



DRAFT Generic Incentive Regulation Framework for Natural Gas Utilities

**Stakeholder Meeting
November 24, 2006**

Presentation Outline

- Discuss the following issues list:
 - Goals of plan
 - Mechanics of price cap adjustment
 - Inflation factor
 - Non-routine adjustments (or z-factors) and cost pass-through (or y-factors)
 - Off-ramps
 - Plan term
 - Rebasing rules
 - Reporting requirements
 - DSM
 - Other issues

Goals of Plan

- Rates are predictable and stable
- Price adjustment mechanism is transparent and justifiable
- Utilities achieve sustainable efficiencies that benefit customers and shareholders
- Regulatory process is transparent and less onerous

Goals of Plan

- Utilities continue infrastructure investment to maintain safety and reliability
- Customer service standards are maintained
- DSM activities are maintained as outlined in EB-2006-0021

Mechanics of Price Cap

- Generally, no rate redesign during plan term
 - Gas utilities need to file evidence that supports a change to the status quo
 - Should be addressed at the time of rebasing
- Regulated discretionary services should be part of the price cap

Mechanics of Price Cap (cont'd)

- TCPL raised the question of whether transmission should be separated from distribution / storage
 - Additional analysis is required:
 - Dr. Mark Lowry to examine utility-specific data
 - How will Union separate transmission from embedded delivery charges for residential and/or general service?
- Utilities raised the question of whether declining average usage should be incorporated into the price cap
 - Additional analysis is required:
 - Is declining average usage rate class specific (i.e., mostly pertains to heat-sensitive loads)? How should the declining average usage adjustment apply (i.e., for each rate class, etc.)? How does it affect large volume customers? How to separate out the other variables that affect usage such as changes in economy?
 - Is it fixed for the term of the plan?
 - If incorporated into price cap, this adjustment will be separated from the productivity factor

Inflation Factor

- Actual Can GDP-IPI Final Domestic Demand
 - Recommended on the basis of:
 - Wider coverage compared to CPI
 - Consistent with deflator of inputs in productivity index
 - Less volatile than other indices
 - In contrast with the GDP-IPI FDD Ontario, the Can GDP-IPI FDD is available on a quarterly basis, and therefore, the inflation factor will be based on the most recent inflation trend.
 - Published by trusted source and readily available
 - Less complex than an industry-specific measure
 - Consistent with Board staff recommendation in the second generation incentive mechanism
- Update on annual basis - average of annualized quarterly changes for the four latest available quarters

Inflation Factor (cont'd)

- A forecast is not recommended because GDP-IPI FDD is available from few forecasters
- In the last five years, the cumulative error of GDP-IPI FDD Can (difference between actual and lagged GDP-IPI FDD) is lower than cumulative error of CPI forecast

Year	GDP IPI FDD CAN (year ending December) "Actuals"	GDP IPI FDD CAN (Year ending June) "Last Year" (1)	Difference GDP IPI FDD Actual - Last Year	CPI CAN Actual	CPI CAN Forecast (2)	Difference CPI Actual - Forecast
2001	1.7	1.8	-0.1	2.5	2.4	0.1
2002	2.3	2.3	0.0	2.2	1.6	0.6
2003	1.4	1.7	-0.3	2.8	2.4	0.4
2004	1.7	2.3	-0.6	1.8	1.6	0.2
2005	1.8	1.2	0.6	2.2	1.9	0.3
Cumulative Error in 5 years			-0.3			1.7

(1) Calculated as the average of annualized changes in the quarterly GDP IPI FDD index from Stats Canada

(2) Data from Consensus Forecast: average of 16 forecasts issued in December of the previous year

Non-Routine and Cost Pass-through Adjustments

- Z-factors - limited to changes in legislation, regulation, accounting rules and natural disasters
 - All new proposed accounts must satisfy criteria set
- Y-factors - limited to variance / deferral accounts established in base year. This includes gas supply, transportation and balancing expenses, DSM costs and NGEIR
 - No new y-factors during plan term

Non-Routine and Cost Pass-through Adjustments (cont'd)

In order for amounts to be considered as a z-factor, the adjustment must satisfy all four tests listed below:

Criteria	Description
Causation	Amounts should be directly related to operational requirements created by the Z-factor event. A significant portion of the expenditure should be demonstrably linked to addressing new operational requirements, as opposed to upgrading current procedures and systems to gain efficiencies under the guise of addressing the event. At least 75% of the amounts should be directly and demonstrably linked to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived.
Materiality	The amount must have a significant influence on the operation of the natural gas utility; otherwise they should be expensed in the normal course and addressed through organizational productivity improvements. <u>It is suggested that the threshold amount be \$1M for individual items.</u>
Inability of Management to Control	To qualify for z-factor treatment, the amount must be attributable to some event outside of management's ability to control (i.e., the event causing the amount must be exogenous to the utility and the utility cannot control the amount).
Prudence	The amount must be prudently incurred. This means that the amount incurred by the utility must represent the most cost-effective option for ratepayers.

Off-Ramps

- Gas utilities can apply to Board when conditions are such that continued use of the mechanism produces results that threaten the financial viability of the companies.
 - Board should revisit incentive regulation framework
- When the normalized return on equity (ROE) is 400 basis points above the approved ROE, Board should revisit parameters of incentive regulation framework

Plan Term

- Plan term of 5 years (i.e., base year + 5 years)
 - In NGF report, Board's preference is for a plan term of five years
 - Length of plan will allow utilities to have greater opportunities to implement sustainable efficiency improvements

Plan Term (cont'd)

- Stagger cost-of-service rebasing due to resource-intensive hearing process. Four options:
 - Union starts incentive regulation on January 1, 2008; EGD and NRG have one more year of cost-of-service regulation and start incentive regulation on January 1, 2009
 - Union starts incentive regulation on January 1, 2008; EGD has a limited 2008 cost-of-service (e.g., CIS and cast iron replacement program) and starts incentive regulation on January 1, 2009
 - Utilities start incentive regulation on January 1, 2008 but have different plan terms
 - Utilities file rebasing application 6 months apart

Reporting Requirements

- Annual Requirements:
 - Highlights of the previous year
 - Draft Rate Order for next year
 - Other rate-related changes (rate redesign and z-factors)
- Service Quality Monitoring
- Rebasing

Annual Requirements

During plan term, utilities to file 2 packages of materials each year

1. Highlights of the previous year (actuals) - April 30th

- Financial information (RRR) and additional material
- Service quality information
- Board staff to monitor results
- Information on Board's website
- No formal Board/stakeholder review process

Annual Requirements (cont'd)

- All elements of current RRR and proposed new RRRs:
 - Standard Regulatory Schedules (rate base, utility income, ROE, taxes, etc.)
 - Audited financial statements for regulated entity
 - Customer attachments, capital spending (by USoA account), headcount, and volumes by rate class
 - Above reports to include comparison to prior year actual with variance explanation over \$1 million per item

Annual Requirements (cont'd)

2. Draft Rate Order for Next Year

- Late summer/early fall filing
- Inflation factor, x-factor, etc.
- Deferral and variance accounts clearance / disposition
 - Should be disposed of expeditiously
 - Options: forecast or actual amounts disposition
- Process similar to QRAM (expedited, parties' comments, reply comments, Board Decision & Order)
- Board Rate Order Dec 15th

Annual Requirements (cont'd)

3. Rate-related changes during plan term:

- Rate redesign if needed (onus on utility to justify)
- Z-factors if needed (onus on utility to justify)
- Applicant should allow sufficient time for Board review

Annual Requirements (cont'd)

- “No Surprises” clause
 - Significant restructurings, outsourcing or other changes to be disclosed on a timely basis

Service Quality Standards

- Service Quality Standards (SQS):
 - Under GDAR, gas utilities are required to maintain minimum service levels and report on the following:
 - Telephone answering performance
 - Billing performance
 - Meter reading performance
 - Service appointment response times
 - Gas emergency response
 - Customer complaint (written) response
 - Disconnection/reconnection

Service Quality Standards: Components

- Components of SQS:
 - Measurement Standards
 - Reporting Requirement
 - Compliance Monitoring

Service Quality Standards: Measurement

- Measurement Standards:
 - GDAR establishes the metric to be used to assess a performance standard
 - Metric is based on a yearly and/or monthly percentage
 - Example:
 - Call Answering Service Level: Yearly and Monthly
 - Meter Reading Performance: Yearly
 - Service Appointment Response Time: Yearly

Service Quality Standards: Reporting

- Reporting Requirements:
 - Frequent public reporting of SQSs is considered essential to the incentive regulation framework
 - Quarterly reporting will provide a continuous picture of service quality
 - Performance continued to be measured as per the GDAR

Service Quality Standards: Compliance

- Compliance Monitoring:
 - In the NGF Report, the Board indicated that utilities would be subject to the Board's compliance process.
- The Compliance Process includes:
 - Issue Management
 - Compliance Management

Service Quality Standards: Compliance

- Issue Management:
 - Responding to issues that are not compliance matters
 - Quarterly measurement tracking of SQRs in order to identify significant variances between quarterly filings
 - Discussions between Board staff and the utility to understand the performance within a specific quarter

Service Quality Standards: Compliance

- Compliance Management:
 - Reviewing non-compliance in timely and efficient manner
 - Failure to meet SQR measurement standard as per the GDAR
 - Failure to file required information as per the RRR
 - Includes:
 - Informal Enforcement:
 - Compliance staff work with the party to achieve a fair and appropriate resolution to the matter
 - Any resolution to be documented as a “compliance plan”.
 - Reported to a panel of the Board
 - Formal Enforcement:
 - As per Part VII.1 of the *Ontario Energy Board Act, 1998*

Reporting Requirements - Rebasing

- Rebasing applications must follow the Board's Minimum Filing Requirements for Natural Gas Utilities (MFR). Applications at a minimum must include 3 years of data:
 - a. Test Year = Forecast (Base) Year
 - b. Bridge Year = Current Year
 - c. Historical Year = Last Board Approved Base Year (Actual and Board Approved Forecast)
- In addition to the MFR requirements, utilities must identify efficiency improvements achieved during the plan term
 - For example, the applicant should file qualitative reports setting out the specific steps taken to create efficiencies and improve productivity, and the results achieved.

Reporting Requirements - Rebasing

- Should the application also include the following:
 - Actual data for the interim IR years and supporting variance analysis - detail similar to MFR requirements? Or can this be accessed through interrogatories?
 - Summary schedule of data filed through the other interim reporting processes, accompanied by a high level report on performance, efficiency gains, etc?
- Should the existing MFR be reviewed prior to the rebasing application?

Rebasing Rules

- In determining the new base rates, the NGF report states:
 - Efficiency improvements must be sustainable – not temporary, unsustainable budget cuts. Utilities must provide supporting evidence.
 - Board will review relationship between O&M costs and capital expenditures, and the timing of capital expenditures and the associated impact on customers and shareholders
 - Sudden and significant increases in costs at the time of rebasing will be viewed unfavourably, unless thoroughly justified

DSM

- Treated as a y-factor - DSM activities as outlined in EB-2006-0021 for years 2007, 2008 and 2009
- Interrelationship between declining average usage and LRAM
 - If declining average usage is incorporated into plan, need to avoid double counting. Two options - eliminate LRAM or reduce declining average usage for DSM (LRAM)

ROE

- No annual ROE adjustment during plan term
 - Reflects Board's previous decision, RP-1999-0017 Decision with Reasons dated July 21, 2001, where the Board states that the ROE adjustment is captured in the annual changes of GDP-IPI FDD

Other Issues – Adjustments to Base Year

- UGL's weather-normalization – Not considered as a y-factor since this issue was already decided in Union's 2007 rate settlement
- EGD's cast iron replacement program:
 - Should this be included in the productivity factor?
 - Should this be considered as a cost-pass through (or y-factor)?

Other Issues – System Expansions

- Should the Board encourage system expansions to new communities?
 - If so, how?

Summary

$$\% \Delta P = \% \Delta GDP-IPI - X + Z + Y$$

Where:

- ΔP is the annual percentage change in price;
- $\Delta GDP-IPI$ is the percentage change in the Canada GDP-IPI for final domestic demand;
- X is the productivity adjustment with implicit input price differential, productivity differential, and stretch factor;
- Z may allow for adjustment due to unusual events and additional Board-approved costs outside of the formula; and
- Y is for cost pass-through adjustments that have been established in base year.