GAS RATE FUNDAMENTALS

Fourth Edition
1987

American Gas Association Rate Committee
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GAS RATE FUNDAMENTALS
Fourth Edition

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Foreword

GAS RATE FUNDAMENTALS—Fourth Edition

Gas Rate Fundamentals first appeared in 1960. The book was sponsored by the Rate Committee of the American Gas Association as a reference work on gas rate fundamentals and practices. That edition was "a collection of papers especially proposed by rate men in various segments of the gas industry." A revised edition was issued in 1969, then a Third Edition was published in 1978. Like its predecessors, this Fourth Edition reflects some modest revisions as well as some rather extensive editing of particular chapters. During this latest rewriting effort, the gas industry was changing rapidly. Thus, some chapters may not fully describe important but very recent developments.

Each chapter in this edition was revised by a member of the Rate Committee as well as by the editor. The chapters then were reviewed by other members of the committee. Therefore, the book reflects the work and views of many individual rate professionals. Some members of the Rate Committee may hold views that differ from those presented in this work. Similarly, the publication of *Gas Rate Fundamentals* by the American Gas Association does not imply that the thoughts, viewpoints, and positions expressed are necessarily those of the Association or its member companies.

Because ratemaking is a dynamic art, readers must judge the principles set forth here in the light of their own particular circumstances. They must look beyond the scope of this reference work to determine which ideas are relevant and appropriate to them. In any case, the Fourth Edition of *Gas Rate Fundamentals* continues a tradition begun more than 25 years ago. The book describes principles and practices that will help gas industry rate men and women do their jobs in a technically competent way.

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The Fourth Edition of

GAS RATE FUNDAMENTALS

has been sponsored and prepared by the

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Contents

INTRODUCTION xvii

Gas Utilities in the United States xviii
What Is a Public Utility xviii
Characteristics of Gas Public Utilities xviii

CHAPTER 1: HISTORY OF THE GAS INDUSTRY 1

Manufactured Gas 1
The Lowe Process and Subsequent Developments 3
The Transition to Natural Gas 4
Growth of the Natural Gas Industry 10
Development of Natural Gas Pipeline Companies 11
Pipeline Expansion After World War II 16

CHAPTER 2: NATURAL GAS ECONOMICS 21

Origin of Natural Gas 21
Finding Natural Gas 23
The Production Process 26
Gas Production Economics 27
Long-Term Marketing Commitments 29
Regulation and Prices 33
Natural Gas Use 35
Gas Fuel Advantages 36
Gas Consumption 38
Interfuel Substitution 46
Looking Ahead 48

CHAPTER 3: FUTURE ENERGY SUPPLIES AND NEEDS 51

Total Energy Supply and Demand 51
Future Gas Supplies 53

Conventional Gas Resources 53
Incremental Supply Sources 55
Canadian Gas 56
Mexican Gas 56
LNG Imports 56
Alaskan Gas 57
Coal Gasification 58
SNG from Liquid Hydrocarbons 59
Nonconventional Sources of Methane 60
Future Gas Demand 64
Future Industry Developments 69

CHAPTER 4: THE DEVELOPMENT OF PUBLIC UTILITY REGULATION 71

Early Attempts at Regulation 71
Early History of Regulation 72
Regulation During the 19th Century 73
The Modern Day Regulatory Commission 75
Inadequacies of the State Regulatory Commissions 76
The Development of Federal Regulation 77
Federal Power Act, 1935 78
Public Utility Holding Company Act, 1935 79
The National Energy Act of 1978 80
Guiding Decisions of Courts and Commissions 81
Fair Value Theory–Smyth vs Ames, 1898 82
The Prudent Investment Concept–
Southwestern Bell Telephone, 1923 83
Rate of Return–Bluefield Water Works, 1923 85
Reproduction Cost Concept–
Los Angeles Gas & Electric, 1933 85
End Result Theory–Hope Natural Gas Co, 1944 86
Unilateral Contract Agreements–
Mobile and Sierra Decisions, 1956 87
Validity of Section 4 of the Natural Gas Act–
City of Memphis, 1958 88
A Look to the Future 90

CHAPTER 5: REGULATION OF THE GAS INDUSTRY 91

Segments of the Gas Industry 91
Natural Gas Act of 1938 92
The Supreme Court Upholds the Natural Gas Act 94
Fair Field Price Theory 95

Cost Allocation and Rate Design–
The Atlantic Seaboard Formula 97
The United Formula 98
Regulation of Producer Prices–The Phillips Decision 98
Area Rate Approach 100
Rate Escalation Provisions 102
Purchased Gas Adjustment Provisions 102
The Emergency Natural Gas Act of 1977 103
The Department of Energy Reorganization Act 104
The Public Utility Regulatory Policies Act (PURPA) 104
The Natural Gas Policy Act (NGPA) 104
Competition and Regulation 105
Blanket Certificate Gas Transportation Programs 106
Special Marketing Programs (SMPS) 107
Minimum Commodity Bills–Order No 380 108
District of Columbia Court of Appeals Decisions 108
Pipeline Regulation After Partial Wellhead Decontrol–
Order Nos. 436 and 436A 109
Regulation and the Transition to a Deregulated Industry 110
Foreign Supplies and Regulation 111

CHAPTER 6: LOAD STUDIES AND ANALYSIS 115

Load Characteristics 115
Load Studies 116
Load Testing Methods 116
Statistical Sampling 117
Load Research Test Equipment 118
Space Heating Load Studies 119
Other Residential Uses 123
Commercial Load Studies 124
Industrial Load Studies 125
Summary 130

CHAPTER 7: COST ALLOCATION STUDIES 131

Embedded Cost-of-Service Studies 131
The Cost-of-Service Study Process 138
Allocation of Plant Costs and Related Expenses 139
Adjustments to Basic Data 139
Selecting Classes of Service 140
Segregating Directly Assignable Costs 140
Rearranging Costs into Functional Groups 141
Allocation Factors 141
Allocation of Special Costs 145

Revenue Requirements and Unit Costs 149

CHAPTER 8: FUNDAMENTALS OF UTILITY PRICING 151

Pricing the Service 151
Rate Objectives and Methodologies 152
Value of Service 156
Price Discrimination and Price Differentiation 158
Availability of Gas Supply 159
Interruptible Service 159
Transportation Service 160
Summary 161

CHAPTER 9: RATE FORMS 163

Flat Rate 163
Straight Line Meter Rate 164
Step Meter Rate 166
Block Meter Rate 167
Demand Rates 169
Variable Rates 174
Minimum, Service and Customer Charges 175
Price Adjustments 176
Refund Provisions 178

CHAPTER 10: RATE OPTIONS FOR GAS SERVICE 179

Federal Energy Legislation 179
Residential Rates 180
Commercial Rates 181
Industrial Rates for Non-Interruptible Service 181
Industrial Rates for Interruptible Service 181
Experimental Rates 182
Space Heating Rates 183
Off-Peak Service and Seasonal Service Rates 183
Future Developments in Rate Design 184

CHAPTER 11: THE TARIFF 185

The Tariff 185
Rate Schedule Provisions 185
Tariff Contents and Definitions 187

CHAPTER 12: PIPELINE COST ALLOCATION AND RATEMAKING 193

The Natural Gas Act 193

FERC General Rules and Regulations 194
The Cost of Service 195
Cost Classification and Allocation 197
Ratemaking 205
Pipeline Rates 206
The Tariff 208

CHAPTER 13: CLASSIFICATION AND ANALYSIS OF SALES AND REVENUES 211

Classification of Customers 211
Sales and Revenue Analysis 217

CHAPTER 14: LOAD FORECASTING 219

Forecasting and Ratemaking 219
The Forecaster's Changing Problems 220
Residential 221
Commercial 223
Industrial: Firm Sales 225
Industrial: Interruptible Sales 226
Resale 226
Unaccounted-for Gas 227
Company Use 227
The Gas Balance 228
Peak Day Requirements 229
Revenues 231
Forecasting by Econometric Models 231
Traditional Versus Econometric Forecasting 232

CHAPTER 15: BILL AND CONSUMPTION ANALYSIS 235

Rate Formula 235
Rate Schedule Graphs 237
Typical Bill Comparisons 239
Competitive Cost Comparisons 240
The Impact of Rates on the Company's Revenue 243
Manual Computation of Bills 246
Bill Frequency Distribution Analysis Method 246
Ogive Method 251
Least Squares Method 253

CHAPTER 16: THE RATE DEPARTMENT 255

Responsibilities 255
Monitoring Current Rate and Economic Issues 256

The Rate Case 256
Rate Administration 256
Functions 257
Organization 257

CHAPTER 17: THE RATE CASE 263

Importance of a Rate Case 263
Planning the Rate Case 263
Applications for Rate Increases 266
Legal Setting 266
Hearing Procedure 267
Exhibits and Testimony 267
The Company's Direct Case 268
Jurisdictional Separation 270
Cross Examination and Rebuttal 271
Intervenors 272
Orders and Decisions 273
Public Relations 273
FERC Rate Case Peculiarities 274

REFERENCES 277

ABBREVIATIONS 287

CONVERSION FACTORS 297

INDEX 303

APPENDIX A: ALLOCATED COST-OF-SERVICE STUDY A–1

APPENDIX B: FERC GAS TARIFF–
THIRD REVISED VOLUME NO. 1 ..... B–1

APPENDIX C: CLASS-OF-SERVICE DEFINITIONS C–1

Tables and Figures

TABLES

1-1. Manufactured Gas Production Costs, 1939-1948 5
1-2. Transition of Gas Industry, 1940-1958 9
1-3. Natural Gas Production – Leading State 13
1-4. Load Factor and Costs 17
1-5. Major Interstate Natural Gas Pipeline Companies with Gross Gas Plant in Excess of 100 Million Dollars: 1984 18-20
2-1. Estimated Total Proved Reserves and Net Production of Natural Gas 23
2-2. Gas Wells: Cost per Foot by Depth of Well 24
2-3. Gas Use: 1984 35
2-4. Gas Appliances: 1981 36
2-5. Average Residential Gas Use: 1982 36
2-6. Residential Gas Use: 1980 42
3-1. Alaskan Gas Recoverable Resources 58
3-2. Production Potential of Natural Gas Supply Sources 65
3-3. Future Gas Demand 68
3-4. Outlook for Total Gas Demand 70
6-1. Sample Space-Heating Load Characteristics 120
6-2. Sample Commercial Customer Load Characteristics Data 126
6-3. Sample Industrial Customer Load Characteristics 128
7-1. Gas Plant Accounts 133
7-2. Assignment and Allocation of Costs 135
7-3. Functions and Cost Causation Components 138
7-4. Cost of Service Study Functional Service Levels 142
7-5. Cost Allocation by Coincident Demand 143
7-6. Cost Allocation by Non-Coincident Demand 144
7-7. Cost Allocation by Average and Excess Demand 146

12-1. Impact of Various Cost Classification Methods on Jurisdictional Cost of Service and Revenue Requirements 202
13-1. Customers, Sales and Revenues for a Gas Distribution Company: 1979, 1981 and 1983 218
15-1. Residential Gas Service, Typical Bill Comparison Present and Proposed Rates 240
15-2. Comparison of Competitive Monthly Operating Costs for Electricity and Gas – Residential Service 241-242
15-3.. Space Heating, Comparison of Competitive Annual Costs Electricity and Gas 244-245
15-4. Bill Frequency Distribution – 1983 247-248
15-5. Computation of Revenue Using a Bill Frequency Distribution 250
15-6. Estimating Revenues by Revenue Formula 254
16-1. Rate Functions by Department Size 258-259

FIGURES

1-1. Total gas utility sales by census division 10
1-2. Total gas utility sales by class of service 11
2-1. Natural gas consumption in the U.S. 1960-1984 39
2-2. Fuel consumption in the U.S. by type – 1960-1984 39
2-3. Natural gas sales by region and sector – 1984 40
2-4. Consumption of natural gas by end-use sector – 1960-1984 41
2-5. Natural gas use per residential customer by region – 1975, 1980 and 1984 43
2-6. Industrial gas consumption – 1984 43
2-7. Industrial energy consumption market shares – 1974-1984 44
2-8. Industrial output, energy use, and energy per unit of output 45
2-9. Electric power generation by energy source – 1975-1984 46
3-1. U.S. natural gas and total energy use – 2000 52
3-2. Natural gas production vs. additions: Lower 48 states – 1960-1984 54
6-1. Relationship between hourly heating demand per customer and hourly temperature 121
6-2. Average daily heating load per customer related to average daily temperature (weekdays only) 122

6–3. Actual per customer daily heating load curves compared with estimated load curves (for selected cold days) 123
6–4. Load curve of non-heating use of house heating customer 124
6–5. Illustrative cooking load curve 125
6–6. Load curves of various commercial classifications 127
6–7. Load curves of various industrial classifications 129
8–1. Quasi-optimal pricing given a total revenue constraint 157
9–1. Illustrative flat rate 164
9–2. Illustrative straight line meter rate 165
9–3. Illustrative step rate 166
9–4. Sample application of the step meter rate 167
9–5. Illustrative block rate 168
9–6. Sample application of the block meter rate 169
9–7. Sample application of gas rate with low load factor adjustment 170
9–8. Illustrative Hopkinson demand rate 171
9–9. Sample application of the Hopkinson demand rate 172
9–10. Hopkinson demand rate relationship between load factor and total bill 172
9–11. Illustrative Wright demand rate 173
9–12. Sample application of the Wright demand rate 174
9–13. Wright demand rate relationship between load factor and average rate 175
14–1. Daily sendout of gas during the heating season 230
15–1. Graphic representation of a bill computation 237
15–2. Block rates as hyperbolic curves 238
15–3. Converting block rates to straight lines 239
15–4. Ogive curve: cumulative frequency curve of consolidated factor 252

Introduction

Ratemaking for public utilities involves the application of the principles of economics, engineering, accounting, statistics, law, and public relations. While this is true of ratemaking for all types of public utility enterprises – railroad, telephone, water, electric, and gas – *Gas Rate Fundamentals* applies particularly to gas utilities. Two types of gas companies are described in this reference work:

- A gas *distribution* company is an enterprise that furnishes gas service within its own service area, principally to end-use consumers. Such a utility may also produce and transport part of the gas that it supplies to its customers.
- A gas *transmission* company (i.e., pipeline company) is an enterprise that transports gas from production areas to distribution service areas. Its customers are primarily gas distribution utilities. A pipeline may also produce a part or all of the gas that it transports and it may have some distribution operations.

While gas production companies are mentioned, their operations are not described in any detail in this book.

A proper understanding of ratemaking requires a general knowledge of the history of the gas industry as well as an appreciation of the economics of gas production, transmission, and distribution. Present rate structures reflect historical considerations as well as economic factors. Today, it is impossible for a rate person of a pipeline or distribution company to carry out his or her duties without a general knowledge of other aspects of the gas industry. Moreover, the rate analyst must recognize the mutual responsibilities of each segment of the industry (i.e., production, pipeline transmission, and local distribution). A listing of abbreviations used in the gas industry and a numerical conversion table can be found at the back of the book. A useful companion reference, published separately, is A.G.A.'s Glossary for the Gas Industry.[1]

[1]American Gas Association, *Glossary for The Gas Industry,* 1986.

GAS UTILITIES IN THE UNITED STATES

In 1985, gas utilities in the United States transported and distributed 132 million therms (a therm equals 100,000 Btus) of energy to 50 million customers. The utilities' total revenues were $63.3 billion. To provide this amount of service, the utilities required plant and equipment having a book cost of $87 billion. To furnish future service, the industry invested an additional $5.7 billion in 1984 for new construction and to maintain deliverability.

This giant industry began with the Gas Light Company of Baltimore in 1816, followed by the Boston Gas Light Company in 1822 and the New York Gas Light Company in 1825, to name only the first three enterprises. These early utilities distributed *manufactured* gas. It was used principally for lighting. Gas ranges for cooking came later – in 1851.

Natural gas was first distributed in 1821 in Fredonia, New York. It was, however, 1858 before the first recorded corporation to offer natural gas service was organized, also in Fredonia. For many years thereafter, natural gas was distributed on a small scale in communities near gas fields. As more and more gas fields were discovered, the distribution of natural gas expanded. In the early 1930s, improvements in the manufacture of pipe made long distance pipelines possible. These brought natural gas from the southwest producing areas to the midwest. This caused manufactured gas companies to convert to natural gas or mixed gas operations. After 1945, manufactured gas was supplanted by natural gas because of its economic advantages to utilities and customers alike.

WHAT IS A PUBLIC UTILITY?

A public utility is an entity that furnishes an essential service and operates under grants of public privilege. In brief, it is a business affected with the public interest that operates under a franchise or license issued by a governmental agency. Generally, a utility has a monopoly or partial monopoly on its particular service within a clearly defined area. The firm, however, is not protected from the competition posed by other forms of energy or service. A utility is subject to public regulation – the open scrutiny of its accounting, financing, earnings, pricing, and service policies.

CHARACTERISTICS OF GAS PUBLIC UTILITIES

The unique characteristics of gas public utilities include: