STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

NATIONAL GRID'S GAS COST RECOVERY CHARGE : **DOCKET NO. 3868**

REPORT AND ORDER

I. NGRID'S SEPTEMBER 4, 2007 FILING

On September 4, 2007, National Grid ("NGrid") filed with the Public Utilities Commission ("Commission") its annual Gas Cost Recovery ("GCR") rates for effect November 1, 2007. The GCR is an annual filing that allows NGrid to reconcile and recover its estimated costs for gas supplies, including pipeline transportation and storage charges, for the GCR year beginning November 1. The filing also revises the Natural Gas Vehicle ("NGV") rate and gas marketer transportation rates.

NGrid's filing proposed decreases in its GCR rates for effect November 1, 2007. Specifically, NGrid proposed to decrease its GCR rates on a per therm basis from \$1.1048 to \$1.0844 for residential and small commercial and industrial ("C&I") customers; from \$1.0985 to \$1.0835 for medium C&I customers; from \$1.1130 to \$1.0875 for large low load factor C&I customers; from \$1.0659 to \$1.0614 for large high load factor C&I customers; from \$1.1059 to \$1.0844 for extra large low load factor C&I customers; and no change to the \$1.0513 for extra large high load factor C&I customers. For a typical NGrid residential heating customer consuming 922 therms per year, this would result in a 1.5 percent decrease, or approximately $22 per year, for a total bill of $1,438 per year.[1]

As part of its filing, NGrid filed a Motion for Protective Treatment of Confidential Information pursuant to Rule 1.2(g) of the Commission's Rules of Practice and Procedure.[2] Specifically, NGrid claimed that certain price terms contained in the Distrigas contract and the management fee found in the ConcocoPhillips contract, as set forth in Exhibits GLB-2, GLB-5 and GLB-12, are confidential, commercially sensitive and proprietary and are exceptions to the requirement of public disclosure as set forth in R.I.G.L. §38-2-1 *et seq*. NGrid asserted that public disclosure of this information would be commercially harmful to Distrigas and ConocoPhillips and that confidentiality is required to protect these companies' competitive position, bargaining latitude and negotiating leverage in the marketplace.[3]

In support of its filing, NGrid submitted the pre-filed testimonies of Peter Czekanski, a Principal Analyst for NGrid, and Gary Beland, Manager of Gas Supply for NGrid in Rhode Island. Mr. Czekanski stated that the GCR rates are intended to recover $286.5 million in costs from November 2007 through October 2008. For a residential heating customer using 922 therms per year, this would result in a decrease of

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[1] This bill impact analysis incorporates NGrid's proposed reduction in the Distribution Adjustment Clause ("DAC") factors effective November 1, 2007. The proposed increase in DAC factors reduced the proposed overall decrease by $4.00.

[2] Rule 1.02 states in pertinent part that "[a]ny party submitting documents to the Commission may request a preliminary finding that some or all of the information is exempt from the mandatory public disclosure requirements of the Access to Public Records Act. A preliminary finding that some documents are privileged shall not preclude the Commission's release of those documents pursuant to a public request in accordance with R.I.G.L. §38-2-1 *et seq.*" and that "claims of privilege are made by filing a written request with the Commission. One copy of the original document, boldly indicating on the front page, "Contains Privileged Information - Do Not Release", shall be filed with a specific indication of the information for which the privilege is sought, as well as a description of the grounds upon which the party claims privilege."

[3] NGrid Exhibit 1, Proposed Gas Cost Recovery Filing, filed September 4, 2007.

approximately $22 per year or 1.5 percent. He explained the five gas cost components for the GCR: (1) supply fixed costs; (2) storage fixed costs; (3) supply variable costs; (4) storage variable product costs; and (5) storage variable non-product costs, and how they are derived. He indicated that NGrid's current estimate, as of September 4, 2007, of the gas cost over-collection through October 31, 2007 is $8.8 million. Mr. Czekanski stated that the commodity charge of the NGV rate is based on the supply variable costs included in the GCR rate and will be $0.7901 per therm. He also proposed changes to various gas marketer charges and factors, specifically, $0.0501 per therm for the FT-2 Firm Transportation Marketer Gas Charge, $0.0028 per percent of balancing elected per therm for pool balancing charges, and $0.0879 per therm of capacity for the weighted average upstream pipeline transportation cost.[4]

In his pre-filed testimony, Mr. Beland discussed the estimated gas costs, forecasting methodology, assignments of pipeline capacity to marketers, and the results of the Gas Purchasing Incentive Plan ("GPIP") and the Asset Management Incentive Plan. Mr. Beland stated that the GCR factors are based on prices for gas purchases locked under the GPIP and any non-locked purchases are based on the NYMEX strip as of the close of trading on August 17, 2007. He stated that the GPIP requires NGrid to lock-in future gas prices over a 24 month horizon and that these purchases are made in a structured series of monthly increments. Mr. Beland indicated that this dollar cost-averaging approach ensures that gas rates are less susceptible to short-term substantial price swings, but still gives NGrid the ability to make discretionary purchases when market prices appear favorable.[5]

[4] NGrid Exhibit 1(a), Direct testimony of Peter Czekanski and Schedules.
[5] NGrid Exhibit 1(b) Direct Testimony of Gary L. Beland at 3-5.

Mr. Beland explained that gas prices have decreased because of exceptionally warm weather throughout most of the country during the 2006-2007 winter. Because of the reduced demand, storage was at unusually high levels thus, holding price levels down. A relatively mild 2007 summer also resulted in a reduced demand for gas for electric generation. In addition, the reduction in European demand has resulted in a sharp increase in LNG cargoes diverted to the United States as prices in Europe are lower than in the United States. Therefore, Mr. Beland noted that absent a major event, prices should continue to remain moderate. He also pointed out that to some extent there have been major changes in the supply of natural gas. Specifically, he noted that domestic gas production has begun to increase. However, favorable developments have been offset by the reduction in Canadian supplies and the price of oil which is almost double that of natural gas on a BTU equivalent basis, something which is expected to cause an increase in the price of natural gas and its drilling costs.[6]

Mr. Beland described the model used by NGrid to calculate gas costs. He noted that when the Company purchases supply, the actual cost varies by location or source of the gas supply, but the cost is based on the NYMEX price at the Henry Hub location. This cost differential that results from the location of the gas is a "basis differential" that the company accounts for in estimating the expected cost of gas supply for the GCR period. A reasonable estimate of the expected invoice cost of the supply is created by applying the basis to the NYMEX pricing. To forecast future supply costs, NGrid uses the average basis over the last three years. NGrid categorized the projected gas cost components into five areas: (1) supply fixed costs; (2) storage fixed costs; (3) supply variable costs; (4) storage variable product costs; and (5) storage variable non-product

[6] *Id.* at 5-8.

costs. Mr. Beland explained how pipeline capacity is assigned to marketers. Mr. Beland noted that the supply portfolio allows for a pipeline capacity assignment equal to 119.9% of each customer's normal average winter day's usage. NGrid has made available 23,200 Dth per day of capacity on six different pipline paths that will be available for assignment to marketers. This is the same as last year.[7]

In discussing the GPIP, Mr. Beland stated that NGrid makes mandatory purchases over a moving 20 month period beginning 24 months prior to the start of that month of delivery and ending four months before the month of delivery. The average cost of mandatory purchases forms the benchmark price for the incentive calculation. He stated that in all months, with the exception of April and October, 70% of all projected purchases must be locked in or covered by financial hedges four months before the month of delivery; the quantity is 60% for the months of April and October. If the cost of discretionary purchases is made below the benchmark price, NGrid receives an incentive, but if the cost of discretionary purchases is made above the benchmark, NGrid incurs a penalty. Mr. Beland estimated a $361,083.66 incentive was earned for the 12 month period ending June 30, 2007. NGrid proposed a few edits to the GPIP to substitute the term "hedge" or "hedge purchases" wherever prior language implied that physical gas purchases would be made. Mr. Beland explained that since hedge purchases require contract volumes of 10,000 Dth, he was proposing a change in the GPIP language to accommodate required purchase quantities. Mr. Beland also calculated the estimated reduction in fixed costs to be $260,904 which results in an asset management incentive of $52,181 for NGrid. Lastly, Mr. Beland indicated that NGrid's filing assumes that no

[7] *Id.* at 8-14.

LNG will be used on an economic dispatch basis, this will allow the 20.39% factor as the cost allocation factor to be used as the factor for pressure support costs.[8]

II. DIVISION

On October 17, 2007, the Division of Public Utilities and Carriers ("Division") submitted the pre-filed testimony of Bruce R. Oliver to address NGrid's filing. Mr. Oliver stated that excluding reconciliations, NGrid's overall gas costs for the 2007-2008 GCR period reflect a net decrease of 8.5% from the levels NGrid projected in the prior docket. He pointed out that the primary cause of the reductions is the result of the projected reduction in Supply Variable Costs, 10.8% including reconciliations. He also pointed out that Total Fixed Costs have increased, 6.0% including reconciliations. Mr. Oliver indicated that NYMEX prices for natural gas declined and then rose, but because of such a small net change in NGrid's projected gas costs he found no need to alter the NYMEX prices used in the projections. However, Mr. Oliver noted that he did not believe that the low level of gas prices are typical and likely to be sustainable on a long term basis. He pointed out, however, that warmer than normal weather during the coming winter could prolong the period of atypically low near-term natural gas prices. Additionally, current differentials between gas and oil prices are unusually high. This differential will tend to increase natural gas prices and cause a shift in demand resulting in a slower than anticipated decline in overall gas use.[9]

As for storage, Mr. Oliver stated that the U.S. will enter the winter heating season with full storage inventories. He did caution that growth in weather sensitive gas use has exceeded growth in natural gas storage capacity and he expressed some concern

[8] *Id.* at 14-21.

[9] Division Exhibit 1 Direct Testimony of Bruce R. Oliver's Direct Testimony and Exhibits at 5-13, Exhibit BRO-2.

regarding sufficient storage inventories in the event of an extremely cold winter. Mr. Oliver expected NGrid to achieve full storage capacity levels prior to the start of the coming winter season. Mr. Oliver found NGrid's forecasts of sales and throughput for the 2007-2008 GCR period to be reasonable.[10]

Mr. Oliver noted that NGrid's forecasted normal weather sales for the 2007-2008 GCR period are 2 percent below comparable projections made for the 2006-2007 period. He pointed out that NGrid's forecasted reduction in annual firm sales is less dramatic than the 5% reduction that the Company forecast for the prior year. He also recommended that the Commission take note of NGrid's projection of continued greater reductions in Winter sales than Non-Winter sales and noted that NGrid forecast a 19.6% increase in forecasted throughput for its FT-2 volumes for the coming year. Even with the Company's forecasted increase in FT-2 volumes, overall annual throughput is expected to decrease by 1.4%. Mr. Oliver pointed out that the forecasted increase in FT-2 throughput is heavily influenced by customer migration from other service classifications and does not reflect a strong overall increase in combined annual service volumes for Medium, Large and Extra-Large C&I customers who should see a slight decrease in their annual throughput.[11]

Mr. Oliver analyzed NGrid's forecasted changes in its Design Winter Service Requirements that resulted in a 13.8% forecasted reduction in Design Winter Sales volumes and a 12.9% overall reduction in Design Winter Total Sales and FT-2 throughput requirements. He noted that NGrid's annual load factor should improve noticeably because of the percentage of design winter sales declining more than annual

[10] *Id.* at 15-16.
[11] *Id.* at 17-19.

sales. He pointed out that NGrid's filing does not address the relationship between its available resources for meeting forecasted design day peak requirements, changes in the forecasted peak day and design winter demands and the costs of maintaining excess capacity resources. He could not assess whether NGrid's forecasted changes in annual and design winter sales impacted its forecasted gas supply requirements and long range gas supply planning because the Company had not at the time of his testimony filed a new Long Range Gas Supply Plan.[12]

Regarding the GPIP, Mr. Oliver found that NGrid acted within the provisions of the plan to produce noticeable cost savings for Rhode Island customers. He noted, however, that the Company left out one discretionary purchase of 2,000 Dth per day for June 2007 resulting in an understatement of the volume of discretionary purchases and an overstatement of the weighted average NYMEX price for those purchases. This adjustment resulted in a revised total GPIP Incentive payment for NGrid for FY 2007 of $364,389.24, $3,305.58 more than previously calculated. He also reviewed with Mr. Beland the changes that NGrid proposed to the GPIP. The first change proposed replacing the words "purchase" and "purchases" with "hedge" and "hedges," and Mr. Oliver suggested this change be to replace the words "purchase" and "purchases" with "purchase and/or hedge" and "purchases and/or hedges." The second change was to add a paragraph regarding NGrid's making of hedges in increments of one contract, or 10,000 Dth. Mr. Oliver suggested language he believed ensured consistency with the structure of the current mandatory purchase/hedge provisions of the plan. Mr. Oliver represented

[12] *Id.* at 19-21.

that he discussed both of his changes with Mr. Beland who did not object to either of Mr. Oliver's suggestions.[13]

As for the asset management incentive, Mr. Oliver stated that the company's calculation of the incentive was correct. Mr. Oliver noted that the asset management incentive is dependent on approval of the levels for NGrid's fixed supply costs and fixed storage costs as well as pipeline, storage and peak resources reasonably consistent with meeting NGrid's design winter and design peak day supply requirements. With significant declines in forecasted weather normal through-put in NGrid's GCR filing, Mr. Oliver indicated that the appropriateness of NGrid's gas supply capacity, fixed supply costs and fixed storage costs should be examined. Mr. Oliver stated he was not in a position to provide the Commission with an opinion on the appropriateness of NGrid's fixed supply costs or fixed capacity or the possible need for adjustments to NGrid's asset management incentive for the GCR period ending October 31, 2008. He recommended that the Commission suspend NGrid's Management Incentive Plan and deny any increase in fixed costs until the Company has substantiated the level of its fixed costs in its Long Range Gas Supply Plan. Mr. Oliver noted that as a result of the merger, the individuals responsible for procuring Rhode Island's gas procurement and gas supply planning may be those who are not in Rhode Island and have little familiarity with the needs of Rhode Island customers. Therefore, Mr. Oliver indicated that the establishment of a sound planning base for NGrid's gas supply will provide the Commission the ability to ensure that adequate and appropriate levels of gas supply resources are provided and maintained for Rhode Island.[14]

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[13] *Id.* at 21-25.
[14] *Id.* at 25-28.

Mr. Oliver stated that NGrid's GCR reconciliation appeared accurate. Lastly, Mr. Oliver asserted NGrid adjusted its usage levels from measures of "typical" use with "average" use for all rate classes. This result captured the average usage levels for all classes of customers.[15]

III. HEARING

Following published notice, a public hearing was conducted on October 29, 2007 at the Commission's offices at 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NGRID:	Laura Olton, Esq.
FOR THE DIVISION:	Paul Roberti, Esq. Assistant Attorney General
FOR THE COMMISSION:	Patricia S. Lucarelli Chief of Legal Services

At the hearing, NGrid presented Mr. Czekanski and Mr. Beland as its witnesses. Mr. Beland noted the Company made additional capacity releases available in order to accommodate some requests from marketers. He noted that NGrid agreed with Mr. Oliver's suggested language change regarding the gas purchase incentive plan. He disagreed, however, with Mr. Oliver's recommendation that the Commission deny any increase in NGrid's supply fixed costs until a full analysis of the Long Range Gas Supply Plan is made. He pointed out that Mr. Oliver noted a reduction in total variable costs that would not have been achieved absent the increase in the supply fixed costs. Mr. Beland explained that the fixed costs incurred for the additional capacity through the Tennessee Connexion pipeline are largely offset because this pipeline capacity allows NGrid to purchase gas supply in a much lower cost market. Mr. Beland noted that NGrid will use

[15] *Id.* at 30-31.

approximately 30% less LNG that it did last year because of the additional pipline capacity acquired by NGrid. [16]

Mr. Beland explained the impact of changes in the financial hedging program, and testified that there would be no impact on the cost to ratepayers of selling a financial hedge for a gain. Mr. Laflamme explained that NGrid would have a tax liability on the sale of a financial hedge for a gain; however, he further explained that the gain on the sale of a financial hedge would be offset by receiving less revenue from ratepayers in the recovery of gas cost. He noted that the operation of the GCR will result in zero taxable income.[17]

Both Mr. Beland and Mr. Czekanski discussed the commodity purchase incentive. Mr. Beland accepted Mr. Oliver's recalculated adjustment of the incentive. Mr. Czekanski stated that the $460,000 incentive that NGrid has accrued would be charged to gas costs going forward in November, and the Company would not receive the $52,000 award associated with the asset management incentive. He agreed that this incentive amount should be deferred until the Long Range Gas Supply Plan is reviewed.[18]

The Division presented Mr. Oliver as its witness. On direct examination, Mr. Oliver explained that in addition to weather, gas supply and oil prices, reduced usage has been a major response to higher prices. He noted that NGrid has had significant reductions in its forecast sales to firm customers and throughput requirements and significant reductions in their design winter requirements which were forecasted to be down 12.9 percent. Conservation and energy efficiency legislation will impact these winter requirements. Mr. Oliver referred to his exhibits, specifically BRO-5 and BRO-6,

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[16] Transcript of Hearing, Docket 3868 ("Tr."), October 29, 2007 at 8-14.
[17] *Id.* at 23-53.
[18] *Id.* at 53-55.

that show sales by class and the reductions experienced by NGrid. He explained that this is part of the reason for the reduction in LNG dispatch from prior years. He testified that the GCR estimates filed by the Company are reasonably accurate and recommended approval of those rates subject to a review of fixed gas supply costs in the Long Range Gas Supply Plan docket.[19]

IV. COMMISSION FINDINGS

The Commission finds that NGrid's Motion for Protective Treatment and supporting memorandum provide a firm basis for protecting this commercial and financially sensitive information. This information is privileged and confidential and the protection of such is necessary to protect not only the companies that are parties to contracts but the ratepayers whose interests could be compromised or adversely affected should NGrid be required to make public details of its contractual negotiations.

The Commission further finds that the Gas Cost Recovery factors, set forth on a per therm basis, of: $1.0844 for residential and small commercial and industrial customers; $1.0835 for medium commercial and industrial customers; $1.0875 for large low load factor commercial and industrial customers; $1.0614 for large high load factor customers and industrial customers; $1.0844 for extra large low load factor commercial and industrial customers; and $1.0513 for extra large high load factor commercial and industrial customers were appropriately calculated. Further, the Commission finds that the Gas Marketer Transportation factors of: $0.0501 per therm for the FT-2 Firm Transportation Marketer Gas Charge; $0.0028 per percent of balancing elected per therm for the Pool Balancing Charge; a weighted average upstream pipeline transportation cost of $0.0879 per therm of capacity; the Natural Gas Vehicle Rate of $0.7901 per therm;

[19] *Id.* at 63-96.

and the Gas Procurement Incentive of $364,389 to be reasonable and appropriately calculated. The Commission believes that all of the calculations and the conclusions of the Commission which are based on those calculations are supported by the evidence presented by the parties.

The Commission is satisfied that the agreed to change of language in the GPIP is consistent with the structure of the current mandatory purchase/hedge provisions of the plan. Finally, the Commission finds that further review of the recently filed Long Range Gas Supply Plan is necessary prior to a ruling on NGrid's Asset Management Incentive of $52,181 and on the appropriate fixed cost benchmark for the 2007-2008 GCR period. The Commission defers ruling on these matters until such time as a complete and thorough review is conducted.

Accordingly, it is

(19151) ORDERED:

1. The Gas Cost Recovery factors, set forth on a per therm basis, of: $1.0844 for residential and small commercial and industrial customers; $1.0835 for medium commercial and industrial customers; $1.0875 for large low load factor commercial and industrial customers; $1.0614 for large high load factor customers and industrial customers; $1.0844 for extra large low load factor commercial and industrial customers; and $1.0513 for extra large high load factor commercial and industrial customers, are approved for usage on and after November 1, 2007.
2. The Gas Marketer Transportation factors of: $0.0501 per therm for the FT-2 Firm Transportation Marketer Gas Charge; $0.0028 per percent of balancing elected per therm for Pool Balancing Charge; and a weighted average upstream pipeline

transportation cost of $0.0879 per therm of capacity are approved for usage on and after November 1, 2007.

3. The Natural Gas Vehicle Rate of $0.7901 per therm is approved for usage on and after November 1, 2007.
4. The proposed changes in the Gas Purchasing Plan tariff to reflect the Company's use of financial hedges which incorporate the Division's recommendations to the tariff language are approved.
5. The Gas Procurement Incentive of $364,389 is approved.
6. The Motion for Protective Treatment of certain pricing terms in the Distrigas contract and the portfolio management fee established by the Conoco Phillips contract, specifically Exhibits GLB-2, GLB-5 and GLB12, is approved.
7. Decision on the Asset Management Incentive of $52,181 will be deferred pending review of the Long Range Gas Supply Plan.
8. National Grid shall comply with the reporting requirements and all other findings and directives contained in this Report and Order.

EFFECTIVE IN WARWICK, RHODE ISLAND PURSUANT TO OPEN MEETING DECISION ON OCTOBER 30, 2007. WRITTEN ORDER ISSUED DECEMBER 18, 2007.

PUBLIC UTILITIES COMMISSION

Elia Germani, Chairman

Robert B. Holbrook, Commissioner

Mary E. Bray, Commissioner