



is expected that there would be increases some years and decreases in others, with any such increases and decreases expected roughly to cancel each other out over time.

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## ***Detailed Fiscal Analysis***

H.B. 250 would permit the Public Utilities Commission of Ohio (PUCO) to approve alternative rate plans for natural gas utilities that feature a revenue decoupling mechanism, and would specify that an alternative rate plan filed by a natural gas utility that proposes such a mechanism "may be an application not for an increase in rates," under specified conditions. The bill defines a revenue decoupling mechanism to be "a rate design or other cost recovery mechanism that provides recovery of the fixed costs of service and a fair and reasonable rate of return, irrespective of system throughput or volumetric sales."

### **Background**

The National Regulatory Research Institute (NRRI), the research arm of the National Association of Regulatory Utility Commissioners (NARUC), published a briefing paper on this subject in April 2006. Titled, *Revenue Decoupling for Natural Gas Utilities*, the paper is available on the NRRI web site.<sup>1</sup> As reported there, the NARUC passed a resolution in 2005 advising state commissions to consider the implementation of revenue decoupling.

The bill's definition of a revenue decoupling mechanism is flexible, which would appear to leave the details of what may constitute such a mechanism up to the PUCO. The NRRI briefing paper explains the basic structure of a revenue decoupling plan (on page 9). Under such a plan rates adjust automatically when natural gas usage deviates from the level that was expected at the time of the utility's most recent rate case. The paper presents a simplified example of natural gas usage falling by 5% relative to the expected amount, and a revenue decoupling plan increasing rates automatically by 5.3% to ensure that the utility receives the level of revenue that had been expected. Conversely, if natural gas usage exceeded the expected amount, then that would automatically trigger a rate decrease.

According to the NRRI briefing paper, revenue decoupling proposals result from the effects of the time lags between traditional rate setting cases. In such a case, a portion of the natural gas rate per unit sold that is set is intended to allow the utility to recover its fixed costs. Since fixed costs by definition are independent of the amount of gas sold, some volume of gas sold must be assumed during the rate case to arrive at a per unit rate. If the number of actual units sold exceeds expectations, then the utility will earn profits that are higher than expected; conversely, if the number of actual units sold is less than expected, then the utility will earn lower profits. High natural gas prices since the year 2000 have led many analysts to suggest that U.S. regulators need to focus on policies that promote conservation of natural gas. Traditional rate making approaches discourage natural gas utilities themselves from promoting conservation, since that involves promoting lower profits for themselves. Revenue decoupling mechanisms are intended to break the link between lower natural gas usage and lower profits (or losses) for natural gas utilities. As summarized in the briefing paper, "while RD

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<sup>1</sup> The paper can be found at the web address [www.nrri.ohio-state.edu/NaturalGas](http://www.nrri.ohio-state.edu/NaturalGas).

[revenue decoupling] does not provide the utility with an explicit incentive to promote energy efficiency, it eliminates the disincentive."

Natural gas customers include state and local governments. The U.S. Census Bureau estimates that local governments in Ohio collectively spent \$46.4 million on natural gas utility services during the fiscal year that ended between July 1, 2004 and June 30, 2005. The definition of local governments appears to include counties, municipalities, townships, special districts, and school districts.

### **Fiscal effect**

As explained in more detail in the LSC Bill Analysis, specifying that an alternative rate plan filed by a natural gas utility is not an application for an increase in rates means that PUCO may avoid holding hearings on the application. This may reduce staff time and other resources that would otherwise be needed to conduct hearings. By specifying that an application including a revenue decoupling mechanism satisfies this requirement, the bill may allow PUCO to experience a reduction in the number of hearings held and a consequent reduction in expenditures. Any such reduction would depend on the number of applications that are filed that feature such a mechanism. PUCO expenditures for these purposes are funded from the Public Utilities Fund (Fund 5F6).

The bill may also have an impact on natural gas rates paid by state and local governments as natural gas customers, but that impact would depend on the specifics of revenue decoupling mechanisms approved by PUCO. Assuming PUCO approves mechanisms that generally fit the description in the NRRI briefing paper, such mechanisms would mean that utility customers would pay more for natural gas than they otherwise would during years when natural gas usage is less than expected, but that they would pay less for natural gas during years when usage is greater than expected. So state and local governments, as consumers of natural gas, would pay more for natural gas in some years, but less in others.<sup>2</sup> Although the sizes of increases and decreases in spending on natural gas will depend on how the mechanisms are implemented, on whether energy efficiency programs succeed, and on the future path of natural gas prices, LSC staff believe it likely that such increases and decreases may roughly cancel out each other over time.

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<sup>2</sup> The NRRI briefing paper is noncommittal on the question whether consumers would benefit from a revenue decoupling plan, indicating that whether such plans would benefit consumers is "uncertain."