STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2003-914

September 30, 2004

MAINE NATURAL GAS CORPORATION
Proposed Tariff Revisions for Index and Fixed Price Option Rates and to Implement Gas Cost Reconciliation Mechanism
(35-A M.R.S.A. §§ 307 and 4706)

ORDER

Welch, Chairman; Diamond and Reishus, Commissioners

I. SUMMARY

We approve Maine Natural Gas Corporation's (MNG or the Company) proposed Fixed Price Option rate for September 1, 2004 through August 31, 2005, as well as its proposed changes to its Fixed Price Option Terms and Conditions as described in this Order.

II. BACKGROUND

On December 12, 2003, pursuant to 35-A M.R.S.A. §§ 307 and 4706 and Chapter 120 of the Commission's Rules, Maine Natural Gas Corporation (MNG) filed proposed revisions to its Index Price Option (IPO) and Fixed Price Option (FPO) rate schedules, pages 20.0 and 20.1. MNG initially sought authorization to: 1) reduce the offered time periods for its FPO offerings, which range from 3- to 24-months, to 6- and 12-months and to change the customer enrollment periods from monthly to semi-annually in September and March; 2) remove the heating oil component in its commodity pricing formula and to set the commodity price on a 100% gas plus upstream transportation index to better reflect natural gas costs; and 3) initiate a gas cost reconciliation, or "true up," mechanism to recover its actual gas costs associated with its IPO and FPO customers, but not gas costs associated with its negotiated special contracts. MNG argued that these changes were necessary due to changed price levels and volatility in the gas markets since its initial rate plan was approved.

The Office of the Public Advocate (OPA) and Bangor Gas Company (BGC) are intervenors. BGC was granted discretionary intervention and is restricted to receiving only non-confidential information.

By Order Approving Changes to Index Rate Options dated January 13, 2004, the Commission authorized MNG to change its IPO to remove the heating oil component in its commodity pricing formula and to set the commodity price using the NYMEX gas futures only. The Commission also authorized MNG to include its hedged basis cost in its IPO rate calculation.

We approved MNG's proposed changes to its FPO in an Order dated April 16, 2004 and a Corrected Order issued April 29, 2004 (April 16th Order), including offering a 12-month FPO to take effect September 1st each year.[1]

On August 31, 2004, MNG filed under separate cover: 1) Page 20.1.1 entitled "Final FPO Prices Based on August 27, 2004 Settlement Prices" showing a rate adjustment of $0.4650 per therm, and 2) a letter with attached analysis (in both confidential and redacted versions) in which it explained the basis upon which it had fixed its FPO prices for the period September 1, 2004 through August 31, 2005.[2] On September 7, 2004, MNG filed a letter requesting that the Commission approve a modification in the formula for setting FPO basis price that was established in its April 16th Order. On September 24, 2004, MNG filed an original FPO tariff sheet, Page 20.1, Part B, reflecting the Commission's decision at deliberations on September 20, 2004.

III. ANALYSIS

A. Authority

MNG requests that the Commission modify its April 16th Order with regard to the method by which MNG may set the basis price component of its FPO rate. The Commission may alter or amend any order pursuant to 35-A M.R.S.A. §1321. Rates charged by public utilities must be just and reasonable. 35-A M.R.S.A. §301(2).

B. Method for Setting FPO Basis Price

In our April Order we stated that MNG should set the basis component of its FPO as follows:

> MNG should use the contract price for hedged basis where applicable. If for some reason MNG does not contract for basis prior to a specific FPO period, we will require MNG to calculate basis for the FPO based upon an average of the weighted actual basis at Dracut for similar periods over the prior two years. If after making this calculation, MNG has reason to believe that the results are not reflective of the upcoming period, when it

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[1] We allowed MNG to limit the fixed price options it offers to 12- and 24-month terms and to eliminate the 24-month term when not enough customers sign up for this option.

[2] Prior to our April Order, when MNG filed its monthly FPO rate adjustment, we confirmed that it had been calculated according to the approved formula then stamped them in as effective rate schedules. See *Central Maine Power Company,* Docket No. 96-786, Order Approving Rate Plan (Dec. 17, 1998) (IPO and FPO rate formulas approved).

> files its FPO rates, it can propose other methods along with an explanation as to why the historical basis would not be suitable.

Order (April 29, 2004) at 4.

MNG proposes to change this methodology to increase from two to three the number of historical years it can use to compute an average of the actual weighted basis at Dracut for similar months. In addition, it proposes to modify the tariff language specifying that it may offer an alternative price calculation when it believes the weighted historic average will not produce an appropriate rate. MNG proposes the following language:

> If after making this calculation, MNG has reason to believe that the results are not reflective of the upcoming period, it will file alternative FPO rates with the MPUC along with an explanation as to why the historical basis would not be suitable, and calculate the basis component using the MPUC-approved price.
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> As we noted in our April Order:
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> gas costs are primarily driven by the market, particularly changes in the overall cost of gas, typically defined as the NYMEX price for gas at Henry Hub, and the basis differential, which is the difference between the Henry Hub price and the price at a local delivery point such as Dracut Massachusetts. Both elements have shown considerable volatility in recent years. This underlying level of volatility is fully outside MNG's control.

Order (April 29, 2004) at 10.

Offering customers a fixed price for 12- or 24-months requires that MNG project the prospective rates during August, then disclose the actual rate once it has purchased its FPO volumes at the end of August, projecting likely costs for unhedged portions of the gas needed to serve fixed price customers. MNG must fix the FPO price between the month-end gas purchase closing date and September 1. To keep gas price signals accurate and revenue over- and under-collections small, MNG must predict its FPO gas costs as accurately as possible. MNG uses its current market experience, obtained as it seeks to hedge portions of its gas supply needs, as one indicator of price for the upcoming year.

In instances where MNG seeks approval of an alternative basis calculation, Commission review and approval must be accomplished within three days. This is the time between when MNG must lock in its FPO gas supply purchase and notify customers of what the actual FPO price will be for the upcoming year. Because the time allowed does not fit in well with our normal deliberative process and because

the effect of the basis component on the FPO rate is relatively minor, we will delegate authority to the Director of Technical Analysis to review and approve (or disapprove) MNG's alternative basis price proposal.

C. Rate for September 1, 2004 FPO

We consider MNG's letter of August 31, 2004 to be a request for approval of its FPO rate for the 12-month period beginning September 1, 2004. MNG explains that it entered into contracts for gas covering the full FPO year but only purchased basis for the winter period. MNG informed us that, in its opinion, the available bid price for a contract locking in the non-winter basis price was too high. However, MNG also believed that because basis cost has been rising and that 2002 basis prices were abnormally low within this trend, that the 2-year average of historic prices produced a basis price that was unreasonably low. If it had been able to use the historic basis prices from 2001, the results would have been similar to its understanding of market expectations of basis cost for the upcoming non-winter season. In an effort to have its FPO price most accurately reflect MNG’s best judgment of actual cost for the upcoming year, MNG quoted FPO customers a price of $.465 per therm for the 1-year FPO that included a non-winter basis price of $0.050 per therm. The rate differential between the rate that MNG has offered its customers and the one that would have resulted from the use of the 2-year historic average to price basis would have produced ($.4603) is $0.0047 per therm.

We find MNG's proposed basis price reasonable and approve its alternative calculation of the FPO rate.

Accordingly, we

O R D E R

1. That Maine Natural Gas Corporation's proposed Fixed Price Option rate of $.465 per therm is approved for effect September 1, 2004 through August 31, 2005;

2. That the Director of Technical Analysis is delegated authority, pursuant to Chapter 110, Section 1305, to approve proposed alternative calculations of the basis price component of the Fixed Price Option rate filed pursuant to Page 20.1, Part B of Maine Natural Gas Corporation's Terms and Conditions; and

3. That Maine Natural Gas Corporation's proposed Page 20.1, Part B, Fifth Revision, of its Gas Terms and Conditions, filed September 24, 2004, is approved for effect October 1, 2004.

Dated at Augusta, Maine, this 30th day of September, 2004.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Diamond
Reishus

COMMISSIONER ABSENT: Welch

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.