

# Natural Gas Pricing – Part II

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Natural Gas Pricing - Part II --  
Presentation 7

Extraordinary and volatile costs may require separate mechanisms for recovery outside of the base rate.



# Mechanisms for recovering extraordinary costs

- Automatic Adjustment Clauses
- Deferral Accounting via Regulatory Asset
- Alternative Regulation

# Automatic Adjustment Clauses

- A set of rules for adjusting charges to ratepayers in response to price changes.
- Can be used to manage cash flow issues by having a mechanism to adjust charges as prices change.
- Should only be utilized when expenses are extraordinary, volatile, or new and unaccounted for in the previous rate case.

# Automatic Adjustment Clauses

- Appears separate from base rates on your bill.
- Costs recovered through the clause should not be included in the base rate, or utility will over-collect!
- Collected from customers via billing factors.
- Adjustment times vary on a case by case basis.
- May or may not require formal hearing.

# Sample Calculation of billing factors

- Assuming the regulatory authority has allowed the utility to recover \$500,000 of yearly extraordinary costs not included in the base rate:

Customer class	Allocated cost	MMBTU (per year)	Billing factors (per mmbtu)
Residential	250,000	5,000,000	0.05
Commercial	150,000	3,000,000	0.05
Industrial	100,000	1,000,000	0.1
Totals	500,000	9,000,000	0.06

# The “True-up” Concept

- If usage patterns change, and the utility does not collect its actual cost, then remaining costs are recovered in a subsequent period through a “true-up” of next year’s billing factors.

# Example of a true-up calculation

- If usage patterns changed, and actual costs were not recovered:

Customer class	Allocated cost	Actual recovered	Diff.	MMBTU (per year)	True-up added to next yr (per mmbtu)
Residential	250,000	248,000	2,000	5,000,000	0.0004
Commercial	150,000	148,000	2,000	3,000,000	0.0007
Industrial	100,000	98,000	2,000	1,000,000	0.002
Totals	500,000	494,000	6,000	9,000,000	0.0007

# Automatic Adjustment Clauses

- Examples of costs that have required an automatic adjustment clause
  - Extraordinary Storm costs
  - Pipeline integrity costs
  - Gas in storage investment costs
  - Demand side management costs
  - Fuel costs

# Purchased Gas Adjustment Clause

- Designed to collect the actual cost of fuel from customers.
- Fuel costs are highly volatile and unpredictable.
- Fuel cost in base rates could create massive earnings swings for utilities, which would be detrimental to both utilities and consumers.
- Fuel costs in base rates = more frequent rate cases

# Purchased Gas Adjustment Clause

- Over or under collected amounts are deferred and collected (trued-up) in the subsequent billing cycle
- Over or under collected amounts change during peak and off-peak seasons
- Volatile gas prices may create unusually high over or under-recovered amounts
  - Example: Public Service Company of Oklahoma, \$100,000,000 of under-recovered fuel costs following 2005 natural gas price spike caused by Hurricanes Katrina & Rita.



# Purchased Gas Adjustment Clause

- Adjustment times vary
  - Annual
  - Semi-annual
  - Quarterly
  - Monthly
- More frequent changes equal less over/under collected dollars, but more price volatility.
- Less frequent changes may equal higher over/under collected dollars, but more price stability.
- Less frequent changes may also cause “rate shock.”

# Monitoring and Auditing Automatic Adjustment Clauses

- Varies on a case by case basis
- Purchased Gas Adjustment Clauses are audited on a yearly basis.
  - Monitored on a monthly basis.
- Government oversight plays vital role in ensuring proper management of costs.
- Annual audits of all automatic adjustment clauses require “prudence” reviews.

# Criticisms of Automatic Adjustment Clauses

- Factors adjusted automatically without regulatory approvals may promote inefficiency.
- Collection of actual costs may not encourage utilities to spend wisely.
- Finding imprudence is difficult for regulators.

# Regulatory Asset Example

- Investments included in Rate Base because the regulating authority has previously addressed the merits surrounding the issue and determined that it is in the interest of stakeholders to allow the utility to recover such an investment as a part of rates currently being charged.



# Alternative Regulation

- Price Caps
- Revenue Caps
- Revenue Decoupling
- Earnings Sharing Mechanisms
  - referred to as performance based regulation (PBR) in Oklahoma