2004 Annual Report on Natural Gas Ratemaking Mechanisms

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 ratemaking 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 2004 to promote effective and efficient regulation of natural gas.

In early 2003, it became apparent that consumers throughout the nation were facing increased natural gas prices and market volatility through the remainder of the year. Gas prices spiked to $19.00 per million British thermal units (MMBtu) in February 2003, then ranged from about $4.50 to $6.00 per MMBtu for much of the remainder of the year.[1] In May 2003, the Commission invited Maine's local distribution companies (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.

Throughout 2004, natural gas prices remained at high levels, staying consistently around $5.00 - $6.00 per MMBtu and hitting a high of almost $8.00 per MMBtu, resulting in significantly higher consumer bills, particularly during the winter months, and causing two of Maine's LDCs to consider changes to their existing gas rate structures. This required a continued focus on consumer pricing options and hedging strategies for Maine's gas utilities and consumers. To that end, we approved a fixed price option for Bangor Gas Company and revised fixed and indexed price options for Maine Natural Gas for customers who prefer greater stability and predictability in their monthly bills.

[1] In comparison, gas prices on the spot market during 2002 ranged from approximately $2.00 to $5.25.

Gas Utility Company Activity

A. Maine Natural Gas, L.L.C. (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 included Windham's Enterprise Business Park on Route 302, the Topsham Fair Mall and Highland Green development, and BNAS Brunswick Gardens housing project. In 2004, it continued to increase its customer base for all classes of customers.

When initially certified, under its rate plan, Maine Natural 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 expired March 31, 2004. Unlike Maine's two other LDCs, Maine Natural Gas did not have a cost of gas adjustment to flow its gas commodity costs on to ratepayers. Instead it employed an innovative commodity pricing strategy using market price inputs and offering customers either fixed time or flexible pricing options. In late 2003, the Company reported that market volatility and high gas prices had strained the financial viability of these mechanisms as currently designed and proposed changes to its Indexed Price and Fixed Price Options, as well as a plan to implement a rolling gas cost reconciliation mechanism. Maine Natural Gas proposed to abandon its innovative gas pricing mechanism because of the much greater risk of losses in a volatile gas market. It sought authorization to reconcile its gas costs on a monthly basis. Both Northern Utilities and Bangor Gas Company reconcile their gas costs and revenues in the traditional manner (i.e., at regular intervals). We approved Maine Natural Gas's request and will work with the Company to finalize the details when it is ready to implement this change.

B. Northern Utilities, Inc.

Unlike the ratemaking procedures of Bangor Gas Company, traditional regulatory processes govern Northern Utilities’ (Northern’s) rates and operations. The rapid increases in gas prices nationwide since 1999 have 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. Northern’s limited use of financial hedging instruments under a detailed hedging plan has helped stabilize its gas commodity rates for its customers for the current winter period.

In November 2000, Northern's ultimate parent corporation, NiSource, Inc., merged 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. We determined that it did not appear that Northern was overearning at that time.

Because of ongoing customer complaints regarding call center and billing operations, in 2002 and 2003 the Commission conducted investigations of particular operations and ordered a management audit of Northern's customer services to determine their adequacy. The audit revealed that substantial post-merger internal restructuring, including loss of or migration of a substantial number of service operations and management to the mid-western home of the parent corporation, had negatively impacted certain aspects of Northern's operations. The Commission used the information gained by the management audit to implement a service quality performance incentive plan that became effective January 1, 2004. The plan establishes benchmarks for eleven measures of Company performance that must be met to avoid a monetary penalty, to help ensure that Northern meets adequate service standards. The first annual review of Northern's 2004 service plan performance will begin in March 2005.

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 into 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 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. When combined with the many miles of pipeline and facilities it had already installed in those municipalities, Bangor Gas was poised to greatly expand service and, subsequently, it steadily added 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 of gas revenues, as well as to reduce regulatory expense for making these adjustments. However, the Company determined, following the large price spike in February 2003, that additional mechanisms to mitigate price volatility were necessary. Accordingly, the Commission approved its proposed change from a seasonal to a monthly cost-of-gas rate adjustment to eliminate the accrual of 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. We approved a Fixed Price Option for effect in the 2004-2005 winter period to provide customers with a further bill-stabilizing option.

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 New Hampshire and Massachusetts, periodic informal surveys of selected registered Maine gas marketers have revealed no pressing matters related to gas competition in Maine that have warranted 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 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. Northern has indicated its intention to bring to us in 2005 the question of whether it should be authorized to assign its supply capacity to competitive marketers who take on gas supply service for commercial or industrial customers formerly served by Northern. Both Massachusetts and New Hampshire have implemented mandatory capacity assignment. We will review the extent to which their gas markets have been successful as a result of this policy to help make an informed decision.

At this time, 14 natural gas suppliers are registered to provide service in Maine. Numerous medium and large commercial and industrial customers, representing 89% of all gas volumes delivered in Maine during 2003, are taking transportation-only service from their local distribution company, while purchasing gas from competitive suppliers. However, because of the upfront equipment costs required for 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, persistently higher gas prices in 2003 and 2004 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 feedback 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 measures we should adopt to reduce market barriers and encourage additional market activity for gas supply.