



uniongas

A Spectra Energy Company

Union Gas Trial PBR Experience

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Trial PBR Plan Parameters

- **Price cap plan.**
- **3-year term (2001 – 2003) implemented in late 2001, end of term rebasing using COS.**
- **2.5% x-factor (1.4% stretched productivity offset and – 1.1% input price differential).**
- **Inflation factor – second quarter over second quarter growth in GDPPI.**
- **Price variances related to fuel, UFG and inventory carrying costs passed through.**
- **DSM impacts on throughput reflected in rates.**

Trial PBR Plan Parameters (cont'd)

- **Z-factors limited to changes in legislation, regulatory requirements, and GAAP.**
- **Off-ramp – serious decline or improvement in financial position.**
- **Earnings sharing (50/50) outside of 100 bp deadband.**
- **S&T earnings sharing through deferral accounts retained.**
- **Limited pricing flexibility available but rebasing treatment uncertain.**
- **Annual “customer review process” (CRP).**
- **SQIs: telephone response, emergency response, gas utilization infraction and pipeline system integrity.**

Trial PBR Outcome

- Price changes had to be made retroactively in all years.
- Price cap adjustments:
 - ❑ 2001 1.4%
 - ❑ 2002 (0.5)%
 - ❑ 2003 (2.3)%
- GDPPI restatements contentious.
- Price variances related to pass-through adjustments significant.

Trial PBR Outcome (cont'd)

- **Z-factors related to LPP and pipeline integrity were reflected in rates.**
- **Earnings sharing of \$12.8 million in 2003.**
- **Limited use of pricing flexibility.**
- **CRPs adversarial and time consuming.**
- **No service quality issues.**

Successful PBR Attributes

Long-term commitment must be accepted.

Objectives of plan must be clearly understood.

- ❑ PBR can provide:
 - Incentive to utility to achieve productivity improvements.
 - Customers with stable and predictable rates.
 - Opportunity for utility to focus on customer service and satisfaction.
 - Regulatory process efficiency improvements.
 - Potential for less controversy with stakeholders.
- ❑ COS can provide:
 - Rates reflective of costs.
 - A comprehensive understanding of the utility's costs and revenues.
 - Utility focus on the cost and throughput detail.
 - Venue for stakeholders to keep informed about issues.
 - Venue to have the Board deal with non-rate related matters.

Successful PBR Attributes (cont'd)

- **Stakeholders must:**
 - ❑ Be able to identify benefits.
 - ❑ Accept that there is less of a relationship between price and cost than under COS.
 - ❑ Acknowledge that there is greater utility business risk with PBR, which needs to be matched with the opportunity to earn higher returns.
 - ❑ Have well-defined information filings.
- **Plan parameters (productivity and input price) must be set using objectively verifiable industry data. Such studies are best conducted under the auspice of the Board.**

Trial PBR Criticisms

There was general dissatisfaction with Union's trial PBR. The criticisms were:

- The productivity factor was set too high or too low.
- Establishing the productivity and inflation components of a price cap plan is too complex or arbitrary.
- The price cap parameters selected by the Board (productivity offset and inflation) should have been supported better by evidence.
- Productivity improvements should have been tracked.
- There should have been more opportunity to adjust the price cap parameters throughout the term of the plan.
- Not enough earnings sharing.
- The earnings sharing deadband created an incentive for the utility to manipulate earnings.

Trial PBR Criticisms (cont'd)

There was general dissatisfaction with Union's trial PBR. The criticisms were:

- ❑ Retention of the S&T earnings sharing deferral accounts while instituting an overall earnings-sharing mechanism on other earnings with a different sharing allocation was duplicative, complicated and provided the utility with a bias towards trying to achieve additional earnings in areas where the shareholder benefit was the greatest.
- ❑ There should have been more opportunity to look at the utility's cost structure throughout the PBR term.
- ❑ Information asymmetry was a problem during the plan and after the plan expired.
- ❑ Union should have been able to provide a more detailed continuity (with explanations of variances) of financial information back to the last cost of service proceeding.
- ❑ PBR has nothing in it for ratepayers. It is all about the utilities making higher returns.
- ❑ PBR has nothing in it for the company. It is all about the utilities cutting costs and the utilities providing COS information and processes.
- ❑ The customer review process (CRP) turned out to be the same adversarial, time-consuming rate setting process that existed under COS regulation.
- ❑ With gas cost pass-throughs, PBR was not comprehensive enough.

Union's Incentive Regulation Proposal

Summary of Union's Evidence

- **Price cap plan.**
- **5-year term, starting January 1, 2008.**
- **Adjustment to base to reflect 20 year trend weather normalization method (\$7 million).**
- **Elimination of transportation deferral accounts.**
- **GDP IPI FDD inflation factor.**
- **Average x factor of 0.02% ***
 - ❑ M11/2/01/10 x factor of (0.38%)
 - ❑ Other rate classes x factor of 0.74%

*** PEG's recommendation of 0.52% adjusted to remove the stretch component.**