Utility Views of the Energy Policy Act's Primary Impacts on the Modern Rate Case

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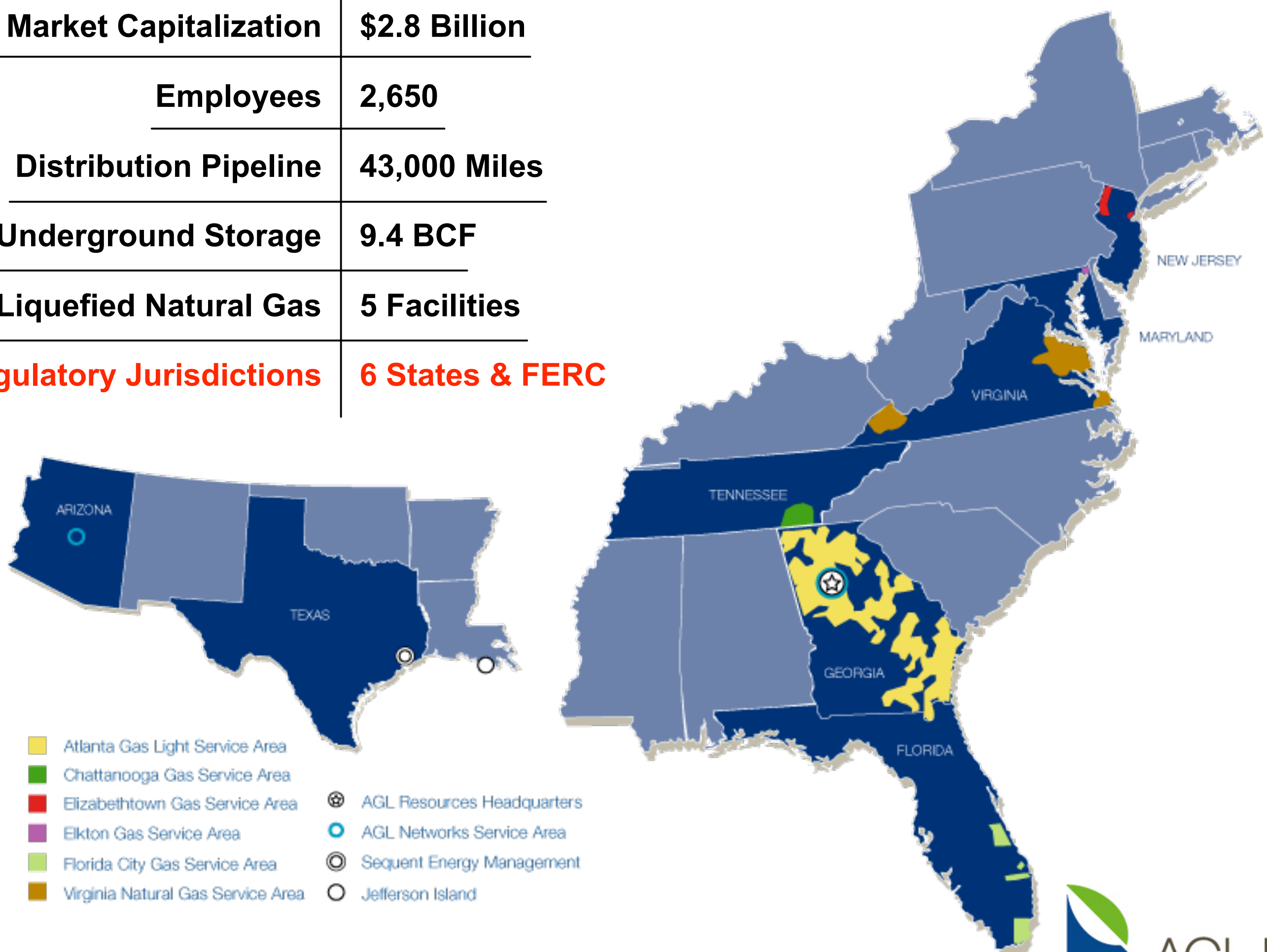
Customers Served	**2.3 Million**
Market Capitalization	**$2.8 Billion**
Employees	**2,650**
Distribution Pipeline	**43,000 Miles**
Underground Storage	**9.4 BCF**
Liquefied Natural Gas	**5 Facilities**
Regulatory Jurisdictions	**6 States & FERC**



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The Issues

Energy Policy Act of 2005

The Modern Rate Case

State and Federal Regulation

Conclusion

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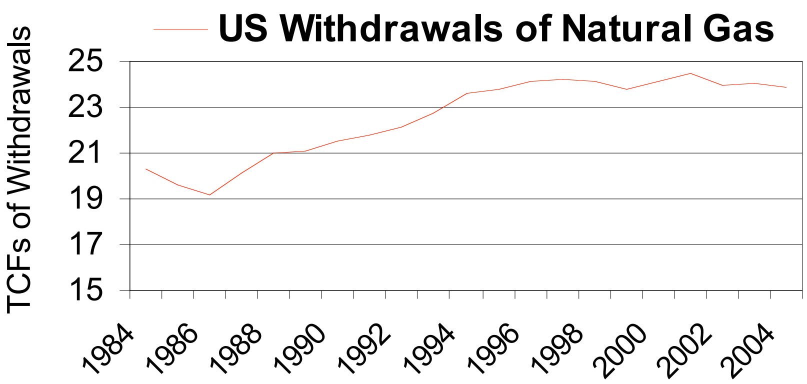
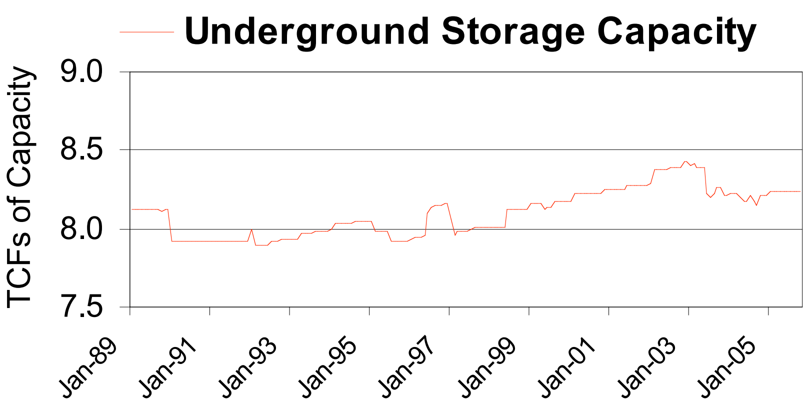
Why the Energy Policy Act of 2005 is needed

- Production has declined and critical infrastructure investment is not occurring
- Order 636 and 2000
  - FERC is hands-off with respect to planning – business cases drive investment
- Critical infrastructure investment is not occurring because of credit and financing issues at pipelines
  - Without pipeline and storage resources in the right locations, supply and demand cannot be matched.





Source: Both US DOE – Energy Information Administration

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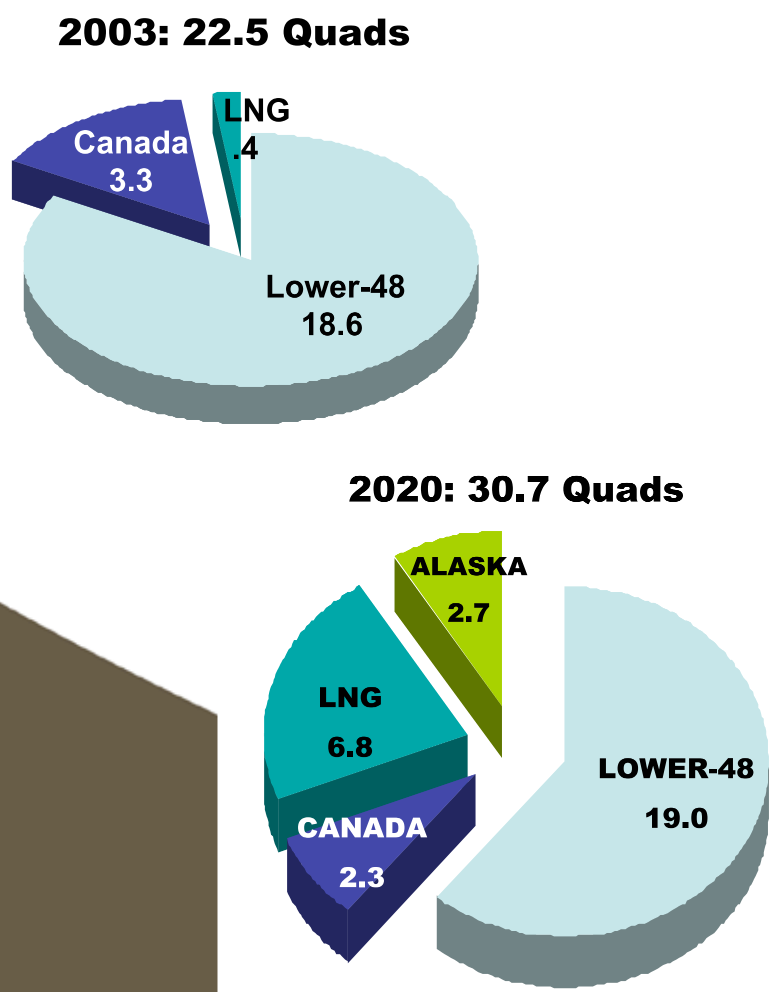
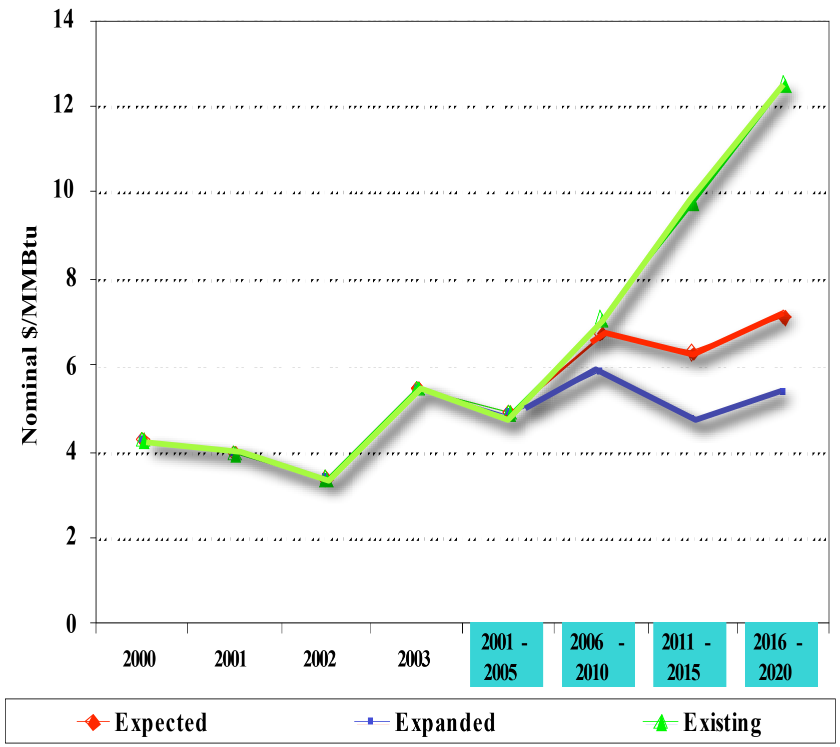
Investment even more critical over time





Forecasted prices are in 5 year averages

Source: AGA - American Gas Foundation

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Energy Policy Act - 2005

- EPA 2005 is about supply and infrastructure, not ratemaking
  - Encourages deepwater and non-traditional resource development with tax credits
  - Encourages Nuclear and Clean Coal electric generation
  - Streamlines and clarifies pipeline, LNG, other storage siting and permitting requirements
  - Encourages demand side management through efficiency tax credits
  - Helps rationalize infrastructure ownership with the repeal of PUHCA

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EPA 2005 – LDC Infrastructure

- Gas distribution system infrastructure encouraged with accelerated depreciation
  - Tax depreciation timeframe shortened from 20 to 15 years
  - State jurisdictions do not adopt tax depreciation rates for ratemaking purposes, but tax expense will change
  - Will encourage investment by LDCs
    - Large LDCs can remove supply bottlenecks, enhance on-system storage, and undertake other access improving investments
- Encouraging creative investments on the part of LDCs may require creative rate treatment from regulators in addition to the tax benefits

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PUHCA Repeal

- Removes barriers to efficient allocation of capital in critical energy infrastructure
- Potential ratemaking impacts include:
  - Affiliate transaction pricing
    - Service Company "at cost rule"
  - Increase likelihood of mergers among utilities
    - How will merger synergies be treated?
  - Uncertainty as to "safeguards" states may adopt
    - Will states develop "mini-PUHCAs"

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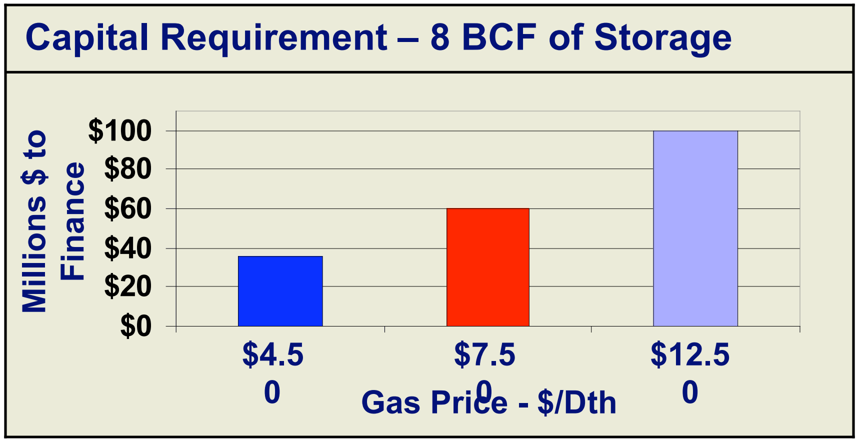
Digression on the value of Mergers



- The cost of financing storage alone is reason enough to drive some mergers
  - Smaller utilities simply cannot attract the necessary capital
  - Companies that cannot finance winter storage, certainly cannot finance critical infrastructure
- Lower expenses created by synergies and technology deployment also support mergers

- PUHCA repeal
  - Effective ring fencing to ensure that customers of regulated utilities are not harmed by non-regulated activities is good business and good regulatory policy.
  - 50 "mini-PUHCAs" at the state level is bad public policy and defeats the efficiency enhancing purpose of repealing the Depression era Act.
- Consolidation is a must
  - Regulators should not disincent merger and acquisition activities
- Merger execution more important than the ability to "make a deal"

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Modern Rate Case

Traditional Elements

Establish the Test Year

Historic Expenses | Projected Expenses

Expenses include: O&M, Depreciation, Taxes , etc.

Rate Base

Determine Value of Rate Base, Capital Structure, and ROE

Address Contentious Issues:
- Appropriate Test Year
- Service Company and other Allocations
- Others will arise

Expenses + Return = Revenue Requirement

Class Cost of Service Allocations & Rate Design

Modern Twist

Progressive Ratemaking: (Finding Settlement Positions)
- Rate Freezes
- ROE Sharing
- Service Quality benchmarks

Addressing Competition:
- Complex Rate Designs
- Transition Costs
- New set of interveners

Short-term view staff positions

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Back to Basic and Progressive Ratemaking

- Traditional rate making are elements still reviewed
  - Not necessary for progressive ratemaking, but Commissions normally want the complete review
- Rate Freezes and ROE sharing mechanisms are the most common non-traditional rate case outcomes
  - Provides rate and regulatory stability
  - Can be structured to include capital or infrastructure improvements or to address other issues

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FERC Rulemakings

- Market Based Rates for Storage
  - Facility may have market power and still be granted market based rate authority
  - No Rate Cases / Reduced Regulatory Compliance costs
  - Rulemaking initiated – Initial comment period ongoing

- PUHCA Repeal:
  - FERC has complete necessary rulemaking
    - FERC rules have limited implications for LDCs

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State Activities

- PUHCA repeal related rulemakings
  - Several states have initiated, more are considering, out comes are uncertain
  - Many state will likely handle the issues on an ad-hoc basis through ring fencing requirements and through ratemaking orders
- Many states have shown interest in encouraging infrastructure and exploration and production
  - Mostly at the legislative, not necessarily commission levels
  - Legislative intent and commission stances may have to be reconciled

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Impact of the Act

- Supply and infrastructure issues are more critical than they have been in years
- EPA 2005 encourages many of the right activities:
  - Infrastructure investment
  - New supply sources
  - Fuel diversity in electric generation
- All these improve supply/price situation for customers

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The New Modern Rate Case

- The modern rate case cannot be only about determining the cost of service
  - It must be about total cost to consumers and that means addressing supply and infrastructure from the wellhead to the burner tip
- Commissions and companies must address the new challenges as partners to find common solutions
  - Commissions and companies must be progressive and take a long term view of meeting customers needs

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