

# A Natural Gas Distribution Rate Primer

This document is intended to provide broad general information regarding natural gas distribution rates and regulation. It is not intended as a substitute for advice from your attorney or qualified consultant. Titles 3 and 4 of the current Texas Utilities Code, and the Railroad Commission of Texas' (Commission) Special Rules of Practice and Procedure, Substantive Rules, and General Rules of Practice and Procedure should be referenced.

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## HOW ARE NATURAL GAS DISTRIBUTION COMPANY'S RATES DETERMINED?

A natural gas distribution utility is entitled to charge rates that will generate revenue equal to its costs. These costs fall into two categories: operating costs and capital costs. A utility's operating costs are its reasonable and necessary expenses to provide natural gas distribution services. For purposes of rate regulation, a utility's capital costs are considered to be its actual cost of long-term debt plus a reasonable rate of return on its investors' funds.

Rates are determined using a two-step process. First, the utilities total costs are calculated as in the following example:

### *Operating Costs*

Operating Expenses	\$50,000
General & Administrative Expenses	\$5,000
Total Operating Costs	\$55,000

### *Capital Costs*

Interest Expenses	\$15,000
Return on Investors' Funds	\$20,000
Total Capital Costs	\$35,000

**Total Costs** **\$90,000**

Second, once total costs have been determined they are allocated among the different types of customers, and divided into fixed and variable costs. Fixed costs are used to calculate a monthly customer or meter charge while variable costs are used to calculate a rate based on consumption.

	<u>Residential Customers</u>		<u>Commercial Customers</u>		
	Fixed	Variable	Fixed	Variable	Total
Operating Costs	21,450	19,175	2,600	11,775	55,000
Capital Costs	<u>13,650</u>	<u>13,000</u>	<u>1,000</u>	<u>7,350</u>	<u>35,000</u>
TOTAL COSTS	35,100	32,175	3,600	19,125	90,000
Number of Months	12		12		
Monthly Fixed Costs	2,925		300		
Number of Meters	195		10		
Volumes Consumed (Ccf)		107,250		60,000	
Monthly Meter Charge	\$15.00		\$30.00		
Consumption Charge		\$0.3000		\$0.3188	

The process of determining total costs and allocating them among the different types of customers is complex and subject to review by the Commission, the Municipalities, and their experts. This system of checks and balances ensures the utility has the ability to charge rates that will cover its costs while, at the same time, the utility's customers will pay a just and reasonable rate for service.

## **WHAT IS THE PURPOSE OF REGULATION?**

Since a utility's initial investment to build its pipeline infrastructure is so expensive, having multiple utilities investing in pipeline to serve the same exact customers would be wasteful and inefficient. Therefore, only one natural gas distribution company typically serves a single customer. Because of this, natural gas distribution utilities are referred to as "natural monopolies." Normally, utilities operate most efficiently as monopolies, but with the potential market abuses of a monopoly. Competitive forces typically control prices for goods and services provided by most business organizations. The regulation of public utilities is intended to operate in lieu of those competitive forces.

The Texas Utilities Code, Titles 3 and 4 (the "Code") provide comprehensive regulation of gas utilities in lieu of natural competition. Regulatory authorities (the Commission and the Municipalities) are empowered by the Code to enact rules and regulations as necessary to adequately perform their statutory duties. Commission rules are not binding upon a municipality when it is exercising its original jurisdiction, but they are applicable when a case is appealed to the Commission and the municipality is a party to the appeal.

## **WHO HAS JURISDICTION OVER NATURAL GAS RATES IN TEXAS MUNICIPALITIES?**

The majority of Texas municipalities are served by investor owned utilities like SÍEnergy. Municipalities grant a franchise to a utility company, allowing the utility to utilize municipal right-of-ways and to operate within its boundaries. By law, municipalities have original jurisdiction over the rates, operations, and services of the natural gas distribution utility within the municipality. Utilities, however, may appeal to the Railroad Commission of Texas the decisions of municipalities in which they provide services.

The Railroad Commission has no authority over the rates, operations, and services of a municipally-owned gas utility operating within the municipality's boundaries unless there is an appeal to the Commission by 5% or more of the customers of the municipally-owned utility living outside the boundaries of the municipality. Any decision by the Railroad Commission will apply only to those customers living outside the boundaries of the municipality. Customers living inside the boundaries of the municipality must look to their municipal council to address rate issues.

## **WHEN DOES THE RAILROAD COMMISSION OF TEXAS HAVE JURISDICTION OVER A MUNICIPALITY'S NATURAL GAS RATES?**

By state statute, the municipality, as the regulatory authority, has a legal obligation to set rates that are just and reasonable. If the utility or any other party to the proceeding at the municipal level is not satisfied with the rates set by the municipality, they may appeal the municipality's rate ordinance to the Commission. Through the appeal process, rates will be determined through a formal evidentiary rate case proceeding. The municipality has standing to participate in this appeal as a party.

An appeal by any party of the rates set by Commission order would go to County District Court. The Commission monitors the overall quality of service and rates provided to a municipality by an investor owned utility. Through regular audits, the Commission assures, among other service issues that the utility charges its customers the rates which have been formally authorized, and orders refunds if customers have been overcharged.

## **DOES THE RAILROAD COMMISSION OF TEXAS HAVE JURISDICTION OVER ANY OTHER NATURAL GAS RATES?**

Yes, the Commission has exclusive original jurisdiction over natural gas utility rates in areas outside of municipalities. Areas adjacent to a municipality, and served by the same distribution system serving the municipality, are referred to as "environs." Areas outside and not adjacent to an incorporated municipality are referred to as "unincorporated areas" or can be "special rate areas" having rates applicable only to service by a given utility within a specified area and not specifically keyed to the rates charged in an incorporated area.

Also, the Commission has exclusive original jurisdiction over the rates and services of a utility, such as a natural gas pipeline, that delivers gas to a distribution utility, or "city gate rates".

## **CAN A UTILITY JUST CHANGE MY MUNICIPALITY'S NATURAL GAS RATES?**

A utility can propose to raise or lower the rates it charges to provide natural gas distribution service within a Municipality. Proposals to increase rates are most common. A utility must follow a specific, formal process to propose and implement a rate increase. But, a rate decrease can be implemented simply through the filing of a new tariff.

## WHAT IS THE PROCESS A UTILITY MUST FOLLOW TO PROPOSE A RATE INCREASE?

A utility must file a written statement of intent to increase rates with the municipality it serves and publish notices in a local newspaper for four successive weeks, and may not put the increased rates into effect until at least 35 days after filing the statement of intent. Upon the filing of a statement of intent, the Municipality may take one of several actions:

1. The Municipality may take no action at all, in which case the proposed rate increase will automatically take effect after day 35.
2. Unless the increase is “a major change” (i.e., one that would increase the aggregate revenues of the utility more than the greater of \$100,000 or 2.5 percent), the Municipality may allow an increase to take effect before the end of the 35 day period.
3. The Municipality may suspend the proposed rate increase for an additional 90 days beyond the 35th day (a total of 125 days from the date that the initial rate increase was filed). If, after 90 days from the date that the statement of intent of proposed rate increase was filed, the Municipality has not established final rates, the utility may put into effect a rate less than or equal to the proposed rate upon filing a bond payable to the Municipality. If, by the 125th day from the date the statement of intent was filed, the Municipality has not adopted a rate ordinance setting final rates, then the Municipality is considered to have approved the rates proposed by the utility, and they go into effect after the 125th day.
4. The Municipality may expressly deny any rate increase, in which case the utility may:
  - a) Maintain the existing rate schedule;
  - b) Appeal to the Commission the Municipality’s rate ordinance denying the requested increase in rates; or,
  - c) File with the Municipality a statement of intent proposing a different rate increase.
5. The Municipality may expressly grant a lower than requested rate increase, in which case the utility may:
  - a) Appeal to the Commission the Municipality’s rate ordinance denying the requested increase in rates and setting rates at a lower level than requested;
  - b) Put the new rates into effect (even though they are lower than the utility originally requested), and file with the Municipality a new statement of intent proposing another rate increase; or,
  - c) Simply put the new rates into effect (even though they are lower than the utility originally requested).
6. The Municipality may expressly approve the requested rate increase as filed.

## HOW OFTEN CAN A UTILITY PROPOSE A RATE INCREASE?

A utility can propose a rate increase as often as the utility desires. In practice, proposals to increase rates rarely occur more frequently than once per year. Often many years pass before a utility seeks a rate increase.

## IF A MUNICIPALITY DENIES A PROPOSED RATE INCREASE AND IT IS APPEALED TO THE COMMISSION OR DISTRICT COURT, WHAT EXPENSES WILL THE MUNICIPALITY AND ITS RATEPAYERS FACE?

The governing body of any municipality participating in or conducting ratemaking proceedings may select and engage rate consultants, accountants, auditors, attorneys, and/or engineers to advise and represent the municipality with litigation or natural gas utility ratemaking proceedings before any regulatory authority or in court. The natural gas utility engaged in those proceedings is required to reimburse the governing body for the costs of those services only to the extent that the costs are found reasonable by the applicable regulatory authority. The natural gas utility commonly recoups these costs along with its own reasonable rate case expenses by applying a surcharge, which is determined by the regulatory authority, to its utility rates for that particular municipality. This surcharge usually is applied on a per-customer or per-Mcf basis and is typically spread out over a period of time to reduce its impact on ratepayers. The regulatory authority typically monitors the amount of money collected under the surcharge to ensure that the utility does not over collect.



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