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ARKANSAS PUBLIC SERVICE COMMISSION

FILED

IN THE MATTER OF A NOTICE OF INQUIRY )
INTO WHETHER ARKANSAS GAS UTILITIES )
SHOULD INTEGRATE GAS PRICE HEDGING, )
FIXED PRICE OPTIONS, AND OTHER )
ALTERNATIVE MECHANISMS INTO GAS )
PROCUREMENT PLANS )

DOCKET NO. 01-023-NOI
ORDER NO. 3

ORDER

On January 31, 2001, the Arkansas Public Service Commission (Commission) issued a Notice of Inquiry (NOI) in this proceeding. In the NOI, the Commission directed respondents to provide detailed responses and recommendations on topics related to gas utility hedging programs, fixed gas price options, and other related issues. Responses to the questions in the NOI were filed by the General Staff of the Commission (Staff), Reliant Energy Arkla (Arkla), Arkansas Western Gas Company (AWG), Arkansas Oklahoma Gas Corporation (AOG), and WeatherWise.

On April 23, 2001, the Commission issued Order No. 2 which contained a proposed policy statement and nine proposed policy principles to be used to guide the Commission and each gas utility on topics addressed in the NOI. Initial Comments on the proposed policy statement and policy principles were filed on May 10, 2001, by Arkla, AOG, the Attorney General of Arkansas (AG), Staff, and AWG. Reply Comments were filed on May 17, 2001, by AOG, the AG, and Staff. A public hearing on the proposed policy statement and policy principals was held on May 22, 2001.

The following discusses: (1) the various parties' initial and reply comments on the proposed policy principles, and (2) a brief indication of the revisions made by the Commission to the proposed policy principles. The revised policy principles are attached.

### **Proposed Policy Principle 1**

*Gas utilities are expected to take all reasonable and prudent steps to reduce both the volatility and price of natural gas supplies purchased to serve system supply customers.*

In its comments, Arkla contended that this policy principle (PP) should state that there is an added and acceptable cost associated with reducing price volatility. (T. 16). AOG argued that this PP creates an arbitrary standard that insures that the utility will rarely be correct in its purchasing decisions. (T. 124). AWG recommended that the "Least Cost Statute," Ark. Code Ann. §23-15-103, as previously interpreted by the Commission, should be modified to reflect "reasonable" rather than "lowest" cost. (T. 101). Staff proposed that each gas utility be required to notify Staff prior to commencing any hedging program or use financial risk tools so that any concerns may be adequately addressed. (Staff Initial at 2)<sup>1</sup>. Staff also supported a before-the-fact approval of a gas utility's overall purchasing plan by the Commission on an annual basis. (Staff Reply at 2-3). Staff also suggested a collaborative workshop be held to develop common understanding and agreement among the parties. (Staff Initial at 2). The AG stated that clarification is needed to acknowledge that gas supply decisions should be evaluated based on information available at the time decisions are made. (T. 144).

At the public hearing held on May 22, 2001, Arkla Attorney Harder, stated in his opening statement that "...you cannot achieve both the lowest price possible and price volatility." Mr. Harder further stated that "...reduced price volatility comes with a cost and we want to be sure that whatever rules come out of this docket acknowledge that reality." (T.7). AWG Attorney Dangeau stated that "...I do want to re-enforce the idea that the purpose of the hedging program should be to yield control over price volatility as

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<sup>1</sup>Staff's prefiled comments were not included in the transcript filed on June 4, 2001.

opposed to reducing overall cost.” Mr. Dangeau also stated that “. . .we believe you ought to have our gas supply planning done on a reasonable cost basis going forward rather than a least cost, because it may not be possible to get both least cost and control over price volatility.” (T. 9).

The Commission has revised this proposed PP, PP 2., and PP 3. to state that each gas utility should “develop a diversified gas supply portfolio” consisting of gas contracts and /or financial hedging instruments designed to balance factors such as volatility, reliability, price, adequacy of supplies, and the relevant market and profile of the individual gas utility. The Commission has also added the requirement that each gas utility submit its gas supply plan, including its contracting and/or hedging objectives, to the General Staff for review and consistency with the revised policy principles. The prudence of each gas utility’s contracting and hedging decisions will be judged based on the information available at the time those utility decisions were made. (See attached Revised PP 1. and PP 2.)

### **Proposed Policy Principle 2**

*These reasonable and prudent measures may include, but not be limited to, purchasing such supplies on a diversified portfolio basis, which would include a mix of varying term contracts ranging from monthly to yearly to longer-term in duration, if doing so would achieve a fixed price that would be advantageous during the entire length of the term.*

Arkla asserted that this PP would create tremendous regulatory risk for gas utilities. (T. 17). AOG stated that this PP would subject utilities to post mortem review by the Commission. (T. 125). AWG argued that the proposed PP contains a qualifier that renders the PP almost impossible to adhere to and that the use of the word “advantageous” is vague and ambiguous. (T. 102-103).

At the public hearing, in response to the Commission’s question concerning Staff’s recommendation to have Staff annually review the gas purchasing plans of each gas utility, Arkla witness Coogler stated that “I think that’s a good thing. We are willing to submit a gas purchasing plan that also indicates the types of

products we would use or tools we would use for hedging purposes.” (T. 60). AWG witness Gunter indicated that AOG would have no problem with submitting its plan to the Commission. Mr. Gunter stated that “I don’t think that we had contemplated on actually filing the plan with the Commission getting it approved as far as overall gas supply plan. We would like some direction in price approval as far as the hedging strategy portion of that plan.” (T. 113-114). AOG witness Callan indicated AOG would have no objection to filing its plan, but would like to have the flexibility to file revisions or changes to the plan. (T. 135-136).

See proposed PP 1. above for the Commission’s modification of this PP.

### **Proposed Policy Principle 3**

*These reasonable and prudent measures may also include financial risk management tools, to the extent that utilizing such tools could decrease either the volatility or the price of the purchased gas supplies, or both, above and beyond that which would be achieved through a diversified purchase portfolio approach alone.*

AOG contended that using financial risk management tools as set out in the PP insures that a gas utility will not be allowed to recover its costs associated with obtaining gas supply and will subject the utility to hindsight reviews by the Commission. (T. 125). AOG also contended that the Commission has failed to address adequacy and reliability of gas supplies. (T. 126). AWG argued that, if the Commission adopts its amended PP 2, there is no need for PP 3. (T. 103).

See proposed PP 1. above for the Commission’s modification of this PP.

### **Proposed Policy Principle 4**

*To the extent that there are administrative or fee-based costs associated with a particular financial risk management instrument, these costs can be recovered through the ratemaking process as long as there are corresponding or greater benefits to customers.*

Arkla expressed the concern that this PP: (1) creates substantial regulatory risk for gas utilities by

giving the benefit of financial hedging to consumers when the fixed financial hedge price is below the index price and penalizing the gas utility when the fixed price is greater than the index price, and (2) does not clearly state that the costs of the financial hedge is recoverable through the purchased gas adjustment clause (PGA). (T. 18). AWG stated that it should be clearly understood that all transaction costs should flow through the PGA for recovery. (T. 104-105). The AG stated that, like any other investment or expense, the utility should not be able to recover when the ratepayer receives no benefit. (T. 145).

The Commission has revised this PP to allow the recovery, through the PGA, of “fee-based costs associated with a particular financial risk management instrument . . .” that relate to the purchase of gas supplies.

#### **Proposed Policy Principle 5**

*All sales customers, particularly residential and small commercial customers, should be provided with the option of a “fixed commodity cost” gas supply during the winter heating season. Customers should be made aware of the option and be given the opportunity to contract for it in advance of that particular winter heating season. The Commission asks parties to comment on whether such service should be provided by the utility, through an affiliate or by an independent third party.*

Arkla contended that gas utilities should be encouraged to develop fixed price options. Arkla also asserted that gas utilities should be allowed to offer fixed prices to larger customers because the risks are not as great as with smaller customers. (T. 120). AOG stated that providing a fixed commodity cost gas supply for customers should be an option and not a requirement. (T. 126). The Staff noted that many customers expressed interest in fixed pricing for gas purchases for budgeting reasons. (Staff Initial at 2). AWG opined that it will not be feasible to offer fixed-price service to its customers in the upcoming winter months and that, at a minimum, the Commission should not require such an offering until the following year. (T. 106-107). Staff stated that, based on the utilities’ initial comments, it would not be possible to

establish fixed-price offerings by the upcoming heating season. (Staff Reply at 4).

The Commission has modified this PP to encourage the development of fixed-commodity gas supply options.

#### **Proposed Policy Principle 6**

*As soon as each gas utility has sufficient information to be able to reasonably predict the cost of the upcoming winter's gas supply, that utility should engage in the appropriate types of customer education efforts to inform as many of their customers as practical.*

Arkla basically agreed with the PP but stated that gas utilities cannot predict customer bills as weather cannot be predicted. (T. 20). AOG expressed the view that it is not prudent to speculate on weather or gas prices and communicate that speculation to its customers. (T. 127). AWG agreed with this PP, but also suggested that a range of prices be provided the public. (T. 109). The Staff stated that customer education, especially for low-income, elderly, and small business customers, is critical and should begin as soon as the utility is able to reasonably predict the prices to be effective during the upcoming heating season. (Staff Initial at 3).

The Commission has revised this PP to state that "each gas utility should engage in appropriate customer education efforts to inform as many of its customers as practical concerning the utility's good-faith estimate of gas prices for each upcoming heating season."

#### **Proposed Policy Principle 7**

*Levelized billing or average payment plans should be made available to as many residential and small business customers as reasonable and practicable. This should include sufficient customer education efforts to encourage the participation of as many customers as possible. Special efforts should be made to educate and inform low income, fixed income, and elderly customers.*

Only AOG objected to this proposed principle. AOG stated that there is no rational basis for

requiring utilities to make special efforts to educate and inform low-income and elderly customers and that it did not believe it is prudent to expose itself and its credit-worthy customers to increased costs associated with programs which will lead to increased bad debts. (T. 127). The Commission disagrees with AOG's contention that low income, fixed income and elderly customers do not require special educational efforts. The Commission further finds AOG's assertion that the outreach to customers required by this PP would lead to increased bad debt expense to be meritless.

The Commission has retained the basic language of the proposed PP, but has added the statement that “any gas utility needing assistance with efforts to educate and inform low income, fixed income, and elderly customers should contact the Commission for help and suggestions . ...”

#### **Proposed Policy Principle 8**

*Gas utilities should submit revisions to their Purchased Gas Adjustment Clauses (PGAs) to reflect the flow through of any costs associated with hedging transactions.*

Most commenters agreed with this PP. However, the AG and AOG stated that this PP should be consistent with PP 4. (T. 128 and T. 141).

The Commission has made minor language revisions.

#### **Proposed Policy Principle 9**

*Gas utilities should maintain records for their hedging programs which document in writing the following:*

- A. The overall risk management plan which would include specific utility goals and guidelines.*
- B. A Policy and Procedures Manual.*
- C. Corporate (including management and Board of Directors) reporting, monitoring, and tracking requirements.*
- D. An evaluation mechanism to measure hedging program performance.*
- E. Accounting information to determine: (1) the fees, gains, and losses that have flowed through the PGA, and (2) the FAS and IRS accounting treatment for hedging transactions.*

Most commenters generally agreed with this PP.

The Commission has made minor language revisions.

**CONCLUSION**

Based on the comments received from the parties and the additional testimony presented at the public hearing, the Commission adopts the attached revised policy principles (Attachment A).

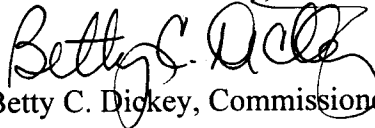
The Commission further finds that collaborative discussions, either in the annual gas supply plan reviews or in a separate forum or filing, should be conducted to address the possibility of alternative PGA procedures that could smooth out the volatility in gas prices and address other issues that may be beneficial to both the gas utility and its customers.

BY ORDER OF THE COMMISSION.

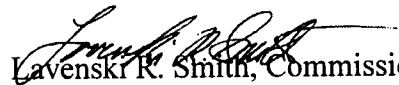
This 20 day of June, 2001.



Sandra L. Hochstetter, Chairman



Betty C. Dickey, Commissioner

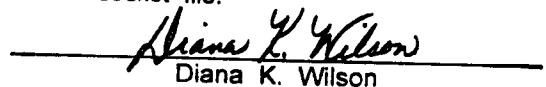


Lavenski K. Smith, Commissioner



Diana K. Wilson  
Secretary of the Commission

I hereby certify that the following order issued by the Arkansas Public Service Commission has been served on all parties of record this date by U.S. mail with postage prepaid, using the address of each party as indicated in the official docket file.



Diana K. Wilson

Secretary of the Commission  
Date 6-20-01

**POLICY PRINCIPLES  
FOR GAS PROCUREMENT PLANS OF UTILITIES**

The Commission intends that these will guide gas utilities in their purchasing decisions as such decisions relate to the issues that were under review in the NOI. The Commission interprets these policy principles as being consistent with Ark. Code Ann. §23-15-103, the "Least Cost Purchasing Statute." Modifications to these principles and/or rules may be required as more experience is gained in these areas.

1. Each gas utility is expected to take all reasonable and prudent steps necessary to develop a diversified gas supply portfolio. The portfolio should consist of an appropriate combination of different types of gas purchase contracts and/or financial hedging instruments that is designed to yield the optimum balance of reliability, reduced volatility and reasonable price. In so doing, each utility should take into consideration various factors including, but not limited to, its particular circumstances, the demographics of its customers, the then-current market projections of both volatility and price, supply/demand estimates, and other relevant information that is available in the industry.
2. On an annual basis, each utility should submit its gas supply portfolio plan, along with its contracting and/or hedging objectives, to the General Staff for Staff's review and determination as to whether or not it appears to be consistent with these policy principles. The reasonableness and prudence of each utility's contracting and hedging decisions shall be judged by the market circumstances and pertinent information that was available to the utility at the time it made those decisions.
3. Each gas utility should submit proposed revisions to its PGA or GSR, as appropriate, to reflect the flowthrough of any costs associated with hedging transactions.
4. To the extent that there are fee-based costs associated with a particular financial risk management instrument, as those costs relate to the acquisition of natural gas supplies, such costs may be recovered through the utility's Purchased Gas Adjustment Clause (PGA).
5. Each gas utility should maintain records for any hedging programs it chooses to utilize that document the following:
  - A. The overall risk management plan, including the utility-specific goals and guidelines.
  - B. A Policy and Procedures Manual.
  - C. Corporate (including management and Board of Directors) reporting, monitoring, and tracking requirements.
  - D. An evaluation mechanism to measure hedging program performance.
  - E. Accounting information to determine: (1) the fees, gains, and losses that have flowed

through the PGA, and (2) the FAS and IRS accounting treatment for hedging transactions.

6. Each gas utility should engage in appropriate customer education efforts to inform as many of its customers as practical concerning the utility's good-faith estimate of gas prices for each upcoming winter heating season.
7. Levelized billing or average payment plans should be made available to all residential and small business customers. Implementation of this principle should include sufficient customer education efforts to encourage maximum customer participation with particular attention to low income, fixed income, and elderly customers. Any gas utility needing assistance with efforts to identify, educate and inform low income, fixed income, and elderly customers should contact the Commission for help and suggestions for designing an education plan designed to reach these customer groups.
8. The Commission encourages each gas utility to explore and, if appropriate, develop and implement fixed-commodity gas supply options for its customers.