2003 Annual Report on Natural Gas Efficiency

Report to the Utilities and Energy Committee
On Actions Taken by the Commission Pursuant to 35-A M.R.S.A. § 4706

Background

Title 35-A M.R.S.A. § 4706(1) authorizes the Public Utilities Commission (Commission) to adopt alternative ratemaking mechanisms for gas utilities "to promote efficiency in operations, create appropriate financial incentives, promote rate stability and promote equitable cost recovery." In particular, the Commission may: adopt multi-year rate-making plans with mechanisms for future rate changes; reconcile costs and revenues; index revenues or rate changes; establish financial incentives; streamline regulation or deregulate services where not required to protect the public interest; approve rate flexibility programs; and modify cost of gas adjustment requirements.

This report describes Commission actions taken during 2003 to promote natural gas efficiency through ratemaking mechanisms, contracts, and unbundling of transportation and commodity services.

Rate Stability Initiative

Gas prices spiked to extremely high levels in February 2003 necessitating mid-period gas cost increases for Northern Utilities and Bangor Gas Company and causing two of Maine's Local Distribution Companies (LDCs) to consider changes to their current existing pricing structures. In response to this price spike, and to the apparently increasing price volatility generally in the gas markets, the Commission has continued to work with Maine's LDCs to determine whether any of the tools available under § 4706(1) should be used to provide customers more stable and predictable prices.

In May, the Commission invited Maine's LDCs to propose pricing options similar to those offered by the heating oil industry, such as fixed price or capped price products, that could be offered to customers to assist them in managing their gas bills. Both start-up LDCs, Maine Natural Gas and Bangor Gas Company, have filed proposals which include revisions to commodity pricing gas cost reconciliation, or bill levelization plans, as described further below.

Gas Utility Company Activity

A. Maine Natural Gas Corporation (formerly CMP Natural Gas, L.L.C.)

Since 1999, using its authority to enter into contracts that rely on entrepreneurial resources rather than regulatory oversight, Maine Natural Gas has contracted with increasing numbers of large customers that serve to "anchor" expansion into new areas. These customers include the Westbrook Energy Center (WEC) gas-fired electric generation facility, Brunswick Naval Air Station (BNAS), and the University of Southern Maine at its Gorham campus. Maine Natural Gas first built facilities to WEC, then to the Gorham campus. In the fall of 2001, the company completed installation of its pipeline system to BNAS for service on November 1, 2001. The Company continues to work toward expanding service in Windham, Gorham, Brunswick, Topsham, and other municipalities within the state. Expansion during 2003 includes Windham's Enterprise Business Park on Route 302, the Topsham Fair Mall and Highland Green development, and BNAS Brunswick Gardens housing project.

When initially certified, under its rate plan, Maine Natural Gas agreed not to seek a base rate increase for five years to counterbalance the degree of entrepreneurial freedom that it was granted by the Commission. This rate freeze will expire March 31, 2004. Unlike Maine's two other LDCs, Maine Natural Gas does not have a cost of gas adjustment to flow its gas commodity costs on to ratepayers. Instead it employs a commodity pricing strategy using market price inputs and offers customers either fixed or flexible pricing options. The Company reports that market volatility and high gas prices have strained the financial viability of these mechanisms as currently designed. Consequently, the Commission is currently considering Maine Natural Gas Corporation's proposed changes to its Indexed Price and Fixed Price Options, as well as its proposal to implement a rolling gas cost reconciliation mechanism.

B. Northern Utilities, Inc.

Unlike the ratemaking procedures of its competitors Maine Natural Gas and Bangor Gas Company, traditional regulatory processes govern Northern Utility's (Northern's) rates and operations. The rapid increases in gas prices nationwide in 1999 and 2000 and in the winter of 2002-2003 required frequent mid-term adjustment of Northern's cost of gas factor. During 2003, the Commission approved Northern's proposed revised hedging program for gas supply procurement designed to dampen the effect of market price spikes on consumers.

In November 2000, Northern's ultimate parent corporation, NiSource, Inc., closed its merger with Columbia Energy Group. The integration of these two large corporate families has resulted in management and policy changes and staff cuts at the Northern/Bay State Gas level. The Commission continues to monitor Northern's post-merger operations and revenues to ensure that service to Maine's customers remains safe, adequate and reasonably priced. The Commission monitored Northern's New Hampshire Division rate case to gather information to assist it in determining whether Maine should initiate a rate case for Northern in 2003.

Because of ongoing customer complaints regarding call center and billing operations, in 2002 and 2003 the Commission conducted investigations of particular operations and a management audit of Northern's customer services to determine their adequacy. The audit revealed that certain aspects of Northern's operations had become substandard following the merger and reorganization. The Commission will use the information gained by the management audit in considering the implementation of a service quality performance incentive plan, such as a benchmark and performance-based mechanism, to help ensure that Northern meets adequate service standards.

C. Bangor Gas Company, L.L.C.

Bangor Gas Company operates under the alternative rate plan approved by the Commission in 1998, which includes a 10-year distribution rate freeze, a rate cap set initially on a 3-year average of oil prices, indexed rate cap increases, pricing flexibility, and authority to enter special contracts without prior Commission approval. The rate plan also includes a seasonal cost of gas adjustment. To date, Bangor Gas has set its gas commodity price for each winter or summer period based on gas market futures and has purchased gas from its affiliate, Sempra Energy, at market prices. Bangor Gas has made two annual rate cap adjustments, as allowed under its rate plan.

In 2001, Bangor Gas completed installation of its main pipeline to the Bangor-Brewer area and, with the many miles of pipeline and facilities it had already installed in those municipalities, was poised to greatly expand service. It is adding to its customer base in all categories of service. Bangor Gas also serves the Bucksport Energy gas-fired electric generation facility, Georgia Pacific (formerly Fort James Corporation), and the University of Maine at its Orono campus.

In 2002, the Commission approved a streamlined mid-period cost of gas adjustment procedure proposed by Bangor Gas to more efficiently match rates with gas costs. Bangor proposed these changes to reduce the potential for large accruals of over-or under-collection gas revenues, as well as to reduce regulatory expense for making these adjustments. However, the Company determined, following the price spike in February 2003, that additional mechanisms to mitigate price volatility were necessary. Accordingly, the Commission approved a change from a seasonal to a monthly cost of gas rate adjustment to eliminate accrual of burdensome large seasonal gas cost balances, as well as a budget payment plan under which customers can elect to spread payment for high winter heating usage over a longer period of time. Two additional proposed pricing options, a Fixed Price Option and a Maximum Price Option, are under consideration for effect in the 2004-2005 winter period to provide customers with further bill stabilizing options.

Natural Gas Restructuring

The Commission has moved slowly toward gas restructuring in Maine, monitoring developments in neighboring New England states and taking actions that suit Maine's market and regulatory environment. While the Commission's regulatory actions to restructure gas service have been moderate compared to actions taken in neighboring New Hampshire and Massachusetts, an informal survey of selected registered Maine gas marketers revealed no pressing matters related to gas competition in Maine that warrant immediate regulatory attention.

In 1999, the Commission approved a comprehensive rate redesign and customer reclassification for Northern Utilities that were necessary to prepare Northern for gas supply competition that is developing in the natural gas industry. In addition, all three gas utilities operating in Maine offer transportation-only ("unbundled") service to all commercial and industrial customers. Customers taking this service must purchase and install telemetering equipment.

At this time, 13 natural gas suppliers are registered to provide service in Maine. Numerous medium and large commercial and industrial customers are taking transportation-only service from their local distribution company, while purchasing gas from competitive suppliers. However, because of the upfront costs of equipment required to provide this service, small commercial customers have not found it economic to participate in the competitive gas supply market. In 2002, we saw some efforts at aggregation of customer loads in certain business sectors, such as restaurants. However, higher gas prices in 2003 have slowed interest in conversions to gas. To date, the market appears to be developing slowly, with marketer focus turning to Maine after they secure business in larger markets to our south. Previous information obtained from suppliers indicates that further regulatory action to assist market development is not necessary at this time. We will continue to monitor gas market activity in Maine and the region, as well as gas utility response, and to consider whether there are ways to reduce market barriers and encourage additional market activity for gas supply in the state.