

**Agenda Date:** October 25, 2012  
**Item Number:** A2

**Docket:** **UG-121434**  
**Company Name:** Northwest Natural Gas Company

**Staff:** Michael Foisy, Regulatory Analyst  
Joanna Huang, Regulatory Analyst  
Chris McGuire, Regulatory Analyst  
Roger Kouchi, Consumer Protection

### **Recommendation**

Issue a Complaint and Order Suspending the Tariff Revisions filed by Northwest Natural Gas Company, in Docket UG-121434, and allow the tariff revisions to become effective on November 1, 2012, on a temporary basis, subject to revision.

### **Background**

On August 31, 2012 and revised on October 15, 2012, Northwest Natural Gas Company (NW Natural 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 that would decrease annual revenue of its Washington operations by \$6,389,729, or -8.37 percent. NW Natural serves 65,135 residential customers and 5,611 commercial customers in three counties in Washington – Clark, Skamania and Klickitat. The proposed effective date is November 1, 2012.

The PGA and Deferral mechanism are designed to pass through the utility's actual cost of natural gas to customers on an annual basis. Periodic technical adjustments to rates are necessary under the terms of the company's tariffs in order to return to customers credit or debit balances with interest in its deferred gas cost accounts (Account 191) and other non-gas cost accounts (Account 186).

The PGA establishes for the upcoming year a projection of the utility's gas costs. The difference between the projected cost and the actual cost is deferred and ultimately amortized back to customers with interest, as a surcharge or refund.

### **Discussion**

#### **Purchased Gas Adjustment**

The PGA reflects a projection of gas cost for the coming 2012-2013 heating season. The PGA 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 with pipeline transporters. Due to lower commodity gas cost, the company is proposing a decrease of approximately \$7.6 million (-9.97 percent) in annual revenue for this portion. Northwest

Natural's current weighted average cost of gas (WACOG) is \$0.60396 per therm (\$0.47373 commodity and \$0.13023 firm demand) and the proposed WACOG is \$0.50394 per therm (\$0.36969 commodity and \$0.13425 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 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

The Deferral reflects balances in Account 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. The deferral portion of this filing results in an increase of approximately \$1.2 million in annual revenue. While proposed deferrals are a refund to customers, the refund amount in current rates are higher than proposed refunds due to a \$4.2 million refund approved May 31, 2012 in Docket UG-120510. Had this refund not been issued then the combined deferral and PGA filings would be larger.

### Revenue and Residential Bill Impacts

A residential customer using 55 therms (the calculated monthly average gas consumption) would pay \$5.82 less per month from \$62.98 to \$58.16. The combined effects of the PGA and Deferral mechanisms on Northwest Natural's rates (\$/therm) and annual revenues are as follow:

Schedule Classes	PGA Change	Deferral Change	Revenue Impact	Percent Change
Residential	(\$0.10459)	\$0.01678	(\$3,156,117)	-7.7%
Commercial	(\$0.10459)	\$0.01617	(\$1,631,107)	-8.1%
Industrial	(\$0.10459)	\$0.01154	(\$634,390)	-15.0%
Interruptible	(\$0.10734)	\$0.01102	(\$968,115))	-15.8%
Total			(\$6,389,729)	-8.37%

### 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 the forecasting.
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 the 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. A common format for PGA work papers that support the filing with the commission.

### **Customer Comments**

Northwest Natural notified its customers of the anticipated rate decrease by bill insert with the September billing. The commission received no customer comments on this filing.

### **Conclusion**

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