

The Public Service Commission Should Deny National Fuel's Request for a Rate Hike

Summary

National Fuel (NF) has requested a rate hike of \$41.7 million per year. The Public Service Commission (PSC) should deny this request because:

- It will unduly burden low-income customers, who are already struggling to pay their utility bills;
- NF is a very profitable company, with skyrocketing executive compensation and large dividends;
- As noted by the PSC's auditors and other experts, many of NF's claimed expenses are questionable; and
- Instead of investing in additional fossil fuel infrastructure, New York and its utilities should be investing in energy efficiency and renewables.

In addition, the PSC should ensure that NF's low-income programs reach all low-income customers, and it should deny NF's request to be relieved from regulatory penalties.

Rate Case Basics

When public utilities such as NF want to raise the rates that they charge customers, they must file a rate case with the PSC. In April 2016, NF submitted a filing (Case 16-G-0257) with the PSC to make changes to NF's current rate structure and regulations.

In its filing, NF seeks a revenue increase of approximately \$41.7 million per year. For the average reader, it is hard to understand NF's proposed budget, and to identify exactly how the money will be spent, and what benefit customers will gain from it.

The largest of NF's proposed expenses is construction, which includes the modernization of existing pipelines, as well as multimillion dollar expansion projects.³ NF describes its new customer information system as its other primary expense.⁴

Expenditure	Cost (in millions) ¹
Construction	\$10.8
Depreciation Expense ²	\$10.3
Labor	\$7.2
Revenue	\$6.7
All Other Operations & Maintenance	\$6.3
Cost of Equity	\$3.9
Customer Information System	\$3.2
Uncollectible Expenses	\$3.1

Two other important issues are raised by the rate case. One is the future of NF's low-income programs. The second is NF's proposal to remove certain regulatory mechanisms. This could put residents of NF's service area at risk when it comes to gas leaks and other safety issues.

Revenue Increase

Impact on Low-Income Customers

Many, but by no means all, of NF's low-income customers receive aid through the Home Energy Assistance Program (HEAP), a federal program, administered by states, in which certain qualifying customers receive aid in the form of payments made directly to the utility by the government. NF's rates are different for HEAP customers and non-HEAP customers.

Currently, a non-HEAP residential customer pays a fixed-rate cost of \$15.54 and then pays declining-block rates for service delivery. That is, after paying the fixed rate, residential customers pay a certain amount for the first 46 centum cubic feet (ccf) of fuel they consume, and then pay a lesser rate for any ccfs beyond that. NF proposes to raise both the fixed rate and the cost per ccf of fuel.

For non-HEAP residential customers, the fixed rate would rise from \$15.54 to \$19.66. For HEAP customers, it would rise from \$10.28 to \$11.29.⁵ NF claims that its proposal will result in a 7.16% rate hike for the average residential customer.⁶ It is important to note, however, that much of that hike will come from the increases in fixed rates: for non-HEAP residential customers, an increase of 26.5%, and for HEAP customers, an increase of 9.8%.⁷

Energy costs are already unduly burdensome on low-income households, so this rate hike would only serve to heighten financial instability for those households. Currently, 36% of low-income households in NF's service area spend at least 50% or more of their income on housing costs.⁸ In New York, energy costs alone consume 41% of household income for those who are at or below 50% of the federal poverty level.⁹ As the PSC noted in another rate case, a household's energy burden rises as the household's income goes down.¹⁰ Thus, any increase in gas rates will have disproportionate effects on low-income households.

Further, because NF operates on a declining-block rate model, when residents conserve gas, they end up paying a *higher* cost per ccf of gas.¹¹ For example, at the proposed rates, if a household uses 40 ccfs of gas, residents will pay \$1.43 per ccf, but if it uses 100 ccfs, its residents will pay \$1.00 per ccf.¹²

High Fixed Rates Would Get Higher

National Fuel is proposing to raise the fixed rate costs for HEAP customers by 9.8% and for non-HEAP customers by 26.5%. NF customers already pay an unusually high amount in fixed rate costs, which reduces their incentive to conserve gas.

Thus, for low-income households that face an increased financial burden as a result of this rate hike, attempts to conserve gas will not provide them with much relief.

The impact on low income customers is particularly unjust, given the profitability and the executive compensation at NF. The Public Accountability Initiative has reported that CEO pay at NF has mushroomed from \$2.4 million in 2007 to \$6.7 million, or \$3,230 per hour in 2015; that NF raised its dividends for the 46th straight year, and that NF's largest individual shareholder earned \$12.2 million in dividends in 2015.¹³

A Very Profitable Company (2015)

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Challenges to Customer Fixed Rate

In a rate case, interested parties (such as public interest groups, local officials, and representatives of customers) may submit testimony to be reviewed by the Administrative Law Judge. Since NF's initial filing, several parties have challenged NF's proposed fixed rate calculation. Some parties question NF's inclusion of gas mains in the fixed rate charge, and others argue that NF's fixed rates were too high to begin with when compared to other public gas companies.

In NF's budget, all costs are categorized as either "customer related" or "demand related."¹⁴ If a cost varies based on how many customers NF has, the cost is deemed customer related. If a cost varies based on how much gas is being consumed, the cost is deemed demand related. Currently, NF labels the cost of gas distribution mains as primarily customer related. This means that gas mains are included in the customer's fixed rate cost. However, the number of gas mains and their associated cost is not directly related to NF's number of customers.

A main is the pipeline that carries gas from the gate station (where gas from local distribution companies reaches a local gas utility like NF) to a service line (which carries gas into someone's home).¹⁵ If an individual owns a house and decides to rent half of it out, thus creating two separate customers for NF, the company does not need to increase the length of the gas main to serve that new customer. Rather, new mains are built based on demand.¹⁶ By classifying mains as customer related rather than as demand related, the burden of the main cost is shifted from larger customers to smaller customers (as they consume less of the utility).¹⁷ The Utility Intervention Unit (UIU) recommends that NF re-label the gas main charge as 100% demand-based (as has occurred in many other rate cases), which would result in a reduction of non-HEAP customers' fixed cost to \$7.49.¹⁸

Even without the proposed increase, NF's residential fixed rates are already on the high end when compared to other utility companies. The UIU notes that gas rates in New York are some of the highest in the country.¹⁹ One expert, Richard Ford, using NF's own list of comparable companies, found that NF charges \$4.34 more than the average fixed rate of its peers.²⁰ High fixed rates like this shift cost

burdens from larger customers onto smaller customers because smaller customers do not receive the proportionate benefit from the utility.²¹ High fixed rates also fail to encourage conservation because customers are forced to pay the fixed rate regardless of how much gas they use.²²

Challenges to the Budget

Auditors from the PSC have challenged NF's proposed \$41.7 million budget, including the expenses for the customer information system, executive compensation, and labor.

Currently, NF's budget does not include the monetary benefits of obtaining a new customer information system. The system is anticipated to improve worker productivity, streamline workflow, and allow NF to leverage discounts on other software, all of which will undoubtedly result in financial benefits.²³ Yet, none of this is reflected in the budget. Both the UIU and the Public Safety Commission recommend that these monetary benefits be passed back to the customer.²⁴

In its filing, NF requested approximately \$2.6 million for executive compensation. To demonstrate the need for an increase, NF commissioned a study of NF's executive compensation in comparison to peer companies.²⁵ The auditor who examined this study stated that NF did not provide enough information for the auditor to make a decision on the \$2.6 million figure. Further, the PSC mandates that increases in executive compensation must be 'focused, solely or in large part on goals for safety, reliability, environmental protection or customer service.'²⁶

Even Higher Compensation Requested by NF

The PSC auditor recommended rejecting NF's request for \$2.6 million more in executive compensation, noting that it was associated with financial performance, not benefit to the ratepayers and the environment.

The auditor found NF's rationale for increased executive pay to be primarily associated with the company's financial performance.²⁷ Ultimately, the auditor recommended that the entire \$2.6 million be denied for lack of information within the filing and for lack of demonstrated benefits to ratepayers, reliability, environmental impact or customer service.²⁸

Another PSC auditor challenged NF's labor cost figures. While NF accounted for the cost of borrowing labor from other jurisdictions, it failed to include the income it receives by charging *out* labor to other jurisdictions.²⁹ As a result, the auditor said, NF's labor expense forecast should be reduced by approximately \$5.9 million.³⁰ This auditor also recommended further reductions in the budget such as: \$0.5 million reduction in the implementation of the customer information system,³¹ a \$1.2 million reduction in the staff cost of contractors and outside services, and a \$1.5 million reduction in operation and maintenance expenses.³²

Despite the insights provided by these auditors, NF's proposed budget remains largely unintelligible to the larger public. Since this is a public rate case, all testimony is publically accessible online. However, the immensity of NF's submitted testimony and lack of summarizing documents means that it is impossible for an ordinary person to really understand the case. In cases such as these, the PSC should

prepare a simple summary of the utility’s proposal that highlights all the key issues for the public to consider.

Finally, it simply does not make sense for New York’s ratepayers to be making additional investments in fossil fuel infrastructure at a time when the state needs to be moving as quickly as possible away from fossil fuels. According to climate scientists, to have a two-thirds chance of staying below a global increase of two degrees Celsius, we can release 800 gigatons more CO₂ into the atmosphere. But as the recent landmark study by the Oil Change Institute revealed, coal mines and oil and gas wells currently in operation contain 942 gigatons worth of CO₂.³³ In other words, every responsible government in the world needs to move – even more quickly than previously believed – to phase out existing fossil fuel infrastructure, not to add to it.

Low-Income Programs

On May 20, 2016, the PSC filed an Order that changed New York State regulations for low-income programs. Under the new Order, public utility companies must set their target energy burdens for low-income households at 6% (3% for electric and 3% for gas).³⁴ In other words, a household that earns below 200% of the federal poverty line should not spend more than 3% of its income on gas each year.³⁵ To attain the target, the PSC stated, NF should offer households a discount of \$3 - \$31 depending on the household’s income.³⁶

While the goal is to reach all 2.3 million low-income households in the state of New York, the PSC acknowledges that utilities will need new methods to identify eligible customers. In the meantime, utilities are to provide this discount program to households that are currently enrolled in the HEAP.³⁷ Manual enrollment of other, non-HEAP enrolled households, is acceptable when “practicable,” i.e., when it is “not administratively burdensome and within the budget constraints.”³⁸

Many Low-Income Customers Get No Relief

In New York State, thirty to fifty percent of HEAP-eligible households do not receive HEAP.

Given that the current energy burden for some households exceeds 40% of household income, an energy burden target of 6% is undoubtedly a significant step. However, the PSC should order a quick solution to the question of how to reach low-income customers who do not receive HEAP because 30-50% of HEAP-eligible households in New York State are not enrolled in the program.³⁹ Thus, if utilities do not quickly establish new methods of low-income household identification, a sizable number of low-income households will be excluded from this much-needed program.

In the Order, the PSC goes on to define the budget cap for this program as 2% of the company’s revenue.⁴⁰ The PSC calculated that all New York State gas companies—except NF—could achieve the 6% target and remain within the 2% budget cap, but that NF would have to spend approximately 3% of

its total revenue on the low-income programming.⁴¹ The PSC did not make clear whether NF should increase the budget cap to achieve the target energy burden, or whether the target energy burden should be sacrificed for the budget cap.⁴² In this rate case, the PSC should clarify that NF’s budget cap will be raised to 3% to fully fund the program.

Removal of Regulatory Penalties

While not discussed in NF’s filing letter, NF is also asking the commission to remove various regulatory targets and penalties. Currently, if NF fails to meet a target, NF is punished by way of a negative revenue adjustment. The PSC imposes targets on NF related to damage prevention, leak management, emergency response, and non-compliance for pipeline safety regulations. NF proposes to remove all targets as it claims that they are purely punitive and discourage improvement beyond the target.⁴³ NF also incurs penalties if it does not provide satisfactory customer service as measured by Service Quality Performance Mechanisms (SQPMs).⁴⁴ In its filing, NF proposes to do away with SQPMs as well.⁴⁵

NF asserts that it is already managing risks through its existing programs, but in the PSC’s testimony, the staff notes that NF has had some problems meeting targets in the past.⁴⁶ In 2015, the PSC identified NF as a “poor performer” in avoiding excavator error damages, and every year, on average, the PSC cites NF for 36 high-risk pipeline safety violations.⁴⁷ In prior years, the PSC found NF to have been in non-compliance on a larger scale. In 2014, the PSC found that NF had failed to carry out required tests when performing plastic fusions for the period of three years prior. All plastic fusion work had to be stopped immediately until NF personnel could be brought into compliance with regulations.⁴⁸ And perhaps most notably, an explosion and fire occurred at a Pennsylvania home in NF’s service area in 2004, which resulted in the death of two residents. Investigators believe that the explosion occurred due to a misaligned plastic joint that had been installed by NF.⁴⁹ Clearly, regulatory targets and penalties are still necessary to protect the public.

Safety Issues Remain a Concern
Every year, on average, the PSC cites NF for 36 high-risk pipeline safety violations.

The PSC should maintain regulatory mechanisms not only because NF has had a spotty history of safety, but also because NF is a publicly-sanctioned monopoly. Ideally, a for-profit company has a financial incentive to provide a safe product and quality service. As a monopoly, however, NF does not have to compete for customers’ business and therefore lacks that incentive.⁵⁰ This is, in part, why regulations of this kind are standard practice in the public utility industry. In fact, if NF were to remove its SQPMs, it would be the only major utility company in New York without them.⁵¹

NOTES

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- ¹ Total costs in this table exceed \$41.7 million as NF's budget includes multiple lines of income. Figures are taken from Carl M. Carolotti, "Filing Letter," National Fuel Gas Distribution Corporation, April 28, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={EC7550A1-8754-44CB-AB05-62FFD2395423}>, Attachment C.
- ² Depreciation in the public utility realm refers to the service value lost over the natural lifetime of equipment that cannot be restored by maintenance. Potential causes include wear and tear, deterioration, obsolescence, etc. See "Spanos Testimony," National Fuel Gas Distribution Corporation, April 28, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={7D84720F-58DA-4D87-B5C5-C360CEE891D3}>, 3.
- ³ For more information on pipeline expansion, see "Direct Testimony of Kevin D. House," National Fuel Gas Distribution Corporation, April 28, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={80324678-831B-4F75-B64D-64B48AE320AF}>, 14-15.
- ⁴ Carl M Carolotti, 1.
- ⁵ "Exhibit__WDY-03," Public Utility Law Project of New York, Inc., August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={1D3C9AE8-D490-4DF0-818F-04410749DB7D}>, 2.
- ⁶ Carl M. Carolotti, "Filing Letter," 2.
- ⁷ "Direct Testimony of William D. Yates, CPA," Public Utility Law Project of New York, Inc., August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={885DE74F-246A-4E4D-8D4A-4D8F840252A8}>, 25.
- ⁸ Ibid, 28.
- ⁹ "Staff Report," New York State Department of Public Service, Case 14-M-0565, June 1, 2015, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={73F1F127-09C1-460D-9F42-D6AE106B3C52}>, 4.
- ¹⁰ "Oder Adopting Low Income Program Modifications," State of New York Public Service Commission, Case 14-M-0565, May 20, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={BC2F31C9-B563-4DD6-B1EA-81A830B77276}>, 5.
- ¹¹ "Exhibit__WDY-03," 1.
- ¹² Ibid.
- ¹³ "National Fuel Hikes Rates in Buffalo to Pay Billionaire Shareholder Mario Gabelli," *Public Accountability Initiative*, accessed October 26, 2016, <http://public-accountability.org/wp-content/uploads/NationalFuelRateHike.pdf>.
- ¹⁴ There are also categories for "commodity-related" costs and "revenue-related" costs, but those are not relevant for this discussion. "Testimony of UIU Rate Panel," Utility Intervention Unit, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={26A5F1D3-50A0-47BB-8261-064769F6CDE0}>, 10.
- ¹⁵ Karen Merkel (National Fuel Corporate Communications), e-mail message to author, October 24, 2016.
- ¹⁶ "Testimony of UIU Rate Panel," Utility Intervention Unit, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={26A5F1D3-50A0-47BB-8261-064769F6CDE0}>, 15; Richard Ford, "Customer Charge Calc," August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={21C5C02B-DFCE-4309-9940-1BB297D738B0}>, sheet 1.
- ¹⁷ "UIU Rate Panel," 15.
- ¹⁸ Ibid, 32; "UIU Gas Rate Panel Direct Exhibit," Utility Intervention Unit, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={450ED5F2-C80C-46F2-98FE-4296FEDDF3A2}>, schedule 2, 1.
- ¹⁹ UIU Rate Panel, 36.
- ²⁰ Richard Ford, "Utility Fixed Fees Around the Country," August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={A05C59A8-1E09-4E02-94C1-}>

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- [699BAEB58620](#)}, sheet 1.
- ²¹ “UIU Rate panel,” 38.
- ²² Ibid.
- ²³ “Boyle Testimony,” National Fuel Gas Distribution Corporation, April 28, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={D1D7245F-F63A-47A7-A456-C392CECA0207}>, 13-19.
- ²⁴ “Testimony of Gregg Collar,” Utility Intervention Unit, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={958377B9-4034-4814-B385-9C61D8D3006B}>, 23; “Staff Policy Panel Testimony,” New York State Department of Public Service, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={EA0EF163-1CAA-4732-A7D6-1AA29130D837}>, 6.
- ²⁵ See “Staff Gadomski REDACTED Exhibits,” New York state Department of Public Service, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={71C47250-6B5B-4823-A45C-F74B85860488}>.
- ²⁶ “2011 Order,” case 10-E-0362, November 21, 2011 as cited in “Staff Gadomski Testimony (Redacted),” New York State Department of Public Service, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={FF8E524E-51AD-46D5-BC1A-84AB9471D432}>, 13.
- ²⁷ Ibid, 12.
- ²⁸ Ibid, 13-14.
- ²⁹ “Staff Haslinger Testimony,” New York State Department of Public Service, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={717E270B-1EF1-4015-AABF-4A41323F702D}>, 6.
- ³⁰ Ibid, 11.
- ³¹ Ibid, 21.
- ³² Ibid, 18; It should be noted that all of these figures reflect NF’s multi-year budget, rather than strictly the \$41.7 million revenue increase.
- ³³ Greg Muttit, “The Sky’s the Limit: Why the Paris Climate Goals Require a Managed Decline of Fossil Fuel Production,” Oil Change International, September, 2016. http://priceofoil.org/content/uploads/2016/09/OCI_the_skys_limit_2016_FINAL_2.pdf
- ³⁴ “Order Adopting Low Income Program Modifications,” 3.
- ³⁵ Ibid, 4.
- ³⁶ Ibid, 25.
- ³⁷ Ibid, 3.
- ³⁸ Ibid, 17.
- ³⁹ “Energy Affordability for Low Income Utility Customers,” *New York State Energy Democracy Alliance*, accessed on October 26, 2016, <http://energydemocracyny.org/energy-affordability-for-low-income-utility-customers>.
- ⁴⁰ “Low Income Order Panel Supplemental Testimony,” National Fuel Gas Distribution Corporation, June 10, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={9E336EFE-30A8-49CB-A9F3-14F54A1AC1B2}>, 3.
- ⁴¹ Ibid, Appendix C.
- ⁴² “Staff Consumer Services Panel Testimony,” National Fuel Gas Distribution Corporation, August 26, 2016, [file:///C:/Users/buffguest/Downloads/%7B1C9F67B7-E8D8-459F-94A2-A7989CFA16AB%7D%20\(3\).pdf](file:///C:/Users/buffguest/Downloads/%7B1C9F67B7-E8D8-459F-94A2-A7989CFA16AB%7D%20(3).pdf).
- ⁴³ “Staff Gas Safety Panel Testimony,” New York State Department of Public Service, August 26, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={8EA70887-2539-4FD0-9C09-7868FB7F6506}>.
- ⁴⁴ “Customer Service Panel Testimony,” National Fuel Gas Distribution Corporation, April 28, 2016, <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={8CD455C5-FC26-4F6D-B7C8-6E904B6FE5AE}>, 13-14.
- ⁴⁵ Ibid.
- ⁴⁶ “Gas Safety Panel,” 28.
- ⁴⁷ Ibid 28, 41. High risk violations are those that “lead to a greater likelihood of an adverse impact on public safety with regard to loss of life or property and damage to the environment,” 41.
- ⁴⁸ “Gas Safety Panel,” 51-53.
- ⁴⁹ “Staff Policy Panel,” 39.

⁵⁰ “Customer Service Panel,” 18.

⁵¹ “UIU Collar Direct Exhibits,” Utility Intervention Unit, August 26, 2016,
<http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={A9A26537-7A4B-4B10-BE05-7B9A18E53A7C}>, 1.

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