

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 02A-267G

APPLICATION OF PUBLIC SERVICE COMPANY OF COLORADO FOR
AUTHORIZATION TO IMPLEMENT MONTHLY GAS COST ADJUSTMENT
TARIFFS, TO EFFECT A CHANGE IN THE COMPANY’S ACCOUNTING FOR
GAS STORAGE INVENTORY AND PETITION FOR WAIVER OF CERTAIN GAS
COST ADJUSTMENT RULES.

**INITIAL COMMISSION DECISION
APPROVING STIPULATION AND
AGREEMENT WITH MODIFICATIONS**

Mailed Date: September 22, 2004
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I. BY THE COMMISSION**A. Statement**

1. Public Service Company of Colorado (Public Service or Company) filed its Application in this docket on May 10, 2002. In its Application, Public Service requested that the Commission authorize it to revise the Gas Cost Adjustment (GCA) clause of its Colorado PUC No. 6-Gas tariff and grant it the necessary waivers of the Commission's Rules governing GCAs, 4 *Code of Colorado Regulations* (CCR) 723-8 (GCA Rules), so that it may commence recovering its purchased gas costs through a monthly GCA process in lieu of the current annual GCA process. As part of its proposal to transition from an annual to a monthly GCA process, Public Service requested two related changes. First, Public Service requested that it be permitted to change its method of accounting for the cost of stored natural gas inventory from the current, last-in first-out (LIFO), pricing method to the weighted average cost (Average Cost) method. Second, Public Service requested that the Commission policy requiring asymmetrical treatment in the charging and crediting of net interest accrued on deferred gas cost account balances be relaxed to permit symmetrical treatment.

2. In support of its Application, Public Service submitted the direct testimony and exhibits of four witnesses. Mr. Fredric C. Stoffel, Vice President, Policy Development, for Xcel Energy Services Inc. (XES), Mr. William H. Meckling, Pricing Consultant for XES, Mr. Kurtis J. Haeger, Director, Gas Acquisition and Trading for XES, and Mr. Donald W. Wendell, Accounting Services Controller for XES. The Commission gave notice of the Application on May 14, 2002.

3. On June 13, 2002, timely petitions to intervene were filed on behalf of the Colorado Office of Consumer Counsel (OCC), Colorado Energy Assistance Foundation (CEAF) (now known as Energy Outreach Colorado (EOC)), and Aquila, Inc. (Aquila). A timely Notice

of Intervention was filed by the Staff of the Public Utilities Commission (Staff) on July 1, 2002. The intervenors and Public Service will collectively be referred to as “Parties.”¹

4. On June 19, 2002, the Commission, by minute entry at its Weekly Meeting, deemed the Application complete as of June 28, 2002, and assigned the matter to an Administrative Law Judge (ALJ) of the Commission. On August 14, 2002, the ALJ convened a prehearing conference, wherein the interventions of all petitioners were granted, and established hearing dates and a procedural schedule. On November 12, 2002, Staff filed the answer testimony and exhibits of Dr. Gary E. Schmitz, Principal Economist, Ms. Sandra Johnson Jones, Rate/Financial Analyst, and Ms. Bridget McGee-Stiles, Rate/Financial Analyst. The OCC filed the answer testimony and exhibits of Mr. Kenneth V. Reif, Director of the OCC, Mr. Michael J. McFadden, President of McFadden Consulting Group, Inc., Mr. James G. Greenwood, Rate/Financial Analyst for the OCC, and Ms. Dian P. Callaghan, Administrative Director of the OCC. CEAF filed the answer testimony of Ms. Karen Brown, then the Executive Director of CEAF. On December 3, 2002, Public Service filed the rebuttal testimony and exhibits of Messrs. Stoffel, Meckling, Wendell, and Haeger, who had previously submitted direct testimony and exhibits, as well as Ms. Rebecca Swisher, Communications Consultant for XES.

5. Two days before the hearings scheduled for December 12 and 13, 2002, to consider the Application, Public Service, Staff, and the OCC tentatively agreed upon certain principles of settlement and a framework within which to resolve all remaining issues. During the following approximately 18 months, the Parties identified and resolved the many secondary, mechanical, and procedural issues arising from the original principles of settlement, and reduced

¹Though Aquila intervened in this proceeding, it was not a signatory to the Settlement. Aquila does not oppose the Settlement. For convenience, we refer to both the intervening parties and signatories to the Settlement as “Parties,” as the case may require.

such agreements to writing. The end result was a comprehensive settlement, “Stipulation and Agreement in Resolution of Proceeding,” which resolved all of the issues among the Parties in this proceeding.

6. Since Public Service’s Application was accompanied by supporting testimony and exhibits, the Commission’s decision would have been due no later than 120 days from the date the Application was deemed complete, unless the Commission found that additional time would be required, in which event the Commission could extend such time limit up to an additional 90 days. *See* § 40-6-109.5, C.R.S. Pursuant to § 40-6-109.5(3), C.R.S., Public Service, as applicant, may waive the time limits set forth in § 40-6-109.5(1), C.R.S., in which case those time limits are no longer binding on the Commission. By letter dated and filed December 11, 2002, Public Service gave notice that it elected to waive the 210-day time limit set forth in § 40-6-109.5(1), C.R.S., in order to allow for an extension of the procedural schedule in order to continue settlement discussions among the Parties.

7. During the time it was developing the comprehensive stipulation and agreement in this proceeding, Public Service requested a separate Commission order granting one of the authorizations sought in its May 10, 2002 Application. On March 23, 2004, Public Service filed an application with the Commission in Docket No. 04A-135G requesting authorization to effect a change in its method of accounting for the cost of stored natural gas from the LIFO pricing method to the Average Cost pricing method, the same authorization originally requested by Public Service in this docket. Public Service asserted that the Average Cost method of pricing gas storage inventory would provide for a better matching of gas costs and revenues under a Monthly GCA process than the LIFO method. Commission approval of this type of accounting change is required in accordance with the Special Instructions to Accounts 117.1, 117.2, and

117.3 of the Uniform System of Accounts. Consistent with generally accepted accounting principles, the proposed accounting change would result in a restatement of Public Service's gas storage inventory accounts and a corresponding change to its Account 191 balance.

8. The Parties in this docket had already agreed in principle to the accounting change proposed and to the specific calculation of the cumulative effect thereof. Seeing that the timing for approval of the settlement in Docket No. 02A-267G would not allow for Public Service to implement the accounting change and record the necessary journal entries until January 1, 2005 due to Internal Revenue Code considerations, Public Service sought expedited Commission approval of the accounting change in Docket No. 04A-135G to be able to implement the requested accounting change effective January 1, 2004. Public Service's application in Docket No. 04A-135G was approved by the Commission in Decision No. C04-0339, mailed April 1, 2004. Pursuant to such approval, Public Service recorded the cumulative effect of the approved accounting change as of January 1, 2004 during its first quarter accounting, resulting in a \$35,918,429 credit to the deferred cost of gas (Account 191). Consequently, this aspect of the Application in this docket is moot and will not be addressed further herein.

9. On July 2, 2004, Public Service, Staff, and the OCC filed the Stipulation and Agreement in Resolution of Proceeding (Settlement), along with their Joint Motion for Approval of Comprehensive Settlement and Request for Initial Commission Decision. The EOC also joined in the Settlement as a signatory. Aquila, while not joining as a signatory to the Settlement, has no objection to the agreements reached therein, nor to the Commission's approval thereof. In the Joint Motion, the Parties requested that the Commission issue an initial Commission decision on the merits of the Settlement, effectively rescinding its previous order assigning this matter to

the ALJ. The Parties proposed an initial Commission decision in order to expedite the Commission's consideration of the Settlement so that it may be implemented before the 2004-05 winter heating season, as proposed therein. In the motion, the Parties requested that the Commission issue its initial decision on the Settlement on or before August 20, 2004, to allow for certain critical deadlines established by the Parties in the Settlement. These deadlines include the implementation date of November 1, 2004, and the roll out of a customer education plan preceding such implementation.

10. On August 6, 2004, in Decision No. C04-0917, the Commission issued its "Decision Setting Expedited Hearing for Initial Commission Decision on Proposed Stipulation," in which the Commission agreed that the public policy implications and timing constraints require an initial Commission decision in this matter. The Commission further determined that a hearing should be held to allow the Commissioners to better understand the Settlement, and to provide a forum for Parties to provide additional information necessary for the Commission to rule on the merits of the Settlement. The Commission could not accommodate the suggested hearing date of July 20, 2004, and instead scheduled the hearing on the Settlement for August 20, 2004. The Commission indicated in Decision No. C04-0917 that it intended to hold deliberations on September 3, 2004, and issue its decision on the merits of the Settlement by September 20, 2004. With respect to the modification of the customer education plan provided for in the Settlement, the Commission directed Public Service to issue the first customer education bill insert before the Commission issued its decision, but otherwise consistent with the timing provided for in the Settlement; that is, during the month of September 2004. The Commission directed Public Service "to work with the Consumer Affairs section of the Commission to revise the language in the first mailing to accommodate this change."

11. Also on August 6, 2004, in Decision No. C04-0923, the Commission requested supplemental information in the form of questions for the Parties to answer at the hearing to provide additional information to enable the Commission to consider fully the merits of the Settlement. The Commission set forth eight categories of questions, including: (a) overview, (b) price forecasting, (c) sensitivity runs, (d) timing of deferred recovery, (e) interest on deferred balance, (f) cycle billing, (g) price volatility mitigation, and (h) price signaling.

12. On August 20, 2004, the Parties to the Settlement filed an Amended Stipulation and Agreement in Resolution of Proceeding.² As explained at the hearing, the Commission's inability to accommodate an August 20, 2004 initial decision date caused the Parties to reconsider certain procedural and timing provisions under the Settlement. As a result, the Parties agreed to modify those provisions, particularly those relating to the customer education plan and the timing and content of bill inserts under that plan. No other substantive provisions of the Settlement were modified under the August 20, 2004 Amended Stipulation and Agreement.

13. At the assigned place and time, the Commission called the matter for hearing. During the course of the hearing Exhibits 1 through 8, 8A, and 9 through 31 were identified, offered, and admitted into evidence. Witnesses for Public Service, the OCC, and Staff testified to explain the Settlement and to respond to questions regarding the Settlement from the Commission and the Commission's advisors. Now being duly advised in the premises, we approve the Settlement consistent with the discussion below.

² For convenience, the term "Settlement" shall hereinafter be used to refer to the August 20, 2004 Amended Stipulation and Agreement. As the July 2, 2004 Stipulation and Agreement has effectively been withdrawn and superseded with the August 20, 2004 Amended Stipulation and Agreement, the latter is before us for consideration.

II. PROPOSED SETTLEMENT

14. In general, the Settlement provides for a significant change in Public Service's GCA mechanism, proposing a shift from the traditional annual GCA filing procedures under the Commission's GCA Rules to a monthly GCA rate filing procedure. The Settlement also establishes procedures for Commission pre-approval of Public Service's annual Gas Price Volatility Mitigation (GPVM) plans applicable to its natural gas sales services. In addition, the Settlement sets forth the Parties' agreements with respect to interest on under- and over-recovered gas costs, post-implementation notice of monthly GCA changes, pre-implementation customer education of the monthly GCA process, and procedural and substantive requirements at the end of the effective period of the Settlement.

15. The Settlement obviously represents the culmination of significant efforts by the Parties. The give and take nature of negotiations is demonstrated by comparing the Parties' prefiled cases to the resolution contained in the Settlement. To understand the compromises embodied under the Settlement, we provide a discussion of the party positions on the Company's original proposal, and how the Settlement achieves a comprehensive solution that addresses the Parties' concerns.

16. Under the monthly GCA mechanism originally proposed by Public Service in its May 10, 2002 Application, certain types of costs – deferred gas costs, upstream pipeline service costs, and supplier demand charges – would continue to be subject to periodic changes through annual and interim GCA applications under the less-than-statutory-notice (LSN) application procedure currently used for annual and interim GCA applications. However, the Commodity Gas Cost component would be subject to a monthly GCA filing, which Public Service proposed to file at the very end of each month to update the projected gas commodity costs and sales

quantities for the following calendar month. This monthly GCA filing would be based on gas pricing information available during the bid week (generally, the last business week of the month). Under this monthly GCA filing, the Gas Commodity Cost updates would be filed using a streamlined procedure during the last week of each month to become effective automatically on the first day of the following month without a Commission order approving the particular changes. The Monthly GCA filing under Public Service's proposal would incorporate changes to the other three GCA cost component changes -- the Upstream Service Cost, Gas Demand Cost, and Deferred Gas Cost components -- that were last approved by the Commission in previous annual and interim GCA filings by the Company.

17. In its direct testimony, Public Service represented that contract, storage, and market information important to improving the accuracy of the projected gas commodity costs for a particular month is not available until bid week, which occurs shortly before the beginning of the month. Public Service contended that its proposed monthly GCA process would allow more accurate and timely information to be used to project the gas commodity costs that would be incurred by Public Service during the following month, resulting in a better matching of cost recovery and cost incurrence. Public Service asserted that, by allowing for such timely changes in the GCA, the level of under- or over-recovered gas costs reflected in Public Service's deferred gas cost account (Account 191) would be minimized and more accurate price signals would be sent to Public Service's customers. Public Service stated that both of these benefits would provide for more informed choices by Public Service's natural gas customers.

18. Public Service also requested as part of its Application that the Commission permit the Company to recover interest on net under-recovered gas costs reflected in Account 191 at the end of the Gas Purchase Year, rather than excluding such net interest from the

calculation of the Deferred Gas Cost as currently required by Commission policy and GCA Rule 4 CCR 723-8-4.5. Public Service contended that continuing the asymmetrical treatment of interest would not be consistent with the proposed shift from an annual to a monthly GCA process, which would allow for the best possible gas cost projections by the utility. Public Service was attempting to put into place a mechanism to minimize over- and under-recoveries in Account 191. Public Service asserted that it was no longer appropriate to penalize Public Service by denying interest recovery, as the rationale stated by the Commission in previous decisions denying interest symmetry was largely to provide an incentive for utilities to minimize over- and under-recoveries.

19. As a general matter, both Staff and the OCC opposed implementation of the Monthly GCA as proposed by Public Service in its Application, as well as the proposed modifications to the asymmetrical treatment of interest. Both Staff and the OCC disputed the purported benefits to residential and small commercial customers of providing price signal information, questioned the accuracy of the price signal information proposed, believed the process proposed by Public Service would allow for increased month-to-month gas price volatility, and believed that more definitive hedging strategies would be required to mitigate this volatility and result in smaller deferred gas cost balances. Staff opposed the streamlined monthly procedures proposed by Public Service as not providing for sufficient legal notice and not allowing for traditional Staff review of the Commodity Gas Cost rate changes. Staff also challenged the asserted benefit of more accurate price signals as being limited by the relative price inelasticity of natural gas in the retail segment. The OCC further criticized the Company's proposal as failing to adequately protect customers from gas price volatility. Both the OCC and EOC also believed that such a fundamental change in the way gas costs are passed on to

customers would require more extensive customer education efforts than proposed by Public Service in its Application.

20. The Settlement addresses these concerns. The Settlement provides for Public Service to implement a modified version of the monthly GCA mechanism that it originally proposed in its Application, and establishes a set of procedures through which the Commission will review and approve in advance of a Gas Purchase Year, certain aspects of Public Service's annual GPVM Plan. The Parties indicate that the proposed GCA process will result in reduced Account 191 balances and provide customers a better matching of cost recovery and cost incurrence than under the current GCA mechanism. As part of the GPVM Plan, the Parties agree to establish certain hedging targets and parameters for Public Service to follow during the four Gas Purchase Years subject to the Settlement, covering the period from July 1, 2005 through June 30, 2009. The Parties assert that the GPVM Plan provides a robust hedging program intended to reduce the level of gas price volatility experienced by Public Service's customers. The Settlement sets forth the Parties' agreement on the rolling forward of accumulated net interest on under- and over-recovered gas costs, which allows for interest symmetry within a specified tolerance band, and asymmetrical treatment when accumulated net interest falls outside the tolerance band. The Settlement also sets forth the GCA tariff changes and the waivers of the GCA Rules that should be granted in order for Public Service to implement the modified Monthly GCA mechanism. The Settlement also provides for detailed procedures for the post-implementation notice of monthly GCA changes and pre-implementation customer education of the monthly GCA process.

21. The Parties to the Settlement agree that the provisions of the Settlement will terminate in approximately five years unless the Commission, upon application by Public

Service, issues an order authorizing the continuation of the procedures and mechanisms established under the Settlement or the modification thereof. Specifically, Public Service will be required to file an application with the Commission on or before March 15, 2008, requesting that the Commission determine whether the monthly GCA mechanism will be continued, discontinued, or modified based on an evidentiary hearing, if the Commission deems a hearing necessary. The Settlement requires that the Commission determine either: (i) that the Monthly GCA mechanism be continued after the GCA effective period expiring September 30, 2009, and the GPVM Plan approval program be continued after the Gas Purchase Year ending June 30, 2009; or (ii) that any part of such mechanism and/or program should be modified or terminated. The purpose is to establish a formal procedure that assures that the modified GCA mechanism and the GPVM Plan program approved by the Commission may be evaluated and improved upon, or discontinued, through the participation of interested persons, instead of becoming a permanent mechanism.

22. Notwithstanding the Parties' agreement to resolve this case as set forth in the Settlement, it is the Commission's independent obligation to review the Settlement to ensure it is in the public interest. To this end, the Commission issued a list of questions in Decision No. C04-0923 and directed Public Service to be prepared to respond to them at the hearing on August 20, 2004. Through the testimony of its four witnesses at the hearing, Public Service provided a thorough and comprehensive response to the questions presented in Decision No. C04-0923, as well as follow-up questions from the Commission and its advisors. Based on this testimony, the testimony of witnesses for the OCC and Staff, and the exhibits admitted at the hearing, the Commission makes the following findings and conclusions.

A. Filing Procedures Under the Monthly GCA Mechanism

23. Under the Settlement, the Parties agreed that Public Service should be permitted to implement a Monthly GCA mechanism which, although similar in many respects to the Monthly GCA mechanism proposed in Public Service's original Application, includes certain significant modifications. In connection with the implementation of the settled Monthly GCA mechanism, the Parties request that the Commission direct Public Service to file revised tariff sheets in the form of the *pro forma* tariff sheets attached as Appendix D to the Settlement, and grant Public Service certain waivers of the GCA Rules and such other waivers as necessary to effect the terms of the Settlement.

24. Under the settled Monthly GCA mechanism, Public Service's recovery of purchased gas costs will be separated into four GCA components that make up the GCA rates to be approved by the Commission: (1) Gas Commodity Cost, (2) Gas Demand Cost, (3) Upstream Service Cost, and (4) Deferred Gas Cost (or "Deferred"). The Monthly GCA filing process will consist of two types of filings: 1 Annual GCA application, generally filed in September to be effective October 1; and 11 Monthly GCA applications. As part of its Annual GCA application, Public Service will calculate the Upstream Service Cost and Gas Demand Cost components of the GCA rates for a 12-month period. The Gas Commodity Cost and Deferred Gas Cost components will be calculated in the Annual GCA application and in the other 11 Monthly GCA applications based on an effective period of 1 calendar month. Similar to the interim GCA applications allowed under the current GCA Rules, Public Service may propose to change the Upstream Service Cost and Gas Demand Cost components if circumstances warrant.

25. All of these filings will be submitted through traditional LSN application procedures as provided for in the GCA Rules, and filed not less than two weeks prior to the first

day of the month for which the proposed GCA rate(s) will be effective. The two-week notice period is consistent with the Commission's current GCA Rules (*see* 4 CCR 723-8-4.2). This procedure is in contrast to Public Service's proposal in its Application to file the 11 Monthly GCA filings approximately 3 business days before the beginning of the month in which the GCA rate changes were to go into effect. We note that a legal question arose as to whether Public Service's original proposal complied with the Commission's statutory notice requirements. We agree with the resolution that any GCA application that proposes to change the effective rates the utility charges its customers should provide sufficient time for Staff and Commissioners to review the application for completeness and accuracy, and for the Commission to issue an order approving or rejecting the application before the proposed effective date of the revised GCA rates. We therefore find that the annual and monthly GCA filings and preliminary review process set forth in the Settlement provide a reasonable process for Commission review and approval.

B. Forecasting of Index Prices

26. In order to accommodate the two-week notice period for the processing of monthly GCA applications, the Settlement provides that, in forecasting the portion of the Gas Commodity Cost subject to index pricing, Public Service will base its projections on the New York Mercantile Exchange (NYMEX) futures contract for the applicable effective month, adjusted for the applicable basis. Specifically, Public Service will use the published daily NYMEX Settlement Price on the seventh business day of the month prior to the GCA calendar month in which the GCA rates will be in effect. Public Service will use the NYMEX contract month that corresponds to the GCA calendar month, adjusted for basis differentials between the

NYMEX Settlement Price and the respective indexes applicable to the various areas in which Public Service purchases its gas supplies.

27. Prior to the August 20, 2004 hearing, there was no evidence presented in this proceeding as to how well the seventh business day NYMEX futures settlement price will track the index prices applicable to index-based purchases made by Public Service. As indicated by our list of questions in Decision No. C04-0923, we were concerned with using the NYMEX futures price to forecast the following month's applicable index price. We generally wanted to know how closely the NYMEX price tracked the applicable index price in recent history, and what the expected result would be on Public Service's Account 191.

28. At the hearing, Public Service presented evidence through its witness, Mr. Haeger, that there is a very close correlation over the past ten years between the seventh day NYMEX price and the Henry Hub first of month index price. Mr. Haeger also presented evidence showing that there is a very close correlation over the past four years (the period for which data was available) between the basis-adjusted, seventh day NYMEX price and the corresponding index price applicable to Public Service's primary index-based contracts. This primary index is the first-of-the-month Colorado Interstate Gas Company (CIG) Rocky Mountain price, as published in *Inside FERC's Gas Marketing Report*. As explained by Mr. Haeger, there have been several occasions over the course of the past several years in which the wholesale gas market was significantly volatile during the approximately three-week time period between the seventh business day and the first of the following month. In each case, the NYMEX price rebounded back to closely track the applicable CIG index the following month. The evidence provided by Mr. Haeger provides a thorough understanding of how well the seventh day NYMEX price tracks the applicable index price, indicating that the NYMEX settlement should provide a

reasonable forecast for Gas Commodity Costs for index-based purchases. On whole, we find the seventh business day NYMEX futures settlement price to be a reasonable proxy for projecting the index prices applicable to index-based purchases made by Public Service, and we approve its use.

C. Deferred Gas Cost Recovery

29. The Settlement provides that the Deferred rate component will be calculated by dividing the monthly Account 191 cumulative balance at the end of the month preceding the GCA filing, after being adjusted for unbilled revenues, by the total annual volumes of gas under those Rate Schedules to which the Deferred rate component is applicable. Under this approach, Public Service would recalculate the Deferred rate component each month based on 12 months of projected volumes. This creates an asymptotic effect in designing rates. That is, instead of designing the Deferred rate component to amortize the Deferred balances through a discrete period, this method recalculates the rate component each month, spreading the full rate recovery over several years. The Deferred rate component decreases as the Account 191 balance decreases, so the recovery mechanism would cause the balance to approach zero over several years, but would never reach zero. Of course, the continued under- and over-recoveries of costs would cause the Account 191 balance to cross zero from time to time, as indicated by witness Haeger's testimony. Through its witness, Mr. Meckling, Public Service indicated at the hearing that this method would recover 73 percent of the Deferred balance within 12 months, 92 percent within 24 months, and 98 percent within 36 months.

30. In response to the Commission's question of how the Settlement can be modified to recover a Deferred balance within 12 months, Mr. Meckling stated that using half of the annual volumes to calculate the Deferred rate component could accelerate the recovery.

Mr. Meckling stated that it is highly unlikely to have a Deferred amount as high as the \$120 million example in the Commission's questions, as demonstrated by witness Haeger. Further, by using half of the annual volumes to calculate the Deferred rate component, the first month's rate would be twice the rate amount applied under the Settlement method. Mr. Meckling stated that because of this initial Deferred rate doubling, Public Service would prefer to use the method specified in the Settlement, but would not object to using half of the annual volumes if required by the Commission. Witnesses for Staff and OCC also stated a preference to use the method specified in the Settlement, using full annual volumes.

31. We agree that if the Deferred balance remains within +/- \$20 million, the amount carried beyond one year is insignificant. Though we also agree that it is quite unlikely to have a Deferred balance higher than \$20 million, it is possible for a one-time anomaly to result in a Deferred balance that is several times higher. Such an event would have to be a "perfect storm," where several factors converge in a manner that causes actual gas costs to be radically different from those forecast based on the seventh day NYMEX applied to normal usage. For example, a major national supply could be cut off just before the index price (*i.e.*, first-of-month CIG) is established for December, in conjunction with a forecast for record cold weather. The seventh day NYMEX price would not reflect these subsequent changes, and higher than normal consumption due to cold weather would likely be supplied with index-based purchases. While unlikely, a Deferred balance significantly higher than \$20 million could be generated, and applying the Deferred rate calculations specified in the Settlement would undermine one of the primary goals of the monthly GCA: to prevent substantive Deferred cost amounts from being carried into a subsequent period.

32. We have identified four approaches that could be used for the recovery of Deferred balances: (a) Settlement Method -- use the method specified in the Settlement, where the monthly Deferred balance is divided by 100 percent of annual volumes; (b) 50 Percent Method -- use 50 percent of annual volumes, as described by Mr. Meckling; (c) 75 Percent Method -- use 75 percent of annual volumes ; or (d) Threshold Amortization Method -- use the Settlement method until the Deferred balance rises to a specified level, in which case a fixed 12-month amortization of Deferred costs is applied.

33. As discussed by Mr. Meckling, the biggest drawback of the 50 Percent Method is that it applies a high rate to the first month of recovery. The Settlement Method would set a Deferred rate component that would recover approximately 1/12 of the Deferred amount in a month of average consumption, but the 50 Percent Method would set a rate component at twice that level. Because large Deferred balances are more likely to be generated when prices are high, prices are also likely to be elevated when the Deferred rate component would be applied. Under the 50 Percent Method customers might be required to pay an unusually large Deferred cost at a time when rates are already high. The 75 Percent Method only increases the Settlement Deferred rate component by a factor of 1.5, but it would take longer to recover the Deferred account balance.

34. We agree with the Parties that the Commission should reject the 50 Percent Method because of its high initial Deferred rate. We also reject the 75 Percent Method, because it has somewhat of a high initial Deferred rate, and it does not accomplish the goal of a 12-month Deferred recovery.

35. Under the Threshold Amortization Method, a 12-month amortization would generate the same Deferred rate component as the Settlement Method for the first month, but it

would then remain fixed instead of decreasing each month like the Settlement Method. However, at the end of the 12-month amortization period the rate will abruptly change, potentially sending an incorrect market signal to customers. In contrast, all other methods gradually decrease the Deferred rate component so there is no abrupt rate change when the Deferred cost recovery is complete.

36. On balance, we find that the Threshold Amortization Method provides a necessary safeguard in case a large Deferred balance is generated. When Deferred balances are below the amortization threshold, the procedures established in the Settlement will recover Deferred amounts in a reasonable manner. If an unusual event were to occur and the Deferred balance exceeds the threshold level, a fixed amortization will minimize the costs that are carried into a future period. In this case, the Deferred recovery would be subject to the 12-month amortization, consistent with the amortization period specified in the GCA Rules.³

37. As discussed above, the 12-month amortization should only be implemented if the Deferred balance reaches an unusually high level. Because the amortization will be difficult to administer, and because the Deferred recovery procedures in the Settlement avoid abrupt Deferred rate changes, the amortization threshold should be set at a high enough level so that the Settlement can function without unnecessary interference. We agree with the evidence provided by witness Haeger that the Deferred balance will likely remain within +/- \$20 million. We also agree that carrying Deferred balances within this range to a subsequent period, consistent with the Deferred recovery mechanism proposed in the Settlement, will not unduly affect rates.

³ The GCA Rules also require that recovery of the amortization of deferred costs can only begin with the annual filing effective in October or November, but the Threshold Amortization Method would start the recovery of the 12-month amortization of deferred costs in accordance with the timing proposed in the Settlement, in any month of the year.

Therefore we find that the amortization threshold should be set high enough to provide a cushion around the +/- \$20 million operating range, and low enough to prevent a Deferred balance in excess of +/- \$20 million from remaining after one year. An amortization threshold of +/- \$30 to 40 million would meet these criteria. In order to ensure that the amortization will be triggered only in extreme circumstances, we will select +/- \$40 million as the proper threshold.

38. Accordingly, the Commission will require a modification to the calculation of the Deferred rate component, as discussed above. That is, the Deferred rate component shall be recalculated monthly in accordance with the Settlement so long as the Account 191 Deferred balance, as corrected to eliminate the effect of unbilled revenues (the “Deferred Gas Cost Amount”) is equal to or less than \$40 million, either positive or negative. However, in the event the Deferred Gas Cost Amount exceeds \$40 million, either positive or negative, Public Service shall calculate a rate to recover the entire Deferred Gas Cost Amount based on a 12-month amortization period using 12 months of projected volumes (Fixed Deferred Rate). This Fixed Deferred Rate shall be applied as a part of the Deferred rate component for the next 12 months, or until one of the following events occurs: a) If the Deferred Gas Cost Amount in any subsequent month exceeds the Deferred Gas Cost Amount that originally triggered the Fixed Deferred Rate implementation, then Public Service shall recalculate a new Fixed Deferred Rate portion of the Deferred rate component based on the new Deferred Gas Cost Amount; or b) If the Deferred Gas Cost Amount in any subsequent month either crosses zero (*i.e.*, the Deferred Gas Cost Amount changed from an under- recovery to an over-recovery, or vice versa) or is projected to cross zero in the following month, the Fixed Deferred Rate portion of the Deferred rate component shall terminate, and only the Deferred recovery procedures in the Settlement will apply.

39. During the time that the Fixed Deferred Rate applies, Public Service shall continue to calculate a separate Deferred rate component based on the procedures in the Settlement, except that the amounts included in the Fixed Deferred Rate recovery levels shall be removed from the calculation. That is, the Deferred recovery procedures in the Settlement shall apply to under- or over-recoveries generated after the Fixed Deferred Rate is implemented, aside from the reduction in the Deferred Gas Cost Amount that is expected from the application of the Fixed Deferred Rate.

D. Interest Symmetry

40. The Settlement provides for a modification of the current asymmetrical treatment of interest on net under-recovered gas costs for Public Service under the Monthly GCA mechanism. Under the current procedure followed by Public Service, monthly interest (positive or negative) on the Account 191 balances is accumulated and netted over the course of the Gas Purchase Year (*i.e.*, through each June 30). On each June 30, Public Service normally credits the net interest to sales customers by recording it to Account 191, if it reflects net negative interest on over-recovered gas costs, and writes off the net interest “below the line” at the expense of shareholders if it reflects net positive interest on under-recovered gas costs.

41. Effective with the June 30, 2004 Account 191 balance, the Settlement provides for Public Service to “roll,” or carry forward, net interest accumulated from one gas purchase year to the next, as long as the accumulated net interest does not exceed a tolerance band. The tolerance band is initially set at \$1.0 million (*i.e.*, having an upper limit of \$1.0 million positive and a lower limit of \$1.0 million negative). Within the applicable tolerance band, Public Service will not be required either to credit such net interest to customers or to write off such net interest below the line at the end of each such gas purchase year.

42. To the extent Public Service's accumulated net interest on its Account 191 monthly balances as of June 30 exceeds the tolerance band, the amount of accumulated net interest in excess of the tolerance band limit shall be either credited to customers, in the case of net over-recovered gas costs, or written off below the line, in the case of net under-recovered gas costs. Whenever Public Service is required either to credit excess net interest to customers or write off net interest at the end of any gas purchase year, the upper or lower limit of the tolerance band, as applicable, will automatically increase to equal the actual accumulated net interest before the credit or write-off. The tolerance band so adjusted will then be effective for subsequent periods until changed by the accumulation of net interest at the end of a subsequent gas purchase year that is outside the new tolerance band.

43. While complicated, we believe that this resolution of the issue of interest symmetry is fair and reasonable. We recognize that this mechanism reflects a hybrid approach, providing for symmetrical treatment of net interest on Deferred Gas Costs within the specified tolerance band, but continuation of the current policy of asymmetrical treatment when net interest falls outside the tolerance band. This is a reasonable compromise based on the specific facts and circumstances present in this case. The Commission has denied previous utility requests for symmetrical interest on Deferred balances, largely on the basis that the costs are within the utility's control, and the utility could prevent large Deferred balances by making more interim GCA filings. Because Public Service is now implementing a plan that appears to be the best available method to control the Deferred balances, we find that interest within the tolerance band results from Deferred costs that are not within the control of the utility, and should be subject to symmetrical interest.

E. Impact of Cycle Billing

44. When a rate changes on a specific day, such as the first day of a month, which falls between the dates a customer's meter is read, usage for that customer must be apportioned to the appropriate rates in effect at the time the gas was consumed. Due to the increased frequency of rate changes that will result from a shift to a monthly GCA mechanism and the fact that all meters are not read on the first day of each month, the Commission questioned in Decision No. C04-0923 how customers' usage changes will be impacted by cycle billing under the Monthly GCA mechanism.

45. At the hearing, Public Service explained the process used for prorating a customer's usage based on historic non-heating usage, heating usage, and heating-degree-days. The Company's billing system divides the customer's consumption into non-heating related usage and heating related usage. Since the non-heating usage essentially does not vary much from day to day, the non-heating usage is subtracted from the total usage to determine the heating load. The billing system prorates the non-heating usage based on the number of days each rate is in effect. The heating usage is prorated based on the number of heating degree days -- a measure based on the outdoor temperature -- during each period different rates are in effect. This is based on the assumption that a customer's consumption of gas relating to heating needs will change in response to the changes in the weather -- specifically, the outdoor temperature. Based on the share of the heating degree days in each period, the heating load is sub-divided into the different rate periods.

46. We agree that Public Service's heating degree day approach should track actual customer usage as accurately as can be done under its existing measurement system. Without the availability of actual measurement on the day a rate change takes effect, there is no perfect way

to prorate a customer's usage between two periods. While a different measurement system could provide for more accurate billing, particularly when a customer's usage does not respond linearly to heating degree days, it is very unlikely that the value of the increased measurement accuracy would outweigh its cost. The Commission finds that Public Service's method of allocating usage to different periods for the purpose of applying rates in effect to appropriate usages is a fair and reasonable approach to allocate customer usage between periods in which different rates are in effect.

F. Procedures Regarding Gas Price Volatility Mitigation Plans

47. The Settlement acknowledges, and the Commission agrees, that a GPVM Plan should be an integral part of Public Service's regular gas procurement activities. Under the current procedures, Public Service's GPVM Plan is a required component of its annual Gas Purchase Plan (GPP) submittal pursuant to the GCA Rules. Under the GCA Rules the Commission does not approve the GPP, but uses it as a part of its after-the-fact prudence evaluation. The Settlement sets forth a set of procedures whereby the merits of the GPVM Plan will be reviewed and approved by the Commission for reasonableness in advance of the Gas Purchase Year in which the GPVM Plan will be implemented. These procedures are similar to, and were negotiated by the Parties in conjunction with, parallel procedures adopted by the Commission for approval of Public Service's GPVM Plan for its electric generation fuel procurement activities in Docket No. 04A-045EG.

48. Under these procedures, Public Service is required to file its Gas Department GPVM Plan by January 15 of each year, to be effective March 15 of that same year, and applicable to the Gas Purchase Year commencing the following July 1. Each year, in its application for approval of that year's GPVM Plan, Public Service will set forth a request that the

Commission issue a notice of application filed that adopts certain expedited procedures specified in the Settlement. The Parties intend that the Commission's review and approval of Public Service's proposed GPVM Plans will constitute only a Commission determination that the GPVM Plan is deemed prudent based upon information available at the time and to the extent that, if Public Service implements such plan as approved, the associated hedging costs will not be subject to disallowance in any subsequent gas cost prudence review proceeding. The reasonableness and prudence of the underlying transactions, any deviation by Public Service from the plan, failure to modify the plan for changes in circumstances, or Public Service's failure to implement the plan as approved will not be presumed prudent and will continue to be subject to the prudence review standard established in the GCA Rules. The Parties agree that Public Service should continue to exercise professional judgment in the performance and continuation of the GPVM Plan in light of changing circumstances, and do not contemplate that Commission findings initially approving the GPVM Plan will affect appropriate implementation and modification of the plan.

49. Once approved by the Commission, the GPVM Plan will remain in effect through the Gas Purchase Year unless and until the Commission approves an amendment to the GPVM Plan. If conditions change to the point where an update to the GPVM Plan is required, Public Service or any other party may request that the Commission modify the GPVM Plan previously approved. Although unlikely given the comprehensive approach Public Service has presented in its previous GPVM Plans, an approved GPVM Plan should be subject to change where circumstances require. Public Service and interested parties should have the opportunity to request modification of an approved GPVM Plan where circumstances change and Public Service is still able to modify its actions in a timely manner. Given the importance of providing

certainty to Public Service and interested parties and the difficulty in implementing subsequent changes, we find that substantial justification should be required for changing the GPVM Plan, once approved by the Commission.

50. The Settlement calls for the GPVM Plan to provide for sufficient hedging of Public Service's gas supply portfolio using the various tools available to Public Service in order to reduce the magnitude of gas price volatility at reasonable cost to Public Service's gas sales customers. These tools include the use of natural gas storage, fixed price contracts, and the financial instruments authorized for use by Public Service as set forth in its gas tariff. To accomplish this, the Parties agreed to establish certain hedging targets and parameters, which are set forth in a confidential appendix to the Settlement, for the Commission to approve and Public Service to follow for each of the four Gas Purchase Years subject to the Settlement, covering July 1, 2005 through June 30, 2009. These hedging targets and parameters represent a robust hedging program intended by the Parties to reduce the level of gas price volatility experienced by Public Service's customers.

51. The Settlement does not provide for the Commission to approve Public Service's GPVM Plan for the 2004 through 2005 winter heating season. As indicated by several of our questions posited in Decision No. C04-0923, because the Settlement provides for the Monthly GCA mechanism to go into effect on November 1, 2004, we had certain concerns going into the hearing about what changes Public Service planned to make to mitigate gas price volatility for the upcoming winter heating season. Mr. Haeger explained that Public Service voluntarily has implemented the same hedging targets and parameters agreed to in the Settlement for the upcoming winter heating season. Mr. Haeger represented that this aspect of the Settlement had been negotiated several months ago, and Public Service adopted these same targets and

parameters in the GPVM Plan included as part of Public Service's Gas Purchase Plan filed with the Commission on June 1, 2004 in Docket No. 04P-288G, in accordance with the Commission's GCA Rules. Based on these facts, we are satisfied that the Settlement need not address gas price volatility mitigation for the upcoming winter heating season. We agree that subsequent GPVM plans should require Commission approval, consistent with the terms of the settlement.

G. Customer Education and Notice of Monthly GCA Changes

52. Because the change to a monthly GCA mechanism is a landmark modification in the manner in which Public Service changes its natural gas rates, it is important to ensure that customers learn about and understand the basics of the monthly GCA. The Settlement provides for comprehensive customer education program. The pre-implementation plan includes two monthly bill inserts to be received by sales gas customers prior to November 1, 2004, as well as information on the Xcel Energy website.

53. The post-implementation plan includes the legal notice, a first of the month display ad each month, an *Update* article, at least one press release each month, Interactive Voice Response system on the Xcel Energy customer service phone system, information on the Xcel Energy website, and access to Xcel Energy customer service representatives as needed.

54. The Commission finds that pre-implementation customer education plan and post-implementation customer notice plan provided for in the Settlement will afford customers ample opportunity to learn about, understand, and be apprised of the monthly GCA process and price changes. The approach is comprehensive and multi-faceted.

H. Implementation of the Monthly GCA Mechanism

55. The Parties propose that Public Service's first filing under the Monthly GCA mechanism and procedures will be on October 15, 2004, to be effective November 1, 2004.

Under the current schedule set forth in GCA Rule 4 CCR 723-8-2.1, Public Service would normally file its Annual GCA application in mid-September 2004, to be effective October 1, 2004. However, in order to afford Public Service additional time within which to conduct the Customer Education Plan, the Parties request that Public Service be permitted a one-time, one-month delay of the filing of its regularly scheduled Annual GCA filing, to file an Annual GCA application under the new Monthly GCA mechanism and procedures by October 15, 2004, to be effective November 1, 2004. We approve the one-month delay in Public Service's filing of its regular Annual GCA application under the current GCA Rules in order to make its first Annual GCA application under the new Monthly GCA mechanism on October 15, 2004, to be effective November 1, 2004. In connection with this ruling, the GCA rate changes reflected in Public Service's last GCA application in Docket No. 03L-400G, as approved by the Commission in Decision No. C03-1096, shall continue in effect for one additional month through October 31, 2004.

III. RULING ON SETTLEMENT

56. The most compelling justification for switching from an annual GCA process to a monthly GCA process is the prospect of minimizing the Deferred balances experienced by Public Service. By changing its Gas Commodity Cost component on a monthly basis, Public Service will be able to better track actual gas costs in its rates. Better cost tracking means better matching of cost recovery with cost incurrence and should result in much smaller Deferred balances than Public Service has experienced in the past. Indeed, one of Public Service's primary objectives in filing to change from an annual to a monthly GCA was to eliminate the build up of huge balances of under-recovered gas costs. At the hearing, Public Service's witnesses testified that Public Service's deferred gas cost balance in January 2001 reflected

under-recovered gas costs of \$258.9 million. Customers were saddled with GCA rates higher than GCA costs for several months to pay down the huge deferred balance. This caused an incorrect price signal, to say nothing of customer confusion and frustration. The monthly GCA should prevent a recurrence of this problem.

57. Under the current annual GCA process, a large deferred gas cost balance translates into a large deferred rate component in the GCA rates when the true-up is performed in an Annual GCA filing. As a result, Public Service would be collecting or refunding, as the case may be, gas costs or collections from previous periods. This raises equitable concerns about customers from one period incurring costs, or receiving refunds, from periods in which the make-up of customers was different. We find that the approach provided for in the Settlement should result in a significant reduction in the deferred gas costs balances experienced by Public Service.

58. Because Public Service's GCA rates will better track its actual gas costs from month to month, the Settlement will also result in improving the accuracy of price signals to Public Service's customers. While there is significant debate among the Parties in this proceeding whether and how much retail customers actually will respond to price signals represented in Public Service's GCA rates, the Commission finds that, to the extent a customer is given an opportunity to respond to any such price signal, the Settlement provides a much better opportunity for such response than the current annual GCA mechanism.

59. Given the weight of the evidence in this proceeding and all of the facts and circumstances as discussed above, we find that the Settlement is fair and reasonable. Accordingly, with the single modification regarding the calculation of the Deferred rate

component detailed above, the Commission finds that approval of the Settlement is in the public interest.

IV. ORDER

A. The Commission Orders That:

1. The Commission hereby approves the Settlement in its entirety, with one modification regarding the calculation of the Deferred Gas Cost component, as discussed above.

2. The Commission hereby grants a waiver of the Gas Cost Adjustment Rules, as specifically detailed in the Settlement, in order to allow Public Service Company of Colorado to implement the Monthly Gas Cost Adjustment mechanism set forth in the Settlement. This waiver will expire on September 30, 2009, unless extended by the Commission. Specifically, the Commission grants Public Service Company of Colorado the following waivers:

- waiver of the GCA Rules to the extent necessary to permit the GCA Effective Period to vary by GCA component;
- partial waiver of GCA Rule 4 CCR 723-8-4.5, Interest on Under- or Over-Recovery, to permit Public Service to carry forward its net interest calculations on its Account 191 balances within the Tolerance Band and in accordance with the procedures provided for in the Settlement;
- waiver of GCA Rule 4 CCR 723-8-4.7.7, GCA Exhibit No. 7, and Rule 4 CCR 723-1-41.5.4 (Form of Notice) relating to Customer Notice to the extent necessary to allow for the determination of the bill impact based on current month and effective month estimated normal usage; and
- any other waivers of the Commission's current GCA Rules to the extent necessary for Public Service to implement the Monthly GCA mechanism and procedures established by the Settlement and approved by the Commission herein.

3. Public Service Company of Colorado is directed to implement the Customer Education Plan as outlined in Paragraph 69 of the Settlement.

4. Public Service Company of Colorado is directed to file, within business five days following the Mailed Date of this Decision, revised tariff sheets in substantially the same form as

the *pro forma* tariff sheets attached as Appendix D to the Settlement, with the modified calculation of the Deferred Gas Cost component. Such revised tariff sheets shall be filed to become effective October 15, 2004. To the extent not covered above, any other waivers necessary for Public Service Company of Colorado to place into effect these revised tariff sheets are hereby granted.

5. The Commission grants Public Service Company of Colorado an extension of time to allow for a one-month delay in the filing of Public Service Company of Colorado's regularly-scheduled Annual Gas Cost Adjustment application under Gas Cost Adjustment Rule 4 *Code of Colorado Regulations* 723-8-2.1. Accordingly, Public Service Company of Colorado shall file its first Annual Gas Cost Adjustment application under the new Monthly Gas Cost Adjustment procedures approved herein on or before October 15, 2004, to be effective November 1, 2004.

6. The Gas Cost Adjustment rate changes reflected in Public Service Company of Colorado's last Gas Cost Adjustment application in Docket No. 03L-400G, as approved by the Commission in Decision No. C03-1096, shall continue in effect for one additional month until November 1, 2004. Public Service Company of Colorado is granted any waivers of the Commission's Gas Cost Adjustment Rules or Decision No. C03-1096, as necessary, to keep such rates in effect one additional month through October 31, 2004.

7. The 20-day period provided for in § 40-6-114, C.R.S., within which to file applications for rehearing, reargument, or reconsideration begins on the first day following the Mailed Date of this Decision.

8. This Order is effective on its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' DELIBERATIONS MEETING
September 3, 2004.**

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Commissioners