversely affect earnings. When this situation exists, utilities should be able to propose appropriate mechanisms to provide the utilities with a reasonable opportunity to earn their authorized rates of return in spite of reduced sales volumes. The information reviewed in this inquiry does not demonstrate that situation for Iowa utilities to date, but the Iowa utilities in this docket have nonetheless proposed several different alternatives solutions to declining customer usage, perhaps in anticipation of increased emphasis on energy efficiency programs. The suggested changes included rate design proposals, incentive mechanisms, and automatic rate adjustments, among other things.

One reason that Iowa utilities may not be subject to the same pressures as utilities in other jurisdictions is that the Board allows recovery of the costs associated with approved energy efficiency plans through an automatic adjustment mechanism for natural gas utilities, the Energy Efficiency Cost Recovery (EECR). This pass through of energy efficiency plan costs alleviates some of the disincentive for utilities to promote greater energy efficiency by customers. The Board recognizes that the EECR may not be a complete answer, however, as it compensates utilities for expenditures but does not address the possible adverse effect reduced energy consumption might have on utility returns.

Information reviewed by the Board in this docket concerning Iowa natural gas utilities shows that Iowa rate-regulated utilities have experienced a reduction in average customer usage over the past ten years, as have utilities in other jurisdictions. The information does not indicate that reduced usage has substantially adversely affected utilities' net operating income. The Board examined annual reports from 1995 to 2005 for each of the four rate-regulated natural gas utilities showing the average residential usage by utility from 1995 to 2005, the net operating income of each utility over the same period, and the relationship between weather and total purchases of natural gas by utility over the same period. The data shows that average residential customer usage has declined and total purchases have declined while winter weather has generally been warmer than normal over the past several years. The data does not show a direct correlation between net operating income and declining customer usage as a result of energy efficiency programs to date.

However, it is unclear whether updated, more aggressive programs will change this situation. Each utility is likely to be affected differently, so each utility's situation should be considered separately. Separate consideration for each utility will allow the Board to determine whether any decline in net operating income is the result of a decline in customer usage due to increased energy efficiency or some other factor.

The Board believes decoupling mechanisms or rate design changes are appropriate when the circumstances support the need for such mechanisms. Some of the decoupling mechanisms that have been adopted in other jurisdictions are similar to the automatic adjustment mechanisms that are provided for pursuant to Iowa Code § 476.6(8). The Board has adopted these types of mechanisms to respond to costs that the utility management has little or no control over, that are volatile (i.e., subject to sudden and important changes in level), and that are an important factor in determining the total cost of service to customers. Under this statutory authority, the Board has adopted automatic adjustments for the purchase of natural gas, the purchased gas adjustment (PGA), and for fuel costs for electricity, the energy adjustment clause (EAC). The Board has also adopted an automatic adjustment mechanism, the EECR, pursuant to Iowa Code § 476.6(16), that authorizes the recovery of the costs of implementing an energy efficiency plan approved by the Board.

At this time, the Board considers the standards established for the automatic adjustment mechanisms listed above to be the appropriate standards for considering whether there is a need for an automatic adjustment mechanism to compensate a utility for reduced customer usage because of increased energy efficiency. The decoupling mechanisms reviewed by the Board in this docket did not effectively identify the effect of increased energy efficiency by customers and often included other factors in the determination of when an adjustment would be made. The Board understands there may be a need by a utility to remove any disincentives that would limit promotion of increased energy efficiency, however, decoupling mechanisms that adjust for other factors may go beyond what the Board considers to be reasonable.

A review of the decoupling mechanisms suggested by the participants shows there was not a general consensus supporting use of decoupling mechanisms or a single type of mechanism. Since there was a lack of consensus, the Board will not attempt to establish a single, specific automatic adjustment mechanism that would be applicable to all of the rate-regulated utilities. Instead, the Board will encourage each utility to review its circumstances and determine if increased energy efficiency and reduced customer usage have caused, or are likely to cause, a decline in net operating income. If a relationship is shown, the utility should develop a proposal that may include an automatic adjustment mechanism, rate design change, or other solution that it considers reasonable to address the situation and should make the appropriate filing with the Board for consideration in an appropriate proceeding. Since each rate-regulated utility will make a separate determination of whether it should make a filing and those filings will be considered in separate dockets, no further action is required in this docket. Docket No. NOI-06-1 will therefore be closed.

IT IS THEREFORE ORDERED:

Docket No. NOI-06-1 is closed.

UTILITIES BOARD

/s/ John R. Norris

/s/ Diane Munns

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Curtis W. Stamp

Dated at Des Moines, Iowa, this 18th day of December, 2006.