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MEMORANDUM

To: Public Service Commission

From: Division of Public Utilities
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Date: May 28, 2009

Subject: Evaluation of the Two New Standards Added to PURPA (Retail Policies for Natural Gas Utilities) by the 2007 Energy Independence & Securities Act (EISA) as set forth in Docket No. 08-999-06.

ISSUE

The Energy Independence and Security Act of 2007 (EISA) – at § 3203 (a) - requires the Utah Public Service Commission (Commission) consider and make a determination for integrating energy efficiency resources into utility, state, and regional plans. It also requires public notice and hearing on adoption of the standards listed in subsection (b), as well as adoption of those standards if they are found to be appropriate and consistent with state law.

15 USCS § 3203

§ 3203. Adoption of certain standards

(a) Adoption of standards. Not later than 2 years after the date of the enactment of this Act [enacted Nov. 9, 1978] (or after the enactment of the Energy Policy Act of 1992 [enacted Oct. 24, 1992] in the case of standards under paragraphs (3)[,] and (4) of subsection (b)), each State regulatory authority (with respect to each gas utility for which it has ratemaking authority) and

each non-regulated gas utility shall provide public notice and conduct a hearing respecting the standards established by subsection (b) and, on the basis of such hearing, shall--

- (1) adopt the standard established by subsection (b)(1) if, and to the extent, such authority or non-regulated utility determines that such adoption is appropriate and is consistent with otherwise applicable State law, and**
 - (2) adopt the standards established by paragraphs (2), (3), (4), (5), and (6) of subsection (b) if, and to the extent, such authority or non-regulated utility determines that such adoption is appropriate to carry out the purposes of this title [15 USCS §§ 3201 et seq.], is otherwise appropriate, and is consistent with otherwise applicable State law.**
- (c) Procedural requirements. Each State regulatory authority (with respect to each gas utility for which it has ratemaking authority) and each non-regulated gas utility, within the 2-year period specified in subsection (a), shall adopt, pursuant to subsection (a), each of the standards established by subsection (b) or, with respect to any such standard which is not adopted, such authority or non-regulated gas utility shall state in writing that it has determined not to adopt such standard, together with the reasons for such determination. Such statement of reasons shall be available to the public.**

This memo specifically addresses the addition of the two new natural gas Standards (5) and (6) from subsection § 3203 (b) of EISA):

(b) Establishment. The following Federal standards are hereby established:

Standard 5

- (5) *INTEGRATED RESOURCE PLANNING – Each natural gas utility shall***
(A) integrate energy efficiency resources into the plans and planning processes of the natural gas utility; and
(B) adopt policies that establish energy efficiency as a priority resource in the plans and planning processes of the natural gas utility. 15 USCS § 3203 (a) (5).

Standard 6

- (6) *Rate Design Modifications to Promote Energy Efficiency Investments-***
(A) In General- The rates allowed to be charged by a natural gas utility shall align utility incentives with the deployment of cost-effective energy efficiency.

(B) Policy Options- In complying with subparagraph (A), each State regulatory authority and each non-regulated utility shall consider—
(i) separating fixed-cost revenue recovery from the volume of transportation or sales service provided to the customer;
(ii) providing to utilities incentives for the successful management of energy efficiency programs, such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs;
(iii) promoting the impact on adoption of energy efficiency as one of the goals of retail rate design, recognizing that energy efficiency must be balanced with other objectives; and
(iv) adopting rate designs that encourage energy efficiency for each customer class. 15 USCS § 3203 (a) (6).

Questar Gas Company (the Company) is the only natural gas utility over which the Commission has comprehensive ratemaking authority and that the Commission determined is subject to these two new PURPA standards.

RECOMMENDATION: ADOPTION OF STANDARDS

Standard (5) and Standard (6) are appropriate for the state of Utah and are not inconsistent with state law. Regarding Standard (5) the Commission already has established standards in the Company's IRP process that meet the criteria set forth in this standard. The Division recommends the Commission formally adopt the new Standard (5) This Standard is current Commission policy.

The requirements in Standard 6 subtitle (A) and subtitle (B) also may be interpreted to conform with current Commission practice as witnessed by the creation of the CET tariff and subsequent promotion of the Company's DSM pilot programs as approved in Docket No. 05-057-T01¹, as well as the focus of on-going rate design issues presented in QGC's last rate case in Docket No. 07-057-13. The Division recommends the Commission adopt Standard (6).

¹ Commission orders issued May 26, 2006 and January 16, 2007, Docket No. 05-057-T01

BACKGROUND

On November 5, 2008, the Commission scheduled an informal proceeding to discuss the new integrated resource planning standard applicable to electric and gas utilities enacted by the 2007 Energy Independence and Security Act (EISA). As a result of this proceeding, the Commission scheduled a Technical Conference regarding the natural gas matters for January 27, 2009 in Docket No. 08-999-06. The following is the Division's conclusions from that technical conference and support for its recommendations.

ANALYSIS

Integrated Resource Planning

The Commission regulates only one investor owned gas utility in the state, Questar Gas Company. In September 1994, the Commission issued IRP standards for Mountain Fuel Supply Company (predecessor to Questar Gas Company). The Commission defined the IRP as a planning process used by the utility to evaluate possible resources as follows:

“to ensure that the Company's present and future customers are provided natural gas service at the lowest cost consistent with safe and reliable service, the fiscal requirements of a financially healthy utility and the long-run public interest.”²

With respect to integrated resource planning and demand-side resources, the Commission's Report and Order on Standards and Guidelines (Order) in Docket No. 91-057-09 states the following:

“The IRP must evaluate supply-side and demand-side resources on a consistent and comparable basis. Previous IRP's have not evaluated demand-side resources adequately. In order to provide an objective cost-effective measure for demand-side resources, the cost of gas avoided through conservation and energy efficiency measures must be calculated.”³

² Docket 91-057-09. “In the Matter of the Analysis of an Integrated Resource Plan for Mountain Fuel Supply Company, Guidelines for Integrated Resource Planning.” page 2.

³ Id. pages 7, 8.

In these pronouncements, issued as early as 1994, the Commission stated the importance of Demand Side Management programs as an integral part of the natural gas utility's IRP process. In December 1997, the Company filed a petition to modify the Standards and Guidelines for Integrated Resource Planning. In that petition, the Company acknowledged in their proposal that

“Utah regulatory agencies currently have an interest in gathering and transportation options, capacity turn-back, interruptible rates, *demand-side resource analysis*, daily balancing and no-notice transportation, and risk analysis.”⁴ (Italics added)

In an effort to further delineate and refine the IRP process, the Commission issued an order on March 31, 2009 in Docket No. 08-057-02 which again established the importance of DSM programs in the Company's IRP process. In that order, the Commission established the importance of the modeling assumptions used in demand-side management issues as well as the importance of the results of the total resource cost, ratepayer impact cost, utility cost and participant cost tests of those demand side management resources. The order also enumerates that the IRP planning horizon should be of sufficient length to economically evaluate viable energy efficiency measures.⁵

The Commission has well established policies in place that integrate energy efficiency resources into the plans and planning processes of the Company and has adopted policies that establish energy efficiency as an important resource in the Company's plans and planning processes. These policies clearly meet Standard (5), subtitle (A) and the Division recommends formal adoption of this subtitle.

Standard (5), subtitle (B) requires policies that establish demand side resources as a priority in the IRP process. Current IRP guidelines do not necessarily state demand side resources as a priority resource. However, demand side resources are an important consideration and an integral piece of data necessary in determining the overall gas

⁴ Docket 91-057-09, 95-057-04, 97-057-06 “Petition to Modify the Final Standards and Guidelines for Integrated Resource Planning for Mountain Fuel Supply Company.” Mountain Fuel Proposal Section, paragraph (f), December 19, 1997.

⁵ Docket No. 08-057-02, “Report and Order on Standards and Guidelines for Questar Gas Company”, Appendix A, §III, d, §IX, B, 1c, 8.

supply requirement. The Company is currently engaged in a pilot DSM program. The information necessary to determine the effectiveness of these DSM programs won't be gathered and analyzed until mid-year 2010. The resultant analysis of this data will facilitate a better understanding and determination about the effectiveness of the pilot DSM programs. Until that determination can be made, the Company and regulators are taking a more cautious approach, as witnessed in the recent reduction made to the rebates available in the Therm-Wise attic insulation program.⁶ A major issue at that time was, even though the engineered savings are cost effective and a continuation of the rebate at the higher amounts would ensure more participation, until actual data could be gathered and analyzed, regulators felt it would be more prudent to reduce the rebate amount until the total cost of the program, compared to its effectiveness in reducing natural gas usage, could be further analyzed. However, even though a more cautious approach has recently been advocated by regulators in reducing the rebate amounts in the insulation programs, the fact that total aggregate spending in all DSM programs has not been limited to budgeted amounts demonstrates the importance that regulators place on cost-effective demand side management programs as a priority resource.⁷ Because EISA requires formal adoption of this standard, the Division feels the Commission should adopt Standard (5), subtitle (B).

Rate Design Modifications to Promote Energy Efficiency

Standard (6), subtitle (A), states the rates that a natural gas utility be allowed to charge should align the incentives of a utility with providing cost-effective energy efficiency programs. At the conclusion of the rate case in Docket 02-057-02, as part of a stipulation, the Commission ordered the formation of a Task Force to study a variety of rate-design and cost-allocation issues for consideration in future proceedings.⁸ One result of that Task Force was a desire on the part of the parties to continue discussing the Company's declining usage per customer in the GS rate class and to seek possible solutions to that issue.⁹ That process resulted in a Joint Application

⁶ See Docket No. 09-057-T04

⁷ See Docket No. 07-057-05, Division Memo to Commission, Review of QGC 2008 DSM Programs.

⁸ Commission Report and Order, Docket No. 02-057-02, December 30, 2002, p42.

⁹ QGC COS & Rate Design Task Force Report, Docket No. 02-057-02, June 17, 2004, p5.

being filed with the Commission on December 16, 2005 requesting approval of the Commission for the Company to create a Conservation Enabling Tariff, as a pilot program, with the express purpose of separating fixed-cost recovery from the gas sales volumes. As part of the application, the Company agreed to actively pursue and promote DSM programs for the benefit of their customers in the GS rate class over the term of the pilot period.

The Commission approved the Joint Application on May 26, 2006. This established the CET tariff for the GS rate class as a three-year pilot program with a conditional one-year review. On January 16, 2007, the Commission approved the creation a suite of the DSM programs for the GS rate class on a three-year pilot program basis. The one-year CET review and continuation of the CET pilot program as a three-year pilot program was confirmed in a Commission order issued November 5, 2007. With the creation of the CET tariff, the Company is allowed to accrue and eventually collect the difference between what is collected in volumetric rates and what is “allowed” based on a pre-determined revenue amount per customer, thus separating or decoupling the fixed-cost recovery from the volume of sales service provided to the GS rate class customer. Creation of the CET tariff, by the Commission, removed a disincentive for the Company to actively pursue offering cost-effective DSM program to the customers in the GS rate class, but does not necessarily encourage or incent the Company to pursue these programs.

Standard (6), subtitle (B) offers some policy options that regulators may consider in order to comply with the general purpose stated in Standard (6), subtitle (A). A key phrase found in Standard (6), subtitle (B) forms the basis of the Division’s recommendation to adopt Standard (6). That phrase is “each State regulatory authority and each non-regulated utility *shall consider*”¹⁰ (Italics added).

¹⁰ See Standard (6) subtitle (B) cited above.

With the approval of the CET tariff as a pilot program, the requirement of Standard (6), subtitle (B), option (i) for the sales customers of the GS rate class is met.¹¹ The CET tariff does separate the fixed-cost revenue recovery from the volume of sales service for 91% of the retail sales volumes which covers 99.9% of all customers. The other 9% of system sales volumes represents customers who comprise both large commercial and industrial customers. Although not opposed to the CET tariff, these large commercial and industrial customers requested to opt out of the CET pilot program at the time of its inception. These customers pursue gas demand-side management programs on their own based on the cost-benefit of those programs. Large commercial and industrial customers must consider the most economic and efficient use of natural gas in order to remain competitive. This competitive environment drives them to consider and balance energy efficiency with the other objectives of their economic existence as part of their overall business plan.

In reviewing the language of Standard (6), subtitle (B), option (ii) the term “incentive” is used “...such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs”¹². By approving the CET tariff for the GS rate class, the Commission effectively removed any “disincentive” for the Company to actively promote DSM programs to its customers by decoupling the fixed cost recovery portion of costs through its revenue from the sales volumes and volumetric rates. However, the CET does not incent the Company to pursue DSM programs in any particular way. Rather, the Company’s aggressive pursuit of energy efficiency is the result of its commitment to do so in exchange for approval of the CET pilot program. Consistent with the “requirement” standard in the EIAS, the issue of whether the decoupling of rates should include further incentives for Company performance was discussed and considered by the Commission in Docket No. 05-057-T01 as well as the just concluded rate case in Docket No. 07-057-13. However, from those orders it does not appear that an “incentive” was considered for the successful management of energy efficient programs as required in subtitle (B), option (ii). The Commission did find that the existence of the CET tariff

¹¹ Docket 05-057-T01, In the Matter of the Approval of the Conservation Enabling Tariff Adjustment Option and Accounting Orders, a Joint Application of Questar Gas Company, the Division of Public Utilities and Utah Clean Energy.

¹² See Standard (6) subtitle (B), option (ii) cited above.

did reduce the risk to the Company but was unable to determine a precise measurement of how much of a reduction in risk the CET provides in determining an appropriate rate of return or if a reduction is required at all.¹³

In the technical conference held on January 27, 2009 in Docket No 08-999-06, the Company expressed a strong interest in exploring the concept of the Company being able to retain a portion of the cost-reducing benefits accruing from the DSM programs. As further evidence that this policy option is being considered, a non-binding 2009 Utah State Legislative Joint Resolution was issued which states:

BE IT FURTHER RESOLVED that the Legislature urges the Public Service Commission to allow electric and natural gas utilities to earn a profit on their investments in cost-effective energy efficiency and load management programs, with the level of profit tied to the level of energy savings achieved, the net economic benefits provided by the energy efficiency and local management programs, or some other indicator of program performance.¹⁴

Regarding Standard (6), subtitle (B), options (iii) and (iv), the Company's current rate design, for the most part, does not encourage energy efficiency for the GS class. In the Company's last rate case filed in December 2007 (Docket No. 07-057-13), a residential rate design proposal was put forth that began to move toward a rate design that would encourage more energy efficiency. In particular, the Company proposed splitting the GS rate class into separate residential and commercial classes as well as recommending a restructuring of the current declining block rate to a flat rate design for the GS residential rate class. The parties in that case could not decide on the best approach to take in splitting the GS rate class therefore, the Commission, in its order, directed parties to continue to examine other bases for dividing the GS class.¹⁵ The major challenge that exists is how to change the current rate design paradigm. The desired objective in

¹³ Order, Docket No. 05-057-T01, page 11, November 5, 2007; Report and Order on Revenue Requirement, Docket No. 07-057-13, page 14, June 27, 2008.

¹⁴ H.J.R. 9 Joint Resolution on Cost-Effective Energy Efficiency and Utility Demand-Side Management, 2009 General Session State of Utah.

¹⁵ Report and Order on Cost of Service and Rate Design, Docket No. 07-057-13, December 22, 2007, p7.

changing this paradigm is moving from the traditional approach in rate design of reflecting the cost of service or cost causation through monthly fixed charges and declining block rates to rate designs that encourage more efficient use of the natural gas resource while preserving a fair allocation of costs to each rate class. The Commission reaffirmed this objective in its December 22, 2008 order when it stated:

‘To this end, rate classes should be relatively homogeneous so that total system costs can be fairly allocated to each class based on the cost of providing service. The design of appropriately specified classes promotes intra-class equity while allowing for simple and well understood rate designs that promote *energy efficiency and resource conservation*.¹⁶(Italics added)

Based upon the cases and decisions cited above, the Commission has clearly considered and will continue to consider the policy options outlined in subtitle (B) of Standard (6).

CONCLUSION

The new natural gas standards put forth as part of the 2007 EISA is already a major consideration by the Commission and the Company and is a major goal of the State of Utah as evidenced by the following joint resolution of the 2009 Utah State Legislature.

“BE IT FURTHER RESOLVED that the Legislature expresses support for cost-effective energy efficiency and load management programs by customers of Questar Gas and the setting of a natural gas savings goal through a regulatory process that includes Questar Gas, utility regulators, utility customers, and other interested parties designed to reduce projected natural gas sales by an amount equal to not less than 0.5% of its annual retail sales and that do not penalize the utility if it fails to meet the savings goals so long as it makes a good faith effort to meet the goals.”¹⁷

¹⁶ Id. p7.

¹⁷ H.J.R. 9 Joint Resolution on Cost-Effective Energy Efficiency and Utility Demand-Side Management, 2009 General Session State of Utah.

The Division concludes the Commission should formally adopt the new PURPA gas Standards (5) and Standard (6) for natural gas utilities as required because those standards essentially are already in place or are currently being considered and are consistent with current State law. The Commission's past and present IRP and DSM standards for a natural gas utility meet the new standards adopted in the 2007 EISA statement under consideration in this Docket.