



OC's Position and Recommendations on an Appropriate GPIM for GM

Presented before the Régie de l'énergie

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OC's Position on GM's GPIM (Gas Procurement Incentive Mechanism) Proposal

- GM's Proposal for a Performance Indicator for Optimizing Supply Tools should be rejected, rather than modified or improved
- Proposed Performance Indicator deeply flawed for five key reasons discussed in Section 3.2 of OC Report:
 - Asymmetric awards and penalties
 - 2010 Benchmark too easy to beat
 - 2010 Benchmark amounts to a retroactive reward for actions already undertaken and approved by the Régie to optimize the supply structure
 - Potential to increase the regulatory burden
 - Has a much higher incidence on D1 consumers than on other rate classes.

GM's GPIM Proposal Contravenes Key Recommendations Set Out by Costello and Wilson

- Contravenes two key recommendations from Costello and Wilson for GPIM Design Principles and Characteristics (p. 17 of Appendix 1):
 - set sharing rules to provide strong, symmetric incentives under all conditions;
 - define the benchmark to approximate a reasonable strategy – not too easy to beat.
- Fails to deliver on the central objectives of most GPIMs: to provide true incentives for the achievement of lower short-term costs; and to reduce the regulatory burden.

Key Flaws GM's Proposal – Response to Yesterday's Hearings

- Proposed 2010 benchmark is unacceptable, for reasons set out in OC's Report and summarized below
- Yesterday's hearings only further convinced OC that this benchmark is fatally flawed
- other areas of concern include:
 - GM's unwillingness to consider any form of risk-sharing with customers
 - GM's unwillingness to include the gas commodity in the proposed GPIM

Why the 2010 Benchmark is Unacceptable

- too easy to beat, such that GM need not achieve superior performance to earn a bonus
- amounts to a retroactive reward for actions that have already been undertaken (and approved by the Régie) to optimize the supply structure (notably the actions put in place to displace the supply structure to Dawn, approved by the Régie in D-2012-158)

Benchmark is Too Easy to Beat

- 2010 benchmark too easy to beat such that GM need not achieve superior performance to earn a bonus
- Result = inequitable transfer of wealth from consumers to Distributor
- Particularly true for transportation costs because Dawn is much closer to GM service territory than is Empress
- Between 2010 and 2012, GM began the process of optimizing purchase locations (to purchase more Gas at Dawn and decrease purchases at Empress, thus incurring significant savings on transportation).
- With displacement of supply structure to Dawn now scheduled to begin in November 2015, the optimization of the purchase locations will be significantly strengthened
- **Therefore, the choice of a 2010 benchmark is too easy to beat and will be easily beaten every year of the proposed GPIM (2014-2018)**

Benchmark is Too Easy to Beat – cont'd

- Guarantees an award for prudent past management decisions to optimize supply structure
- As of 2016 onward, when supply structure moves to Dawn, GM's bonus will increase dramatically (possibly up to \$5M cap), not due to superior performance, but due to use of a 2010 benchmark that predates deep changes in optimization of purchase locations
- If \$5M cap achieved after displacement to Dawn, the GPIM will fail to provide any incentive at all for further improving performance
- "Benchmarks that are too easy to beat" identified as a common pitfall in GPIM Design and Structure by Costello and Wilson in the NRRI GPIM Report ("A Hard Look at Incentive Mechanisms in Natural Gas Procurement") in Appendix 1 of the OC Report

2010 Benchmark Amounts to a Retroactive Reward for Actions Already Undertaken

- A GPIM should apply to actions going forward (undertaken in year of application of the mechanism), and should not reward past performance, especially relative to a five-year old benchmark, no matter how laudable that past performance has been
- According to Costello and Wilson: the objective of most GPIMs is to provide incentives for lower short-term procurement costs.
- Use of 2010 benchmark will very substantially reward GM for actions already undertaken (and approved by the Régie) to optimize locational purchases, which were made between 2010 and 2012
- OC has been supportive of decisions undertaken by GM regarding the optimization of purchase locations and shift to Dawn, as prudent response to the current context and prudent management on the part of GM; but GM has already been paid for this prudent management through ROE and recovery of costs.

Other Concerns about GM's Proposal – No Sharing of Risks

- GM's unwillingness to accept any form of risk-sharing with customers
 - Inequitable towards consumers
 - Provides distorted incentive for risk-taking
- OC agrees that the nature of the risk to GM is completely different for a GPIM than for an IM on distribution services (where GM generally has more control of outcomes). But this does not imply that sharing rules have to be completely asymmetric in terms of awards and penalties - with zero risk-sharing and only upside for GM.
- Examples of GPIMs in other jurisdictions with penalties for non-achievement of targets (CA: PG&E, SoCal Gas)

Other Concerns about GM's Proposal – Unwillingness to Include Commodity in GPIM

- Including gas commodity in a GPIM is a common practice, to provide distributors with an incentive to lower supply costs by buying at the lowest cost time(s) and location(s)
- All procurement decisions are interrelated, so excluding commodity can create a distortion in incentives (Régie cross yesterday)
- Overarching goal of GPIM is to minimize overall gas costs, so including commodity helps to optimize decision-making to achieve lowest overall gas costs
- The GPIM should be neutral wrt overall level of gas prices and the benchmark would require a true-up for the general level of gas prices

Extension of the Provisions for the Optimization of Financial Transactions

- GM proposing to extend the provisions of the recently expired Incentive Mechanism relative to sharing for the optimization of financial transactions for 2012
- OC Report recommended rejecting the proposal for:
 - Asymmetric awards and penalties
 - Question validity of provisions from an expired IM that was negotiated as a package
 - Proposed extension of provision increases the regulatory burden by setting up a mechanism that applies remaining 6 months of the 2013 rate year
- Yesterday, GM raised asymmetry of sharing is not a valid concern for 2013
- Does not change our recommended rejection of this proposal
- In IR response to the Régie (C-OC-0038), we referenced a targeted IM for Transaction Services used at EGD and approved by the OEB and suggested that the Régie may wish to explore such a mechanism in the case of GM, in the event of a delay in the approval of a more global GPIM

Recommendations: Reject GM's Proposals

- As set out in OC Report:
 - GM's Proposals should be rejected (rather than modified or improved)
 - Both Performance Indicator for 2014-2018 and extension of provisions in the recently expired IM relative to optimization of financial transactions (proposed for 2013)
 - GM has failed to meet its burden of proof to demonstrate that these proposals are well-structured incentive mechanisms that will lead to superior performance while lightening the regulatory burden

Recommendations: Consider Delaying the Implementation of a GPIM Until After the Shift to Dawn

- As set out in OC Report:
 - Delay the application of a global GPIM until conditions stabilize and the displacement to Dawn has been completed
 - Since 2016 is the first year of the displacement to Dawn, consider setting a historic benchmark of 2016 and starting the application of the GPIM in 2017
- As set out in OC IR response to Régie(C-OC-0038):
 - in the event of a delay in the approval of a more global GPIM, the Régie may wish to explore a targeted IM for Transaction Services, such as the one used at EGD, characterized more equitable sharing of awards and penalties.

Alternative Recommendation

- If Régie wishes to implement a GPIM earlier than 2017, OC would recommend consideration of a forward-looking benchmark
- Such a benchmark would have the following qualities:
 - Simple
 - Global (includes commodity and optimization of transactions, operational and financial if possible)
 - Not too easy to beat
 - Consistent with Recommended GPIM Design Principles of NRRI report and best practices in other jurisdictions
- Designed with Expert assistance

Respond to Régie Letter (A-0106)

- OC recommends that GM's Proposal for a Performance Indicator for Optimizing Supply Tools should be rejected, rather than modified or improved
- Therefore the Régie's suggestion to hold technical meetings with an expert on the intervenor side and the presence of Régie staff is consistent with our position
- Complex topic that requires high-level of expertise

Respond to Régie Letter – cont'd

- Recommend that the Régie provide guidance in its decision regarding the nature and the structure of the meetings in order to guaranty efficient and successful meetings.
- A challenge for a Working Group to participate in the design a highly technical proposal so we recommend fewer meetings (maybe 4-5, monthly not weekly) to encourage more thoughtful participation.
- Key that written materials from GM be provided well in advance (at least a week) to allow intervenors to respond in a timely manner and possibly make presentations at the meeting.
- Need to ensure that intervenors can participate actively in the meetings with adequate time and budget to prepare; additional budget for enhanced participation; and adequate expert assistance.

Respond to Régie Letter – cont'd

- Recommend that the Régie provide guidance in its decision regarding the nature and the structure of the meetings in order to guaranty efficient and successful meetings.
- Meetings should explore the possibility of implementing a forward-looking benchmark that is simple; global (potentially including commodity and optimization of transactions, operational and financial if possible); not too easy to beat; in a GPIM that allows for some risk-sharing and is consistent with current best practices in other jurisdictions.
- James Wilson, author of NRRI/PUF report filed in this evidence, and OC's expert in the GM IM case, is available to provide expert assistance; James testified for PG&E regarding their GPIM in 2003 and recommended a simple, global forward-looking benchmark that is still in place today.