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Case Study Proposed Franchise Expansion

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Description of the Proposed Expansion Project

- Company X is considering an expansion of its current franchise
- The expansion entails about 49 miles of 8 inch and 4 inch coated steel pipe into a rural area, including services and meters to provide gas to about 1,923 customers over five years
- The project is currently estimated to cost \$19.6 million, which assumes \$7.5 million in state funding
- Construction is projected to commence in early 2009 if all funding is in place



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New York State Public Service Commission Filing Requirements

- Filing Requirements
 - Environmental compliance (e.g. wetlands, areas of historic significance)
 - Forecast of customer penetration and estimated sales
 - Construction forecasts
 - Financing of the project
 - Economically feasible – 5 year test
 - The expansion must achieve a ROE equal to the system ROE by year 5; if it will not the company can either write-down some of the costs of the project or surcharge customers to make up the difference
 - Gas procurement
 - Safety standards



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Company X's Analysis

- Company X conducted a study of the cost effectiveness of the its expansion proposal and its ability to meet the Commission's five year return on investment test
- The Company made the following assumptions:
 - Penetration is estimated at 44%, 53%, and 68% for residential, small commercial, and large commercial customers (estimates are based on actual number of buildings along the proposed construction route),
 - The large customers would be served under firm tariff service classifications
 - Company X would avoid property taxes on the plant associated with the expansion for 20 years
 - The initial 34 miles of 8 inch pipe would be completed in year 1
 - The 15 miles of 4 inch pipe would be constructed in year 3



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Company X's Analysis

- The analysis indicated that the expansion will only generate about half the allowed return on rate base in year five, premised on 20 years of property tax abatement from the county
- Consequently, the Company X is seeking approximately \$7.5 million in additional governmental economic assistance as a “tax free” contribution in aid to construction and project cost offset
- Company X estimates that the combined economic assistance would result in a rate of return on rate base of 7.77% in year five (the Company's allowed rate of return established in its last rate filing), and therefore meets the Commission's policy statement for franchise expansions



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Staff's Review of the Informal Franchise Expansion Filing

- Company X asked Staff to review its feasibility model to determine if there were any errors before the Company made an official filing with the Commission and to determine the level of state assistance
- Staff reviewed Company X's informal filing and suggested that the utility fine tune its analysis, taking the feedback into consideration, and proceed with its formal filing with the Commission
- Company X indicated that it first wanted to secure a more accurate construction cost estimate from prospective contractors, in the early spring 2008 timeframe, and would then promptly file its application with the Commission
- Company X again filed a more detailed informal filing with Staff and Staff again advised the Company to file a formal petition with the Commission asking for approval of the expansion



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Staff's Concerns and Recommendations

- Concern: Staff sees the level of assumed residential and commercial conversions as a critical issue with conversion costs as a potential barrier
 - Recommendation: Staff recommends that customers need to be protected from bearing the impact of Company X's inability to attach a critical level of customers. If Company X believes its forecast is conservative, it should have no problem agreeing to this condition
- Concern: Staff questions the company's assumption that all large commercial customers and prisons in particular would remain as firm customers
 - Recommendation: Signed long term contracts with these customers would mitigate Staff's concerns



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Staff's Concerns and Recommendations (cont.)

- Concern: Staff is concerned with the certainty and availability of the municipal/county tax incentives; currently the tax abatements are verbal commitments
 - Recommendation: The tax abatements would need to be signed contracts
- Concern: Staff is troubled with the uncertainty of the forecast level of environment costs
 - Recommendation: If the company agreed to cap these expenses at the forecast level provided to Staff, our concerns would be mitigated



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Staff's Concerns and Recommendations (cont.)

- Concern: Staff has compared the construction costs to other utilities recent projects and has found Company X's estimates to be practical, however with the rising costs of materials and energy, these estimates could quickly become obsolete
 - Recommendation: If the company agreed to cap these expenses at the forecast level provided to Staff, our concerns would be mitigated