

Agenda Date: October 25, 2012
Item Number: A4

Docket: **UG-121569**
Company Name: Puget Sound Energy, Inc.

Staff: Christopher T. Mickelson, Regulatory Analyst
Kathryn Breda, Regulatory Analyst
Roger Kouchi, Consumer Protection

Recommendation

Issue a Complaint and Order Suspending the Tariff Revisions filed by Puget Sound Energy, Inc., in Docket UG-121569, and allow the tariff revisions to become effective on November 1, 2012, on a temporary basis, subject to revision.

Background

On September 27, 2012, Puget Sound Energy, Inc. (PSE 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 by approximately \$77.0 million (-7.7 percent). PSE serves over 785,000 natural gas customers in six counties in Washington – King, Kittitas, Lewis, Pierce, Snohomish, and Thurston. 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 account (Account 191).

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.

In addition to the proposed PGA and Deferral mechanisms, the company is proposing to transfer \$35.6 million of the \$42.0 million projected balance of over-collected commodity costs and none of the under-collected demand costs to the amortization account. The remainder of the commodity deferral will remain in the current commodity account as it relates to Docket UG-120812.¹

¹ The commission approved PSE's request to change the existing natural gas tracker mechanism into a rider mechanism by using funds from the PGA commodity deferral account to recover 2012 natural gas conservation program expenditures.

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 \$64.5 million (-6.5 percent) in annual revenue for this portion. PSE's embedded weighted average cost of gas (WACOG) is \$0.64177 per therm (\$0.50845 commodity and \$0.13332 firm demand) and the proposed WACOG is \$0.57195 per therm (\$0.43770 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/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.

Deferral 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. Actual gas costs were lower than projected by approximately \$12.4 million (-1.3 percent) requiring a decrease in annual revenue.

Revenue and Residential Bill Impacts

A residential customer using 68 therms (the calculated monthly average gas consumption) would pay \$5.82 less per month from \$82.41 to \$76.59. The combined effects of the PGA and Deferral mechanisms on PSE's rates (\$/therm) and annual revenues are as follow:

Schedule Classes	PGA Change	Deferral Change	Revenue Impact	Percent Change
<i>Residential</i>				
Schedule 23	(\$0.07182)	(\$0.01386)	(\$47,717,630)	-7.2%
Schedule 16	(\$0.07181)	(\$0.01386)	(\$1,037)	-7.2%
<i>Commercial</i>				
Schedule 31	(\$0.07189)	(\$0.01387)	(\$17,490,290)	-7.9%
Schedule 41	(\$0.07308)	(\$0.01401)	(\$6,791,354)	-10.1%
<i>Interruptible</i>				
Schedule 85	(\$0.07262)	(\$0.01396)	(\$1,467,907)	-12.3%
Schedule 86	(\$0.07256)	(\$0.01395)	(\$1,133,213)	-10.5%
Schedule 87	(\$0.07265)	(\$0.01396)	(\$2,362,221)	-13.4%
Total			(\$76,963,651)	-7.7%

Cause for Suspension

In addition to actual spot/index market prices, financial hedging costs, and the percentage of volumes hedged are all components 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 Comment

PSE posted its proposed tariff changes on its website as required by WAC 480-100-193. This filing represents a decrease in rates; therefore PSE is not required to provide an additional notice to its customers. The company issued a news release to advise media in its service territory of the specifics of the filing. The commission received one customer comment opposing the decrease.

General Comment

The customer believes that PSE is not reducing its costs enough from the profits made from the low wholesale price of natural gas, estimating that the rate decrease should be closer to 15 percent.

Staff Response

Staff advised the customer that PSE receives no profit from the wholesale purchase of natural gas. Staff provided the consumer the fact sheet entitled Understanding Purchased Gas Cost Adjustments. The consumer was also advised of the opportunity to participate at the open meeting.

Conclusion

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