

Agenda Date: October 25, 2012
Item Numbers: A5 and A6

Dockets: **UG-121592 and UG-121623**
Company Name: Cascade Natural Gas Corporation

Staff: Joanna Huang, Regulatory Analyst
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Recommendation

Issue a Complaint and Order Suspending the Tariff Revisions filed by Cascade Natural Gas Corporation in Dockets UG-121592 and UG-121623, and allow the tariff revisions to become effective on November 1, 2012, on a temporary basis, subject to revision.

Background

On September 28, 2012, Cascade Natural Gas Corporation (Cascade or company) filed with the Utilities and Transportation Commission (commission) tariff revisions for both the company's Purchased Gas Adjustment (PGA) and Deferred Gas Cost Amortization (Deferral) mechanisms in Docket UG-121592 and UG-121623, respectively. The proposed effective date is November 1, 2012. The impact of the combined filings is an annual revenue decrease of approximate \$14.5 million or 6.3 percent.

The PGA and Deferral mechanisms are designed to pass through to customers the utility's actual cost of natural gas on an annual basis. The PGA establishes a projection of the utility's gas cost for the upcoming year. The difference between the projected cost and the actual cost is then deferred in Account 191. Each year the balances of Account 191 are amortized back to customers with interest, whether it is a refund for over-collection or a charge for under-collection.

Cascade is a natural gas utility serving approximately 196,081 gas customers in various areas. Its major Washington service locations include Aberdeen, Bellingham, Bremerton, Yakima, and Walla Walla.

Discussion

Purchased Gas Adjustment

The PGA reflects a projection of gas cost for the coming 2012-2013 winter season. This portion of the filing consists of two parts; the cost of gas purchased (Commodity) by the company from its gas suppliers and the cost of pipeline and storage capacity (Demand) under contracts to transport natural gas from the upstream gas suppliers to its distribution system. The company is proposing a decrease of approximately \$10.1 million in annual revenue for this portion of the revised filing. Currently, Cascade's embedded weighted average cost of gas (WACOG) is

\$0.59755 per therm (\$0.47372 commodity and \$0.12383 firm demand). The proposed WACOG is \$ 0.55457 per therm (\$0.40281 commodity and \$0.15176 firm demand).

In arriving at an estimated commodity cost for the coming year, the company uses a variety of known and estimated inputs. Known inputs include volumes of gas to be delivered within the PGA year hedged at a fixed price, actual cost and volume of gas in storage, and to some extent the remaining expected load transacted at spot market prices or hedged at a fixed price through financial instruments. Estimated inputs include load for the PGA year, future spot/index market prices and prices for financial hedges that will be transacted in, and for, the PGA year.

The term hedging as staff is using it refers to the conversion of a future supply contract at market prices to a fixed price through the use of financial instruments.

Financial instruments known as hedges have the *potential* to mitigate risk of rising natural gas prices by locking in an assumed low fixed price now. However, in a declining natural gas price environment, financial hedging has the *potential* to lock in “above market” prices for gas customers.

Deferred Gas Cost Amortization

The Deferral reflects balances in Accounts 191 for the period of November 2011 to October 2012, resulting from the difference between actual gas costs incurred and gas costs projected in rates last year. Actual gas costs were lower than projected by approximately \$4.3 million requiring a decrease in annual revenue.

Revenue and Residential Bill Impacts

A residential customer using 57 therms (the calculated monthly average gas consumption) would pay \$3.77 less per month from \$51.48 to \$47.71. The combined effects of the PGA and Deferral mechanisms on Cascade’s rates (\$/therm) and annual revenues are as follow:

Schedule Classes	PGA Change	Deferral Change	Revenue Impact	Percent Change
<i>Residential</i>				
Residential - Sch. 503	(\$0.04493)	(\$0.02114)	(\$7,730,267)	-6.49%
Commercial - Sch. 504	(\$0.04537)	(\$0.02150)	(\$5,560,370)	-6.99%
Industrial Firm - Sch. 505	(\$0.04755)	(\$0.02234)	(\$694,885)	-8.49%
Industrial – Sch. 511	(\$0.04755)	(\$0.02247)	(\$561,470)	-8.72%
Industrial Int.-Sch. 570	(\$0.04972)	(\$0.02306)	(\$308,836)	-10.42%
Institutional – Sch. 577	(\$0.04972)	(\$0.02271)	(\$31,889)	-9.61%
Non Core Dist. – Sch. 663		0.00130	\$434,157	3.49%
Total			(\$14,453,559)	-6.30%

Cascade defers and recovers their conservation program costs through their annual PGA filing. Conservation costs are deferred in the first year and recovered from rate payers in the second year. The conservation deferral balance as of October 31, 2012, is \$3,724,357. This amount is

included in the schedule 595 rates as \$0.01587 per therm added to gas and transport costs. In the prior year, the October 31, 2011, conservation deferral balance was \$3,771,164. As a result of the decrease, the average residential customer using 57 therms per month will see their bill decrease by \$0.02 per month.

Cause for Suspension

In addition to actual spot/index market prices, financial hedging costs and the percentage of volumes hedged are a component in the cost of gas passed on to ratepayers. The last few years have seen a sharp decline in natural gas prices with a slower decline in the cost of gas passed on to ratepayers. There is the possibility that locking in prices of future gas supplies through financial hedging has led to commodity costs passed on to ratepayers being significantly higher than what would have been absent financial hedging or at least a decrease in the volumes hedged. Commission staff has not pre-determined prudence or lack thereof for any of the natural gas utilities regulated by this commission. And it should be noted that financial hedging in the face of rising natural gas prices could benefit ratepayers,

In order to determine that commodity costs passed on to ratepayers are fair, just, reasonable, and sufficient, commission staff has determined that a thorough review of financial hedging activities and policies of all natural gas utilities regulated by this commission is needed at this time. Therefore staff is requesting suspension of this filing, along with the PGA filings of other investor-owned utilities in order to allow for more time to review hedging transactions, potential implication of procurement/hedging guidelines and uniformity of PGA reporting. Potential areas of review include, but are not limited to:

1. Guidelines for implementing portfolio purchases of natural gas.
2. Guidelines for the level and type of financial hedging of natural gas prices.
3. Guidelines for documentation of financial hedging decisions.
4. Guidelines for the sources and methodology for forecasting long-term natural gas prices.
5. Guidelines for the source and methodology for the forecasts of spot (cash) natural gas prices included in the PGA.
6. Guidelines for the use of storage as part of the company portfolio of natural gas.
7. Guidelines for documentation of natural gas market reviewed by the company in making purchasing decisions.
8. Sharing of gas financial hedging costs between the company and its customers and the percentage for such sharing.
9. A common format for PGA filings with the commission.
10. Common formats for PGA work papers that support the filing with the commission.

Customer Comments

Cascade notified its customers of the anticipated rate decrease through its own webpage. The company will also inform its customers of the rate decrease with a bill message on the first bill

following the effective date of the tariff revision. The commission received no customer comments on this filing.

Conclusion

Issue a Complaint and Order Suspending the Tariff Revisions filed by Cascade Natural Gas Corporation in Dockets UG-121592 and UG-121623, and allow the tariff revisions to become effective on November 1, 2012, on a temporary basis, subject to revision.