FRONTIER NATURAL GAS COMPANY

DOCKET NO. G-40, SUB 158

TESTIMONY OF JULIE G. PERRY

ON BEHALF OF

THE PUBLIC STAFF – NORTH CAROLINA UTILITIES COMMISSION

February 15, 2021

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND PRESENT POSITION.

A. My name is Julie G. Perry and my business address is 430 North Salisbury Street, Raleigh, North Carolina. I am the Accounting Manager of the Natural Gas & Transportation Section in the Accounting Division of the Public Staff. My qualifications and experience are provided in Appendix A.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

The purpose of my testimony is to (1) provide my conclusions regarding the prudence of Frontier's hedging decisions during the review period, and (2) discuss changes to Frontier's gas procurement policy during the review period.

Q. PLEASE EXPLAIN HOW YOU CONDUCTED YOUR REVIEW.

A. I reviewed the testimony and exhibits of the Company's witnesses, the Company's monthly Deferred Gas Cost Account reports, monthly financial and operating reports, the gas supply and pipeline transportation contracts, and the Company's responses to Public Staff data requests. The responses to the Public Staff data requests contained information related to Frontier's gas purchasing philosophies, customer requirements, and gas portfolio mixes. In addition, the Public Staff had several virtual meetings with Company witnesses and management related to the Company's Gas Supply Procurement Policy.

GAS PROCUREMENT CHANGES, INCLUDING HEDGING

Q. PLEASE EXPLAIN HOW THE PUBLIC STAFF TYPICALLY CONDUCTS ITS REVIEW OF HEDGING ACTIVITIES.

A. The Public Staff's review of the Company's hedging activities typically includes an analysis and evaluation of the following information:

1. The Company's monthly hedging costs, as reflected on the invoices of UGI Energy Services, LLC (UGI);
2. Detailed source documentation, such as physical gas confirmations, that support the amount of gas hedged and the strike prices;
3. Workpapers supporting the derivation of the maximum hedge volumes targeted;
4. The monthly summary of hedging costs (benefits);

5. Hedging plan documents that set forth the Company's gas price risk management policy, hedge strategy, gas price risk management operations, and the gas procurement policy;
6. Documentation from meetings of Frontier's Gas Supply Planning Committee and the Risk and Supply Committee of its parent company, Hearthstone Utilities, Inc.;
7. Testimony and exhibits of the Company's witnesses in the annual review of gas costs proceeding; and
8. Company responses to the Public Staff's data requests.

Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE STANDARD SET FORTH BY THE COMMISSION FOR EVALUATING THE COMPANY'S HEDGING DECISIONS?

A. The appropriate standard for the review of hedging decisions by local distribution companies (LDCs) is set forth in the Commission's February 26, 2002, Order on Hedging in Docket No. G-100, Sub 84 (Hedging Order). In the Hedging Order, the Commission concluded that the purpose of hedging is to reduce the volatility of commodity costs. The Commission noted that hedging involves costs and risks and that it is possible that the long term cost of hedged gas will be higher than gas bought at market prices. The Commission stated it understands that with the use of hedging mechanisms, costs and risks are accepted in exchange for reduced volatility.

The Commission concluded that hedging is an option that must be considered in connection with an LDC's gas purchasing practices. The Commission stated that an LDC's decision to make no effort to mitigate price spikes – including a decision not to hedge – would be a decision subject to review in the LDC's annual gas cost prudency review proceeding just as much as a decision to hedge.

The Commission further concluded that if an LDC decides to hedge in some fashion, prudently incurred costs in connection with hedging should be treated as gas costs under N.C. Gen. Stat. § 62-133.4. The Commission stated that while such costs cannot be pre-approved within the context of the annual gas cost prudency review, the Commission recognized that the review of the prudency of a decision to hedge or not to hedge should be made on the basis of the information available at the time each decision is made, not on the basis of the information available at the time of the prudency review proceeding.

The Commission ordered that each LDC should address its current hedging policy and program in its testimony in each annual gas cost prudency review, explaining why and how it hedged or why it did not hedge during the test period.

Q. PLEASE DESCRIBE HOW FRONTIER'S HEDGING PLAN RELATES TO THE COMPANY'S OVERALL GAS SUPPLY PROCUREMENT POLICY.

A. The primary difference between Frontier's hedging approach and the approach of the other LDCs in the State is that Frontier uses physical hedges exclusively and does not use financial hedges, such as options, futures, or swaps. A physical hedge is a fixed price contract between two parties to buy or sell physical natural gas supplies at a certain future time, at a specific price, which is agreed upon at the time the deal is executed. Since Frontier's hedges include the physical purchase of fixed price gas supplies for firm delivery at its city gate on a monthly basis to meet its customer demand, it is considered part of the Company's overall gas supply procurement policy to serve its customers peak needs.

Q. PLEASE EXPLAIN THE REASONS FOR THE CHANGES TO THE COMPANY'S GAS SUPPLY PROCUREMENT POLICY.

Company witness Younger testified that Frontier made changes to its Gas Supply Procurement Policy during the review period. She stated that the three main changes involve (1) new tariff provisions that govern balancing priorities by Transcontinental Gas Pipe Line Company, LLC (Transco), which restricted the amount of swing flexibility that Frontier has at its city gate, (2) Frontier entering into a new three-year Asset Management Agreement (AMA) with UGI that became effective April 1, 2020, which reflects the changes in Transco's tariffs, and (3) significant updates to the Company's hedging plan.

In general, the primary reason for most of the changes to the Company's Gas Supply Procurement Policy were due to the new, more restrictive Transco tariff changes that impacted Frontier's flexibility to balance its daily gas supply nominations against actual deliveries to Frontier. After discussions with Transco, Frontier found that only 3,613 dekatherms (dts) of its Transco capacity is actually delivered directly to Frontier's city gate and, therefore, is the only capacity that can be used to cover any daily swings in winter usage above the daily nominations, whereas in the past Frontier could swing on the entire 8,613 dts per day of its Transco capacity.

Due to this change Frontier revised its gas daily nomination strategy to begin nominating a base level of 5,000 dts per day of Transco capacity for each day of the winter months at Zone 3 pricing while procuring Zone 5 delivered gas supplies for the remaining daily winter nominations needed for each month of the winter period. As part of the negotiation on its new AMA, Frontier worked with UGI to lock in or hedge prices for 60% of the 5,000 dts per day at Zone 3 prices and also to hedge 60% of the Zone 5 delivered pricing positions up to the required daily nomination for each winter month. Frontier will use the first of the month (FOM) pricing bases for both Zone 3 and Zone 5 for each winter month for the remaining 40%.

Company witness Younger testified that Frontier's gas procurement policy changes, including changes to its hedging plan, reduce or eliminate concerns over customer exposure to potential gas cost volatility. Under the current policy, Frontier can rely on its Transco capacity of 3,613 dts priced at Zone 3 daily basis to handle swings in volumes to due to weather during winter months, instead of Zone 5 daily prices which have historically been more volatile.

Q. PLEASE DESCRIBE YOUR ANALYSIS OF THE COMPANY'S HEDGING PLAN DURING THE REVIEW PERIOD.

A. It appears that Frontier's new Gas Supply Procurement Policy has provided an appropriate strategy to address the volatile Zone 5 daily market, as well as the new Transco tariff changes beginning with the current review period. By purchasing winter hedges for each month of April to September for each upcoming winter period November through March, using FOM pricing for the remaining expected daily nominations at Zone 3 and Zone 5, as well as utilizing the 3,613 dts at Zone 3 pricing for swing volumes needed above the daily nominations, it should greatly help mitigate the risk of price spikes to customers due to large temperature fluctuations and price volatility during the winter period.

I believe that the revisions to Gas Supply Procurement Policy provide a reasonable level of price mitigation during the winter months and should reduce the Zone 5 daily pricing exposure to Frontier, which has had a history of extremely volatile peaks during the heating season. I recommend that Frontier continue to work with the Public

Staff to discuss its Gas Supply Procurement Policy, including hedging and other price mitigation strategies, as changes to the policy are contemplated.

Q. BASED ON YOUR REVIEW AND ANALYSIS, WERE THE COMPANY'S HEDGING DECISIONS DURING THE REVIEW PERIOD PRUDENT?

A. In my opinion, based on what was reasonably known or should have been known at the time the Company made its hedging decisions affecting the review period, as opposed to the outcome of those decisions, my analysis leads me to the conclusion that the decisions were prudent.

Q. HAS THE COMPANY COMPLIED WITH THE ORDERING PARAGRAPHS IN THE PRIOR ANNUAL REVIEW ORDER?

A. Yes. Ordering Paragraph 4 of the Commission's Order on Annual Review of Gas Costs issued June 30, 2020, in Docket No. G-40, Sub 153, Frontier's prior annual review proceeding, states that "Frontier and the Public Staff shall continue to work together to discuss Frontier's Gas Supply Procurement Policy, including hedging and other price mitigation strategies, as changes to the policy are contemplated".

Frontier and the Public Staff had conference calls, as well as met virtually in April and May 2020, to discuss Frontier's new Gas Supply

Procurement Policy and to share how the Company planned to utilize its new Gas Supply Procurement Policy in preparation for the 2020-2021 winter period. This included discussions on hedging and other price mitigation strategies to protect customers from possible gas cost volatility.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

APPENDIX A

QUALIFICATIONS AND EXPERIENCE

JULIE G. PERRY

I graduated from North Carolina State University in 1989 with a Bachelor of Arts degree in Accounting and I am a Certified Public Accountant.

Prior to joining the Public Staff, I was employed by the North Carolina State Auditor's Office. My duties there involved the performance of financial and operational audits of various state agencies, community colleges, and Clerks of Court.

I joined the Public Staff in September 1990, and was promoted to Supervisor of the Natural Gas Section in the Accounting Division in September 2000. I was promoted to Accounting Manager – Natural Gas & Transportation effective December 1, 2016. I have performed numerous audits and/or presented testimony and exhibits before the Commission addressing a wide range of natural gas topics.

Additionally, I have filed testimony and exhibits in numerous water rate cases and performed investigations and analyses addressing a wide range of topics and issues related to the water, electric, transportation, and telephone industries.