STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. G-40, SUB 153

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of		
Application of Frontier Natural Gas Company	)	ORDER ON ANNUAL REVIEW
for Annual Review of Gas Costs Pursuant to	)	OF GAS COSTS
N.C. Gen Stat. § 62-133.4(c) and	)	
Commission Rule R1-17(k)(6)	)	

HEARD: Tuesday, March 3, 2020, at 10:00 a.m., in Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina

BEFORE: Commissioner Daniel G. Clodfelter, Presiding; and Commissioners Kimberly W. Duffley and Jeffrey A. Hughes

APPEARANCES:

For Frontier Natural Gas Company:

0.James H. Jeffries IV, McGuireWoods LLP, 201 N. Tryon Street, Suite 3000, Charlotte, North Carolina 28202

For the Using and Consuming Public:

Elizabeth D. Culpepper, Staff Attorney, Public Staff – North Carolina Utilities Commission, 4326 Mail Service Center, Raleigh, North Carolina 27699

BY THE COMMISSION: On December 2, 2019, pursuant to N.C. Gen. Stat. § 62-133.4(c) and Commission Rule R1-17(k)(6), Frontier Natural Gas Company (Frontier or Company) filed in Docket No. G-40, Sub 150, the public testimony and exhibits of Fred A. Steele, President/General Manager, in connection with the annual review of Frontier's gas costs for the 12-month period ended September 30, 2019. On December 3, 2019, Frontier filed the public and confidential testimony and exhibits of Taylor B. Younger, Regulatory Compliance Engineer, along with the confidential exhibits of Fred A. Steele.

On December 11, 2019, the Commission issued its Order Scheduling Hearing, Requiring Filing of Testimony, Establishing Discovery Guidelines and Requiring Public Notice (Scheduling Order). The Scheduling Order set the annual review of the Company's gas costs for hearing on March 3, 2020, set prefiled testimony dates, and required Frontier to publish notice of the hearing.

On January 3, 2020, the Commission ordered the transfer of the application, including supporting testimony (Application), in Docket No. G-40, Sub 150 to a new sub docket, Sub 153, and all parties were directed to file all future documents relating to Frontier's Application in that docket.

On February 14, 2020, the Public Staff filed the joint direct testimony of Neha R. Patel, Utilities Engineer, Natural Gas Division; Shawn L. Dorgan, Staff Accountant, Accounting Division; and Julie G. Perry, Accounting Manager, Natural Gas & Transportation Section, Accounting Division (Public Staff Panel or Panel).

On February 18, 2020, Frontier and the Public Staff filed a joint motion for witnesses to be excused at the hearing and requested that the prefiled testimony and exhibits of all witnesses be received into the record without requiring the appearance of the witnesses.

On February 25, 2020, Frontier filed its affidavits of publication.

On February 26, 2020, the Commission issued its Order Denying Motion to Excuse Witnesses and Providing Notice of Hearing Topics. On March 2, 2020, Frontier filed written responses to the Commission's hearing topics.

On March 3, 2020, this matter came on for hearing as scheduled, and all prefiled testimony and exhibits were admitted into evidence. No public witnesses appeared at the hearing.

On April 20, 2020, the Joint Proposed Order of Frontier and the Public Staff was filed.

No other party intervened in this docket.

Based upon the testimony and exhibits received into evidence and the record as a whole, the Commission makes the following:

FINDINGS OF FACT

1. Frontier is a public utility as defined by N.C.G.S. § 62-3(23), organized and existing under the laws of the State of North Carolina with its headquarters in Elkin, North Carolina.

2. Frontier is a natural gas local distribution company (LDC), primarily engaged in the business of purchasing, transporting, distributing, and selling natural gas to approximately 4,137 customers in North Carolina, as of September 30, 2019.

3. Frontier has filed with the Commission and submitted to the Public Staff all of the information required by N.C.G.S. § 62-133.4(c) and Commission Rule R1-17(k) and has complied with the procedural requirements of such statute and rule.

4. The review period in this proceeding is the 12 months ended September 30, 2019.

5. During the review period, Frontier incurred total gas costs of $6,776,781, which was comprised of pipeline demand charges of $1,920,925, gas supply costs of $4,902,962, and other gas costs of ($47,106).

6. The appropriate Deferred Gas Cost Account balance as of September 30, 2019, is a debit balance of $417,132, owed to Frontier by its customers.

7. Subject to the deferred account reclassifications and adjustments agreed to by the Public Staff Panel and Frontier, Frontier properly accounted for its gas costs during the review period.

8. Frontier's hedging decisions during the review period were reasonable and prudent.

9. During the review period, Frontier purchased all of its gas supply from a full requirements gas supply contract.

10. Frontier's Asset Management Agreement (AMA) with UGI Energy Services, LLC (UGI), provided for up to 20,000 dekatherms (dts) a day for additional gas supply requirements delivered to Zone 5. These terms have been carried forward into Frontier's new AMA with UGI which should allow the Company to serve its firm market on peak days through the 2021-2023 winter period.

11. Frontier utilized pipeline capacity from Transcontinental Gas Pipe Line Company, LLC (Transco).

12. Frontier met its supply and capacity needs through a combination of the AMA with UGI, Transco capacity, and a peaking contract.

13. Frontier has continued its "best evaluated cost" gas supply strategy policy.

14. The Company's gas costs during the review period were prudently incurred, and Frontier should be permitted to recover 100% of its prudently incurred gas costs.

15. Frontier should not be required to implement a rate increment in this docket.

16. For the current review period, it is appropriate for Frontier to use the net-of-tax overall rate of return of 6.60% as the applicable interest rate on all amounts

over-collected or under-collected from customers as reflected in its Deferred Gas Cost Account.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1-2

These findings of fact are essentially informational, procedural, or jurisdictional and are based on evidence uncontested by any of the parties. The evidence supporting these findings is contained in the official files and records of the Commission, the testimony and exhibits of Company witnesses Steele and Younger, and the testimony of the Public Staff Panel.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 3-4

The evidence supporting these findings of fact is contained in the testimony of Frontier witnesses Steele and Younger, the testimony of the Public Staff Panel, and the provisions of N.C.G.S. § 62-133.4(c) and Commission Rule R1-17(k)(6).

N.C.G.S. § 62-133.4 requires that each natural gas utility submit to the Commission information and data for an historical 12-month review period concerning its actual cost of gas, volumes of purchased gas, sales volumes, negotiated sales volumes, and transportation volumes. Commission Rule R1-17(k)(6)(c) requires the filing of work papers, direct testimony, and exhibits supporting the information.

Frontier witness Steele testified that the Company is required to submit to the Commission, on or before December 1 of each year, certain information for the 12-month test period ended September 30 as required by Commission Rule R1-17(k). The Public Staff Panel confirmed that the Public Staff has reviewed the monthly reports filed by Frontier. The Commission, therefore, concludes that Frontier has complied with all of the procedural requirements of N.C.G.S. § 62-133.4(c) and Commission Rule R1-17(k) for the review period.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 5-7

The evidence supporting these findings of fact is contained in the testimony and exhibits of Frontier witness Steele and the testimony of the Public Staff Panel.

Company witness Steele's Schedule 1 reflected that Frontier's total gas costs for the review period were $6,776,781. The Public Staff Panel testified that this amount was comprised of pipeline demand charges of $1,920,925, gas supply costs of $4,902,962 and other gas costs of ($47,106).

The Public Staff Panel also testified that it had reviewed the testimony and exhibits of Company witness Steele, 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, which contained information related to Frontier's gas purchasing philosophies, customer requirements, and gas portfolio mixes.

Company witness Steele testified that as of September 30, 2019, Frontier's Deferred Gas Cost Account had an ending debit balance of $410,265.36, owed to Frontier from customers, as shown on Company witness Steele's Schedule 8. The Public Staff Panel testified that based on timing differences associated with an estimated settlement adjustment made by the Company related to a settlement agreement entered into by Frontier and the Public Staff in Docket No. G-40, Sub 149, which impacted accrued interest, and the correction of a transportation customer balancing true-up entry mentioned earlier in testimony, the Public Staff recommended a debit adjustment to Frontier's deferred account balance as of September 30, 2019, in the amount of $6,867. The Public Staff Panel further stated that the Company was in agreement with the adjustment. Therefore, the Public Staff Panel testified that the appropriate Deferred Gas Cost Account balance as of September 30, 2019, is $417,132, debit balance owed to Frontier

The Public Staff Panel also testified that the Company properly accounted for its gas costs during the review period. The Public Staff Panel explained that it reclassified certain costs represented by the Company as Demand and Storage Costs on Schedule 2 to the testimony of Company witness Steele.

Based on the foregoing, the Commission concludes that the appropriate Deferred Gas Cost Account balance as of September 30, 2019, is a debit balance of $417,132, owed to Frontier by its customers, and that Frontier has properly accounted for its gas costs incurred during the review period.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The evidence for this finding of fact is contained in the testimony and exhibits of Company witness Younger and the testimony of the Public Staff Panel.

The Public Staff Panel testified that on December 9, 2019, Frontier filed a letter in Docket No. G-40, Sub 149 as a result of the Commission's Order in Frontier's prior Annual Review of Gas Costs proceeding detailing the steps taken and progress made by the Company to bolster its gas supply planning. The letter described the steps which included designating Company witness Younger as the lead gas supply planning person and utilizing the availability of the following from Hearthstone Utilities, Inc. (Hearthstone), Frontier's parent company: (1) two consultants to assist in gas supply planning and purchasing decisions; (2) an experienced regulatory individual to participate in risk committee and gas procurement procedures; and (3) an engineer with experience in gas distribution. In addition, the Public Staff Panel testified that Frontier stated that it is forging an excellent working relationship and communicates regularly with UGI about its natural gas supply needs.

The Public Staff Panel also testified that on June 4, 2019, the Company met with the Public Staff to discuss its updated Gas Supply Procurement Policy and to share how the Company planned to utilize its revised Procurement Policy in preparation for the 2019-2020 winter period. This meeting included discussions on hedging and other price mitigation strategies to protect customers from possible gas cost volatility.

During the hearing and as contained in Frontier's filed written responses to the Commission's questions, the Commission explored the responsibilities of Frontier's natural gas supply group, and the support that Frontier received from its parent company. Company witness Younger stated that Frontier's supply group consisted of herself, Fred Steele, and Ted Gambill. Witness Younger testified that Mr. Gambill has an engineering background and over ten years of experience working with multiple asset managers, assists with decision making, and can step in during her absence to perform the daily and monthly supply duties. Witness Younger stated that her daily supply duties include oversight of natural gas supply planning and purchases, managing gas planning, marketer nominations and actual usage. She added that the supply group forecasts the upcoming month's daily usage using the Company's historical usage and forecasted weather to run a regression analyses to set its first of the month (FOM) nominations, and participates in the annual review of gas costs proceedings. She further stated that Frontier receives assistance and expertise from its parent company's preferred gas cost consultants before setting the FOM nominations while also receiving input to responding to data requests in the annual review of gas costs proceedings.

Company witness Younger also testified that the Company has made significant updates to its Gas Supply Procurement Policy under the guidelines for hedging. Witness Younger stated that Frontier may procure hedges in winter strips for any period within the months of November through March. Witness Younger testified that Frontier did not utilize the policy for this review period but had hedges for the 2019-2020 winter.

Company witness Younger testified that Frontier has made a conscious effort to engage the Hearthstone Utilities Risk and Supply Committee in all aspects of its gas supply planning by providing committee members with not only weekly usage updates, but also more insight into Frontier's hedging plan and purchases. Witness Younger also explained that Frontier had sought to seek outside expertise for all gas supply endeavors by utilizing the Hearthstone's gas supply consultants, Al Harms and Len Gilmore. Witness Younger testified that these consultants are now included in all gas supply meetings and worked with UGI, Frontier's current gas supply asset manager to determine the best strategy to make sure Frontier was not subject to the volatile Zone 5 daily gas market. Witness Younger explained that Frontier entered into a peaking supply contract of 3,232 dts a day for any 20 days throughout the months of January and February. Witness Younger stated that the contract would work as a "no-notice supply", meaning volume of gas over and above Frontier's nominated FOM quantity would automatically be classified as peaking supply, and as soon as the seasonal quantity for peaking service had expired, any additional supply would be priced at Gas Daily Average Transco Zone 5 South price.

The Public Staff Panel testified that the appropriate standard for the review of hedging decisions by LDCs is set forth in the Commission's February 26, 2002, Order on Hedging in Docket No. G-100, Sub 84. The Public Staff Panel summarized Frontier's hedging policy changes that state Frontier anticipates it will hedge 50% of expected average daily flow for each winter month. The Panel noted that witness Younger further explained that Frontier would subtract out current capacity of 8,613 dts from the expected maximum daily flow for each month to conclude how much of the forecasted Zone 5 purchase gas should be hedged for that month, and that the remaining Zone 5 purchases should be executed with FOM pricing, to minimize the likelihood of the need to purchase volatile Zone 5 daily priced gas.

The Public Staff Panel testified that the primary difference between Frontier's hedging approach and the approach of other LDCs is that Frontier uses physical hedges exclusively and does not use financial hedges, such as options, futures, or swaps. The Panel explained that 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. The Panel further stated that if Frontier hedges, its gas supply portfolio typically includes the physical purchase of fixed price gas supplies for delivery at its city gate on a monthly basis.

The Public Staff Panel explained that although Frontier did not utilize the updated Gas Supply Procurement Policy for this review period, the peaking supply contract enabled the Company to lock-in a $3.072 per dt strike price for all peaking contract gas used. Exhibit B to Company witness Younger's testimony shows that the peaking supply contract also provided the flexibility for Frontier to use up to the maximum contract quantity of 64,640 dts over any number of days in January and February 2019, if it preferred that option instead of only being able to nominate 3,232 dts per day for 20 days.

The Public Staff Panel testified that entering into the peak day arrangement with UGI helped mitigate the risk of price spikes to customers during the winter period that could be caused by large temperature fluctuations resulting in price volatility. The Public Staff Panel stated that even though Frontier did not utilize its hedging strategy during the current review period, the peak day service with the locked-in pricing provided a reasonable level of price mitigation during January and February 2019.

The Public Staff Panel further recommended 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. Lastly, the Public Staff Panel concluded that 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, that Frontier's hedging decisions were prudent.

Based on the Public Staff Panel's investigation and the review of the data filed in this docket, the Commission concludes that Frontier's hedging decisions during the review period were reasonable and prudent. The Commission further agrees that Frontier should 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.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 9-14

The evidence for these findings of fact is contained in the testimony and exhibits of Company witnesses Steele and Younger, and the testimony of the Public Staff Panel.

Witness Steele testified that Frontier has contracted with Transco for interstate pipeline capacity and that it contracts with UGI to centralize purchasing and reliability of gas deliveries under a full requirements contract. Company witnesses Steele and Younger both testified that Frontier met its supply and capacity needs through a combination of the AMA with UGI, Transco capacity, and a peaking contract.

Witness Steele testified that the UGI AMA further provides for additional daily or monthly gas requirements above the 8,613 dts up to 20,000 dts delivered to Zone 5 and that these terms have been carried forward into the Company's new AMA with UGI which will allow the Company to serve its firm market on peak day through the 2021-2022 winter period. Company witness Younger also testified that the supply group developed a proposal request for an AMA for the period of April 1, 2020 - March 31, 2023 since the current agreement would end on March 31, 2020. In Frontier's filed response of Company witness Younger to the Commission's hearing topics directed to Frontier, the Company stated that Frontier had chosen to award the new AMA contract to UGI. Witness Younger stated that this contract was similar to the one Frontier had utilized over the past three years but with negotiated lower volumetric fees per dt starting April 1, 2020, through March 31, 2023.

The Public Staff Panel stated that it had evaluated the report on a Design Day Study (DDS) prepared by Dr. Ronald H. Brown, PhD, shown on Confidential Exhibit B. The Panel explained that Dr. Brown utilized the Marquette University GasDay program in evaluating Frontier's projected peak day demand and concluded that it accurately calculated Frontier's peak day using reasonable assumptions, such as heating degree days and frequency of occurrence of such cold weather events. The Public Staff Panel also concurred that Frontier had adequate capacity in order to serve its firm market on peak days through the 2021-2022 winter period. The Panel confirmed at the hearing that the Company had provided data for its five-year capacity planning in a response to a data request from the Public Staff, which means that Frontier should have adequate capacity in order to serve its firm market on peak days through the 2021-2023 winter period. The Company confirmed at the hearing that the five-year annual update of the design-day study will be updated annually.

With respect to the filed response of Company witness Younger to the Commission's hearing topics directed to Frontier that pertain to the Company's recent DDSs, the Company witnesses testified that Dr. Brown performed the 1 in 20 years DDS in November 2017. In addition to the DDS, the Company testified that Dr. Brown performs an annual analysis for the Company with actual expected maximum gas flows as well as expected average flows for every month for the upcoming year. Further, the Company witnesses testified that this analysis is used by Frontier for its FOM nomination and procurement purposes. Company witness Younger stated that this report has proven more useful than the DDS report, which is only used to make sure that the Company is prepared to serve its customers if the unlikely 1 in 20 years peak day happened. Witness Younger further stated that the Company has determined that it now has the option of preparing the DDS annually, which could go out five years, by utilizing its own Engineering Department or by consulting Dr. Brown with Marquette Energy Analytics. Company witness Steele testified that the Company's gas supply policy is best described as a best evaluated cost supply strategy, and that this strategy is based upon the following criteria: operational flexibility, supply security, creditworthiness, reliability of supply, the cost of the gas, and the quality of supplier customer service.

Company witness Steele stated that the foremost criterion for the Company is security of gas supply, which refers to the assurance that the supply of gas will be available when needed. He further testified that Frontier understands the necessity of having security of gas supply to provide reliable and dependable natural gas service and has demonstrated its ability to do so, that this criterion is required for Frontier's firm sales customers, who have no alternate fuel source, and that the Company's contracts with its suppliers implementing this strategy have allowed Frontier to accomplish this objective. Company witness Steele further stated that security of gas supply is required because of the daily changes in Frontier's market requirements caused by the unpredictable nature of weather, the production levels/operating schedules of Frontier's industrial customers, the industrial customers' option to switch to alternative fuels, and customer growth during the test period. Witness Steele noted that while Frontier's gas supply agreements have different purchase commitments and swing capabilities (i.e., the ability to adjust purchase volumes within the contract volume), the gas supply portfolio as a whole must be capable of handling the seasonal, monthly, daily, and hourly changes in Frontier's market requirements.

Witness Steele also explained that the other primary criterion is the cost of gas, which refers to Frontier's commitment to acquiring the most cost effective supplies of natural gas available for its customers while maintaining the necessary operational flexibility, security, and reliability to serve its customers' needs.

Frontier addressed the exploration of a liquefied natural gas (LNG) facility in Company witness Steele's direct testimony, Company witness Younger's filed response to the Commission's hearing topics, and at the hearing. In its filed response, Frontier stated that UGI has shown an interest in supplementing Frontier's system with an LNG facility that UGI would own and operate. The Company stated that besides trucking LNG to other potential customers, Frontier would have access to this storage facility and injection site to use on peak days since liquefaction possibilities at the proposed site do not currently seem economically feasible. The Company also stated that once Frontier receives its cost estimates for this proposed LNG facility from UGI, it will prepare an analysis to compare costs of an LNG facility versus constructing additional transmission lines to an alternative natural gas supply. In its filed responses to the Commission's questions, the Company stated that the analysis would be shared with the Public Staff upon completion. The Public Staff Panel testified that they would review Frontier's options at acquiring capacity based on many factors including cost-effectiveness and reliability.

The Public Staff Panel testified that during the review period, Frontier experienced customer growth of 7.3%, which is approximately four times the growth rate of legacy LDCs in North Carolina. The Panel also testified that there was a slight decrease in Frontier's sales and transportation volumes from what was experienced in the prior review period.

The Panel further testified that based on its investigation and the review of the data filed in this docket, they determined that the Company's gas costs during the review period were prudently incurred and that its gas purchasing decisions were prudent.

Based on the foregoing, the Commission concludes that the Company's gas costs incurred during the review period were reasonable and prudently incurred and that the Company should be permitted to recover 100% of its prudently incurred gas costs.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 15

The evidence for this finding of fact is contained in the testimony and exhibits of Company witness Steele and the testimony of the Public Staff Panel.

Company witness Steele stated that Frontier anticipates the current deferred account balance will move back towards zero dollars over the winter months. Frontier did not propose any temporary rate increments or decrements (temporaries) in this proceeding.

The Public Staff Panel testified that in response to a Public Staff data request the Company stated that Frontier anticipates receiving a Transco refund in March 2020, which would move the Company's deferred account balance closer to zero dollars. The Public Staff Panel agreed with the Company's request to not implement any temporaries in the current proceeding. The Public Staff Panel also recommended that Frontier monitor the deferred account balance and, if needed, file an application for authority to implement new temporary increments or decrements through the Purchased Gas Adjustment mechanism in order to keep the deferred account balance at a reasonable level.

Based on the foregoing, the Commission concludes that Frontier should not be required to implement a rate increment in this proceeding. The Commission agrees that Frontier should monitor the deferred account balance and, if needed, file an application for authority to implement new temporary increments or decrements through the Purchased Gas Adjustment mechanism in order to keep the deferred account balance at a reasonable level.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 16

The evidence for this finding of fact is contained in the testimony and exhibits of Company witness Steele and the testimony of the Public Staff Panel.

The Panel testified that it reviewed the Company's interest rate calculations for all known corporate income tax rate changes, and determined that the decrease in North Carolina's corporate income tax rate (from 3.00% to 2.50%, effective January 1, 2019) had no effect on the calculation of the net-of-tax overall rate of return. Therefore, the Public Staff Panel stated that it is appropriate that Frontier continue to use the net-of-tax overall rate of return of 6.60% as the applicable interest rate on all amounts over-collected or under-collected from customers reflected in its Deferred Gas Cost Account, effective January 1, 2019.

Based on the foregoing, the Commission concludes that it is appropriate for Frontier to continue to use the net-of-tax overall rate of return of 6.60% as the applicable interest rate on all amounts over-collected or under-collected from customers reflected in its Deferred Gas Cost Account.

IT IS, THEREFORE, ORDERED as follows:

1. That Frontier's accounting for gas costs during the 12-month period ended September 30, 2019, is approved;

2. That subject to the deferred account adjustment provided for in the Public Staff Panel's testimony, the gas costs incurred by Frontier during the 12-month period ended September 30, 2019, were reasonably and prudently incurred, and Frontier is hereby authorized to recover 100 % of its gas costs incurred during the period of review;

3. That Frontier's hedging activities during the review period were reasonable and prudent;

4. 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; and

5. That Frontier shall continue to use the net-of-tax overall rate of return of 6.60% as the applicable interest rate on all amounts over-collected or under-collected from customers reflected in its Deferred Gas Cost Account.

ISSUED BY ORDER OF THE COMMISSION.

This the 30th day of June, 2020.

NORTH CAROLINA UTILITIES COMMISSION

A. Shonta Dunston

A. Shonta Dunston, Deputy Clerk