DECISION MEMORANDUM

TO: **COMMISSIONER KJELLANDER**
COMMISSIONER SMITH
COMMISSIONER HANSEN
COMMISSION SECRETARY
COMMISSION STAFF
LEGAL

FROM: **JOHN HAMMOND**

DATE: **JUNE 18, 2003**

SUBJECT: **IN THE MATTER OF THE APPLICATION OF INTERMOUNTAIN GAS COMPANY FOR AUTHORITY TO INCREASE ITS RATES FOR SERVICE, CASE NO. INT-G-03-1.**

On May 7, 2003, Intermountain Gas Company filed an Application with the Commission for authority to place into effect new rate schedules that would result in an overall increase of approximately $61 million or 37.76% in revenues. The Company requested an effective date of July 1, 2003 for its proposed rate schedules. On May 28, June 4 and 5, 2003, the Commission convened public workshops and hearings in Boise, Idaho Falls and Twin Falls. Pursuant to the Commission's Notice of Modified Procedure, persons interested in submitting comments were requested to do so no later than June 13, 2003. Order No. 29242 at 5. Intermountain Gas was required to file any reply comments no later than June 17, 2003.

THE APPLICATION

Intermountain Gas requests authority to pass through to each of its customer classes the change in gas related costs resulting from: (1) changes in Intermountain Gas's firm transportation and storage costs resulting from the Company's management of its storage and firm capacity rights on pipeline systems including the Williams Northwest Pipeline ("Williams" or "Northwest"); (2) an increase in Intermountain Gas's weighted average cost of gas ("WACOG"); (3) an updated customer allocation of gas related costs pursuant to the Company's purchased gas cost adjustment provision; and (4) the inclusion of temporary surcharges and credits for one year relating to gas and interstate transportation costs from the Company's deferred gas account. Application at 3-4. The Company also requests authority to eliminate the temporary surcharges and credits included in its current prices during the past 12 months. *See*

Case No. INT-G-02-3. The aforementioned changes will result in an overall price increase to Intermountain Gas's RS-1, RS-2, GS-1 and LV-1 customers and a decrease to Intermountain Gas's T-1 and T-2 customers.

The overall effect of the Company's proposed changes in this would be an increase in Idaho revenues of 60,972,028 or a 37.76% increase. The net increase is made up of:

Permanent Adjustments:

• Elimination of Surcharges and Credits from INT-G-02-3	$10,163,440
• WACOG Adjustment	$47,034,183

Temporary Surcharges and Credits:

• Fixed Cost Collection Adjustment	$2,217,435
• Uncollected Gas Costs in Account 186	$4,427,982
• Market Segmentation	($2,366,437)
• Miscellaneous Gas Costs & True Ups	($504,575)

The following tables represent Intermountain Gas's proposed changes in rates per customer class.

Customer Class	Revenue	Proposed Average Increase $/Therm	Proposed Average Increase % Change	Proposed Average Price $/Therm
RS-1 Residential	33,384,066	0.23826	33.44%	0.95075
RS-2 Residential	108,992,880	0.23129	37.90%	0.84164
GS-1 General Service	74,025,514	0.23886	42.49%	0.80100
LV-1 Large Volume*	2,089,088	0.22058	53.91%	0.62976

*T-1 Tariff price plus the Weighted Average Cost of Gas (WACOG) $0.50305 per therm
WACOG = total commodity cost of gas / total purchase therms

Transportation	Revenue	Proposed Average Increase $/Therm	Proposed Average Increase % Change	Proposed Average Price $/Therm
T-1 Transportation	3,338,014	(0.00421)	-4.22%	0.09554
T-2 Transportation	602,291	(0.00024)	-0.89%	0.02672

Intermountain Gas proposes to allocate the change in rates to each of its customer classes in accordance with its PGA tariff and approved cost-of-service methodology.[1]

[1] *See* Case Nos. INT-G-95-1, INT-G-88-2 and U-1034-137.

The Company also requests that the Commission set its WACOG at $0.50305 as it believes that the current forecast for market prices for natural gas dictate that it be set at this level as compared to the $0.32000 per therm currently included in the Company's tariffs. However, Intermountain Gas states that forward market prices for gas could be subject to fluctuations. Accordingly, the Company is committed to file an application with the Commission prior to this winter's heating season should those forward prices materially deviate up or down from its proposed WACOG.

The Company contends that its Application has been brought to the attention of its customers through a customer notice and by a press release sent to daily and weekly newspapers, and major radio and television stations in the Company's service area.

PUBLIC HEARINGS

The first of three scheduled workshops and hearings was held in Boise on May 28, 2003 at the Commission's hearing room. One Intermountain Gas customer attended the workshop. No customers testified at the hearing. Additional workshops and hearings were held on June 4, in Idaho Falls and June 5, in Twin Falls. Two customers attended the Idaho Falls workshop. One customer testified at the hearing. In Twin Falls, no customers were in attendance at either the workshop or hearing. Television and newspapers covered all three meetings and hearings.

WRITTEN COMMENTS

A. Public Comments

The Commission has received written comments from 185 customers. None favored the Commission authorizing the proposed rate increase. Two of the respondents stated that if such an increase were warranted, only part of the increase should be granted. They further recommended that the Commission review wholesale gas prices in six months and if they have not declined, the Commission could order further rate increases. One customer, a farmer, said that $8,600 in additional unbudgeted costs that he would incur as a result of one rate case increase "will cut in a very thin margin, possibly into a loss situation."

B. Advanced Energy Strategies, Inc.

Intervenor, Advanced Energy Strategies, Inc. ("AES") filed written comments on June 13, 2003. AES asserts that Intermountain Gas has done very little to proactively mitigate the effect that rising natural gas costs have had on its customers. AES contends that this action, or lack thereof, is a business strategy employed by IGC to purposely allow and facilitate a rise in retail gas rates in order to increase incremental revenues from captive customers. Furthermore, AES asserts that Intermountain operates its facilities and has marketing practices that provide a maximum benefit to the Company's owners at the expense of residential and small commercial ratepayers who do not qualify for participation in transport gas rate schedules. Specifically, AES raises concerns regarding three broad topics that it contends helps to maximize investor value at the expense of ratepayers. First, AES raises concerns regarding the operation of Intermountain's natural gas storage facilities in Nampa, Idaho. AES believes that Intermountain Gas fills its storage facilities with relatively low cost gas that the Company has purchased and then sells it to customers at a new higher retail price. AES posits that it is unclear whether this additional revenue is flowed through to ratepayers or simply benefits Intermountain's ownership.

AES asserts that the Commission should examine Intermountain Gas's conservation efforts. AES stated that Intermountain Gas does promote energy efficiency, to a minimal degree. However, it contends it does not result in significant, measurable or quantifiable gas savings. AES contends that Intermountain does not promote or practice energy conservation in a meaningful way that might help to mitigate the impacts of aggregate consumption on the national market. AES thus suggests that the Commission review the Company's current conservation practices and review whether additional programs and measures are warranted.

Lastly, AES contends that it is possible that as the Company's gas costs raise so will its profits. AES asserts that this may not be the appropriate proceeding to consider IGC's approved rate of return, but feels that the Company's "internal hurdle rate of 12.5% represents an enviable investment opportunity available to only a very few over the past three years."

In conclusion, AES contends that it has raised valid issues that present the opportunity to examine more closely Intermountain Gas's practices. AES contends that such an examination will provide insights that will counterbalance Intermountain's arguments in support of its Application.

C. Commission Staff Comments

1. Staff Audit

Staff conducted a detailed audit of the Company's gas costs incurred in the PGA period under review. Staff verified Intermountain's profits would not increase if the

Commission granted the Company's Application. In addition, Staff states that it is currently conducting a comprehensive financial audit of Intermountain Gas.

Staff states the Company made attempts to reduce the price of gas for customers. First, it sold a large portion of its Sumas gas, then purchased a similar quantity of Rockies gas at a lower price. This resulted in reduced purchased gas costs. Second, Staff found that in 2002, the Company executed financial transactions to fix the price for a portion of gas purchased for customers to protect them from significant upward swings in the price of gas on the wholesale market. Third, Staff notes the Company continues to actively search for opportunities to market its extra pipeline capacity to maximize revenue. Intermountain's intermediary IGI has consistently bid out the Company's extra capacity appropriately or purchased the capacity itself at the highest rate allowed. Fourth, Staff found IGI has also issued three requests for proposals to meet Intermountain's short-term gas supply needs that have largely been cost-effective. Fifth, for the month of March 2002, Staff notes the Company sold all of its gas priced at the first-of-the-month index and repurchased gas on the daily market. This strategy proved effective as prices fell from the first-of-month highs to lower levels. Sixth, the Company did not renew a storage contract for some of its Canadian gas because the supplier wanted a significantly higher price for that storage capacity. Intermountain found it would be cheaper to purchase the gas during the winter than to pay significantly more for storage. Even though this appears to have been the best economic decision at the time, it did not secure the price of gas through the winter and prices have increased significantly since the decision was made. Finally, Staff found, as required by Commission Order No. 29199, Intermountain solicited proposals from several gas marketers to find the most reliable and inexpensive management partner.

2. WACOG

Staff reviewed Intermountain's transportation and gas procurement contracts, the Company's gas price forecast, and national market price trends. Based on these factors Staff states that there have been significant increases in the demand for natural gas along with market volatility and higher prices for natural gas. Thus, Staff found the Company's proposed WACOG reasonable.

Staff notes that the Commission could consider a smaller WACOG increase but current market estimates exceeded the Company's request by approximately 5 cents per therm. In addition, external factors could force the prices even higher, such as a colder than normal winter or a warmer than normal summer. Thus, even at the Company's requested WACOG deferred gas costs could be generated. Accordingly, Staff recommends approval of the Company's WACOG as requested. Staff recommends that the Commission require Intermountain to continue to file its quarterly WACOG reports for the current gas year and to also file WACOG reports for the projected 2004-2005 gas year to allow Staff to follow the same data and results the Company should be monitoring.

3. <u>Risk Management and Price Stability</u>

Staff found that the Company has greatly improved documentation of risk management activities. However, Staff notes that customers' rates clearly remain unprotected from annual market volatility. For example, RS-2 customers are still being asked for a 38% increase in rates. In fact, RS-2 gas costs will go up 57% over the last PGA cycle.

Staff questioned why 2003-2004 hedges were not secured. The Company replied "the obligation of the Gas Management Committee is not to project what prices will do nor is it the Committee's objective to 'beat' a projected WACOG, but rather to ensure Intermountain's gas supplies are purchased at a prudent price level."[2] Staff did not disagree with this practice, however, it believes the Company should add an additional element to its risk management activities that involves consideration for customer rate stability.

Staff states that there are methodologies that could provide a more disciplined approach to minimize price volatility for the Company's gas customers. Accordingly, Staff recommends that the Commission require Intermountain Gas to file a more formal risk management policy within 90 days. Staff recommends that the Commission direct the Company to formalize this policy with special emphasis on managing reliability, price, service quality, credit risk, and customer rate volatility. Staff also states that the formal policy should include trigger points or volatility limits that could be used to make hedging decisions or forward market purchases. Staff also believes that after the initial filing, this formal policy could easily be incorporated into the Company's biannual Integrated Resource Planning (IRP) process in the future.

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[2] Intermountain Gas response to Staff audit requests dated May 20, 2003.

4. Long Term Gas Purchases

Staff also voiced concerns related to the Company's recent decision not to seek formal proposals for its long-term gas needs. The Company responded to Staff that long term suppliers and producers are not responding to formal proposals any longer. Staff has not been able to ascertain the validity or reasonableness of this position because there have been no formal proposals for Staff to review. Staff believes it is reasonable to ask the Company to perform at least the same level of due diligence for long-term contracts as it does when it looks for short-term arrangements. Staff contends that reliability and credit worthiness should be a part of the formal process documentation for long-term as well as short-term contracts. Thus, Staff recommends that the Company perform a formal Request for Proposals with closed bids submitted to Intermountain Gas for independent evaluation when searching out new long-term supply and transportation arrangements.

5. Demand Side Management

Staff encouraged the Company to continue its current programs, mass media and website activities to promote the efficient use of natural gas. These media activities provide all customers with valuable conservation information and provide individuals with ways to reduce their own monthly energy bills. Staff also recommends that the Company continue to explore new DSM opportunities for its customers.

6. Customer Notice

Staff found that customers were notified of the Company's Application by bill stuffer and had until June 13, 2003 to file comments with the Commission. Staff reviewed the customer notice and press release and determined both complied with the notice requirements of IDAPA 31.21.02.102. The customer notice was mailed with cyclical billings beginning May 7, 2003 and ending June 4, 2003.

7. Customer Service

Based on past experience with increases in rates, Staff states that complaints and inquiries regarding Intermountain Gas would increase significantly in 2003-2004. Similarly, Intermountain Gas would see an increase in the number of customers that contact the Company directly. During the 2001-2002 heating season, customers had a difficult time getting through on the Intermountain Gas Customer Service telephone line. After reviewing Intermountain's Service Levels and Abandoned Call data, Staff is concerned about Intermountain Gas's ability to handle an increased volume of incoming telephone traffic that might be expected following another major rate increase.

Staff notes that Intermountain Gas claims it has taken steps this year that will allow them to handle the additional incoming calls generated as a result of the proposed price increase. Since 2002, three additional full-time customer service representatives have been hired and two full-time, temporary positions were created. Also, three representatives in outlying local offices have been identified as remote agents who can step in and answer calls during peak times if needed. Customers can also communicate with the Company through the Intermountain Gas Website at www.intgas.com. Intermountain Gas claims their e-mail response time is within 24 hours. Staff also suggested the Company use a facsimile machine for customers to submit complaints and inquiries, who are unable to reach Intermountain by telephone during peak times. This method could be employed when call volumes reach unacceptable levels by playing a message while customers are waiting on hold giving them the option of sending a fax. This would be in addition to reminding customers of Intermountain's Website.

Consumer Assistance Staff also suggests an additional Level Pay promotion be offered in September of this year. A Level Pay promotion just before the winter would encourage customers to sign-up for Level Pay in the fall and average their projected higher usage winter bills over a longer period of time. Staff believed this would help to address approximately one third of the comments from customers on fixed incomes who worried that they could not afford a 38% increase in winter heating costs.

8. Staff Recommendations

Based on the foregoing comments, Staff recommends that:

1. The Company's proposed WACOG of $.50305 be approved.

2. The proposed temporary surcharges and credits be approved.

3. The Company seek formal or informal proposals for long-term gas supplies as well as short-term supplies.

4. The Company continues to increase its documentation regarding its purchase and other decisions.

5. Intermountain continue to file its quarterly WACOG reports for the current gas year and also begin filing WACOG projections for the subsequent gas year as well.

6. The Commission direct the Company to formalize its risk management policy with special emphasis on managing reliability, price, service quality, credit risk, and customer rate volatility and file this formalized written policy within 90 days.

7. The Company allow customers to ask questions and seek service through facsimiles as well as over the phone and through the Internet.

8. Intermountain perform an additional Level Pay promotion in September to allow customers the opportunity to sign up before the winter heating season. Customers would be encouraged to sign-up for Level Pay in the fall and average their projected higher usage winter bills over a longer period of time.

D. Intermountain Gas's Reply Comments

First, the Company states that it will continue to seek both formal and informal proposals for gas supplies and will continue to document its efforts. However, the Company reiterated that no long term producer or supplier who sells to Intermountain is willing to directly negotiate a fixed price. Thus, formal proposals are not feasible. In addition, the Company states that it continues to ensure that its supplies are aligned with secure, reliable, reputable and credit worthy producers and suppliers who it is comfortable will always provide firm, uninterrupted gas supply for its core market needs. The Company also states that the ability of its long-term suppliers to meet the benchmarks for creditworthiness and ability to deliver firm, uninterrrupted supplies have all been established in the market and thus, need not be tested through a formal RFP process. The Company also states that it will continue to file its quarterly WACOG reports for the current gas year and can also begin filing WACOG projections for the subsequent gas year as well.

The Company also states that it has a formal Gas Management Risk Management Policy and will continue to review and discuss gas management strategies that incorporate Staff's recommendations. However, the Company states because it is a Policy and not a Procedure Manual it needs to be flexible while still providing general direction. To this end the Company states that within 90 days it is willing to make documentation available to Staff regarding these strategy reviews and the outcome of these reviews as it pertains to any action taken by the Commission.

The Company also states that it has begun the process to implement using the facsimile machine to respond to customer inquiries and anticipates providing such a service within the next several weeks. Intermountain Gas also states that it will perform a September Level Pay promotion.

Intermountain Gas also responded to AES's comments. The Company states that AES's assertions wrongly speculate that Intermountain Gas is engaged in questionable activities. The Company also points out that AES did not attend any of the workshops or hearings and did not submit any data requests to the Company.

Intermountain Gas asserts that contrary to AES's comments it is not profiting in any way by a rise in retail natural gas prices as demonstrated by the Company's practices and documented findings by the Commission Staff. The Company also asserts that contrary to AES's comments that it promotes several avenues for the wise and efficient use of natural gas and that these are documented in the Company's Integrated Resource Plan. Finally, Intermountain Gas asserts that contrary to AES's comments that the Company does not receive a rise in its profit margin due to any Commission authorized upward change in its WACOG.

Intermountain Gas states that the comments provided by AES provide little or no value to its customers and in fact provide "misleading, if not slanderous, information" to any who read them.

COMMISSION DECISION

1. Does the Commission wish to approve the Company's proposed temporary surcharges and credits contained in its PGA Application?

2. Does the Commission wish to approve the Company's proposed WACOG of $.50305?

3. Does the Commission wish to require the Company to seek formal or informal proposals for long-term gas supplies as well as short-term supplies?

4. Does the Commission wish to direct the Company to continue to increase its documentation regarding its gas purchases and other decisions?

5. Does the Commission wish to require Intermountain Gas to continue to file its quarterly WACOG reports for the current gas year and also begin filing WACOG projections for the subsequent gas year as well?

6. Does the Commission wish to direct the Company to formalize and file its risk management policy with special emphasis on managing reliability, price, service quality, credit risk, and customer rate volatility, within 90 days?

7. Does the Commission wish to require the Company to allow customers to ask questions and seek service through facsimiles as well as over the phone and through the Internet?

8. Does the Commission wish to require Intermountain Gas to perform an additional Level Pay promotion in September to allow customers the opportunity to sign up before the winter heating season?

John Hammond

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