

Decision No. R99-1094

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 99S-293G

RE: THE INVESTIGATION AND SUSPENSION OF TARIFF SHEETS FILED BY
PUBLIC SERVICE COMPANY OF COLORADO WITH ADVICE NO. 550-GAS.

RECOMMENDED DECISION OF
ADMINISTRATIVE LAW JUDGE
KEN F. KIRKPATRICK
ACCEPTING STIPULATION
AND GRANTING APPLICATION

Mailed Date: October 8, 1999

Appearances

James Albright, Esq., Denver, Colorado, for
Public Service Company of Colorado; and

Victoria Mandell, Assistant Attorney
General, Denver, Colorado, for the Staff of
the Commission.

I. STATEMENT

A. On May 18, 1999, Public Service Company of Colorado ("Public Service") filed Advice Letter No. 550-Gas proposing certain changes to its gas tariff. The purpose of the filing was to revise the gas cost adjustment ("GCA") tariff provisions. By Decision No. C99-580, June 9, 1999, the Commission set the tariff sheets attached to Advice Letter No. 550 for hearing, suspending their effective date for 120 days. Staff of the Commission timely intervened. Peoples Natural Gas Company,

Division of Utilicorp United. Inc., was authorized to participate as an *amicus curiae*.

B. The matter was set for a hearing to be held on October 5, 1999 in a Commission hearing room in Denver, Colorado. On September 21, 1999, Public Service and Staff filed their Stipulation and Settlement Agreement, with an accompanying Motion for Expedited Approval of Stipulation and Settlement Agreement and Request for Waiver of Response Time. The undersigned Administrative Law Judge ("ALJ") notified the parties that the Motion for Expedited Approval was denied, and the hearing on October 5, 1999 would be used as a hearing on the Stipulation.

C. At the assigned place and time the undersigned called the matter for hearing. During the course of the hearing, Exhibit 1 was identified, offered, and admitted into evidence. Testimony was received in support of the Stipulation from Staff and Public Service. At the conclusion of the hearing, the matter was taken under advisement.

D. In accordance with § 40-6-109, C.R.S., the undersigned now transmits to the Commission the record and exhibits in this proceeding.

II. FINDINGS AND CONCLUSIONS

A. The purpose of the tariff provisions proposed in this proceeding is to allow Public Service to include the cost of financial derivatives in the definition of "actual gas costs" in the GCA tariff. This would allow Public Service to recover the costs of such financial derivatives from its natural gas customers through the GCA. Natural gas available for purchase by Public Service is sold on an indexed rate, not a fixed contract price. That is, the price of the gas fluctuates according to various indices. In the past, in order to minimize price volatility and fluctuation, Public Service has been fixing the prices of its gas supplies indirectly through its gas suppliers. Public Service pays an additional fee beyond the price of the gas to a supplier or marketer to fix the price of gas. Public Service desires to fix the price of gas itself without dealing with these gas suppliers by purchasing swaps or other financial derivatives from financial institutions.

B. Swaps are financial instruments, offered by a financial institution as opposed to a gas supplier or marketer, which convert the price of a variable contract for natural gas to a fixed price for a fee. Depending on how the price fluctuates, a financial institution either pays Public Service or receives

money from Public Service for the difference between the fluctuating price and the fixed price set forth in the swap.

C. Financial derivatives such as swaps have been around for many years and allow entities such as Public Service to convert variable prices to fixed prices. By purchasing swaps directly from financial institutions and not from suppliers or marketers of natural gas, Public Service will be able to avoid placing themselves in a position of revealing market information to third-party marketers who can profit from the transaction at the expense of Public Service. In addition, the purchase of the swaps directly is a quicker process. The overall purpose of the purchase of swaps, and hedging in general, is to reduce the exposure of Public Service's retail customers to fluctuations in the price of gas.

D. The proposed Stipulation in this proceeding contains several protections for ratepayers. Public Service is prohibited from speculating with ratepayer funds, with speculation defined as purchasing and selling financial derivatives for financial gain. Public Service will not sell a swap even if the swap increases dramatically in value. Rather, once a swap is purchased it will be maintained to ensure a level price for contracted gas. Public Service will limit itself to a percentage of its gas supply that can be fixed using financial derivatives to that amount set forth in its Gas Purchase Plan.

The current amount in its Gas Purchase Plan on file for the upcoming heating season is less than 50 percent of its total gas supply. In addition, Public Service will specify in its Gas Purchase Plan the months that it will fix the price of gas. It will also specify individual authorization limits of its traders, to prevent the possibility of rogue trading or trading in excess of prudent amounts.

E. The settlement also calls for Public Service to make additional reports that will set forth certain information regarding each hedge transaction. Public Service will retain all invoices, work papers, and internal reports associated with the hedge transactions for Staff review.

F. Public Service states that it does not anticipate any increased financial risk associated with the use of financial derivatives. It agrees not to claim in testimony or otherwise in any gas rate proceeding that any risk associated with trading natural gas based financial derivatives should be considered in the determination of the cost of equity recoverable in Public Service's gas rates.

G. Staff testified that it supports GCA treatment of the settlement costs and transaction costs for derivatives because the settlement costs and transaction costs are so closely tied to the commodity purchase price itself that they are deserving

of GCA treatment. Staff notes that the use of derivatives is a mature financing technique.

H. Public Service points out that the GCA covers its current use of indirect derivatives. If the cost of direct use of financial derivatives were not permitted to be recovered in the GCA, Public Service would bear additional risk of recovering those ultimately in a rate proceeding and that would be a disincentive for Public Service to use these financial instruments.¹ This would be a detriment to the ratepayers.

I. The ALJ finds and concludes that the Stipulation and Settlement Agreement should be accepted. The Stipulation contains sufficient safeguards for ratepayers while at the same time allowing for the benefit of prudent use of financial derivatives to be realized by ratepayers. The Stipulation contains protections against speculation in derivatives with ratepayer funds. The reporting requirements should allow Staff to evaluate the efficacy of the use of the financial derivatives during the three-year period. The use of financial derivatives will give Public Service an additional tool to protect its ratepayers from the volatility in the gas market. Finally, the three-year limited nature of the program will act as an ultimate sunset

¹ Of course, allowing GCA treatment of these costs does not insure they will ultimately be allowed. The use and costs of derivatives are subject to review like any other costs and expenses.

should the program prove undesirable. For these reasons the Stipulation and Settlement Agreement should be accepted and the Application granted. However, one modification should be made to the tariff sheets filed, namely, the tariff sheets filed should reflect the three-year sunset nature of the Stipulation.

J. In accordance with § 40-6-109, C.R.S., it is recommended that the Commission enter the following Order.

III. ORDER

A. The Commission Orders That:

1. The Stipulation and Settlement Agreement filed September 21, 1999 is accepted and incorporated into this Order as if fully set forth. The Stipulation and Settlement is attached as Appendix A. Public Service Company of Colorado is authorized and ordered to file a tariff sheet identical to the one attached to the Stipulation and Settlement Agreement, with the exception that it should include a three-year sunset provision for the inclusion of Gas Price Management costs in Accounts 1807 through 54 in the definition of actual gas costs. Public Service Company of Colorado shall file such a tariff sheet under a new advice letter, citing this Decision as authority, to be effective on one day's notice. The advice letter and tariff sheet shall be filed within seven days of the effective date of this Order.

2. The tariff sheets filed under Advice Letter No. 550-Gas are permanently suspended and canceled.

3. This Recommended Decision shall be effective on the day it becomes the Decision of the Commission, if that is the case, and is entered as of the date above.

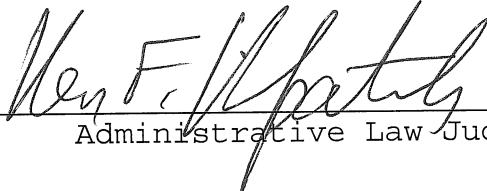
4. As provided by § 40-6-109, C.R.S., copies of this Recommended Decision shall be served upon the parties, who may file exceptions to it.

a. If no exceptions are filed within 20 days after service or within any extended period of time authorized, or unless the decision is stayed by the Commission upon its own motion, the recommended decision shall become the decision of the Commission and subject to the provisions of § 40-6-114, C.R.S.

b. If a party seeks to amend, modify, annul, or reverse basic findings of fact in its exceptions, that party must request and pay for a transcript to be filed, or the parties may stipulate to portions of the transcript according to the procedure stated in § 40-6-113, C.R.S. If no transcript or stipulation is filed, the Commission is bound by the facts set out by the administrative law judge and the parties cannot challenge these facts. This will limit what the Commission can review if exceptions are filed.

5. If exceptions to this Decision are filed, they shall not exceed 30 pages in length, unless the Commission for good cause shown permits this limit to be exceeded.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO


Administrative Law Judge