

State of Florida



# Public Service Commission

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## -M-E-M-O-R-A-N-D-U-M-

**DATE:** August 7, 2008

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Lee, McNulty, Draper, Kummer) *OK WBM ESD JSW*  
Office of the General Counsel (Fleming) *CH*

**RE:** Docket No. 080003-GU – Purchased gas adjustment (PGA) true-up.

**AGENDA:** 08/19/08 – Regular Agenda – Participation at Commission’s Discretion

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** McMurrian

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\080003.RCM.DOC

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### Case Background

The Commission adopted the purchased gas adjustment (PGA) for recovery of purchased gas costs by regulated natural gas utilities. The Commission has conducted the PGA review as an annual process since 1993. By Commission Order No. PSC-07-0934-FOF-GU, issued November 26, 2007, in Docket No. 070003-GU, the Commission approved for each investor-owned natural gas utility a levelized PGA factor, which serves as a cap, or maximum recovery factor, for calendar year 2008.

On July 22, 2008, Florida City Gas (City Gas or the company) filed a petition for approval of a mid-course correction to its PGA cap. City Gas proposes to increase the cap from \$1.14875 per therm to \$1.48875 per therm, to be applied to bills issued after September 1, 2008.

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By Commission Order No. PSC-93-0708-FOF-GU, issued May 10, 1993, in Docket No. 930003-GU, In Re: Notice of Proposed Agency Action Order Establishing Annual Purchased Gas Cost Recovery Hearing, the Commission determined that a utility may, at its option, request a mid-course correction if revised projected expenses for the remainder of the period significantly exceed projected revenues for the period when using the Commission-approved cap. The Commission has previously approved mid-course corrections to the PGA cap when the amount of projected under-recovery was substantial.<sup>1</sup>

Similar to the fuel clause for electric utilities, the PGA allows regulated natural gas utilities dollar for dollar cost recovery, at no profit, on gas supply costs. Unique to the PGA, however, is its rate cap and monthly flex-down mechanism. Rather than a set factor fixed for the next period as in the fuel clause, the PGA factor set by the Commission is a cap, which serves as the maximum monthly rate a company can charge its customers for recovery of PGA costs. The flex-down mechanism allows monthly rates to be adjusted below the cap according to market conditions, in order to minimize the cumulative true-up balance over the 12-month period. As a result, customers may experience fluctuations in monthly PGA rates.

The Commission's mid-course correction decision only determines the timing of natural gas cost recovery, not the prudence of underlying costs. A prudence review of such costs will occur in preparation for the hearing in Docket No. 080003-GU, scheduled for November 2008. Any costs found to be imprudent will be credited to ratepayers with interest through the PGA true-up mechanism. The base rates of City Gas were most recently reviewed in Docket 060657-GU, which the Commission decided on October 23, 2007.<sup>2</sup>

Jurisdiction over this matter is vested in the Commission by several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06.

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<sup>1</sup> See, Orders Nos. PSC-05-1028-PCO-GU and PSC-05-1029-PCO-GU, issued October 21, 2005, in Docket No. 050003-GU, In re: Purchased gas adjustment (PGA) true-up.

<sup>2</sup> Order No. PSC-07-0913-PAA-GU, In Re: Petition for approval of acquisition adjustment and recognition of regulatory asset to reflect purchase of Florida City Gas by AGL Resources, Inc.

### Discussion of Issues

**Issue 1:** Should the Commission grant the petition of Florida City Gas for an increase in its Purchased Gas Adjustment (PGA) cap from \$1.14875 per therm to \$1.48875 per therm?

**Recommendation:** No. The Commission should deny City Gas's request for an increase to its PGA cap. The Commission should maintain the current cap of \$1.14875. Current market prices do not support a change in the cap. (Lee, McNulty)

**Staff Analysis:** City Gas's current PGA cap of \$1.14875 per therm for the period January 2008 through December 2008 was set by Commission Order No. PSC-07-0934-FOF-GU, issued November 26, 2007. For January and February 2008, the company's PGA rates were set below the cap, at \$0.92 and \$1.02 per therm, respectively. The company has set its PGA rate at the cap of \$1.14875 per therm since March 2008 due to the unexpected increase in natural gas commodity costs.

Without the proposed increase of its PGA cap to \$1.4875 per therm, City Gas's petition states that City Gas's fuel expenses will exceed its fuel revenues by \$6,682,009, or approximately 15 percent, for the period January 2008 through December 2008. According to the petition, this is mainly due to the fact that 2008 natural gas costs are significantly higher than the company's original projection in 2007. The reasons cited by the company for such significant cost increases include the increased global demand for energy, the increased use of natural gas for electric generation, and the uncertainty of the upcoming hurricane season.

A residential customer with monthly consumption of 20 therms would incur an additional gas cost of \$6.80 per month if the PGA rate were to be increased to the proposed new cap in the final four months of 2008. According to City Gas's petition, the proposed correction would completely eliminate the expected 2008 end-of-year true-up of \$4.6 million (see Table 1). In fact, the correction would result in a slight over-recovery of \$58,966, if rates were set at the proposed cap. As a result of this and the latest forecast in natural gas prices, City Gas reported in response to a staff data request that it expects to decrease its 2009 PGA cap to below \$1.32 per therm.

City Gas has used the NYMEX natural gas price forward curve (the NYMEX) as a basis of its fuel commodity forecasts. Natural gas prices as reflected in the NYMEX began to decline starting on July 15, 2008, and the price decline continued after City Gas filed its petition on July 22, 2008. In its July 30, 2008, response to a staff data request, the company stated that if this price trend were to continue, its customers should see no price increase as a result of the increase to the PGA cap. In addition, City Gas responded to an August 8, 2008, staff data request showing that its current PGA cap would result in a 2008 end-of-year true-up of only \$86,024 (under-recovery) based on the most current market data (i.e. the NYMEX of August 5, 2008). However, City Gas believes the proposed increase to its PGA cap is still needed to give it the flexibility to better manage the fluctuations in the market under the PGA rate cap and flex-down mechanism.

<b>Table 1</b>			
<u>2008 End of Year True-up, With and Without Proposed Mid-Course</u>			
	Per City Gas Petition		Per Recent Market Data
	Without Mid-Course	With Mid-Course	Without Mid-Course
Projected 2008 Fuel Cost (6 month actual)	\$52,516,937	\$52,516,937	\$48,001,999
Projected 2008 Revenue	\$45,834,928	\$50,498,236	\$45,834,928
2008 Under-recovery	(\$6,682,009)	(\$2,018,701)	(\$2,167,071)
2008 End-of-Year True-up (adjusted for true-ups, OSS Margins, and Interest)	(\$4,622,122)	\$58,966	(\$86,024)

Staff believes several options are available to the Commission to address City Gas's request for mid-course correction of its PGA cap. Staff presents three options below.

*Option 1: Deny City Gas's Request for Mid-Course Correction* - In its petition, City Gas states that its reason for seeking a mid-course correction to its PGA cap is the significant increase in the cost of natural gas. At the time City Gas filed its petition, the price of natural gas had been elevated for a period of several months, with a moderate decline in the price occurring just prior to filing of the petition. However, the NYMEX has experienced a sustained and significant decline after the filing of the petition, and this decline nearly eliminates the projected under-recovery of \$4.6 million identified in the petition. The NYMEX is the best market price information available to the gas utility industry. In addition, Florida City Gas is over-recovered in its PGA by \$1.6 million through June 2008. If City Gas were granted the increase as requested and the most recent market data is correct, and if City Gas were to charge at the cap for the remainder of 2008, City Gas would be over-recovered by \$4.6 million at the end of 2008. Given the current economic conditions facing consumers at this time, any attempt to avoid large potential over-recoveries should be strongly considered.

*Option 2: Approve City Gas's Request for Mid Course Correction As Filed* - The PGA rate cap and flex-down mechanism give the flexibility to balance the need to reduce customer rate volatility and the need to send timely price signals to customers. The company has shown that it implements this flex-down mechanism based on market conditions. In 2007, when natural gas commodity costs declined unexpectedly, City Gas's monthly PGA rates were adjusted far below the cap, ranging from \$0.77 to \$0.98 per therm, or at 46 percent to 31 percent below the 2007 cap of \$1.4311 per therm. This year, the company's PGA rate has been at its approved cap since

March 2008. Although natural gas prices have fallen sharply since the company filed its petition, it is uncertain whether this trend will continue. Should this trend reverse, the current cap may constrain the company's flexibility to use the flex-down mechanism to match market conditions and to avoid the potential for a large, accumulated true-up in 2009. Thus, increasing the cap reduces the probability of a significant underrecovery.

*Option 3: Allow Half of City Gas's Requested Increase to its 2008 PGA Cap* - A moderate increase in City Gas's PGA cap is supported by several considerations. First, as stated in Option 2, natural gas prices are inherently unstable, so providing a higher cap would afford City Gas flexibility in managing its PGA true-up level. Second, in the past, the company has appropriately utilized the flex-down mechanism when its natural gas costs have decreased. Third, restricting the increase to approximately half the requested increase, or \$1.3175 per therm, would reduce the impact to customer bills by half, assuming rates are at the PGA cap. Under this option, a residential customer using 20 therms per month would experience an increase in their gas bill of \$3.40 per month from September 2008 through December 2008, rather than \$6.80 per month during that same period as proposed by City Gas in its petition.

The changes in the price per therm and residential bills (calculated at 20 therm per month usage and set to the cap) for each of the options is shown in Table 2 below.

	Current	Option 1 (Deny Petition)	Option 2 (Approve Petition)	Option 3 (Grant Half of the Requested Cap Increase)
PGA Cap (\$/therm)	1.14875	1.14875	1.4875	1.3175
Increase in Cap Compared to Current Cap (\$/therm)	N/A	0	.34	.17
20 Therm Res. Bill at Cap (\$)	45.0	45.0	51.8	48.4
Increase in Bills Compared to Current (\$)	N/A	0	6.80	3.40

Conclusion

Staff recommends the Commission approve Option 1 and deny City Gas's request to increase its PGA cap. Under its current PGA cap, City Gas has been able to reasonably respond to changing market conditions without experiencing an under-recovery through June 2008. In addition, the most recent market information does not indicate that the Company will become under-recovered by any significant degree by the end of 2008. Staff believes any change in the cap should be based on significant changes in market price using the best and most recent market information. The potential for large over-recoveries should be avoided. Thus, staff does not believe that any change to City Gas's PGA cap is warranted at this time.

However, staff also recognizes that Option 2 (approve City Gas's request for mid-course correction as filed) and Option 3 (allow half of City Gas's requested increase in its PGA cap) would provide City Gas with greater flexibility to respond to natural gas price volatility in the remaining months of 2008, which could prevent a significant 2008 under-recovery. Thus, while staff recommends Option 1 for the reasons stated above, the Commission has the discretion to adopt Options 2 or 3 considering that the current trends could reverse.

**Issue 2:** What is the appropriate effective date for the revised cap if the Commission grants the mid-course correction requested by Florida City Gas?

**Recommendation:** If the Commission approves staff's recommendation in Issue 1 to deny a change in City Gas's PGA cap, this issue is moot. If the Commission approves a new cap in Issue 1, the new cap should become effective with ratepayers bills beginning September 1, 2008. (Draper)

**Staff Analysis:** City Gas has requested that the new PGA cap become effective with ratepayers bills beginning September 1, 2008. Staff has reviewed the notice City Gas sent to customers with August billings, notifying customers of the requested increase in the cap. This will allow customers to be informed of the requested increase in the cap. As noted in Issue 1, the increase in the cap does not automatically mean customers' bills will increase. The cap allows the utility to charge up to that amount, but the utility may charge less than the cap as gas prices fluctuate. City Gas states that it will provide further notice to its customers of the Commission's final decision.

Docket No. 080003-GU

Date: August 7, 2008

**Issue 3:** Should this docket be closed?

**Recommendation:** No. This docket is an on-going docket and should remain open. (Fleming)

**Staff Analysis:** This docket is an on-going docket and should remain open.