Regulatory/Governmental Incentives To Attract Investment In Natural Gas Distribution Infrastructure

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Investors/Developers Will Want:

- **Stable (or predictable) regulatory regime**
- **Mitigation of political risk**
  - Government will not materially change the rules after the project has been agreed
- **Opportunity to earn a reasonable return on investment and to recover investment in a reasonable period of time under the circumstances**

Stable Regulatory Regime/Absence of Political Risk

- **Once rules are established, rules should remain in place**
- **Examples:**
  - Distributor as merchant or distributor as open access service provider?
    - Either model might work, but if investment is made under one model and then other model is implemented, investor's opportunity to earn return is likely diminished
  - Exclusive market must be preserved
    - Investor must have right to capture developing market
    - Gas infrastructure will likely attract incremental gas consumers
    - Cannot permit new loads to bypass distribution system

Stable Regulatory Regime/Absence of Political Risk, cont'd.

- **Examples, cont'd.**
  - Tariff/Cost Recovery Methodology
    - Reservation charge basis or volumetric basis?
    - Straight Fixed Variable rate design or other?
    - Many examples of components of rates, such as rate base, return, O&M, rate design and taxes
- **Investor can assess economic opportunity and decide whether or not to invest based on known rules**
  - If rules change (or even if there is a risk that rules will change), investor's opportunity to earn return is diminished
  - Returns need to reflect risk of material regulatory/governmental changes

Opportunity to Earn a Reasonable Return on Investment and To Recover Investment in a Reasonable Period of Time

- **Stable (or predictable) regulatory regime**
- **Risks must generally be mutually recognized and agreed between regulator and investor**
- **Level of return must reflect risk**

Level of Return Must Reflect Risk

- **Trying to attract investor/developer to construct/operate a *new* gas distribution system**
- **Higher level of risk than periodic rate case filed by an established gas distribution system**

Risk Factors

- **Form of cost recovery**
  - Reservation charges or volumetric?
- **Regulatory risk**
  - Might the rules change?
  - Will the change be detrimental to the investor?
- **Creditworthiness**
  - Will customers pay their bills? Service obligation for customers?
- **Construction/Development risk**

Risk Factors, con't.

- **Size of market**
  - What load exists and what load is projected?
  - Need to reward investor for providing backbone for growth
- **Exclusivity of market**
  - Is there competition? Might there be competition in the future?
- **Reward reliability/high-quality service**

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Level of Return Must Consider Competing Demands on Capital

- Alternate investment opportunities
- If investors can allocate capital where there is less risk for the same or greater return, they will do so
- Investment in a gas distribution system must be an attractive use of capital

Bundled Versus Unbundled Services

- Which model will best attract investors?
- Which model will encourage conversion to natural gas in the marketplace?
- Which model will help make natural gas the fuel of choice in the marketplace?

Regulatory Considerations

- **Attract investors by allowing a reasonable return on investment**
- **Provide a stable and predictable regulatory environment**
- **Create a regulatory model that maximizes transparency**
  - Stakeholders -- regulators, investors, ratepayers -- will be more likely to trust a regulatory regime they understand

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