DECISION MEMORANDUM

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

FROM: DONOVAN E. WALKER

DATE: SEPTEMBER 21, 2005

SUBJECT: INTERMOUNTAIN GAS COMPANY'S 2005 PGA – Case No. INT-G-05-2

On August 8, 2005, Intermountain Gas Company filed its annual Purchased Gas Cost Adjustment (PGA) Application with the Commission requesting authority to place new rate schedules in effect as of October 1, 2005 that will increase its annualized revenues by $67.6 million (27.2%). The PGA mechanism is used to adjust rates to reflect changes in the costs for the purchase of gas from suppliers, including transportation, storage, and other related costs of acquiring natural gas. The Company's earnings will not be increased as a result of the proposed changes in prices and revenues.

The Commission issued a Notice of Application and Modified Procedure on August 26, 2005. Order No. 29856. Pursuant to Rule 125, IDAPA 31.01.01.125, Commission Staff conducted two public workshops, one in Pocatello on September 12, 2005, and one in Boise on September 13, 2005. Comments were received from AARP Idaho, CAPAI, Commission Staff, and approximately 34 individual customers. The Company submitted reply comments on September 21, 2005.

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 the Company'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 the Company'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.

According to its Customer Notice, if its Application is approved, the Company states that rates for residential customers using natural gas for space heating only could increase an average of 25.5%. Rates for residential customers using natural gas for space and water heating could increase an average of 27.4%, and rates for commercial customers could increase an average of 28.4%.

Intermountain Gas proposes increasing the WACOG from the currently approved $0.55492 per therm to $0.73219 per therm. The Company states that over the past year natural gas prices have more closely followed the price of crude oil, as hedge funds and traders have become increasingly indifferent as to which commodity provides btu's to the marketplace, and that both crude oil and natural gas prices are at historic high levels. The Company states that the price levels in its Application are forward prices currently available through the use of financial derivatives as of July 29, 2005. Intermountain states that, although current commodity futures prices dictate the use of $0.73219 WACOG, it continues to remain vigilant in monitoring natural gas prices and is committed to come before the Commission prior to this winters heating season to amend these proposed prices, if the forward prices materially deviate from the $0.73219 per therm.

AARP IDAHO'S COMMENTS

AARP Idaho is a nonprofit, nonpartisan membership organization for people 50 and older. It has approximately 162,000 members representing all segments of the socio-economic scale. AARP asks that as the Commission deliberates it keep the interests of residential customers, especially those on fixed and low incomes, in mind. It states that older Americans are particularly susceptible to extremes in temperature, and that any degradation in utility services can pose serious health concerns. The organization cites and quotes information from the U.S. Department of Energy regarding dramatic price increases in natural gas and electricity as a result of the supply disruption associated with Hurricane Katrina. It urges a close look at Intermountain's gas procurement process, and a thorough review and evaluation of all information and data offered to justify the Company's proposals. AARP also requests that the Commission ensure that adequate low-income assistance is available to help reduce energy burdens on those customers.

AARP recommends the adoption of "automatic program enrollment." By this the organization intends that customers who participate in any means-tested financial assistance programs, such as LIHEAP, Medicaid, TANF, welfare assistance, Food Stamps, etc. would be automatically enrolled in Idaho's low income energy assistance program(s). The organization also states simply that funding for energy assistance programs should be expanded to meet growing customer needs.

COMMUNITY ACTION PARTNERSHIP ASSOCIATION OF IDAHO'S (CAPAI) COMMENTS

Citing poverty statistics in the State of Idaho, demand for energy assistance, and the increasing energy rates and prices, CAPAI asserts that it is critical "to take substantive steps toward a deeper analysis and course of action toward addressing poverty in Idaho, and those exacerbating factors, such as increasing utility costs." CAPAI states that Intermountain Gas Company is unique in that it does not have a low-income weatherization program in place. Acknowledging that its concerns may fall outside the scope of this proceeding, the organization proposes that the Commission initiate a separate proceeding for the purpose of assessing Intermountain's attempts to address the needs of its low-income customers.

STAFF COMMENTS

Staff reviewed the Company's filing and gas purchase contracts to verify that the Company's earnings will not increase because of the filing, that the deferred costs are prudent, and to determine the reasonableness of the WACOG request. Staff discussed: 1) the effects of the one-time 15-month deferral period resulting from the timing adjustment ordered in last years PGA; 2) the Company's new gas contracts for purchases and storage; 3) Intermountain's 2004-2005 financial hedge transactions; 4) market prices and factors affecting the WACOG; 5) the Company's newly developed Gas Supply Risk Management Program and the $696,276 recovery hold back from the 2004 PGA; and 6) customer relations issues.

In order to better align the price changes from the PGA with the time the gas was to be used, Order No. 29540 from the 2004 PGA directed the Company to file the 2005 PGA by August 15, 2005, with an effective date of October 1, 2005. This has the effect of having a one-time 15-month deferral period for this 2005 PGA. The deferral period in 2006 and forward will once again be 12 months. Although the additional three months of deferred costs added substantial amounts to this increase, the same recovery would have been sought from customers no matter when the Company filed its Application. With the August filing date the Company and Staff will have more reliable data in which to estimate winter gas commodity prices.

The Company was able to acquire a contract for additional gas storage facilities for the next 35 years. The additional storage allows the Company to purchase gas in the summer when prices have traditionally been lower and use the gas during the winter when gas is traditionally higher priced. Although gas price volatility has made the summer-winter price spreads less predictable, the storage continues to provide operational flexibility that allows the Company to save money by avoiding certain high-priced peaks during the winter. Staff reviewed the analysis performed by the Company in acquiring this additional storage and agrees that the additional storage does reduce the costs that will ultimately be passed on to customers.

Intermountain Gas used two different hedging strategies during the PGA year. First, the Company compared first of month gas prices to what it believed would be the daily prices for the coming month, trading its monthly price for a series of daily prices if forecasted to be lower. This technique was done six times throughout the year, and overall resulted in a savings over the first of month pricing. The second type of hedging strategy used by the Company involved a traditional financial instrument to fix the price of gas for any given month or months. The Company utilized this method once during the year. In December it executed fixed price hedges for 90% of the January 2005 gas purchases. The Company provided detailed documentation and analysis to justify its decision. Overall, the Company's financial hedges provided a benefit of $115,033.06 to customers for the PGA year.

The Company was directed to develop better risk management policies and practices in the 2004 PGA Order No. 29540, $696,276 was reserved for future determination and possible adjustment pending the filing of updated risk management policies and procedures. Staff worked with Intermountain over the last 15 months to assist the Company in developing a more appropriate risk management/hedging policy, and on September 1, 2005 the Company filed its Gas Supply Risk Management Program with the Commission. The Risk Management Program is an ongoing effort that Staff and the Company expect to enhance and refine as the program is evaluated in connection with the marketplace. Staff recommended that the $696,276 previously set aside be included for recovery in this case, and Staff will file separate comments associated with the Risk Management Program to specifically address the individual aspects of the program.

Staff pointed out that customer complaints relating to the Company's collection of deposits were up significantly in 2005, and attributes this in part to a rule change regarding deposits that became effective in 2003. Staff believes that the combination of higher rates, a substantial rate increase, and deposit collection policies creates a situation where space heating only customers may be disproportionately affected by higher rates. Additionally, Staff reports that Intermountain Gas, as compared to other Idaho energy companies, has a disproportionately small contribution level to low-income assistance programs, and has no low-income weatherization program what so ever. Staff recommends opening a docket to specifically address these issues.

Staff Recommendations

1. The Commission should approve the requested WACOG of $.73219/therm.[1] Given the magnitude and cost of deferring the proposed increase at approximately $53.6 million per year, Staff does not believe it is reasonable to deny the proposed WACOG increase. Staff noted that the increase, if approved by the Commission, would have a significant adverse impact on customers, especially lower and fixed income consumers, but also provide a strong signal to conserve and to consider alternative heating sources. In addition to sending a less appropriate price signal, Staff states that setting a lower WACOG would ignore additional price increases that have occurred since the Company's filing and the potential for a higher deferral balance subject to recovery next year. Staff also recommended that the Company continue its monthly reporting of changes to the balances in the deferral accounts and continue to provide a quarterly WACOG report.

2. The Commission should approve the collection of the deferred amounts as requested.

3. The Commission should allow the Company to collect the $696,276 that was reserved last year while risk management actions were investigated.

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

[1] The comments of the Commission Staff filed September 20, 2005, contained a typographical error in the WACOG amount ($.773219) in Staff's recommendations on page 12. The correct amount is $.73219.

5. The Commission should open a separate docket to investigate/evaluate customer issues such as: customer deposit rules, policies and practices; the Company's contributions to fuel funds; and energy conservation and weatherization programs for the Company.

PUBLIC COMMENTS

The Commission received approximately 34 written comments from customers. All but one customer opposed any increase. More than half of the comments identified themselves as low-income and senior citizens on fixed incomes. Many of the comments addressed the fact that many of their utility bills, not just natural gas, have been increasing, and that increase is outstripping any increase in income they may have, and in many cases outstripping their ability to pay. The one customer who did not oppose an increase stated that, although they did not want their winter heating bill to increase, they did not want their service to suffer from lack of funds to supply the product. They were in favor of the increase if Intermountain Gas truly needed it to cover their operating and wholesale costs. Another customer requested that any increase be implemented incrementally, instead of all at once, in the hopes that the large increase may be offset with future savings.

COMPANY REPLY COMMENTS

In reply comments submitted on September 21, 2005, the Company addressed Staff's recommendation to open a docket to address customer deposits, fuel fund contributions, and low-income weatherization. The Company believes that opening a docket to examine these issues "would be redundant to the undertakings already addressed in previous dockets which established practices now followed and adhered to by the Company."

The Company states that the issue of customer deposits was addressed as recently as 2003, when changes to Rule 105 were approved by the Commission. The 2003 proceedings took into account the unique nature of the RS-1, space heating only, customers who, in contrast to electric or gas space and water heating customers who consume year round, have usage limited to the heating "season." Adoption of the new deposit rules took into account the on-again, off-again nature, and accompanying risk, of this particular class of customer and the deposit rules were modified accordingly.

The Company states that Staff's statistics with regard to fuel fund contributions may be misleading. The contribution efforts should also be viewed in the context of the relative size of Intermountain as compared to the other utilities noted by Staff. If viewed in the context of net income per customer, Intermountain's level of shareholder contributions far exceeds that of the other utilities noted by the Staff. The Company also notes its sponsorship, volunteer time, and shareholder contribution in activities such as the Project Warmth Golf Tournament, which is a major funding source for Project Warmth in eastern Idaho.

Regarding low-income weatherization, the Company notes that it has not raised its prices to accommodate weatherization or conservation funding, as other utilities have. The Company believes this to be appropriate in light of its customers already funding these programs though their other utilities. As included in its IRP, Intermountain continues to communicate and support those conservation efforts that benefit all of its customers, which encourage the wise and efficient use of all energy sources, which do not translate into higher prices to those customers who would otherwise provide weatherization subsidies, and are not redundant to those measures offered in the marketplace which can be funded by various governmental and private agencies.

COMMISSION DECISION

1. Does the Commission wish to approve Intermountain Gas Company's Application and WACOG as filed and recommended by Staff?

2. Does the Commission wish to allow the Company to collect the $696,276 that was reserved last year while risk management actions were investigated?

3. Does the Commission wish to direct the Company to continue to file quarterly WACOG projections and monthly deferred costs reports with the Commission and Staff?

4. Does the Commission wish to open a docket to evaluate/address customer issues such as: deposit rules, policies and practices; the Company's contributions to fuel funds; and energy conservation and weatherization programs for the Company?

Donovan E. Walker

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