DECISION MEMORANDUM

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

FROM: LISA NORDSTROM

DATE: JUNE 18, 2004

RE: 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.

On May 5, 2004, Intermountain Gas 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. If its Application is approved, Intermountain states that customer rates will increase on average by approximately 10%. Because of changes in Intermountain's gas-related costs, Intermountain states that its earnings will not be affected as a result of the proposed decrease in prices and revenues. The Commission issued a Notice of Application, Modified Procedure and Comment Deadline on May 12, 2004. As of the comment deadline, 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.

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's firm transportation and storage costs resulting from Intermountain'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.

According to its customer notice, Intermountain states that residential customers using natural gas for both space and water heating could experience an average monthly increase of $6.02 (9.9%). Those residential customers using natural gas for space heating only could experience an average monthly increase of $4.08 (8.7%). Moreover, commercial customers could experience an average monthly increase of $26.19 (10.5%).

Intermountain proposes increasing the WACOG from the $0.47500 per therm 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 states that it is 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.

NORTHWEST INDUSTRIAL GAS USERS' COMMENTS

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'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'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 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 3 months delay) are then collected on a 12-month amortization schedule. If the Commission does change the effective date of the current Intermountain PGA, NWIGU respectfully requested 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.

IDAHO COMMUNITY ACTION NETWORK COMMENTS

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 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, to educate the public on the issues, and to get 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.

STAFF COMMENTS

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's new case contracts for purchase and storage management; 2) Intermountain's 2003-2004 financial hedge transactions; 3) the IGI Resources administrative contract; 4) past and future market prices affecting the Average Weighted Cost of Gas (WACOG); 5) alternatives to the WACOG proposed by the Company; 6) customer notice of the Application; and 7) customer relations.

Risk Management and Hedging: Staff was particularly concerned that despite clear Commission risk management statements regarding the need for customer rate stability, a reasonable purchase methodology 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. 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 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 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. 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. The proposal will then be presented to Staff for additional discussion.

Summary of Staff Recommendations:

1. 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 could be even more severe and will provide customers little additional time to react or prepare. Without a change in the WACOG, 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 consider a more immediate WACOG adjustment if natural gas costs/prices materially decline.

2. The Commission should direct the Company to send conservation tips and contact information to customers in the next bill and then send a reminder to customers in October that rates are higher than for the prior heating season.

3. To more closely coincide with the winter heating season, 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.

4. 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 methodological approach. Consequently, the Commission should reserve $696,276[1] of the upcoming 2004-2005 deferral 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.

5. The Commission should direct the Company to continue to file its WACOG projections and deferred costs reports with the Commission and Staff.

6. In calculating the level pay amount, Intermountain's practice has been to divide customers' annual energy bill by 11 rather than the 12 months used by all other Idaho energy utilities. The Commission should require Intermountain to calculate level pay amounts using 12 months as a divisor to make monthly level pay amounts more affordable.

PUBLIC COMMENTS

The Commission received 17 written comments from customers, all opposing any increase. Eight of the commenters 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

[1] 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 $.5549. 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.

PGA review should take place closer to the heating season; two did not think the time of year made any difference.

COMPANY REPLY COMMENTS

In a response filed June 17, 2004, Intermountain concurs with the Staff's recommendation to implement the Company-proposed WACOG on July 1, 2004. As was stated in the Company's Application, Intermountain ". . . 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." Intermountain is also committed to sending a timely price signal to customers reminding them by mailer prior to the winter heating as to the change in their natural gas prices. 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.

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 recovers from customers during the warm, low sales volume periods of summer and fall. By way of example, postponing the PGA until October 1, 2004 would add an incremental 3-4% increase to the proposed residential prices. Thus, Intermountain requests a continuation of the Company's ability to request a July 1 PGA implementation date. Intermountain strongly believes that a July 1 implementation date, coupled with the above-mentioned 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.

Intermountain Gas believes a review of its total performance shows that it has exercised very good judgment and financial accountability. For instance, Intermountain has exercised judgment in managing its business affairs such that it has not had to request an increase to the service component of its prices for over 20 years – a record unmatched by any other retail gas utility. Intermountain continually searches for and adopts measures that benefit its retail prices. The renegotiation during the past 12 months of the Company's Asset Management and

Administrative Service Agreement contracts highlighted by the Staff will alone save customers in excess of$10,000,000 over the lives of the contracts.

In addition to cost savings Intermountain Gas has sought, whenever practical, to mitigate the impacts of price volatility to its customers by employing various gas management tools and by offering unit prices to its customers that remain constant for a prescribed period of time. We believe Intermountain's history of cost containment for the benefit of its customers speaks loudly and favorably with regards to its record of exercising good judgment and financial accountability, including matters of sourcing, transporting and price mitigation of its customer gas supply.

Notwithstanding this record, the Company respects the Staff's perceived need for a more "formal, methodological or systematic strategy" with respect to the Company's WACOG so as to aid Staff in its review of the Company's Application. However, Intermountain does not believe that the incorporation of automatic "trigger points" is in its customers' best interest. There is no substitute for good judgment employed using a backdrop of natural gas price fundamentals and other market indicators. Having said that, 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 is preparing a risk management proposal to the Staff that will be presented for their review and discussion prior to the month of December. Intermountain Gas strongly opposes the Staff's proposal to "reserve $696,276 for future determination" pursuant to future discussions with the Staff. The Company remains committed to work with the Staff to bridge those areas of concern.

Finally, Intermountain is currently in the process of updating its customer billing system which includes the process behind level payment amounts. As part of that update, Intermountain is including a revision to the level pay calculation whereby future level payment amounts will be calculated by dividing by 12 months rather than an 11-month period.

COMMISSION DECISION

1. As requested by the Idaho Community Action Network, does the Commission wish to hold public hearings before making its decision?

2. If not, does the Commission wish to:

   a. Approve Intermountain Gas' Application and WACOG as filed?

b. Specifically address the following issues:

   i. What WACOG amount to implement. (i.e., that recommended by Company and Staff, or some other amount?)

   ii. What date the Company's PGA applications should be filed and/or rates go into effect? (Note: NWIGU and the Company recommend no change, Staff recommends no change this year but that both be moved closer to the heating season next year, and ICAN favors delaying a decision until fall of this year.)

   iii. Whether the Company should be required to send conservation tips and contact information to customers in the next bill, and then send a reminder to customers in October that rates are higher than for the prior heating season. (Note: Staff recommended this and the Company agreed)

   iv. Reservation of $696,276 of the upcoming 2004-2005 deferral 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. (Note: recommended by Staff and opposed by the Company)

   v. Whether the Commission should require Intermountain to calculate level pay amounts using 12 months. (Note: recommended by Staff and agreed to by the Company)

Lisa Nordstrom

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