

Regulatory Oversight of Gas Supply Planning and Utility Performance

Ken Costello

Director, Natural Gas Research and Policy

*The National Regulatory Research
Institute*

Prepared for NARUC Gas Committee

July 22, 2008

Questions

- Why is gas planning important?
- What are the different elements of a gas supply plan?
- What are the major challenges in gas supply planning?
- What role can a commission play in gas supply planning?
- How does planning relate to actual utility performance?
- What are the features of a comprehensive regulatory process that oversees both gas supply planning and utility performance?
- What are the major issues and areas of contention?

The Importance of Gas Supply Planning

- Planning is the foundation for performance
- Good performance requires good planning
- Poor planning reflects poor decision-making that ultimately leads to poor utility performance
- Gas procurement and pipeline transportation can make up about 75-80 % of the costs for a utility
- Planning focuses on the ability of a utility to acquire adequate gas supplies and transportation to meet future demand
- Since FERC Order 636, gas utilities have taken a more active role in gas procurement and related activities where a utility has to make important decisions

Different Elements of a Gas Supply Plan

- Objectives
- Projected prices
- Available gas supplies and delivery capacity
- Demand projections
- Kinds of commercial transactions (spot market purchases, contracting)
- Hedging strategy
- Portfolio policy for price and supply diversity
- Reliability criteria
- Affiliate and outsourcing transactions
- Treatment of uncertainty

Major Challenges in Gas Supply Planning

- One management expert depicts long-term planning as: *A simplified road map of complex terrain based on provisional knowledge that is subject to revision in light of new information*
- From a narrow technical perspective, gas supply planning is an optimization problem where the utility
 - Attempts to maximize an “objective function” containing different objectives of planning and their relative importance
 - Operates in an environment of uncertainty over future demand, prices for gas supplies, transportation-capacity availability, and so forth
 - Faces operational, contractual and market constraints

Major Challenges in Gas Supply Planning -- *continued*

- Regulatory review requires an assessment of the inputs and assumptions placed into models and their effects on a utility and its customers
- This assessment requires
 - Knowledgeable, experienced and skilled commission staff
 - Tools and methods that extend beyond optimization modeling; for example outside-of-modeling analyses and judgment

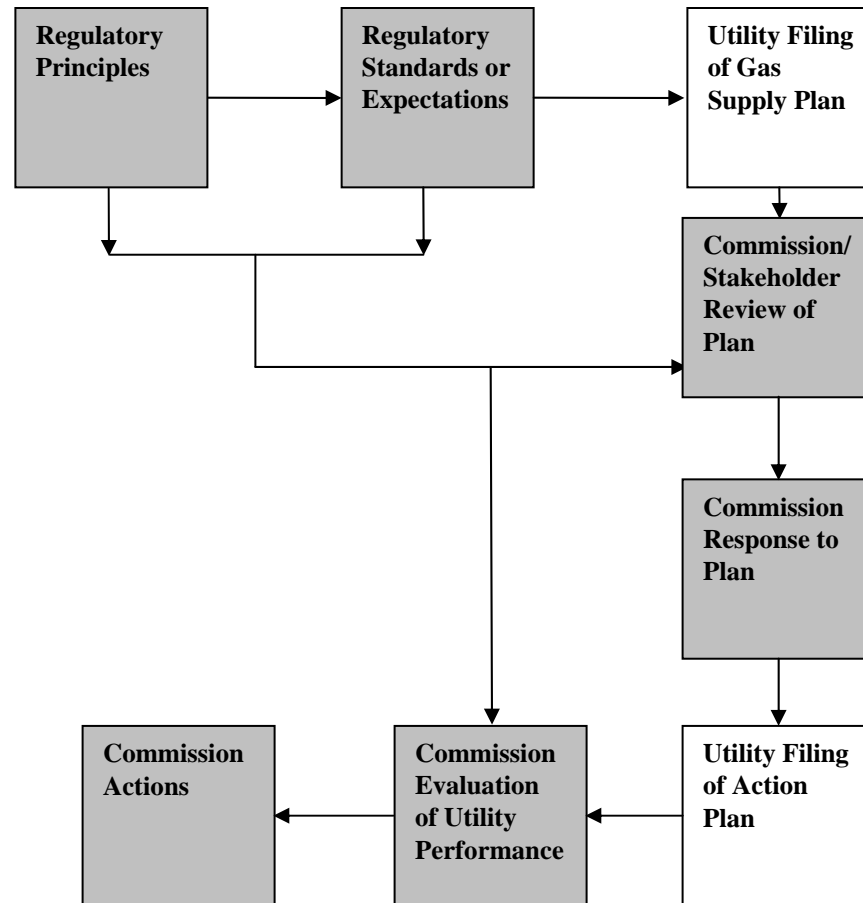
What Role Can a Commission Play in Gas Supply Planning?

- Communicate to the utility what it expects before a plan is filed (via principles and standards)
- Analyze a utility plan in relation to the principles and standards established
- Make recommendations on a filed plan
- Make decision on a plan in terms of commitment to future cost recovery and other regulatory actions

The Relationship of Planning to Actual Utility Performance

- Actual performance depends on both past utility planning and plan-execution actions
- Things inevitably change to thwart even the best-laid plan or its execution (e.g., I want to send my kids to private colleges and pay for it without taking out any loans; but then I lost my job)
- New information can warrant a utility to change (1) its plan or (2) the execution of an existing plan
- Utilities should execute a plan as circumstances change by capturing new information, making mid-course corrections and getting the time right

A Proposed Process for Regulatory Oversight



Major Issues and Areas of Contention

- Need for commission principles/standards
- Required commission staff expertise
- Commission commitment to a utility's plan or strategy
- Execution of a plan in light of new information
- Commission evaluation of actual utility performance
- Scope and nature of commission retrospective reviews
- Commission evaluation of its own policies/practices that affect utility behavior in planning and execution
- Legal constraints to implementing the proposed process
- Net benefit of the proposed process relative to existing approaches