Office of the Secretary
Service Date
June 30, 2004

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF INTERMOUNTAIN GAS COMPANY FOR AUTHORITY TO INCREASE ITS PURCHASED GAS COST ADJUSTMENT (PGA) RATE.	))))))	**CASE NO. INT-G-04-2** **ORDER NO. 29540**

On May 5, 2004, Intermountain Gas Company (Intermountain Gas, Company) filed its annual Purchased Gas Cost Adjustment (PGA) Application (Application) with the Commission for authority to place into effect on July 1, 2004, new rate schedules that will increase its annualized revenues by $22.1 million. The PGA account is a deferral mechanism for over- and under-collections and for realized savings on spot market gas purchases. Intermountain Gas supplies natural gas to approximately 200,000 customers in southern Idaho. If its Application is approved, Intermountain Gas's rates will increase on average by approximately 10%. Because of changes in its gas-related costs, Intermountain Gas's earnings will not be affected as a result of the proposed increase in prices and revenues.

The Commission issued a Notice of Application, Modified Procedure and Comment Deadline on May 12, 2004. Order No. 29500. As of the comment deadlines, the Commission received input from the Northwest Industrial Gas Users (NWIGU), Idaho Community Action Network (ICAN), Commission Staff, 17 individual customers, and a response from the Company. After reviewing the comments and record in this case, the Commission grants the Application, changes the time frame for future PGA filings, and establishes risk management requirements as set out in greater detail below.

THE APPLICATION

With its Application, Intermountain Gas seeks to pass through to each of its customer classes a change in gas-related costs resulting from: 1) changes in Intermountain Gas's firm transportation and storage costs resulting from management of its storage and firm capacity rights on pipeline systems, 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 Intermountain Gas's deferred gas cost account. Application at 3-4.

Intermountain Gas proposes increasing the WACOG from the $0.47500 per therm[1] currently included in the Company's tariffs to $0.55492 per therm. The Company states it believes that current future prices, subject to the laws of supply and demand, are poised to soften. Although current commodity future prices dictate the use of this $0.55492 per therm WACOG, Intermountain Gas committed to come before the Commission prior to this winter's heating season to amend these proposed prices if forward prices materially deviate from the $0.55492 per therm. *Id.* at 5.

COMMENTS

A. Northwest Industrial Gas Users

NWIGU is a non-profit trade association comprised of 32 end-users of natural gas with major facilities in the States of Oregon, Washington, and Idaho. NWIGU members include diverse industrial interests that purchase transportation services from interstate pipelines and purchase sales and transportation services from local distribution companies like Intermountain Gas.

In response to the Commission's request for comments on whether Intermountain Gas's PGA applications in this and future cases should be processed and approved closer to the winter heating season, NWIGU supported retaining the current annual filing structure with rates effective July 1. NWIGU does not perceive any customer benefit from a change in the effective date of Intermountain Gas's PGAs for either the current filing or in the near future.

NWIGU members are concerned with the significant cost increases reflected in the current Intermountain Gas filing, in particular for T-1 and T-2 firm transportation services (with 16% and 24% proposed increases, respectively). Changing the effective date of this filing will only increase the magnitude of the costs to be collected if 15 months of costs (12 months plus three months delay) are then collected on a 12-month amortization schedule. If the Commission does change the effective date of the current Intermountain Gas PGA, NWIGU respectfully

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[1] A "therm" is a commercial unit of heat energy and comprises approximately 100 cubic feet of natural gas. A therm is equivalent to 100,000 Btus (British thermal units).

requests that the costs be amortized over a longer period of time so that the rate impact of date shifting is mitigated to the T-1 and T-2 customers.

B. Idaho Community Action Network

On behalf of its members and low-income customers, ICAN opposed the PGA increase requested by Intermountain Gas. ICAN argued that the proposed average 10% increase in residential rates is too much for low-income families to absorb. Intermountain Gas's records show that many of its customers are having trouble paying their power bills. During the 2002-03 winter heating season, 6,207 households taking service from Intermountain Gas received LIHEAP assistance, 2,592 declared moratorium eligibility, and 728 were disconnected in March, April and May of 2003 for non-payment. Raising the rates by 10% would make it even harder for these families to keep their heat on this winter.

ICAN requested that the PUC hold public hearings before deciding this Application because of the large effect a 10% rate increase would have on consumers. ICAN contends hearings would also help educate the public on the issues and allow for additional consumer input from people who are more comfortable speaking rather than writing down their opinions. Finally, ICAN asked the PUC to delay deciding on the PGA increase until the fall when: 1) people will be more interested and likely to participate, and 2) the PUC can make a more informed decision about winter rates when there is more information available.

C. Commission Staff

Staff has reviewed the Company's filing and related documentation to verify that the Company's earnings will not increase because of the filing. Staff particularly described: 1) Intermountain Gas's new gas contracts for purchase and storage management, 2) Intermountain Gas's 2003-2004 financial hedge transactions, 3) the IGI Resources administrative contract, 4) past and future market prices affecting the weighted average cost of gas (WACOG), 5) alternatives to the WACOG proposed by the Company, 6) customer notice of the Application, and 7) customer relations issues.

WACOG and Timing of PGA Cases: To more closely align rate changes with the winter heating season, Staff believes the Commission should direct the Company to file its *next* PGA case during the late summer of 2005 for an effective rate change on or about the end of October 2005. Staff also recommended the Commission implement the Company-proposed WACOG through fall of 2005 unless the forward prices decline materially before that time.

While noting the diminished price signal associated with raising rates in July when customers may not notice, Staff also recognized that a single increase in October 2004 could be even more severe and would provide customers little additional time to react or prepare. If this Application's WACOG is not approved, Staff estimated that the Company would likely defer an additional $5 million in gas costs to be included in the surcharge by October 2004. Staff also recommended that the Company be directed to continually monitor its WACOG and implement an immediate WACOG adjustment if natural gas costs/prices materially decline.

Risk Management and Hedging: Staff is particularly concerned that despite clear Commission statements regarding the need for customer rate stability, a reasonable purchase methodology, a need for a risk management strategy and requirements for increased documentation, it is still unclear how the Company makes fixed-price decisions because the Company's purchase strategy does not allow for any method of measurement or systematic review. Staff believes the current written policy is so broad that it allows the Company to simply guess when using management discretion to make decisions rather than conducting a thorough analysis.

As a result, Staff could not state with certainty that the Company's decisions (or lack thereof) related to hedging were prudent. For example, last winter IGI presented the Company with an opportunity to secure 2004-2005 gas at a price of $0.4511, below the WACOG of $0.475 in place at the time. This price hedge would have guaranteed a decrease during the next PGA period while providing significant price protection. However, the Company decided to wait and perhaps hedge the price if it fell below $0.425/therm. Gas prices did not fall to $0.425/therm and in fact rose to its current projected level of $0.55492/therm. It is this undocumented decision-making and apparent reliance simply on a price view that Staff believes is inappropriate. Although it is inappropriate to lock in high prices solely for the sake of stability, Staff believes that not locking in at least some gas under a layering approach at prices below the current WACOG was a mistake. Even if prices had declined below the prices that were locked in, additional hedges could have been purchased and customers would have received a lower price in the next period, providing significant price protection.

Staff continues to advocate a hedging policy that includes volatility limits and purchase points and has discussed this approach to hedging with the Company. The need for established policies and procedures that include reference or trigger points, an action point linked to the WACOG currently in rates, and layering concepts for hedges have been the primary focus of these discussions. According to Staff, Intermountain Gas's management has committed to expand its policy and procedures to better identify these concepts and further document its activities. Intermountain Gas's management will develop and present to its Risk Committee a more concrete proposal with recommended changes to its policy and procedures. The proposal will then be presented to Staff for additional discussion.

Without some financial accountability, it appears that the Company has not, and currently will not, routinely make forward fixed-price decisions for customer rate stability using a reasonable, systematic and methodical approach. Consequently, Staff recommended the Commission reserve $696,276[2] for possible future adjustment if the Company does not present the Commission by December 20, 2004 with: 1) reasonable documentation and rationale for its hedging inaction last winter, and 2) enhanced risk management policies and procedures.

D. Individual Customers

The Commission received 17 written comments from customers, all opposing any increase. Eight of the commentors questioned the need for an additional increase after the 33% increase granted last year. One stated, "All the utility companies need to be reined in. Rates are already too high." Five indicated that they are seniors on fixed incomes. Four of the comments mentioned the proposal to change the time of year for reviewing the PGA. Two thought the PGA review should take place closer to the heating season; two did not think the time of year made any difference.

E. Company Reply

WACOG and Timing of PGA Cases: In a response filed June 17, 2004, Intermountain Gas concurred with the Staff's recommendation to implement the Company-proposed WACOG on July 1, 2004. In regard to future PGA applications, the Company noted that postponing the next PGA price adjustment until the late fall of 2005 might have negative implications to customers. Additional months of deferred gas costs beyond a 12-month period cause upward price pressure on the PGA, primarily from fixed costs paid to the various pipelines that Intermountain Gas recovers from customers during the warm, low sales volume periods of

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[2] This amount is 10% of the savings customers would have achieved had the Company locked 25% of its 2004-2005 gas needs on December 8, 2003 when natural gas options priced at $.4511/therm were available to reduce the current forecasted WACOG of $.55492. This is based on what Staff believes would have been a reasonable hedge purchase and shares an appropriate amount of the additional cost (10%) with Intermountain Gas.

summer and fall. For example: postponing the PGA until October 1, 2004, will add an incremental 3%-4% increase to the proposed residential prices. Thus, Intermountain Gas requested a continuation of the Company's ability to request a July 1 PGA implementation date. Intermountain Gas strongly believes that a July 1 implementation date, coupled with informational mailers to customers, better enables customers to prepare for the upcoming winter heating season. Moreover, a July 1 implementation date provides customers additional months to better prepare their equipment efficiencies, conservation decisions and budgets before the winter heating season commences.

Risk Management: Intermountain Gas Company believes a review of its total performance shows that it has exercised good judgment and financial accountability. For instance, Intermountain Gas has not had to request an increase to the service component of its prices for over 20 years and recently renegotiated the Company's Asset Management and Administrative Service Agreement contracts that will save customers more than $10,000,000 over the lives of the contracts.

Notwithstanding this record, the Company respected Staff's perceived need for a more "formal, methodological or systematic strategy" with respect to the Company's WACOG to aid Staff in its review of the Company's Application. However, Intermountain Gas does not believe that the incorporation of automatic "trigger points" is in its customers' best interest because there is no substitute for good judgment employed with natural gas price fundamentals and other market indicators. However, the Company believes it can bridge the needs of the Staff with the Company's approach to decision-making and is committed to work towards that end.

The Company noted that it is preparing a risk management proposal for Staff's review and discussion before December. Intermountain Gas strongly opposes the Staff's proposal to "reserve $696,276 for future determination" pursuant to future discussions with the Staff and remains committed to work with the Staff to bridge those areas of concern.

DISCUSSION AND FINDINGS

We have reviewed the record, including the Application and comments filed by interested parties, and find that we have adequate information upon which to base our decision. In contrast to a general rate case, the annual PGA tracker considers only those changes in gas costs that are generally recognized as outside the Company's control. Although holding the public hearings requested by ICAN would certainly add to our present record, we believe that the comments received by the Commission thus far adequately represent the public sentiment on the issues presented by Intermountain Gas's Application. Thus, we find that public hearings are not necessary in this case.

A. The WACOG

The Commission is required to establish "just and reasonable" rates for utilities subject to our jurisdiction. *Idaho Code* § 61-502. The PGA mechanism is designed to pass through prudently incurred commodity costs in a timely fashion. Wholesale natural gas prices have fluctuated dramatically over the past few years, resulting in higher natural gas costs for gas utilities nationally and in Idaho. As Staff explained, "significant upward pressure remains on the price of natural gas." Staff Comments at 6. Because natural gas commodity prices are subject to supply and demand in the spot and futures markets, considerable uncertainty exists. Both Intermountain Gas and Staff believe the Company-proposed WACOG of $0.55492 per therm to be appropriate. Although Intermountain Gas believes prices could soften before winter like they did last year, forward monthly NYMEX natural gas futures for the northwest region during the 2004-2005 PGA period were in the range of $.4910 to $.6155 as of June 10, 2004. The proposed WACOG is consistent with this amount.

For the foregoing reasons, we find it reasonable to increase the WACOG from $0.47500 per therm to $0.55492 per therm. When combined with the adjustments, surcharges and credits agreed upon by Staff and the Company, rates per therm will increase on average by 10.04%. The following table indicates the annualized change in rates per customer class:

Customer Class	Proposed Increased Class Revenue	Proposed Average Increase $/Therm	Proposed Average % Increase	Proposed Average Price $/Therm
RS-1 Residential	2,880,945	0.08046	8.72%	1.00316
RS-2 Residential	11,080,132	0.08083	9.93%	0.89442
GS-1 General Service	7,495,842	0.08128	10.52%	0.85423
LV-1 Large Volume*	234,154	0.07422	12.33%	0.67593
T-1 Transportation	325,822	0.01540	16.12%	0.11094
T-2 Transportation (Demand)	109,884	0.16628	24.18%	0.85393
T-2 Transportation (Commodity)	0	0.00000	0.00%	0.00656
Total Requested Amounts	**$22,126,779**	**$0.07127**	**10.04%**	**$0.78105**

*T-1 tariff price plus the Weighted Average Cost of Gas (WACOG)

As a result of this increase, residential (RS-1) customers using an average of 48 therms per month for natural gas for space heating will experience an increase from 92¢ to $1.00 per therm, or about $3.86. Residential (RS-2) customers using an average of 69 therms per month for natural gas space and water heating will experience an increase from 81¢ to 89¢ per therm, or about $5.58. Commercial customers using an average of 299 therms per month will experience an increase from 77¢ to 85¢ per therm, or about $24.30.

The rate increase approved in this Order shall become effective on July 1, 2004. The Commission orders Intermountain Gas to adjust its billing and file new tariffs prior to implementing the new rate. *Idaho Code* § 61-618.

The Company's Application indicated that Intermountain Gas " . . . is committed to come before this Commission prior to this winter's heating season with an Application to further amend these proposed prices, should these forward prices materially deviate from the $0.55492 per therm." Application at 5. Although "materially deviate" was not defined by the Company, the Commission directs Intermountain Gas to promptly seek a rate adjustment if forward commodity prices decrease by 5% or more below the $0.55492 per therm WACOG. The Commission also directs the Company to continue to file its WACOG projections and deferred costs reports with the Commission.

As it explained in its Reply Comments, Intermountain Gas intends to send customers a reminder prior to the winter heating season that rates are higher than for the prior heating season. Included with this reminder will be: 1) conservation tips that customers can adopt to save money on their winter heating season bill, 2) contact information for those customers needing assistance for payment of their natural gas bill, and 3) payment options available to customers to include Level Pay. Reply Comments at 1. The Commission finds this approach reasonable and will send a proper price signal to customers prior to this year's heating season.

B. Timing of Future PGA Cases

The Commission asked commentors to specifically address whether Intermountain Gas's PGA applications in this case and future cases should be processed and approved closer to the winter heating season to: 1) take advantage of end-of-summer storage and market pricing data, 2) improve the effectiveness of customer pricing signals, and 3) promote customer interest in PGA proceedings when held closer to the winter heating season. Order No. 29500 at 5.

The NWIGU supports retention of the current annual filing deadline effective July 1 because it "does not see any customer benefit to altering the filing schedule this year or in the near term." NWIGU Comments at 2. Intermountain Gas also believes a July 1st implementation date coupled with the reminder mailed to customers is the best approach because it "better enables customers to prepare for the upcoming winter heating season" by providing "additional months to better prepare their equipment efficiencies, conservation decisions and budgets before the winter heating season commences." Reply Comments at 2. Comments from individual customers were evenly split between those who thought changing the filing date would be beneficial and those who did not perceive any benefit to customers.

The Commission Staff recommended the Company "be directed to file its 2005-2006 PGA establishing new rates by October 31, 2005, to more closely coincide with the heating season" to strengthen the price signal currently diminished by reduced summer time consumption. Staff Comments at 7. Like the NWIGU and Company, Staff was concerned delaying the effective date this year would add to the Company's deferred costs and leave little time for customers to prepare. ICAN also supported delaying a final decision on the PGA Application until fall when there is greater customer interest and the Commission can make a more informed decision.

The Commission is charged with setting just and reasonable rates upon the best information available to us. Due to the market volatility experienced the last several years, we have struggled to set rates using futures pricing information that projects what winter commodity prices will be six months in the future. Although we used the best information available in May, better information is available in August. We understand that commercial customers need time to plan and budget their natural gas usage. However, we believe all customers will benefit from rates based on more accurate pricing information to minimize over- and under-collection. We also believe that customers will be more receptive to the price signal sent by a fall PGA filing because of its closer proximity to the heating season.

For these reasons, the Commission finds it reasonable for Intermountain Gas to submit its PGA filings by August 15 beginning in 2005 so that the Application can be reviewed before rates go into effect October 1. By beginning the new schedule with next year's PGA filing, Intermountain Gas and its customers have enough notice to adjust their capital budgets as needed. Delaying the effective date of the next PGA filing rather than this one may mitigate concerns regarding the accrual of additional deferred costs and eliminate the need for a longer amortization period as requested by the NWIGU.

C. Risk Management Policies and Procedures

The Commission has had concerns about the nature of the Company's risk management strategies. While it is true that the Company has largely been successful using subjective "market fundamentals" in recent years, we believe Intermountain Gas must systematically minimize upside risk using a flexible methodology that can be audited. The Company's current risk management approach appears to leave Intermountain Gas and its customers more vulnerable than necessary. We previously asked and required the Company in Order Nos. 28783 and 29277 to change how it manages market risk to achieve these ends. Although considerable time has passed, these concerns have not been adequately addressed.

The Commission believes that a more systematic approach will benefit both customers and the Company in the long term. While using market fundamentals alone to lock in gas prices can be effective if Intermountain Gas correctly predicts market prices, it leaves ratepayers at tremendous risk if lower prices were not locked in when available. The Company has talented staff that continually monitors the natural gas commodity market for opportunities; we want this to continue so that ratepayers have the benefit of Intermountain Gas's considerable expertise. Enhanced hedging strategies can and should incorporate the fundamentals presently used by the Company while minimizing upside risk through layering of fixed price hedges.

The Company must continue to use good judgment and its risk management plan should be flexible enough to allow for this. To conduct prudency reviews, the Commission needs to know what information the Company used when it decided whether or not to purchase natural gas. Criteria that trigger action or Company explanations of why action was not taken are essential so that the Commission may assess the Company's decisions and avoid hindsight reviews. We are not singling out Intermountain Gas in this regard; we have previously required enhanced risk management plans and policies from Avista and Idaho Power.

In light of the foregoing, the Commission finds it reasonable to direct Intermountain Gas to create a hedging and risk management strategy that accomplishes these goals and to include the Staff in that process. The Company and Staff should incorporate volatility limits and layered purchase points as necessary to achieve rate stability without being unnecessarily rigid in design. To ensure that these important risk management issues are adequately resolved in a timely manner, the Commission finds it appropriate to reserve $696,276[3] of the upcoming 2004-2005 deferral for possible future adjustment if these enhanced policies and procedures are not presented to the Commission. The Commission will review the disposition of this hold back when the Company files its policy.

D. Level Pay

In calculating the level pay amount, Staff noted that Intermountain Gas's practice has been to divide customers' annual energy bill by 11 rather than the 12 months used by other Idaho energy utilities. Intermountain Gas explained that it is currently in the process of updating its customer billing system and the process that calculates level payment amounts. As part of that update, Intermountain Gas intends to revise the level pay calculation so that future level payment amounts will be calculated using a divisor of 12.

To be consistent in our treatment of Level Pay plans among Idaho utilities, the Commission directs Intermountain Gas to calculate level pay amounts using 12 as a divisor. Because bills will be averaged or "levelized" over an additional month, this change will make monthly level pay amounts more affordable. Intermountain Gas shall implement this change for level pay plans created after July 1, 2004, and for all existing plans as the Company reviews them for annual adjustments.

ORDER

IT IS HEREBY ORDERED that Intermountain Gas's Application is granted. The Company will file tariffs in conformance with a WACOG of $0.55492 per therm to be effective July 1, 2004. For meters read on or after the effective date of this Order, usage will be prorated back to July 1, 2004. Intermountain Gas shall promptly seek a rate adjustment if forward commodity prices decrease by 5% or more below this WACOG.

IT IS FURTHER ORDERED that Intermountain Gas pass through its proposed permanent adjustments and temporary surcharges and credits to customers as filed.

IT IS FURTHER ORDERED that $696,276 be reserved for future determination and possible adjustment pending the filing of risk management policies and procedures.

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[3] This amount is 10% of the savings customers would have achieved had the Company locked 25% of its 2004-2005 gas needs on December 8, 2003, when natural gas options priced at $.4511/therm were available to reduce the current forecasted WACOG of $.55492.

IT IS FURTHER ORDERED that Intermountain Gas send customers a reminder prior to the winter heating season that rates are higher than for the prior heating season. Included with this reminder shall be: 1) conservation tips that customers can adopt to save money on their winter heating season bill, 2) contact information for those customers needing assistance for payment of their natural gas bill, and 3) payment options available to customers to include Level Pay.

IT IS FURTHER ORDERED that Intermountain Gas file future PGA Applications on or about August 15 so that rates may go into effect on October 1.

IT IS FURTHER ORDERED that Intermountain Gas continue to record and retain copies of information used to make important decisions regarding the purchase of gas and financial transactions.

IT IS FURTHER ORDERED that Intermountain Gas continue to file updated WACOG projections and deferred costs reports with the Commission.

IT IS FURTHER ORDERED that Intermountain Gas calculate level pay amounts using 12 months as a divisor for level pay plans created after July 1, 2004, and for all existing plans as the Company reviews them for annual adjustments.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in this Case No. INT-G-04-2 may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this order or in interlocutory Orders previously issued in this Case No. INT-G-04-2. For purposes of filing a petition for reconsideration, this order shall become effective as of the service date. *Idaho Code* § 61-626. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 29th day of June 2004.

PAUL KJELLANDER, PRESIDENT

MARSHA H. SMITH, COMMISSIONER

DENNIS S. HANSEN, COMMISSIONER

ATTEST:

Jean Jewell
Commission Secretary

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