



# ATTORNEY GENERAL OF WASHINGTON

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March 1, 2013

**SENT VIA E-MAIL & U.S. MAIL**

Steven V. King  
Acting Executive Director and Secretary  
Washington Utilities and Transportation Commission  
1300 S. Evergreen Park DR SW  
P.O. Box 47250  
Olympia, WA 98504-7250

Re: WUTC v. Cascade Natural Gas, Corporation, Dockets UG-121592 & UG-121623

WUTC v. Puget Sound Energy, Inc., Docket UG-121569

WUTC v. Northwest Natural Gas Company, UG-121434

WUTC v. Avista Corporation, Docket UG-121501

Dear Mr. King:

Local distribution companies (LDCs) serving Washington ratepayers have utilized hedging, both financial<sup>1</sup> and physical,<sup>2</sup> as part of their natural gas procurement strategy for many years. It has been generally assumed that hedging is normally an appropriate tactic to manage fuel costs.<sup>3</sup> However, the issue is very complex. Although hedging may be an appropriate component to a company's procurement practices, a close look at how hedging has performed in Washington over the last ten years causes Public Counsel to question whether the ratepayer has been harmed unnecessarily. The losses<sup>4</sup> have far exceeded the gains,<sup>5</sup> by a margin that can only be described

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<sup>1</sup> Financial hedging is the use of financial tools, such as price swap agreements, futures contracts, option contracts, etc., where a financial counterparty guarantees a fixed price for a set volume of gas to be delivered at a specified location for a specified period of time. The Company will buy gas in the spot market and the Company will make a payment to the financial counterparty if the spot market price is lower than the fixed price. On the other hand, if the spot market price is higher than the fixed price, the financial counterparty will make a payment to the Company to lower its cost of gas to the fixed price.

<sup>2</sup> Physical hedging is an arrangement with a gas supplier to deliver an agreed volume of gas at a specified location for a specified period of time at a fixed price.

<sup>3</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705, Order No. 11 at ¶ 153.

<sup>4</sup> Hedging losses are the difference between the contract price and the spot market price in the month of delivery. Losses occur when the contract price is greater than the spot market price.

<sup>5</sup> Hedging gains are the difference between the contract price and the spot market price in the month of delivery. Gains occur when the contract price is less than the spot market price.

To: Mr. King

Re: Dockets UG-121592 & UG-121623; Docket UG-121569; UG-121434; & UG-121501

March 1, 2013

Page 2

as astounding. These net losses highlight the need for more rigorous review and reconciliation of gas procurement practices and more transparency in the Purchase Gas Adjustment (PGA) process.

Public Counsel recommends that the current PGA dockets for each company remain open as it is premature to lift the suspensions or close the investigations.

### **Current Investigation Has Been Severely Constrained by Procedural Challenges**

The Commission issued complaints and orders suspending operation of the tariffs filed by the four natural gas local distribution companies serving Washington on October 31, 2012. The companies' PGA filings were presented at the Commission's regularly scheduled open meeting on October 25, 2012.<sup>6</sup>

The suspended proposed tariffs for each of the companies would decrease rates for the companies' PGA and Deferred Gas Cost Amortization mechanisms. The Commission allowed the rates to go into effect as proposed by each of the four companies, subject to revision. In doing so, the Commission noted that an investigation is warranted into each of the companies' hedging and procurement practices. In particular, the Commission stated it should investigate whether the hedging and procurement practices of each company results in fair, just, reasonable, and sufficient rates. To that end, the Commission instituted such an investigation and instructed Commission Staff to file a status report, including recommendations on the disposition of the tariffs or the need for further process to make the appropriate determinations, by March 1, 2013.

Public Counsel filed its Notice of Appearance in each of the PGA dockets. Because the Commission did not issue a protective order, both Staff and Public Counsel were required to secure nondisclosure agreements with each of the companies before sharing information with their respective outside consultants. This process took a considerable amount of time and was finally completed, for Public Counsel, on January 31, 2013. After the nondisclosure agreements were executed, we were able to share with our consultant the confidential materials produced by the companies in response to Staff data requests.

Public Counsel additionally requested data regarding each company's hedging practices, both physical and financial, and information regarding past PGA filings. While the requests were

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<sup>6</sup> *WUTC v. Northwest Natural Gas Company*, Docket UG-121434, Order No. 01, Complaint and Order Suspending Tariff Revisions; Allowing Rates on a Temporary Basis, Subject to Revision; *WUTC v. Avista Corp.*, Docket UG-121501, Order No. 01, Complaint and Order Suspending Tariff Revisions; Allowing Rates on a Temporary Basis, Subject to Revision; *WUTC v. Puget Sound Energy, Inc.*, Docket No. UG-121569, Order No. 01, Complaint and Order Suspending Tariff Revisions; Allowing Rates on a Temporary Basis, Subject to Revision; *WUTC v. Cascade Natural Gas Corp.*, Docket Nos. UG-121592 and UG-121623, Order No. 01, Complaint and Order Suspending Tariff Revisions; Allowing Rates on a Temporary Basis, Subject to Revision.

To: Mr. King

Re: Dockets UG-121592 & UG-121623; Docket UG-121569; UG-121434; & UG-121501

March 1, 2013

Page 3

detailed, they were reasonable, relevant, and within the scope of the investigation, and designed to elicit information necessary to judge each company's hedging and natural gas procurement practices in the proper context.

We have not received all information requested due to company requests for additional time to respond, and in some cases, refusal to provide requested information. We anticipate receiving some additional data on March 5, 2013, and if these proceedings continue, we hope to work with the companies to obtain the remaining necessary data. Because we are anticipating more data to be received, Public Counsel intends to file additional comments on or about **March 8, 2013**, in these dockets.

### **Colossal Hedging Losses Borne by Washington Ratepayers**

The available data indicates that the hedging and natural gas procurement policies of the LDCs have not been beneficial to ratepayers. Evaluating how those policies have performed over a ten year period is appropriate because years with *increasing* gas prices and years with *declining* gas prices will both be present. We now know that, over the ten year period November, 2002 to October, 2012, hedging and natural gas procurement policies have produced a net loss of at least \$860 million in Washington, based on non-confidential data provided by the four LDCs. The bulk of these losses, approximately \$800 million, occurred during the past five years.

Because commodity costs, including hedging costs, are passed directly to ratepayers through the PGA mechanism, ratepayers have borne the full burden of these net losses. Data provided by the companies indicate they are exposed to additional substantial losses as a result of current hedged positions. Public Counsel has reason to believe that net losses may approach \$1 billion based on this exposure.

Public Counsel recognizes that hedging can function as a form of insurance, and that there will be costs associated with such programs. However, those costs should be reasonable. When the losses eclipse the gains by such a tremendous magnitude over a ten year period, it suggests that the programs, as currently structured, may not be reasonable.

### **Need for More Robust Regulatory Review**

The Commission indicated that it approves of companies using hedging when it stated, "If hedging is an appropriate tactic to manage fuel cost risk, *and we think it is*, then it is appropriate for the cost of hedges to be included in power cost rates."<sup>7</sup> The Commission has not had an opportunity to investigate whether the companies' hedging and procurement practices are

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<sup>7</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705, Order No. 11 at ¶ 153 (emphasis added).

To: Mr. King

Re: Dockets UG-121592 & UG-121623; Docket UG-121569; UG-121434; & UG-121501

March 1, 2013

Page 4

harming or benefiting ratepayers. It has that opportunity now, and the investigation is not, in Public Counsel's view, complete. Thus, it is premature to lift the suspensions and close the dockets.

In addition, the performance of the hedging and procurement policies indicates a strong need for more robust review of PGA filings. It would be appropriate for the Commission to issue a CR-101 after completing these dockets. Public Counsel is committed to participating in a rulemaking or policy docket addressing PGA filing requirements, review, and reconciliation. Public Counsel, however, cautions that commencing such a rulemaking or policy docket before adequate information is received from the companies dampens the ability to effectively evaluate what changes to the current process may be warranted, most effective, and/or appropriate.

#### **Public Counsel Recommendation**

In light of the magnitude of the net losses demonstrated over several years, the impact on ratepayers, the complexity of the issues, and the fact that the investigation thus far has been procedurally challenged by its compressed and limited nature, Public Counsel strongly encourages the Commission to allow the investigations in these four matters to continue.

Public Counsel recommends that the PGA dockets for Puget Sound Energy, NW Natural, Avista, and Cascade remain open, that the tariffs remain suspended, and if necessary, that the matters be set for hearing. Public Counsel also strongly urges the Commission to immediately issue a protective order in each of the dockets and provide that discovery is available per WAC 180-07-400 through -425. Allowing these investigations to continue will raise the likelihood of the Commission having before it adequate evidence with which to evaluate whether the companies have acted prudently or whether disallowances would be appropriate.

To this end, Public Counsel also recommends that the Commission order each company to participate in technical conferences with Staff and Public Counsel to evaluate, modify, and strengthen the hedging programs, with the goal of making the programs more effective and less costly for ratepayers. These technical conferences should occur within the current PGA dockets, and potentially, could serve as an alternative to setting each matter for hearing.

To: Mr. King

Re: Dockets UG-121592 & UG-121623; Docket UG-121569; UG-121434; & UG-121501

March 1, 2013

Page 5

### **Conclusion**

Public Counsel appreciates the opportunity to submit these comments and additional comments next week after further data is provided by companies and incorporated into our analysis. We will be present at the Open Meeting at which these matters are taken up by the Commission and will be available for oral comment and questions.

Sincerely,



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