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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF INTERMOUNTAIN GAS COMPANY FOR AUTHORITY TO INCREASE ITS RATES FOR SERVICE.	**CASE NO. INT-G-04-2** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Lisa Nordstrom, Deputy Attorney General, and in response to the Notice of Application, Notice of Modified Procedure and Notice of Comment Deadline issued in Order No. 29500 on May 12, 2004, submits the following comments.

BACKGROUND

On May 5, 2004, Intermountain Gas Company (Intermountain, Company) filed its annual Purchased Gas Cost Adjustment (PGA) 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. Intermountain supplies natural gas to approximately 230,000 customers in southern Idaho. The PGA account is a deferral mechanism for over- and under-collections and for realized savings on spot market gas purchases. If its Application is approved, Intermountain states that customer rates will increase on average approximately 10%. Intermountain states that its earnings will not be affected as a result of the proposed increase in prices and revenues.

THE APPLICATION

Intermountain seeks to pass through to each of its customer classes a change in gas-related costs resulting from: 1) changes in Intermountain's firm transportation and storage costs resulting from the Company's management of its storage and firm capacity rights on pipeline systems, 2) an increase in Intermountain'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's deferred gas cost account. Application at 3-4.

Intermountain also seeks to eliminate the temporary surcharges and credits from Case No. INT-G-03-1 that were included in its prices during the past twelve months. These changes would result in an overall price increase to all customers. Because the Company seeks only to recover costs already incurred and costs that will increase over the next year, Intermountain's earnings will not increase as a result of the requested changes in prices. The overall effect of the proposed changes would be an increase in the Company's revenues of $22,126,779. The net increase is made up of:

Proposed Permanent Price Changes	
Increase in Producer/Supplier Costs	21,187,419
Changes in Storage and Transportation Costs	5,686,865
Adjustment to Fixed Cost Collection Rate	(448,865)
Eliminating INT-G-03-01 Temporary Surcharges	(3,693,563)
Total Permanent Price Change:	**22,731,856**
Proposed Temporary Surcharges (Credits)	
Fixed Cost Collection Adjustment	3,191,821
Capacity Release & Purchases	(539,196)
Segmentation Credits	(2,358,522)
Overcollection of 186 Accounts	(1,097,480)
Other Items	198,300
Total Temporary Price Surcharges (Credits):	**(605,077)**
Total Proposed Price Change:	**22,126,779**

Staff determined that the impact of the Company's proposal by class of service is as follows:

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)

Permanent Changes

The permanent adjustment reflects an increase in rates to raise the WACOG and associated costs of storage and delivery by $26,874,284. Intermountain proposes increasing the WACOG from $0.47500 per therm currently included in the Company's tariffs to $0.55492 per therm. The Company states that it currently believes future prices, subject to the laws of supply and demand, are poised to soften. Although current commodity future prices dictate a WACOG of $0.55492 per therm, Intermountain states it is committed to come before the Commission prior to next winter's heating season to amend the WACOG if forward prices materially deviate from those used to calculate the $0.55492 per therm. *Id.* at 5. The permanent changes also include the elimination of the temporary surcharge from last year's tracker (Case No. INT-G-03-1) and an adjustment to the fixed cost collection rate. These changes would increase Idaho annual revenues by $22,731,856.

Temporary Changes

The temporary surcharges and credits reflect the true up of prior-period costs deferred in the Company's PGA 186 accounts. The surcharges and credits are separated into a fixed cost collection deferral true-up, capacity releases and pipeline segmentation credits,[1] a refund of the

[1]Capacity releases and pipeline segmentation credits refer to the Company's rights to excess capacity on the Williams Northwest Pipeline. This pipeline is the only interstate line that runs through Southern Idaho. The excess capacity is "released" or sold to industrial users, marketers and others. The Company provides a credit to customers for the released capacity through a temporary credit that is trued-up on a yearly basis.

over collected gas costs, and other smaller items. The total amount of temporary credits requested by the Company is $605,077.

STAFF AUDIT

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 made addition findings discussed below.

New Gas Contracts for Purchases and Storage Management

During 2003 and 2004 Intermountain renewed most of its long-term contracts for supply and for storage management. These contracts were made with credit-worthy parties and have terms of up to ten years with prices tied to market indices. Intermountain prefers to set its long-term supply contracts at index prices and then use financial instruments to firm the price when appropriate. For the most part, the contracts were obtained following a Request for Proposals (RFP) process that allowed several companies to compete in meeting Intermountain's needs. One exception was a contract with BP Energy (BP) for winter gas purchases. Because IGI is a wholly-owned subsidiary of BP, and the contract was made without a solicitation of bids or another competitive process, Staff questioned whether the transaction was reasonable. However, after obtaining additional information from the Company and comparing the contract to other options, Staff believes the contract is reasonably priced and justified.

Intermountain also renewed a storage management contract with Duke Energy. Staff reviewed the selection process and the subsequent contract and believes it is prudent. Staff generally encourages the Company to obtain services and products in an open, competitive fashion. This allows Staff and the Commission the opportunity to ensure that customers receive the best price for the most appropriate goods and services.

2003-2004 Financial Hedge Transactions

During the month of September 2003, Intermountain determined that it would be appropriate to lock all gas costs for the winter of 2003. These hedges allowed the Company to purchase its gas at a price that was very close to the WACOG of $.475 per therm for the 2003-2004 PGA period. These hedges eventually ended up costing approximately $200,000 more than

the indexed market prices but provided significant upward price protection for the 2003-2004 PGA period. There are currently no financial hedges in place for the 2004-2005 PGA period.

IGI Resources Administrative Contract

During the Staff's PGA mechanism investigation, Case No. INT-G-01-1, Staff recommended and the Commission ordered the Company to solicit RFPs for its administrative services agreement with IGI Resources that was about to expire on March 31, 2004[2]. Intermountain notified IGI that it would terminate the contract and seek proposals from other companies to manage its resources. During May 2003, Intermountain requested a proposal from five entities that it determined could provide the necessary services. IGI and Avista Energy were the only entities that submitted proposals. After reviewing all aspects of both proposals, Intermountain chose IGI and signed a seven-year agreement. As part of the new contract, IGI Resources agreed to reduce its administrative fee.

WEIGHTED AVERAGE COST OF GAS (WACOG)

The requested WACOG of $.55492/therm is an increase of 17% over the $.475 WACOG currently included in Company rates. The current WACOG was approved by the Commission last year after the Company requested a WACOG of $.50305/therm. The reduced WACOG of $.475/therm was still 48% higher than the 2002 WACOG.

Although last year's Company-proposed WACOG of $.50305/therm was based on forward gas prices available at the time, market prices for natural gas softened and the Company was able to purchase financial hedges in September 2003 at prices that in aggregate were below the WACOG approved by the Commission. The result was very little accrual in the Company's gas cost deferral account and an actual reduction in the Company's deferred cost collection requested in this case.

The Commission may be faced with similar conditions again this year. Like last year, market prices are higher than the current WACOG, and forward prices on May 21, 2004 (after the Company filing) indicate market prices could produce a WACOG above the Company's request, but the Company believes prices could soften before winter.

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[2] See Order No. 29199, page 5, Case No. INT-G-01-1.

In spring and summer 2003, high natural gas prices in Idaho were caused by extremely low storage levels and increased access to Northwest gas from other market areas. In the fall of 2003 prices declined after drilling increased and storage needs were satisfied. Today even though the storage injection picture has improved for the 2004 season, significant upward pressure remains on the price of natural gas. Factors causing that pressure include oil prices at near record levels, an improving economy creating increased demand for electricity and natural gas, improved access by new markets to northwest natural gas and a new pipeline anticipated to begin delivery in 2005 from Wyoming to Kansas.

Not all market indicators are negative. Increased natural gas prices have spurred significant increases in natural gas exploration, drilling rig counts have continued to increase over the last twelve months and approximately three dozen sites are proposed for new liquefied natural gas (LNG) import terminals increasing supply opportunities from overseas. The first of the new LNG import terminals is anticipated to come online in late 2004 or 2005. Imports to the few current LNG receiving terminals are also significantly higher than in years past.

Natural gas is a commodity subject to the market forces of supply and demand both in spot and futures markets. Natural gas prices over the past five years have been highly volatile and unpredictable. Seasonal swings in market prices have traditionally seen low prices in spring/summer and higher prices in fall/winter, although in 2002, summer prices were higher and winter prices were lower.

Given the uncertainty in natural gas prices, and the various objectives that parties may want to achieve, there are several alternatives that the Commission could consider in setting the WACOG.

1) The Commission could simply approve the WACOG increase to $.55492/therm as proposed by the Company. The Company's proposed WACOG is based upon forward market prices as of April 30, 2004 and if anything, appears to underestimate the WACOG if current forward gas prices are utilized. While this alternative sends an immediate, more appropriate price signal to customers, it comes at a time when gas consumption is low and many customers may not notice.

2) The Commission could delay any increase until October when anticipated winter gas prices may be more fully known and the WACOG can be more accurately established. This alternative provides a price signal when more customers are aware of the impact and could result in a lower overall WACOG if gas prices soften. However, there is also a risk that gas prices will

increase resulting in both a larger deferred cost balance to be included in the surcharge and a higher WACOG.

3) The Commission could approve a modest increase in the WACOG now and then adjust the WACOG again in October if necessary. This alternative sends at least some immediate price signal to customers, it partially mitigates higher future deferred cost balances and it reduces the possibility of a much larger WACOG increase in October. The downside is that it will likely result in two rate increases in four months. It is also more administratively burdensome and possibly more confusing to customers.

Staff believes it is important to provide a price signal to customers that reflect the price the Company is paying for gas. Customers are encouraged to conserve as prices increase. Unfortunately, the timing of the request diminishes the price signal that many customers will receive because of reduced summer time consumption. Nevertheless, without a change in the WACOG, Staff estimates that the Company will likely defer an additional $5 million in gas costs to be included in the surcharge by October 2004. While Staff recognizes the problem of increasing rates in July when customers may not notice, we also recognize that a single increase in October could be even more severe and will provide customers little additional time to react or prepare.

Staff recommends that the Commission increase the WACOG as proposed by the Company in this case and direct the Company to send conservation tips and contact information to customers in the next bill. In October the Company should be directed to send a reminder to customers that rates are higher than for the prior heating season. Staff also recommends that 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. Staff believes that while current market price forecasts dictate an increase is necessary at this time, various factors also indicate that a delay in filing next years PGA can be accommodated. Finally, while Staff does not necessarily support multiple rate increases as described in Alternative No. 3, it does recommend that the Company be directed to continually monitor its WACOG and consider a more immediate WACOG adjustment if natural gas costs/prices materially decline.

RISK MANAGEMENT

Over the past four years the annual range of weekly price movement on northwest natural gas markets was between $.23/therm and $2.7/therm with rate adjustments ranging between $.13/therm and $.28/therm. This is compared to the total change in winter rates throughout the

1990's of $.058/therm. Neither customers nor the Company can easily absorb these large annual price fluctuations.

As it has over the last few years, Intermountain proposes a WACOG based solely on forward market prices. Other than a small amount of gas in storage, the Company has currently made no fixed price purchases for the upcoming PGA period or any other period in the future. Because there are no fixed-price transactions, there is no assurance that the proposed rates will recover the actual commodity cost for the next year. Nor is there any assurance that the price customers pay for gas will not increase again in the near future should market prices increase. Without some financial accountability, it appears that the Company will not routinely make forward fixed-price decisions for customer rate stability using a reasonable, systematic and methodological approach.

PGA Investigation

The issue of price volatility is not new to customers and the Commission. While Staff understands that Intermountain has little control over the volatile market prices, both Staff and the Commission have searched for better ways to encourage the Company to make prudent purchases for customers. On July 13, 2001, in Case No. INT-G-01-3 the Commission stated:

> The Commission is concerned that the current PGA mechanism fails to optimize Company incentives to acquire gas at the lowest market price available while minimizing volatility risks to ratepayers. To address this concern, the Commission directs Staff and the Company to explore modifications to the PGA that will increase the incentives to Intermountain Gas to manage market risk and obtain the lowest commodity price. Once Staff and the Company report their findings, the Commission will consider taking formal action to implement beneficial changes.

ON. 28783 at 11.

During 2001-2003, Staff conducted an investigation relating to Intermountain's purchasing strategy and the PGA mechanism. At the conclusion of the investigation, Staff recommended no change to the mechanism, but asked the Company to increase its documentation efforts so the Commission and Staff could understand the Company's decisions to ensure that they are prudent. Fortunately for customers, natural gas prices declined significantly in 2002 and the PGA process

afforded a significant rate decrease. However, the decrease was short lived, natural gas prices increased, and a substantial rate increase was approved in 2003.

Intermountain's Purchase Strategies

While the Company has improved the documentation provided to Staff, Staff continues to have significant concerns relating to Intermountain's hedging strategies and methodologies. Staff has previously requested and the Commission has ordered the Company to submit its formal gas purchase strategy for review to address these Staff concerns. As a part of that Order, the Commission again emphasized volatility concerns and further put the burden of prudent purchases on the Company:

> IT IS FURTHER ORDERED that ninety days (90) days from issuance of this Order Intermountain Gas shall file a formal, written Risk Management Policy with the Commission. This filing shall place special emphasis on managing reliability, price, service quality, credit risk and customer rate volatility. In addition, this formal policy should also include trigger points or volatility limits that could be used to make hedging decisions or forward market purchases. Finally, this filing shall also address the Company's long-term supply issues and opportunities."

Order No. 29277, page 16.

The Company accordingly filed its Risk Management Policy on September 26, 2003. After Intermountain provided its purchase strategies to the Commission, the Company met with Staff to address Staff questions and explain its risk management process on two separate occasions during the fall and winter of 2003. While the meetings were informative and included discussions with the Company's marketer IGI Resources, it became apparent that the Company still uses subjective "market factors and forces" and advice from IGI before making hedging decisions. There is no formal, methodological or systematic strategy in place. The Company states it does not want to use a systematic approach because it does not want to be tied down to any particular benchmark. Staff believes and has stated many times that it does not believe it is necessary to have unchanging, inflexible benchmarks, but that some objective approach is vital. The 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.

Recommended Policy Changes and Calculation of Sharing

Over the past few years the Staff and the Commission have made clear statements to the Company regarding the need to include customer rate stability and a reasonable purchase methodology to provide that stability in the Company's Risk Management Policy. In addition, the Commission has required increased documentation of gas acquisition strategies, including risk management measures. In spite of these clear statements and requirements for increased documentation, it is still unclear how the Company makes fixed-price decisions, as the Company's purchase strategy does not allow for any method of measurement or systematic review. Staff continues to advocate a hedging policy that includes volatility limits and purchase points. As a result, Staff cannot state that all the Company's decisions or lack of action relating to hedging are 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, based on information that was not disclosed to Staff, 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 $0.5549/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 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. Intermountain's management has committed to expand its policy and procedures to better identify these concepts and further document its activities.

Intermountain's management will develop and present to its Risk Committee a more concrete proposal with recommended changes to its policy and procedures. Intermountain anticipates this review will result in approval of the proposal. The proposal will then be presented to Staff for additional discussion.

Staff's prior PGA investigation concluded that because of the large swings in natural gas prices a sharing mechanism could lead to unreasonable financial ramifications for the Company. For this reason Staff is still not recommending a formal sharing ratio in the PGA. Without some financial accountability, however, it appears the Company has not made forward decisions to assure rate stability in a way that can follow established guidelines and triggers for action while also being reasonable. Staff therefore recommends that the Commission reserve $696,276 of increased WACOG costs for judgment and future adjustment in the deferral if necessary. This amount reflects a sharing with customers calculated based on 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 $.5549[3]. Staff chose 10% to be consistent with the current electric sharing mechanisms and believes that 25% is a conservative volume to layer in for forward natural gas purchases when prices are below the current WACOG in rates. Staff has used these percentage figures for sharing and layering in this case but realizes that the formalized policy and procedures may have different ratios for guidelines.

Staff realizes this amount is a significant sharing for Intermountain. However, the Company has chosen to rely on management discretion for risk management decisions. It is apparent that management's decision to do nothing in December 2003 could prove the more costly alternative for customers. Staff understands the Company's confidence in its management but believes customers should not be penalized for the Company's decision when those decisions do not fit within an established policy or are not properly documented. Had the Company provided the Commission with a risk management plan based on more stringent customer impact criteria such as trigger points or customer rate volatility limits, Staff would have additional criteria to judge the overall results. Staff recommends that this amount of $696,276 be reserved for further evaluation and justification. This evaluation should be completed after serious discussions between Staff and the Company regarding future policy and procedure enhancements, with a final

[3] Total 2003 normalized annual therms (268,262,707) times 25% multiplied by the difference between the December 8, 2003 WACOG ($.4511) and the proposed WACOG ($.55492) times 10% sharing. 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.

report and recommendations or settlement presented to the Commission no later than December 20, 2004. Staff will include in the discussions and its evaluation the importance of the actual gas cost incurred in the 2004/2005 PGA and what affect it should have on the cost sharing adjustment. To the extent an adjustment is necessary, the credit should be applied to all gas purchasing customers on a per therm basis in the next PGA.

CONSUMER ISSUES

Customer Notice

When Intermountain filed its Application on May 5, 2004, both the customer notice and press release were included in the filing. Customers were notified of the Application by bill stuffer and had until June 11, 2003, to file comments with the Commission. Staff reviewed the customer notice and press release and determined that both complied with the notice requirements of IDAPA 31.21.02.102. The customer notice was mailed with cyclical billings beginning May 7, 2004 and ending June 6, 2004.

Customer Comments

As of June 4, 2004, the Commission had received 15 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. Three thought the PGA review should take place closer to the heating season; one did not think the time of year made any difference.

Customer Relations

Several payment methods are available to Intermountain's customers. In addition to mailing in payments, customers may make online payments through the e-payment center or arrange to have payments withdrawn directly from the customer's bank account. In addition to these free payment methods, other options are available that require payment of service fees. More information on all these options are available on Intermountain's website at www.intgas.com.

Programs available to customers who have trouble paying their gas bills include LIHEAP (Low Income Home Energy Assistance Program), Project Share and Project Warmth. Project

Share and Project Warmth serve different geographic areas and do not overlap. Customers in dire need are often able to get assistance from two programs: LIHEAP and Project Share or Project Warmth. In some situations, a customer may not qualify for LIHEAP benefits because his or her income exceeds the income eligibility criteria for the program. However, these customers may still qualify for Project Share funds or Project Warmth funds because those income requirements are more lenient. Generally, the programs have funds available between December 1 and April 30. Information concerning contacting the various organizations may be obtained from Intermountain or the Idaho Public Utilities Commission by telephone or through the respective organization's websites.

During the months of December through February, no electric or gas utility may terminate service or threaten to terminate service to a residential customer who declares that he or she is unable to pay in full for service and whose household includes children (under the age of 18), elderly (age 62 or older), or infirm persons. During the winter protection period, customers are encouraged to make payments or sign-up for a program called the Winter Payment Plan. The Winter Payment Plan is especially appropriate for customers who do not qualify for any of the fuel funds, e.g., LIHEAP, but still have difficulty making ends meet. The Winter Payment Plan offers relief from high winter bills by allowing customers, for up to five months (November through March), to pay one-half of the customer's regular Level Pay amount. Upon making the March payment, the customer is expected to call the Company and establish a payment plan, usually a regular Level Pay amount, with the balance still owing after the winter months rolled into a new Level Pay amount.

Between the effective date of the last PGA, July 1, 2003 and June 7, 2004, the IPUC Consumer Assistance Staff received a total of 243 complaints and inquiries regarding Intermountain. Of these, there were 130 complaints regarding credit and collection issues, of which 98 concerned disconnection of service and 22 concerned deposits, an increase over the same period of time last year. Higher rates have contributed to customers' difficulty in paying their gas bills.

Staff notes that the Commission revised its Utility Customer Relations Rules, with rule changes becoming effective in May 2003 and March 2004. Energy and water utilities regulated by the Commission were allowed to collect deposits under new circumstances, including instances where a customer receives two or more written final termination notices. Another change allowed utilities to collect substantially higher deposits from customers who use gas for space-heating only.