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# The Second Time Around:

## Gas Utility Regulatory Responses During Recessionary Periods

**By Russell A. Feingold**

Vice President, Rate & Regulatory  
Black & Veatch Management Consulting

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# Operating in Uncharted Territory

The personal and broader societal impacts of today's world-wide coronavirus pandemic are unprecedented.

And economically, we are experiencing new and unanticipated challenges from both a business and individual perspective. These challenges also are quickly beginning to impact the regulatory and ratemaking activities of gas distribution utilities in the United States. Interestingly, the impacts on gas distribution utilities today are in many respects different from those that were experienced during and after the 2008-2009 Great Recession. As such, today's business challenges will require the creation of well-conceived and meaningful ratemaking solutions and regulatory policies that recognize the uniqueness of the current situation.

**Clearly, the impact on our economic and social conditions caused by the COVID-19 pandemic has occurred much more rapidly and dramatically than during the 2008-2009 period.**

Today we are experiencing wider and much more encompassing social impacts, with "stay at home" restrictions put into place by states creating new challenges on how business can continue to be conducted effectively – and how we manage our daily lives. Unemployment has increased faster and more dramatically than in the 2008-2009 period.



**Today's business challenges will require the creation of well-conceived and meaningful ratemaking solutions...**



The resulting uncertainty induces people to postpone spending and businesses to defer or scrap investment plans.

This time around could be longer and more severe than during the 2008-2009 period. And perhaps the only good news today as it relates to energy resources is that natural gas prices are relatively low and stable compared to the record high and very volatile natural gas prices that were experienced during the 2008-2009 period. At least this is one energy burden that is off-the-table this time around.



# Issues for Gas Distribution Utilities and Regulators

**With this as a backdrop, there are several important regulatory and ratemaking issues faced by gas distribution utilities today that we believe are critical for utility regulators to address in the near-term, including:**

- Ratemaking recognition of the decline in natural gas usage and the unanticipated costs directly related to responding to COVID-19, and the impact these conditions will have on the utility's near-term financial performance;
- Implementing ratemaking solutions that can provide ratepayer protections and temporary utility bill relief for those customers who have the greatest need;
- Determining how the conduct of pending utility rate cases can be managed to minimize delays and to preserve the rate case evidentiary process; and
- Finding a mix of workable ratemaking solutions to ensure that a fair and reasonable balance is achieved between the needs and interests of the utility's customers and its shareholders.

The decline in natural gas usage (greater in the C&I markets, less so in the Residential market) being experienced today by gas distribution utilities underscores the need for revenue certainty. Unanticipated costs directly related to responding to COVID-19 creates the need for incremental cost recovery methods.

Continued funding of Incremental capital and O&M needs by gas distribution utilities highlights the need for revenue sufficiency. At the same time, there are growing regulatory concerns over customers' bill payment problems and the need to consider short-term remedies such as temporarily reducing customers' gas bills and other ratepayer protections in the form of suspension of disconnections for non-payment, waivers of deposits, late fees and service reconnect fees.

However, the impact of such actions likely will result in an increase in the level of uncollectible expenses (bad debt) incurred by gas distribution utilities, which is a cost of doing business that the utility is entitled to recover through rates.

**Finally, the periodic and timely conduct of utility rate cases before regulators is being affected by planned rate filings that are being delayed by utilities and current rate case schedules that are being extended by regulators.**

Both actions will certainly make it more difficult for gas distribution utilities to meet the financial expectations of their shareholders and lenders.

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# Finding Near-Term Solutions

**There is nothing new in utility regulators having to balance several and often conflicting objectives when establishing regulatory policies and setting rates for a gas distribution utility.**

- Addressing the challenges described above created by the coronavirus pandemic is no different. It is critically important that utility regulators find a combination of workable ratemaking solutions to address these impacts to ensure that a fair and reasonable balance is achieved to accommodate the interests of the utility's customers and its shareholders.
- For example, providing customers with temporary relief from utility service and other regular fees to moderate the level of natural gas bills has to be carefully weighed against preserving the utility's near-term financial performance which can impact cash flow and earnings and negatively impact the utility's credit ratings and stock price (which can have a longer-term impact on customers' natural gas rates).
- Revenue certainty for gas distribution utilities can be addressed through the operation of revenue decoupling mechanisms. This mechanism protects customers and the utility from the variability of revenues attributable to factors which are, in general, largely driven by factors beyond the utility's control, such as changes in weather and economic conditions.

**Today, there is greater recognition of the importance of revenue certainty with revenue decoupling mechanisms approved in most of the states in the U.S.**

In contrast, during the 2008-2009 period, revenue decoupling mechanisms were approved in only 18 states. Despite the greater acceptance of revenue decoupling mechanisms, absent a revenue growth factor to replace growth in sales, revenue decoupling will not address a utility's ongoing need for incremental revenue to fund a utility's infrastructure investments and increases in operating expenses (beyond the level approved in the utility's last rate case).

**Revenue sufficiency can be addressed with other types of rate mechanisms and ratemaking processes such as:**

- **Rate Stabilization Mechanisms and Formula Rate Plans (which have been approved for utilities primarily in southern states)** – which promotes the full and timely recovery of utility costs, and where there are a greater number of states that have them today compared to the 2008-2009 period;
- **Use of a Future Test Year** - which minimizes regulatory lag and better matches costs with revenues and rates and where there are a greater number of states that use them today to set rates compared to the 2008-2009 period;
- **Bad Debt Ratemaking Mechanisms** – some states have approved these mechanisms which enable the gas distribution utility to reflect in rates on a more current basis any changes in the level of bad debt (i.e., uncollectible expenses);
- **Treat unanticipated costs** directly related to responding to COVID-19 for recovery through a future rate case (with a 2020 test year), as a regulatory asset for future recovery or establish or through a temporary cost recovery mechanism; and
- **Rate Case Filings** - a significant increase in the number of rate cases were filed in 2010 (after the end of the Great Recession), but we do not anticipate there will be a similar jump in rate case filings over the next 1 to 2 years with the increased number of ratemaking mechanisms in operation today.

Finally, gas distribution utilities during this period will need to carefully manage their CAPEX and OPEX levels so that the resulting rate impacts to customers can be moderated as these investments and operating expenses are approved by regulators and included in rates.



# The New Business-As-Usual

When we eventually emerge from the current COVID-19 pandemic situation, business-as-usual will undoubtedly find a new “normal.”

Ways of doing business may forever be changed from past practices. While the highest priority for all businesses will be to assess the economic damage and take actions to recover to the fullest extent possible, we should expect there will be a period of time in which the lessons learned from dealing with the impacts of the pandemic will be closely examined to determine if the level of business has fundamentally changed.

- Perhaps more importantly, each part of the world must figure out how we should deal with a possible secondary virus outbreak within the next year to be able to minimize its impact on business activity and society.



“ Ways of doing business may forever be changed from past practices. ”

**For gas distribution utilities and regulators, a key question will be how do you minimize the impacts on utility customers and shareholders from another major pandemic-like disruption?**

- Judicial adoption of ratemaking mechanisms where impacts are greatest makes sense to offset some of the negative financial results so long as a fair and equitable balance can be preserved between the interests of utility customers and shareholders.
- In addition, the longer-term implications of a regulator taking immediate action to provide temporary utility bill relief to customers may be higher future utility rates when the gas distribution utility is permitted to recover lost revenues and/or increased uncollectible expenses from all customers.
- Moreover, regulatory suspension of certain utility non-rate schedule charges may not target those customers most in need of the short-term economic relief that is provided through this kind of short-term remedy.
- At the end of the day, gas distribution utilities and regulators will have to exercise judgment in deciding the degree to which the balance inherent in the longstanding regulatory compact defining the relationship between utility and regulator can be temporarily tilted to address the most urgent needs of either the utility's customers or shareholders without disadvantaging the other group in the process.

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