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DEPARTMENT OF PUBLIC UTILITIES

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Investigation by the Department of Public Utilities on its own motion into the gas procurement practices of Fitchburg Gas and Electric Light Company d/b/a Unitil.

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I. INTRODUCTION AND PROCEDURAL HISTORY

On March 12, 2009, the Department of Public Utilities (“Department”) voted to open an investigation into the gas procurement practices of Fitchburg Gas and Electric Light Company d/b/a Unitil (“Unitil” or “Company”) for the period November 1, 2007 through April 30, 2009 pursuant to G.L. c. 164, §§ 76 and 94A. Order Opening the Investigation by the Department of Public Utilities on Its Own Motion Into the Gas Procurement Practices of Fitchburg Gas and Electric Light Company d/b/a Unitil, D.P.U. 09-09, at 4 (2009). The purpose of this investigation was: (1) to determine whether Unitil has engaged in a purchasing program to mitigate the volatility of gas commodity prices without Department approval; and, if so, (2) to determine an appropriate remedy, including whether Unitil’s ratepayers are entitled to reimbursement for any gas supply costs that are higher than they would have been absent such purchasing program. Id. at 3-4. The Department docketed this investigation as D.P.U. 09-09.

Pursuant to notice duly issued, on April 17, 2009, the Department held a public hearing and procedural conference. On April 1, 2009, the Attorney General of the Commonwealth (“Attorney General”) intervened as of right pursuant to G.L. c. 12, § 11E.

The Department held an evidentiary hearing on June 24, 2009. The Company sponsored three witnesses: (1) Robert S. Furino, director of energy contracts for Unitil Service Corporation; (2) James D. Simpson, vice-president of Concentric Energy Advisors; and (3) Gary Epler, chief regulatory counsel for Unitil Service Corporation. The evidentiary

record includes 60 responses to information requests (including one supplemental response and three revised responses) and four responses to record requests.¹

II. BACKGROUND

The Department opened this investigation after discovering during the Company's 2008/2009 peak period cost of gas adjustment factor ("GAF")² proceeding, Fitchburg Gas and Electric Light Company d/b/a Unitil, D.P.U. 08-GAF-P4, that the natural gas supply costs the Company was incurring were not in line with then-prevailing market prices. Massachusetts local gas distribution companies ("LDCs") typically purchase about one-third of the gas volumes needed to meet peak period customer requirements during the off-peak months of May through October and store these volumes at the time they are purchased underground or in liquefied natural gas facilities for use during the peak winter period when customer demand for

¹ The record also includes: (1) natural gas price data from 2007 through 2008, which the Department has taken official notice of pursuant to 220 C.M.R. § 1.10(2); and (2) the record in Fitchburg Gas and Electric Light Company d/b/a Unitil, D.P.U. 08-73, which the Department incorporated by reference in this proceeding pursuant to 220 C.M.R. § 1.10(3). D.P.U. 09-09, Hearing Officer Memorandum (Aug. 21, 2009); D.P.U. 09-09, Hearing Officer Memorandum (Aug. 13, 2009).

² Costs incurred by LDCs for the purchase, storage, and interstate transportation of gas (referred to as gas supply costs) are recovered via the cost of gas adjustment clause ("CGAC"). The CGAC is the tariff by which LDCs are permitted to recover gas supply costs, whereas GAF refers to the rate that customers pay for gas supply costs. See 220 C.M.R. §§ 6.01, 6.06. LDCs calculate GAFs on a semi-annual basis, once for the peak winter heating period of November 1 through April 30 and once for the off-peak period of May 1 through October 31. 220 C.M.R. §§ 6.05-6.06. LDCs are required to file revised GAFs any time their deferred gas-cost balances at the end of a period are projected to be less than or greater than five percent of the total seasonal gas costs stated in their effective GAF. Investigation Regarding the Promulgation of Rules or the Amendment of Existing Regulations Concerning the Cost of Gas Adjustment Clause, 220 C.M.R. § 6.00 et seq., D.T.E. 01-49-A at 8 (2001).

gas is the highest. See KeySpan Energy Delivery, D.T.E. 03-85, Letter Order at 1 (2003); NSTAR Gas Company, D.T.E. 04-63, Letter Order at 1 (2005); New England Gas Company, D.T.E. 06-3, Letter Order at 1 (2006); see also Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations; Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 18 C.F.R. Part 284, 56 FERC ¶ 61,030, at 101-107 (1992). Companies purchase gas for storage during the off-peak period to take advantage of generally lower prices during the off-peak months. See 18 C.F.R. Part 284, 56 FERC ¶ 61,030, at 103. The remaining two-thirds of the gas supply needed to meet peak-period customer requirements is purchased at the time that the gas will be consumed based on first-of-the-month ("FOM") and spot (i.e., daily) market prices. The Department has recognized that these latter purchases are susceptible to market-price fluctuations affecting an LDC's gas supply costs and, thus, the GAF which an LDC charges its customers. D.T.E. 01-49-A at 7-8. To mitigate this price volatility, the Department requires LDCs to file updated GAFs when their projected deferred gas-cost balances at the end of the peak period deviate by at least plus or minus five percent from the total seasonal gas costs as stated in the LDCs' effective GAFs. Id. at 8.

In 2002, the Department stated for the first time that it would allow LDCs to implement risk-management plans to mitigate the volatility of natural gas commodity prices. Investigation by the Department of Telecommunications and Energy on Its Own Motion, Regarding the Appropriateness of the Use of Risk-Management Techniques to Mitigate Natural Gas Price Volatility, D.T.E. 01-100-A, at 8 (2002). Such plans are subject to Department review and

approval where the burden is on the LDC to establish that the plan is reasonably designed to meet the objective of price stability. Id. at 28.

Pursuant to D.T.E. 01-100-A, several LDCs have obtained Department approval of purchasing programs that allow them to lock in the price of a portion of the company's natural gas supply portfolio such that the company is not paying prevailing market prices but instead the average price obtained by the company over a given purchasing period. New England Gas Company, D.T.E. 06-3, Letter Order at 2 (2006); NSTAR Gas Company, D.T.E. 04-63, Letter Order at 2 (2005); KeySpan Energy Delivery, D.T.E. 03-85, Letter Order at 2 (2003), modified, KeySpan Energy Delivery, D.T.E. 06-65, Stamp Approval (2006).

In January 2009, gas commodity prices decreased significantly resulting in several LDCs seeking and obtaining Department approval to decrease their GAFs from those previously in effect. Bay State Gas Company, D.P.U. 08-GAF-P1, Letter Order at 1 (2009); The Berkshire Gas Company, D.P.U. 08-GAF-P2, Letter Order at 1 (2009); Boston Gas Company, Colonial Gas Company, and Essex Gas Company, each d/b/a National Grid, D.P.U. 08-GAF-P5, Letter Order at 1-2 (2009). Unitil did not initially submit a revised GAF filing to decrease its GAFs. As a result, on January 21, 2009, the Department requested that Unitil demonstrate that the Company's projected deferred gas-cost balance at the end of the peak period would be within five percent of the total seasonal gas costs stated in the Company's GAF approved on October 31, 2008. See 220 C.M.R. § 6.12(3); D.T.E. 01-49-A at 8. Although it was not required to do so because it was within the five percent threshold,

the Company submitted a revised GAF filing on January 27, 2009, which proposed to reduce the Company's GAFs.

In reviewing Unitil's revised GAF filing, the Department issued information requests to the Company regarding its gas costs. D.P.U. 08-GAF-P4, Third Set of Information Requests (January 28, 2009). Unitil's responses to these information requests prompted the Department to open this investigation to determine whether the Company has engaged in a purchasing program to mitigate the volatility of gas commodity prices without prior Department approval and, if so, to determine an appropriate remedy. D.P.U. 09-09, at 3-4.

III. DESCRIPTION OF THE COMPANY'S GAS PURCHASING ACTIVITIES

A. Introduction

Unitil states that it first began purchasing natural gas for the purpose of mitigating the volatility of natural gas commodity prices on October 1, 2001 (Exhs. FGE/RSF-1, at 4; DPU 1-2; DPU 2-3). Under this risk-management purchasing program,³ Unitil locked in prices in advance for a portion of the gas supplies it needed to meet customer requirements for the 2001/2002 peak period (Exh. FGE/RSF-1, at 4).⁴ Prior to the 2001/2002 peak period, the

³ As will be explained below, although it had engaged in this practice since 2001, the Company did not have written guidelines for gas purchases to mitigate price volatility until January 2008 (Exhs. DPU 1-2; AG 1-10). For the purpose of this Order, the Department will refer to the Company's practice of locking in prices for the purpose of mitigating natural gas price volatility as the Company's "purchasing program" or "risk-management program," regardless of whether the purchases occurred before or after the written purchasing guidelines were implemented in January 2008.

⁴ The Company commits itself to taking a specified total volume of gas when its supply contracts are executed but the price for the gas is not determined until the Company

majority of the Company's peak period supplies were purchased at the time the gas was consumed, at either FOM or spot market prices (Exhs. FGE/RSF-1, at 4; DPU 1-5; DPU 1-5 Att.). In this proceeding, the Company states that it decided to take action to mitigate price volatility due to dramatic increases in gas commodity costs during the 2000/2001 peak season but never sought Department approval to do so (Exh. FGE/RSF-1, at 4-5, 7; Tr. at 12-13). The Company also states that it began to evaluate its options for mitigating price volatility as a result of the Department's Order in D.T.E. 01-100-A, which the Company understood to be a strong policy statement by the Department in support of strategies by LDCs to mitigate commodity price volatility and stabilize prices (Exh. FGE/RSF-1, at 8).

Through locking in prices, the Company intended to stabilize the cost of its gas purchases over the peak period and, thus, stabilize the prices charged to customers (Exh. FGE/RSF-1, at 4). To lock in prices, the Company used provisions in its supply contracts that allow it to convert a market index price for a volume of gas to a fixed price for delivery at a forward month (Exhs. FGE/RSF-1, at 4, 4 n.1, 9; DPU 2-1 Att. (a)-(c); Tr. at 36). The Company states that it would lock in a price based on the New York Mercantile Exchange ("NYMEX") strip price available at the time the price is converted for delivery (Exh. FGE/RSF-1, at 9). Thus, the price of commodity on delivery was determined at the time of purchase through the NYMEX futures strip price rather than at the time of delivery through the FOM or spot price at that time (id. at 8-9). The Company did not use

decides to "lock in" a price for a particular volume of gas (Exh. FGE/RSF-1, at 9; D.P.U. 08-73, Tr. at 116).

derivative products, such as futures, options on futures, or swap contracts to lock in prices (id. at 8; Tr. at 37).

B. Price-Lock Purchases

Prior to implementing written guidelines on mitigating peak period natural gas price volatility in January 2008 (“Purchasing Guidelines”), the Company states that it did not rely on a patterned or timed gas procurement schedule, which would be implemented regardless of market conditions (Exh. AG 1-10). Instead, the Company made its price-lock gas purchases in volumes it believed at the time were sufficient to stabilize its filed GAFs based on a number of market indicators such as weather, forward-looking price trends, and anticipated market volatility (Exhs. FGE/RSF-1, at 10; DPU 3-17; AG 1-10).

In contrast, Until’s Purchasing Guidelines, implemented in January 2008, specify the time period over which the Company locks in prices as well as the amount of gas to be locked in each month (Exh. Att. DPU 1-2(a)). Specifically, section III of the Purchasing Guidelines, which addresses the management of natural gas price volatility, provides that the Company will lock in one-tenth of its seasonal baseload⁵ requirements each month over a ten-month period, from November through August, preceding the peak period (id.). Section III.B of the Purchasing Guidelines provides that the remaining gas requirements for the peak period will be purchased at monthly or daily spot market prices, as determined in monthly and seasonal gas

⁵ Baseload refers to the minimum amount of gas an LDC expects to need to fulfill customer gas requirements over a given period of time regardless of changes in temperature.

plans⁶ (*id.*). The Purchasing Guidelines do not address when during the month the price-lock purchases are to be made or the number of price-locks to be executed each month (Exh. Att. DPU 1-2(a)).

The Company states that it does not have a defined approach for determining the quantity of gas subject to price locking each month; rather, the Company states that the quantities subject to price-locks during the 2007/2008 and 2008/2009 peak periods were “largely a function of the time period over which purchases could be made prior to August 30 each year” (Exh. DPU 3-17). For example, the Company states that for the 2007/2008 peak period, it began locking in prices after it executed a supply contract on June 29, 2007 that would allow it to lock in prices (Exhs. DPU 2-1(a); DPU 3-17). For the 2008/2009 peak period, the Company began executing price-locks in February 2008 following implementation of the Purchasing Guidelines in January 2008 (Exh. DPU 3-17).

The Company begins the process of determining when it is appropriate to lock in prices by monitoring NYMEX prices using DTN/ProphetX software⁷ (Tr. at 29-30; D.P.U. 08-73,

⁶ The Department reviews a company’s monthly and seasonal gas plans in its semi-annual CGAC filing. 220 C.M.R. § 6.01. The Department reviews a company’s long-range forecast and supply plan (which Unitil refers to as an “integrated resource plan”) every two years, for the ensuing five-year period. G.L. c. 164, § 69I; Bay State Gas Company, D.T.E./D.P.U. 06-84, at 36-37 (2007) (interpreting G.L. c. 164, § 69I to mean that companies must file their forecast and supply plans with the Department every two years irrespective of the date the Department issues an order on the Company’s previous forecast and supply plan filing). A long-range forecast and supply plan addresses how a company projects its gas sendout requirements (*i.e.*, forecasting) and its plans to meet those projected sendout requirements (*i.e.*, supply planning). In reviewing a forecast and supply plan, the Department is required to ensure, among other things, “a necessary energy supply for the [C]ommonwealth with a minimum impact on the environment at the lowest possible cost.” G.L. c. 164, § 69I.

Tr. at 120). The Company considers market and weather conditions as well as price indicators for anticipated price volatility and upward price trends when determining when to lock in a price and a corresponding volume of gas (Exhs. DPU 2-4(3); DPU 2-9; DPU 3-17; D.P.U. 08-73, Tr. at 116).

Once the Company decides it is appropriate to lock in a price, it calls its gas supplier for a price quote (Tr. at 29; D.P.U. 08-73, Tr. at 118, 121). To ensure that the price quoted reflects market prices, the Company compares the quoted price to the NYMEX futures price using DTN/ProphetX (Tr. at 30; D.P.U. 08-73, Tr. at 121).

For both the 2007/2008 and 2008/2009 peak periods, the Company states that by the end of August it had aimed to secure 65 to 70 percent of its total peak period supply requirements (Exhs. FGE/RSF-1, at 11; DPU 2-4(3); DPU 3-17). This amount includes both the price-locking quantities at issue here, as well as the amounts associated with the purchase and storage of gas in the off-peak period, which are not at issue here⁸ (Exhs. FGE/RSF-1, at 11; DPU 2-4(3); DPU 3-17).

C. Peak 2007/2008 Period

The Company locked in the majority of its 2007/2008 peak period supply requirements over a nine-week period from June 29, 2007 through August 27, 2007 (Exhs. FGE/RSF-1, at 11; DPU 3-3; DPU 3-18 Att.). Twenty-five total purchases were made during these nine

⁷ DTN/ProphetX software provides real-time NYMEX pricing information (Tr. at 30).

⁸ The amount of gas purchased in the off-peak period and placed in storage represents approximately 22 percent of Unitil's peak period gas requirements (Exh. FGE/RSF-1, at 10).

weeks for 69.3 percent of the Company's total peak period requirements (Exhs. FGE/RSF-1, at 11; DPU 1-3 Att. (rev.); DPU 3-18 Att.; DPU 2-8). Of this 69.3 percent, 17.9 percent was planned storage volumes and 51.4 percent was price-lock purchases (Exhs. FGE/RSF-1, at 11; DPU 2-21 n.1). The Company locked in multiple prices for gas supply needed to meet customer requirements each month, except that all of the locked in portion of its gas supply for November 2007 was purchased on July 9, 2007 (Exh. DPU 1-3 Att. (rev.)).

Overall, price-lock and storage purchases for the peak period 2007/2008 totaled 69.3 percent of Unutil's peak period requirements (Exh. FGE/RSF-1, at 11). The price-lock purchases for the 2007/2008 peak period cost \$377,206 more than if the Company had paid NYMEX FOM prices (Exhs. FGE/RSF-2 (rev.); DPU 3-7 Att.). This estimate does not include any costs associated with purchases of gas for underground storage.

D. Peak 2008/2009 Period

As noted above, Unutil put its Purchasing Guidelines in place in January 2008 prior to the start of the 2008/2009 peak period (Exh. DPU 1-2). The Purchasing Guidelines specify that the Company will lock in a percentage of its seasonal baseload requirements each month over a ten-month period starting in November, preceding the peak period (Exh. Att. DPU 1-2(a)). Because the Purchasing Guidelines were not put in place until January 2008, the Company states that it did not conduct price-locks over ten months (i.e., starting in November 2007) (Exh. DPU 3-3). Instead, for the 2008/2009 peak period, the Company locked in one-seventh of its projected peak period requirements each month over

seven months, from February 2008 through August 2008 (Exhs. DPU 3-1(1), tbl. C; DPU 3-3; DPU 3-17).

The Company states that it spread the price-locks as evenly as possible from February 14, 2008 to the end of the purchasing season in August 2008 (Exh. DPU 3-3).⁹ The first purchase for the 2008/2009 peak period was completed on February 15, 2008 (Exh. DPU 3-7 Att.). This was the only date the Company locked in supply for November 2008 (id.).

In addition to locking in its projected peak period requirements for the 2008/2009 peak period by the end of August 2008, the Company locked in additional supply on November 25, 2008 for delivery during the months of January 2009 through April 2009 (Exh. DPU 1-3 Att. (rev.)).¹⁰ The Company explains that its decision to lock in the additional supply during the peak period was based on the following factors: (1) NYMEX prices had declined by approximately 50 percent since July 2008; (2) the Company estimated that it could reduce its total peak period costs by an additional ten to 15 percent when combined with the price-locks already in effect as of November 1, 2008; (3) temperatures for the next 30 to 60 days were forecasted to be below-normal; and (4) the U.S. Energy Information Administration Short-Term Energy Outlook and NYMEX index both indicated an upward price trend for December 2008 through April 2009 (Exhs. FGE/RSF-1, at 11-12; DPU 2-9).

⁹ February 14, 2008 was the effective date of Unitil's supply contracts with Hess Corporation and Virginia Power Energy Market Incorporated (Exh. DPU 3-3).

¹⁰ This purchase was a departure from the Company's newly-established Purchasing Guidelines.

Overall, the total of price-lock purchases for the peak period 2008/2009 and the quantity purchased and placed in storage totaled 77.1 percent of the Company's peak period requirements (Exhs. FGE/RSF-1, at 11; DPU 1-3 Att. (rev.)).¹¹ Of this 77.1 percent, 21.5 percent was planned storage volumes and 55.6 percent was price-lock purchases (Exhs. FGE/RSF-1, at 11; DPU 2-21 n.2). The price-lock purchases for the 2008/2009 peak period cost \$4,270,869 more than if the Company had paid NYMEX FOM prices (Exhs. FGE/RSF-2 (rev.); DPU 3-7 Att.). This estimate does not include any costs associated with purchases of gas for underground storage.

E. Suspension of Price-Locks

After the Department issued its Order opening this investigation on March 12, 2009, the Company suspended the practice of locking in prices except as necessary to fill storage (Exh. FGE/RSF-1, at 10). Fitchburg Gas and Electric Light Company d/b/a Unitil, D.P.U. 09-42, Request for Approval of a Gas Purchasing Plan at 3 (May 11, 2009). On May 11, 2009, the Company requested Department approval of a gas purchasing plan intended to mitigate price volatility, which is currently under investigation in D.P.U. 09-42.

¹¹ This percentage includes the November 25, 2008 price-lock purchase discussed above. Based on the Company's forecasted gas needs as of August 2008, the price-lock purchases plus storage purchases made prior to the start of the peak period totaled 65.1 percent of the Company's peak period requirements. The Company's forecast for its gas needs changed after it completed the price locks so that the price-lock plus storage purchases ended up totaling 70 percent of its gas requirements for the peak period (Exhs. FGE/RSF-1, at 11; DPU 3-1). When the gas volumes purchased on November 25, 2008 are added to the price-lock purchases made prior to the peak period, the total percentage of price-lock plus storage purchases for the peak period is 77.1 percent.

IV. POSITIONS OF THE PARTIES

A. Requirement of Prior Department Approval of Purchasing Program

1. Company

The Company argues that it did not have a legal obligation to obtain Department pre-approval of its purchasing program (Company Brief at 6, 21, 42). The Company contends that the Department's Order in D.T.E. 01-100-A does not require prior approval of gas purchasing programs unless financial instruments are used to effectuate the purchases¹² (id. at 13). The Company argues that in D.T.E. 01-100-A, the Department distinguished between traditional forms of risk management (e.g., storage through the use of physical gas purchases and forward contracts) and modern risk-management functions which use financial instruments (id. at 16, citing D.T.E. 01-100-A at 2). Because the Company contends it only used physical gas purchases and forward contracts, and not financial instruments, it argues that D.T.E. 01-100-A does not mandate prior approval of its forward purchasing strategy (id.).

Unitil further argues that nothing in the Department's subsequent Letter Orders approving the purchasing programs of KeySpan Energy Delivery ("KeySpan"), NSTAR Gas Company ("NSTAR Gas"), or New England Gas Company ("NEGC") modified D.T.E. 01-100-A such that it was necessary for Unitil to obtain Department approval of its

¹² The Company acknowledges that Department approval would be required if it wanted to offer a fixed-price option whereby a limited number of customers elect to pay a premium to be part of a program where the price of gas over the peak period does not change with market prices (Company Brief at 15-16, citing New England Gas Company, D.P.U. 08-31, Stamp-Approval (2008); NSTAR Gas Company, D.T.E. 06-66, Stamp-Approval (2006)). Unitil's purchasing program is not a fixed-price option program (see Company Brief at 15-16, 16 n.5).

purchasing program (id. at 17-20, citing D.T.E. 06-3, at 2; D.T.E. 04-63, at 2; D.T.E. 03-85, at 5 n.2, 6). Specifically, the Company argues that in the Order approving KeySpan's purchasing program, the Department reiterated the difference between mitigating volatility through (1) gas purchases using financial derivatives and (2) changing the timing of physical gas purchases (id. at 18, citing D.T.E. 03-85, at 5 n.2). Unless KeySpan was planning to use financial derivatives to mitigate price volatility, Unitil contends that KeySpan did not need Department approval of its purchasing program (id. at 17, 18, citing D.T.E. 03-85, at 6). By contrast, Unitil argues Department approval of the NSTAR Gas purchasing program was required pursuant to D.T.E. 01-100-A because NSTAR Gas proposed to use financial instruments to lock in prices (id. at 19, citing D.T.E. 04-63, at 2). Finally, the Company argues that although NEGC did not propose to use financial instruments to mitigate price volatility, it may have nonetheless been required to seek Department approval of its purchasing program under G.L. c. 164, § 94A¹³ because it proposed to make physical gas purchases for a term in excess of one year (id. at 20, citing D.T.E. 06-3, at 2).

2. Attorney General

The Attorney General recommends that the Department find that Unitil inappropriately engaged in a gas purchasing program to mitigate price volatility without prior Department approval in violation of the Department's directives in D.T.E. 01-100-A (Attorney General Brief at 4). The Attorney General argues that in D.T.E. 01-100-A, the Department set forth

¹³ General Laws c. 164, § 94A requires Department approval of contracts for the purchase of gas that are in excess of one year in duration.

rules regarding the use of risk management or hedging plans by LDCs operating in Massachusetts (id. at 3). Specifically, the Attorney General states that in D.T.E. 01-100-A the Department directed LDCs seeking to implement risk-management programs to submit a specific plan for Department review and that the burden will be on the LDC to establish that its plan is reasonably designed to meet the objective of price stability (id., citing D.T.E. 01-100-A at 28). Because the purpose of the Company's gas purchasing program was to provide stable commodity prices, the Attorney General argues that Unitil was required to obtain Department approval pursuant to D.T.E. 01-100-A before engaging in its purchasing program (id. at 3-4).

The Attorney General argues that the Department should reject the Company's argument that Department approval of its purchasing plan was not required pursuant to D.T.E. 01-100-A because the Company did not use financial derivatives (id. at 4-5). Given the Department's broad supervisory authority over LDCs under G.L. c. 164, § 76 and the fact that several other LDCs sought Department approval of their purchasing programs pursuant to D.T.E. 01-100-A, the Attorney General contends that Unitil should have sought Department approval of its purchasing program before incurring costs on behalf of ratepayers (id. at 5).

Further, the Attorney General states that there is no support in either D.T.E. 01-100-A or D.T.E. 03-85 for Unitil's assertions that KeySpan either (1) did not need Department approval of its purchasing program or (2) was planning to use financial instruments as part of its purchasing program but did not disclose this to the Department in its petition (Attorney General Reply Brief at 3). Given the absence of specific language in the Department's Order in D.T.E. 03-85 stating that KeySpan could have implemented its plan without Department

approval and that the Department did, in fact, approve KeySpan's purchasing program, the Attorney General contends that the Department's Order in D.T.E. 03-85 was further support that approval of Unitil's program was required pursuant to D.T.E. 01-100-A (id. at 3-4).

B. Prudence of Company Management Decisions

1. Company

The Company contends that, because there was no legal requirement that it obtain approval of its purchasing program, the Department cannot deny cost recovery for expenses incurred in implementing its purchasing program unless the Department determines that the Company's decisions resulted in costs that are excessive, unwarranted, or incurred in bad faith (Company Brief at 12, 24, citing Boston Gas Company v. Department of Public Utilities, 387 Mass. 531, 539 (1982); New England Telephone and Telegraph Company v. Department of Public Utilities, 371 Mass. 67, 79 (1976); New England Telephone and Telegraph Company v. Department of Public Utilities, 360 Mass. 443, 483-484 (1971); Company Reply Brief at 2-3).

The Company argues that there is no evidence to support a finding of imprudence (Company Brief at 23-25; Company Reply Brief at 10-13). Instead, the Company contends the evidence demonstrates that the Company's decisions regarding its purchasing practices were reasonable based on information available at the time of the purchases (Company Brief at 24). Specifically, the Company states that it acted reasonably because: (1) the Company does not benefit from a forward purchasing strategy, and the Company's actions in both the 2007/2008 and 2008/2009 peak periods were undertaken for the direct and exclusive purpose of stabilizing

customer rates—a benefit the Company contends was attained; (2) the Company executed its forward purchases without the use of any type of financial instrument, hedging tool, or financial derivative; (3) in each year, the Company locked in prices by triggering provisions in its physical supply contracts, which had a term of less than one year; (4) the Company disclosed its purchasing practices to the Department in a forecast and supply plan filing prior to the 2007/2008 and 2008/2009 peak periods; (5) the Company locked in gas volumes of 65 to 70 percent of its total peak period gas requirements, including storage; (6) forward purchases were executed for the following peak season; (7) the Company locked in prices through forward purchases executed in systematic increments over a multi-month period; and (8) all forward purchases were executed prior to the upcoming winter period, with the exception of a forward purchase on November 25, 2008, which was made for the specific purpose of taking advantage of substantially reduced prices and forward pricing data did not reveal that this downward price trend would continue (id. at 25).

The Company also argues that its customers were no worse off financially than customers of the three LDCs with Department-approved risk-management programs (i.e., KeySpan, NSTAR Gas, and NEGC) (id. at 3-4, 24, citing Exhs. FGE/RSF-1, at 19-20; FGE/RSF-2 (rev.)). In fact, the Company states that its total gas costs for the nine purchases it made over a nine-week period for the 2007/2008 peak period were \$417,815 lower than the costs would have been had the Company purchased gas using the approaches of KeySpan, NSTAR Gas, and NEGC, in equal installments over ten months (id. at 29, citing Exhs. FGE/RSF-1, at 13-14; FGE/RSF-2 (rev.); DPU 2-14). For the 2008/2009 peak

period, the Company states that this same analysis shows that it paid \$134,971 more in gas costs than it would have if the Company purchased gas using the approaches of KeySpan, NSTAR Gas, and NEGC (id. at 34). As was the case for all LDCs who locked in prices prior to the 2008/2009 peak period, the Company argues that it incurred higher gas costs for the 2008/2009 peak period by locking in prices in advance of the peak period because of substantial and unforeseeable decreases in market prices that occurred during the peak period (id. at 35, citing Exhs. DPU 2-10; DPU 2-11; Tr. at 95-96). Therefore, the Company argues that the evidence shows that its forward purchasing strategy was not out of line with the approaches of LDCs with Department-approved risk-management programs and that the gas costs incurred under its purchasing program were, therefore, prudent (Company Brief at 35).

2. Attorney General

The Attorney General did not take a specific position on the prudence of the Company's actions other than to state that the Department should reject the Company's argument that ratepayers were not harmed by its purchasing program (Attorney General Reply Brief at 5). The Attorney General argues that a comparison of Unitil's gas costs to the gas costs of LDCs with Department-approved risk-management programs demonstrates that ratepayers paid higher gas costs under Unitil's unauthorized purchasing program than ratepayers of LDCs with Department-approved programs (id., citing Exhs. AG 1-7; AG 1-8; AG 1-9). The Attorney General also asserts that ratepayers of KeySpan, NSTAR Gas, and NEGC benefitted from purchasing programs that were, compared to Unitil's plan, more effectively designed both to reduce price volatility and produce lower gas costs (id.).

C. Effect of Prior Disclosure of Risk-Management Program to Department

1. Company

Unitil states that it disclosed its strategy of physical, forward purchases to the Department in its forecast and supply plan filings dated October 31, 2003, September 29, 2006, and September 30, 2008 (Company Brief at 3, 35-37). The Company also states that the Department was made aware of its purchasing strategy through a presentation the Company made at a public hearing held on October 26, 2005 in Unitil's 2005 peak period GAF docket, Fitchburg Gas and Electric Company d/b/a Unitil, D.T.E. 05-GAF-P4 (Company Brief at 38). Unitil contends that the Department's knowledge of its forward purchasing practices indicated to the Company that Department approval of the purchasing program was not required (Exh. FGE/RSF-1, at 20-21). The Company also argues that, because it had previously disclosed its practice of locking in prices in the forecast and supply plan filings as well as at a public hearing, the Department cannot now find that it was acting in bad faith or pursuing any objective other than to protect the interests of its customers (Company Brief at 42).

2. Attorney General

The Attorney General contends that the Department should reject the Company's argument that it received de facto approval of its purchasing program through the Department's approval of the Company's GAF filings (Attorney General Brief at 5-6).

D. Remedy

1. Company

The Company argues that the Department cannot legally impose a remedy that would disallow any of the Company's gas commodity costs because: (1) regulated distribution companies do not require Department pre-approval of supply contracts, commodity prices, or purchasing schedules unless pre-approval is specifically required by statute, regulation, or Department directive; (2) the Company was not required to obtain approval of its program under D.T.E. 01-100-A or under any subsequent Department order; (3) where pre-approval is not required, gas companies must demonstrate that they have exercised prudent business judgment in procuring and managing gas supplies purchased on behalf of customers; and (4) Unitil acted reasonably and prudently at the time decisions were made based on historical experience, prevailing market conditions, published price trends, and Department policy on rate stability and price-volatility mitigation (Company Brief at 2, 4; Reply Brief at 3-4).

Unitil further states that there is no support for the Attorney General's recommendation that the Department disallow \$863,368 in gas costs (Company Reply Brief at 10). According to the Company, the Attorney General's recommendation is not based on a showing that the Company acted imprudently or that the Company violated a legal requirement established by D.T.E. 01-100-A (id. at 10-11). The Company also argues that the Attorney General's proposal to disallow \$863,368 in gas costs unfairly penalizes the Company for not being able to control market prices (id. at 14). Specifically, Unitil states that when it started procuring gas for the 2008/2009 peak period in February 2008 using its newly adopted Purchasing

Guidelines, it began a process to transition to a ten-month period for conducting price-locks so that it could spread out its purchases and increase the number of pricing points for the period (id. at 13). However, when the Company implemented this process, there were only seven months remaining during the price-lock period, requiring the Company to lock in its gas requirements over a seven-month period instead of the ten-month period typically used by LDCs with Department-approved purchasing programs (id.). Unitil contends that this timing difference is significant because gas prices were lower during the three months prior to when it began making purchases and reached historic highs during the seven months that the Company locked in prices (id.). Thus, Unitil contends that it locked in prices only during months when gas prices were higher and, unlike the other LDCs with approved purchasing programs, was not able to take advantage of the lower prices during the prior three months (id. at 13-14). Unitil argues that it cannot control or foresee market prices and that the Attorney General's proposal to disallow \$863,368 in gas costs suggests that the Company did not prudently incur gas costs because it was unable to take advantage of historically low prices (id. at 14).

2. Attorney General

The Attorney General recommends that the Department require the Company to refund \$863,368 to ratepayers in order to partially reimburse its customers for the excessively high gas costs Unitil incurred under its gas purchasing program during the peak GAF periods of 2007/2008 and 2008/2009 (Attorney General Brief at 2). Because Unitil incurred costs in violation of the Department's Order in D.T.E. 01-100-A, the Attorney General recommends that those excess costs be returned to ratepayers (id. at 7). The Attorney General determined

the \$863,368 figure by averaging the gas costs of LDCs with Department-approved purchasing plans during the 2007/2008 and 2008/2009 peak GAF periods and then subtracting Unitil's gas costs during this same period from this amount (id. at 6-8, 8 n.5; Exhs. AG 1-7; AG 1-8; AG 1-9). The Attorney General contends that it is appropriate to refund this amount to ratepayers through the Company's GAF because the Company originally recovered the excess gas costs from ratepayers through its GAFs (Attorney General Brief at 7-8, citing Investigation by the Department of Telecommunications and Energy on Its Own Motion Into Fitchburg Gas and Electric Light Company's Recovery of Costs Related to Gas Inventory, D.T.E. 99-66-A at 26 (2001)).

V. ANALYSIS AND FINDINGS

A. Introduction

The Department is charged with oversight of all gas and electric utilities operating in Massachusetts. G.L. c. 164, § 76; Fitchburg Gas and Electric Light Company v. Department of Telecommunications and Energy, 440 Mass. 625, 634 (2004). Through this general supervisory role, the Department must "ensur[e] that regulated public utility companies provide safe, reliable, and least-cost service to Massachusetts consumers, with minimum impact on the environment." Electric Industry Restructuring, D.P.U. 95-30, at 6 (1995); see 440 Mass. at 634, citing Commonwealth Electric Company v. Department of Public Utilities, 397 Mass. 361, 369 (1986) ("We note that the [Department's] role in guarding the ratepayers' interests and assuring that utility companies are not encouraged to avoid their responsibilities is supported by long-standing decisions in which we have found the legislative

purpose to be protection of ratepayers.”). Pursuant to statute, the Department, among other things, sets rates, pre-approves long-term supply contracts, oversees corporate matters, including the issuance of securities, reviews acquisitions and mergers of utilities, reviews and approves fuel costs and charges, and ensures that utilities fulfill their obligation to serve.

D.P.U. 95-30, at 6, citing G.L. c. 164, §§ 3-33, 69G-69R, 87-94, 94A, 94G, 96, 124-125.

Gas companies procure gas supplies on behalf of their customers, and have a statutory obligation to serve their customers in an efficient and cost-effective manner. D.T.E. 01-49-A at 7, citing G.L. c. 164, § 69I; Cost of Gas Adjustment Clause, D.T.E. 01-09 et seq., at 4 (2001). When gas companies procure supplies in a reasonable and prudent manner, they may recover their costs. Boston Gas Company v. Department of Public Utilities, 436 Mass. 233, 240 (2002). To resolve the issues raised in this investigation, the Department must ultimately determine whether Until’s gas purchasing decisions for the 2007/2008 and 2008/2009 peak periods were prudent.¹⁴

B. Requirement of Prior Department Approval

1. Initiation of Until’s Risk-Management Program

Before reviewing the prudence of the Company’s specific gas purchases during the period under investigation, the Department must first consider whether the Company should

¹⁴ In D.P.U. 09-09 at 3-4, the Department stated that this investigation will inquire into Until’s procurement practices for the period November 1, 2007 through April 30, 2009, which includes the last two peak GAF periods.

have informed and sought approval from the Department of its risk-management program, when it began the program in 2001.¹⁵

Prior to the issuance of the Department's Order in D.T.E. 01-100-A, LDCs purchased gas at either monthly or daily market index prices at the time that the gas was consumed, and were not permitted to purchase gas using techniques aimed to mitigate price volatility.

see also Order Opening Notice of Inquiry on the Appropriateness of the Use of Risk-Management Techniques to Mitigate Natural Gas Price Volatility, D.T.E. 01-100, at 3 (2001) (opening a notice of inquiry into whether LDCs should be permitted to use risk-management tools to mitigate the volatility of natural gas prices); D.T.E. 01-49-A at 7-8 (requiring LDCs to file revised GAFs whenever their gas costs exceed or fall below a threshold level in order to lessen the impact to ratepayers of significant changes in the market prices of gas commodity costs); D.T.E. 01-09 et seq., at 6 (recognizing the need to review the CGAC mechanism to make it more responsive to extraordinary natural gas price fluctuations in light of substantial increases in prices during the winter of 2000/2001); Bay State Gas Company, D.P.U. 98-31, at 27 (1998) ("Although the Department has not permitted the use of risk management tools to reduce costs to ratepayers, we acknowledge that with the evolution of the gas marketplace, the use of various price risk management tools also has the potential to yield gas costs savings with less risk to ratepayers than in the past."). LDCs were, however, permitted to purchase gas during the off-peak period to fill storage to offset peak period

¹⁵ It was during the course of this proceeding that the Department first became aware of the fact that the Company was engaging in this risk-management program as early as 2001 (Exh. FGE/RSF-1, at 4).

demand so long as this method was approved in the Company's long-range forecast and supply plan. See D.T.E. 01-100-A at 2 (noting that a traditional form of risk management includes purchasing gas and placing it in storage to offset winter demand).

Consistent with the gas procurement approach discussed above, prior to implementing its risk-management program on October 1, 2001, Unitil purchased the majority of its peak period supplies at the time the gas was consumed at either FOM or spot market prices (Exhs. FGE/RSF-1, at 4; DPU 1-5; DPU 1-5 Att.; DPU 1-2; DPU 2-3). Although it changed its procurement approach in October 2001, the Company never informed the Department of its new gas purchasing strategy (Exh. FGE/RSF-1, at 4-5, 20; Tr. at 10-13). As a regulated utility company, Unitil seeks to recover its costs for gas procurement from its customers. Before incurring costs under its risk-management program, which it would later seek to recover from its customers, Unitil had an obligation to obtain Department approval of the change in its gas procurement strategy.

Notably, the Company responded to the Department's Notice of Inquiry in D.T.E. 01-100, which sought comment on whether the use of various risk-management tools that could mitigate the volatility of gas commodity prices may be in the public interest. Order Opening Notice of Inquiry, D.T.E. 01-100, at 1 (2001). Unitil filed comments with the Department in January 2002, but never stated that it had deviated from its prior procurement strategy, which involved storing gas in advance of the peak season and supplementing storage with purchases made based on FOM and spot market prices. Order Opening Notice of Inquiry, D.T.E. 01-100 (2001), Response of Fitchburg Gas and Electric Light Company to

Notice of Inquiry (Jan. 14, 2002). As noted above, as a regulated utility procuring gas on behalf of its ratepayers, the Company was required to obtain Department approval of its new purchasing strategy before implementing its program. Further, at a minimum, in its response to the Notice of Inquiry in D.T.E. 01-100, Unitil should have informed the Department that it had already started its program.

2. Department's Order in D.T.E. 01-100-A

a. Background

In D.T.E. 01-100-A at 1-2, 8, the Department found, for the first time, that LDCs may, but would not be required to, implement risk-management programs designed to mitigate the volatility in gas commodity prices. Pursuant to D.T.E. 01-100-A, LDCs are required to file with the Department for review and approval any and all risk-management proposals, including the use of financial risk-management instruments, on a case-specific basis to ensure that they are in the public interest. Id. at 8, 28. The burden is on the LDC to establish that its proposed program is reasonably designed to meet the objective of price stability. Id. at 28. Once the LDC proposes to implement a specific program, the Department stated it will determine the reasonableness of the program and establish parameters on a case-by-case basis.

Id.¹⁶

¹⁶ The Department directed that a proposed risk-management program must: (1) allow customers to volunteer to participate in the plan; (2) maintain the objective of volatility mitigation and price stability rather than the objective of procuring prices below indices; (3) ensure fair competition in the gas supply market; (4) allocate all costs to program participants only; (5) demonstrate the effect that the plan would have on the reliability and transparency of commodity price; and (6) contain no incentive mechanisms. D.T.E. 01-100-A at 28-29. Although not all of these factors will apply

b. Unitil's Risk-Management Program During the Period Under Investigation

Unitil purchased about two-thirds of its gas requirements for the peak periods of 2007/2008 and 2008/2009, including volumes purchased for storage, pursuant to a program that aimed to mitigate price volatility through the use of price-locks (Exh. FGE/RSF-1, at 11-12). From 2007 to 2009, the Company locked in prices for gas delivery at a future date through provisions in the Company's supply contracts that allowed it to convert index commodity prices to locked in prices (id. at 9, 11; RR-DPU-2 Att.; DPU 3-18 Att.; DPU 2-1 Att. (a)-(c)). The Company contends that this strategy did not require Department approval pursuant to D.T.E. 01-100-A or otherwise because it did not involve the use of financial derivatives, such as swaps, futures, or options (Company Brief at 13-16). However, as addressed below, Unitil was engaged in a purchasing program that went well beyond traditional gas procurement (that is, the purchase of physical gas for storage). Furthermore, Unitil was incurring transaction costs to complete the price locks through its risk-management program, akin to the transaction cost that would be incurred using financial derivatives.

Unitil went beyond traditional gas procurement in several respects. First, Unitil was not locking in prices only during the off-peak period, consistent with storage, but was also locking in prices during the peak period (Exh. RR-DPU-2 Att.; DPU 3-18 Att.). Second, the Company was not purchasing physical gas and storing it in advance to meet customer

in every proposed program (i.e., not all programs will have implementation costs that will need to be allocated among only program participants), the Department has found this to be a useful framework when analyzing proposed risk-management programs. D.T.E. 03-85, at 4 n.1.

requirements during the peak period, but was locking in prices for physical delivery at a later date several months into the future (Exh. RR-DPU-2 Att.; DPU 3-18 Att.). For example, on November 17, 2008, the Company locked in prices for gas to be delivered one year later, during each month from November 2009 through April 2010, when the gas was needed to meet customer peak requirements (Exh. RR-DPU-2 Att.). Thus, Unitil was not purchasing gas during the off-peak months to fill its storage in preparation for the forthcoming peak period, but rather was locking in prices for delivery well into the future including peak periods over a year away. Furthermore, it was often locking in these prices during a peak period when the gas prices are typically expected to be relatively high. Third, the Company was locking in supply for a minimum of 69.3 percent of its peak period gas requirements (Exh. FGE/RSF-1, at 11). This amount far exceeds the amount of gas secured through storage by other Massachusetts LDCs, which tends to be about one-third of a company's peak period gas requirements (*id.*). See D.T.E. 03-85, at 1 (purchasing about 32 percent of winter gas requirements for storage); D.T.E. 04-63, at 1 (purchasing about one-third of winter gas requirements for storage); D.T.E. 06-3, at 1 (purchasing about 28 percent of winter gas requirements for storage). Therefore, through its risk-management program, Unitil was not storing gas to offset winter demand or engaging in any other traditional form of gas procurement as permitted by the Department without need for additional approval. Its risk management activities were clearly beyond these types of traditional practices.

Although Unitil was not using financial instruments to effect the price-locks, we find that the Company was nevertheless engaged in a program to mitigate price volatility using

non-traditional risk-management techniques. As such, Unitil was required to obtain Department approval before implementing its risk-management plan. In D.T.E. 01-100-A at 6-7, the Department emphasized the importance of Department review of non-traditional gas purchasing strategies that aim to mitigate price volatility. Because the Department has an obligation to protect the public interest, it is necessary for the Department to review purchasing techniques that deviate from traditional purchasing strategies. See D.T.E. 99-66-A at 24. Because Unitil did not present its risk-management program to the Department for review, we were unable to determine whether the risks being undertaken by Unitil were outweighed by the costs of program implementation, including whether the risks of program implementation were too high given Unitil's supply design, size, and position in the market. See D.T.E. 01-100-A at 6-7. Further, we were unable to assess whether the Company had the necessary expertise to develop and implement a program that was reasonably designed to meet the objective of price stability. See id. at 6-7, 28. Accordingly, we find that before it began incurring costs it would later seek to collect from ratepayers, Unitil was required to obtain Department approval of its risk-management program aimed to mitigate price volatility.

3. Use of Financial Instruments

Unitil asserts that because the language of the Department's Order in D.T.E. 01-100-A distinguishes between traditional forms of gas procurement (e.g., storage through the use of physical gas purchases) and modern risk-management functions, which may involve financial instruments, Department approval of purchasing programs is required only where financial

derivative products are used (Company Brief at 13-14, 16, citing D.T.E. 01-100-A at 2).¹⁷

Nowhere in the Order in 01-100-A, however, does it say that Department approval of a risk-management program is required only when financial derivatives are used. Further, as discussed below, we find that our Order in D.T.E. 01-100-A was sufficiently clear as to put companies on notice that if they wish to deviate from purchasing gas through traditional means for the purpose of mitigating price volatility, Department approval is required.

In light of mounting concerns about natural gas price fluctuations, the Department opened its investigation in D.T.E. 01-100 to consider whether *various* risk-management tools that could mitigate volatility of natural gas commodity costs may be in the public interest. D.T.E. 01-100, at 1. Prior to D.T.E. 01-100-A, LDCs were required to purchase gas using a least-cost strategy and the Department reviewed a company's purchasing practices through a company's forecast and supply plan filing to determine, among other things, whether the plan provided a necessary energy supply for its customers with a minimum impact on the

¹⁷ The Department's Order in D.T.E. 01-100-A states:

A distinction should be made regarding traditional forms of risk-management, which include the use of storage to offset winter demand, through the use of physical gas purchases and forward contracts, and modern risk-management functions, which use financial futures and options contracts to effectuate various forward pricing strategies. For purposes of this Order, both "risk-management" and "hedging" are used interchangeably to mean the use of financial derivative products in combination with physical gas purchases to mitigate commodity price volatility.

D.T.E. 01-100-A at 2 (footnotes omitted).

The Company relies on this language to claim that the Department's Order exclusively applies to the use of financial derivative products (Company Brief at 16).

environment at the lowest possible cost.¹⁸ G.L. c. 164, § 69I. Due to dramatic increases and fluctuations in the price of gas in the 2000/2001 peak winter period, the Department stated that, in certain circumstances, price volatility mitigation could be in the public interest even though this strategy may not be least cost. See D.T.E. 01-100-A at 5-6. The Department stated it would allow, but not require, LDCs to implement a purchasing strategy that aimed to mitigate the volatility in gas prices. Id. at 6. Approval of such risk-management plans was required in order to ensure that they were in the public interest. Id. at 28. Accordingly, the Department established standards by which such risk-management plans would be reviewed on a case-by-case basis. Id.

The directives contained in D.T.E. 01-100-A represented a significant shift in the Department's policy on gas procurement wherein companies could propose to move from traditional methods of gas procurement (i.e., the use of storage to offset winter demand supplemented with gas purchased at FOM or spot market prices) to a purchasing strategy wherein more gas was purchased in advance of the peak winter period for the purpose of mitigating price volatility through forward purchasing strategies and/or financial derivative products. Despite arguing that the Department's directives in D.T.E. 01-100-A were narrowly focused on the use of financial derivatives to mitigate prices, the Company states that it began its own risk-management program (i.e., a program which did not use derivatives), in part, as a result of the broad "policy statement" of D.T.E. 01-100-A in strong support of purchasing

¹⁸ As previously explained, the Department also reviews a company's gas procurement practices through CGAC filings made semi-annually. 220 C.M.R. § 6.00 et seq.

strategies to mitigate commodity price volatility and stabilize prices (Exh. FGE/RSF-1, at 8; Company Brief at 16).¹⁹ Although a significant amount of discussion in D.T.E. 01-100-A involved the various risks associated with using financial derivative products as tools to mitigate price volatility, D.T.E. 01-100-A does not state that Department approval of a risk-management program is required only when financial derivatives are used. Rather, D.T.E. 01-100-A established that, where a company proposes to mitigate price volatility through a program that uses forward gas purchases and/or financial derivatives, such deviation from traditional, least-cost purchasing strategies requires Department approval to ensure it is in the public interest.

In response to the Department's Order in D.T.E. 01-100-A, several LDCs submitted risk-management programs designed to mitigate price volatility for Department approval. D.T.E. 06-3; D.T.E. 04-63; D.T.E. 03-85. Such programs reviewed by the Department are notably similar to Until's risk-management program in that they (1) use forward purchasing strategies in which prices for a portion of the company's seasonal gas requirements would be locked in using the NYMEX futures market and (2) do not use financial derivatives.²⁰

¹⁹ Although Unutil states it began its program, in part, as a result of the Department's Order in D.T.E. 01-100-A, we note that Unutil began its purchasing program on October 1, 2001, a full year before D.T.E. 01-100-A was issued on October 9, 2002 (Exhs. FGE/RSF-1, at 8; DPU 1-2; DPU 2-3).

²⁰ NSTAR Gas proposed to lock in prices through financial contracts with large financial institutions, wherein NSTAR Gas would agree to pay a fixed price for a fixed volume of gas for delivery at a date in the future. The fixed price was to be based on the NYMEX futures price for each month of delivery. D.T.E. 04-63, at 2. Although NSTAR Gas proposed to execute the price-lock purchasing through financial

D.T.E. 06-3, at 2-3; D.T.E. 04-63, at 2; D.T.E. 03-85, at 4-5, modified, D.T.E. 06-65 (approving the Company's request to increase the purchasing period from twelve to 16 months and end the purchasing period by August 31 rather than October 31). The fact that these LDCs interpreted the language of D.T.E. 01-100-A to require them to submit their proposed risk-management programs for Department review demonstrates that Unitil too should have understood that Department approval was required of any risk-management program that deviates from traditional, market-based purchasing. As we have noted above, such approval was required in order to ensure that the proposed risk-management techniques were in the public interest. D.T.E. 01-100-A at 28. Notably, nowhere in these three Orders did the Department state explicitly or implicitly that Department approval of these risk-management programs was not required.

Finally, Unitil argues that language in the Department's Order in D.T.E. 03-85 further demonstrates that pre-approval is only required where financial derivatives are used (Company Brief at 17-18, citing D.T.E. 03-85, at 4 n.1). In explaining the difference between managing the risk of price volatility through forward gas purchases and managing the risk of price volatility through the use of financial derivatives, the Department explained that KeySpan's proposal "amount[ed] to only part of a risk-management plan such as that contemplated in D.T.E. 01-100-A" because KeySpan was only proposing to change the timing of its purchases and not proposing to use financial derivatives. D.T.E. 03-85, at 4 n.1. Contrary to Unitil's

institutions, it stated that it would not incur transactions costs to lock in the prices. D.T.E. 04-63, at 3-5.

assertion, this language in no way suggests that Department approval of a risk-management program is required only when financial derivatives are used. Rather, precisely *because* KeySpan's proposal was part of a risk-management plan such as that contemplated in D.T.E. 01-100-A, the Department reviewed and approved KeySpan's proposal using the standard of review established by D.T.E. 01-100-A. As noted above, the Department would not have committed resources to reviewing a company's proposal if such approval was unnecessary. Further, D.T.E. 03-85 does not suggest that KeySpan could have proceeded with its program without first obtaining Department approval.²¹ Accordingly, for the reasons explained above, we find that Unitil was required to seek Department approval of its non-traditional purchasing strategy under D.T.E. 01-100-A.

4. Costs of Unitil's Risk-Management Program

A further reason that the Company should have sought Department approval of its risk-management program pursuant to D.T.E. 01-100-A is because the Company incurred an additional expense to execute the price-locks, similar to the transaction cost associated with using financial derivatives.

²¹ The Department notes that Unitil was an active participant in D.T.E. 03-85, filing comments wherein it recognized that KeySpan was seeking Department "authorization to implement a change in its natural gas procurement practices. . . . to mitigate price volatility by purchasing in equal amounts each month its normal winter requirements" (Exh. DPU-1). Notably, in its comments Unitil never suggested that KeySpan was not required to obtain Department approval of its risk-management program pursuant to D.T.E. 01-100-A (Exh. DPU-1, at 1; Tr. at 54-55).

A comparison of the prices the Company locked in for the peak periods of 2007/2008 and 2008/2009 to the published settled prices for each lock in date reveals that the prices that the Company locked in during this time period were not the same as the settled NYMEX prices.²² Although NYMEX prices fluctuate throughout the day, it is reasonable to expect that the price paid by the Company, excluding relevant adders, would be no more than the published settled NYMEX futures high price for those dates.²³ The Department notes that, on several occasions, the Company paid prices that exceeded not only the settled NYMEX futures price for the day but also the NYMEX high price for the day.²⁴

Because the Company paid above the published settled NYMEX futures price, the Company incurred an additional cost, or premium, on its supply costs. Although Unitil was not executing its price-locks using financial derivatives which typically have a cost associated with their use, it nonetheless incurred additional costs through its purchasing program. Before incurring such costs, the Company should have sought the Department's approval of its program so that the Department could assess the reasonableness of its purchasing practices and

²² Exhibit DPU 3-18 (att.) contains the prices the Company paid on delivery for gas locked in from 2007 through 2009, including the disaggregation of all relevant adders. An adder is any price factor that causes a change in the NYMEX settled price.

²³ NYMEX publishes on a daily basis the (1) settlement price; (2) high price; and (3) and low price.

²⁴ The locked-in price exceeded the NYMEX high for the day on the following dates: June 29, 2007; July 9, 2007; July 16, 2007; July 23, 2007; July 30, 2007; August 6, 2007; August 13, 2007; August 20, 2007; August 27, 2007; February 15, 2008; April 17, 2008; May 19, 2008; July 18, 2008; and November 25, 2008 (Exhs. DPU 3-18 Att.; DPU-2).

ensure that the additional costs to be incurred would not outweigh the benefits of price stability. See D.T.E. 01-100-A at 6-8.

Despite not seeking Department approval of its purchasing program, the Company paid above-market prices for its gas supply requirements and now seeks to pass these costs on to ratepayers through the CGAC. In D.T.E. 01-100-A at 17, the Department found that if there are additional costs to be incurred under a risk-management program, participation in such risk-management programs must be voluntary, and that any costs associated with such programs can only be passed on to program participants, consistent with the Department's well-established policy on cost-allocation that those responsible for costs incur the costs. Id. at 15, citing Boston Gas Company, D.P.U. 96-50 (Phase I), at 133-134 (1996); Boston Gas Company, D.P.U. 93-60, at 331-337, 410, 432 (1993). Allowing Unitil to pass on these additional costs without Department approval would inappropriately allocate the costs of the Company's risk-management program to all of its ratepayers through the CGAC in violation of the Department's established policy on cost-allocation and the directives contained in D.T.E. 01-100-A.²⁵ See D.T.E. 01-100-A at 15-17.

5. Conclusion

For the reasons explained above, the Department finds that Unitil was required to obtain Department approval of its deviation from traditional gas procurement in 2001. The Department also finds that the Company should have obtained Department approval of its

²⁵ For the other risk-management programs approved pursuant to D.T.E. 01-100-A, none of the LDCs proposed to incur additional costs. D.T.E. 06-3, at 3; D.T.E. 04-63, at 5; D.T.E. 03-85, at 5, modified, D.T.E. 06-65.

risk-management program after the Department issued its Order in D.T.E. 01-100-A, because Unitol (1) used non-traditional purchasing strategies aimed to mitigate price volatility, and (2) incurred additional costs to execute the price-locks that the Company sought to pass on to all of its customers.

C. Prudence of Unitol's Purchasing Decisions

1. Introduction

As discussed above, in D.T.E. 01-100-A the Department established the principle that, under certain circumstances, it may be appropriate for LDCs to use non-traditional risk management techniques (futures purchases and financial instruments) to mitigate the volatility of natural gas prices. The Department established standards for the review and evaluation of any such gas risk-management plans and found that plans consistent with these standards would be deemed to be in the public interest. D.T.E. 01-100-A at 28-29. LDCs with approved risk-management plans still exercise a considerable amount of discretion with respect to the implementation of the plans. However, the fact that the LDC has an approved risk-management plan which has been found by the Department to be in the public interest will serve to narrow the scope and nature of any later prudence review of the LDC's performance under the plan. Specifically, because the Department has previously found the LDC's plan to be in the public interest, any later prudence review would focus on the execution of the approved plan, rather than the broader review of the LDC's planning for and execution of

purchasing decisions. It is this latter type of prudence review that we now must undertake for Unitil.²⁶

Separate from the responsibility of Unitil to seek Department approval of its risk-management program, Unitil is required to plan and execute its gas purchasing decisions in a prudent manner and serve the interests of its customers by purchasing gas in an efficient and cost-effective way. D.T.E. 01-49-A at 7, citing G.L. c. 164, § 69I; see also Boston Gas Company, 436 Mass. at 239-240 (“The rates of a utility can only reflect costs found by the [D]epartment to be reasonably and prudently incurred.”), citing Boston Gas Company, 387 Mass. at 539 (LDCs are “permitted to charge rates which are compensatory of the full cost incurred by efficient management . . . and may not recover costs which are excessive, unwarranted, or incurred in bad faith”); New England Telephone and Telegraph Company, 360 Mass. at 483-484.

In conducting a prudence review, the Department may not interfere with reasonable company judgments made in good faith and within the limits of reasonable discretion. Boston Gas Company, D.P.U. 555-C at 16 (1983). However, the Department is required to determine whether the company’s actions, based on all it knew or should have known at the time, were reasonable and prudent in light of the then-existing circumstances. Milford Water Company, D.P.U. 08-5, at 12-13 (2008), citing Boston Gas Company, D.P.U. 93-60, at 24-25 (1993); Western Massachusetts Electric Company, D.P.U. 85-270, at 22-23 (1986); Boston

²⁶ As a general rule, as long as an LDC has carried out an approved risk-management plan in a prudent manner, the Department would allow it to recover its costs.

Edison Company, D.P.U. 906, at 165 (1982). The Department may not make such a determination based on hindsight judgments. Milford Water Company, D.P.U. 08-5, at 13 n.9, citing Attorney General v. Department of Public Utilities, 390 Mass. 208, 229 (1983); Boston Gas Company, D.P.U. 555-C at 16. Nor is it appropriate for the Department to substitute its judgment for the judgments made by the management of the company. Milford Water Company, D.P.U. 08-5, at 13 n.9, citing 390 Mass. at 229; Boston Gas Company, D.P.U. 555-C at 16. In the sections below, the Department reviews the Company's decisions related to its gas purchases for the 2007/2008 and 2008/2009 peak periods to determine whether such decisions were unreasonable or imprudent, given the Company's obligation to act in the public interest.

2. Speculation

In determining when to lock in a price and corresponding volume of gas, the Company considered market and weather conditions as well as price indicators for anticipated price volatility and upward price trends (Exhs. DPU 2-4; DPU 2-9; AG 1-10). For example, the Company made purchases on November 25, 2008 for delivery in January, February, March, and April of 2009 (Exh. DPU 3-7 Att.). In deciding to make these purchases, the Company reasoned that: (1) prices were about 50 percent lower than they were in July 2008; (2) the average locked-in price for gas purchased on November 25, 2008 was significantly less than the average price the Company paid through price-lock transactions completed prior to the start of the 2008/2009 peak period; (3) temperatures for the next 30 to 60 days were forecasted to be below-normal; and (4) the U.S. Energy Information Administration Short-Term Energy

Outlook and NYMEX index both indicated an upward price trend for December 2008 through April 2009 (Exhs. FGE/RSF-1, at 11-12; DPU 2-9; DPU 2-11).

The Company acknowledges that it could not know whether prices would continue to decline when it decided to lock in additional prices instead of purchasing at FOM or spot market prices (Exh. DPU 2-9). However, the Company anticipated, based on price indicators, that there would be an increase in prices during the peak period, and locked in prices for a significant amount of supply, 107,846 dekatherms (“Dth”), on November 25, 2008 (id.). Unitil made the decision to purchase gas in this manner based on its belief that its locked in prices would be lower than prices in the future.

Regardless of whether Unitil’s belief about price trends later turned out to be wrong or right, the Company inappropriately engaged in speculative purchasing practices in an attempt to obtain below-market prices. In D.T.E. 01-100-A at 6, the Department emphasized that LDCs are not permitted to engage in purchasing practices that attempt to obtain prices below published averages because this may lead to speculative pricing strategies that result in overall higher risk. In order to maintain an objective of price stability, purchases made pursuant to risk-management programs must be made systematically, based on a pre-determined schedule that is followed regardless of changes in market prices. See D.T.E. 01-100-A at 6. By locking in prices based on projections that prices will increase, Unitil attempted to “ ‘beat the market,’ ” which is precisely the type of activity that the Department has directed LDCs not to engage in. Id.; see also Western Massachusetts Electric Company, D.T.E. 06-86, at 14-15 (2007) (companies may not speculate on current or future interest rates by using hedging

instruments as a means to manage the interest rate risk associated with proposed long-term debt issuances). The Department finds that the Company's decision to engage in speculative gas purchases, based on what the Company knew or should have known at the time, was unreasonable and imprudent because it increased the risk of higher costs to customers.

3. Timing of Purchases

The Department has approved risk-management programs in which prices are locked in over a period of twelve to 20 months for approximately 30 to 50 percent of a company's gas requirements, not including gas purchased to fill storage. D.T.E. 06-3, at 2 (approving program in which up to 50 percent of non-storage annual supply is locked in over 20 months); D.T.E. 04-63, at 2 (approving program in which one-third of peak period non-storage supply is locked in over twelve months); D.T.E. 03-85, at 2 (approving program in which one-third of peak period non-storage supply is locked in over twelve months), modified, D.T.E. 06-65 (approving modification to program which increased the purchasing period from twelve to 16 months). The Department has found that purchasing over periods of twelve to 20 months allows a company adequate time to gather multiple pricing points to mitigate the impact of price volatility occurring in any one month because less supply is subject to a high or low pricing point. D.T.E. 04-63, at 5; D.T.E. 03-85, at 4-5. Furthermore, obtaining pricing points for at least twelve consecutive months allows for a market-based average price at the end of the year which ensures that the price charged to customers is reliable and transparent and does not provide customers with distorted price signals. See D.T.E. 01-100-A at 7-8, 7 n.7.

a. Pre-Purchasing Guidelines

For purchases made for the 2007/2008 peak period, the Company did not have any predetermined purchasing plan or written guidelines and, instead, relied on the judgment of four energy traders in the Company's energy contracts department to determine the timing of the purchases as well as the amount of gas to be purchased every month (see Exhs. FGE/RSF-1, at 10-12; AG 1-10; DPU 1-2; D.P.U. 08-73, Tr. at 116). The Company secured 69.3 percent of its 2007/2008 peak period supply requirements, including price locks and storage, over only nine weeks in 2007 (Exhs. FGE/RSF-1, at 11; DPU 3-7 Att.). A nine-week purchasing period could not allow for a sufficient number of pricing points to smooth prices and, thus, mitigate price volatility. See D.T.E. 04-63, at 5 (purchasing gas over a twelve-month period mitigates price volatility because a lesser amount of gas is purchased in any given month); D.T.E. 03-85, at 4-5 (same). For the 2007/2008 peak period, the Department finds that Unitol's decisions to make price-lock purchases (1) without a predetermined purchasing plan to be followed regardless of changes in market conditions, and (2) over a time period that was too short to effectively mitigate price volatility, were unreasonable and imprudent based on all the Company knew or should have known at the time in light of the then-existing circumstances.²⁷

²⁷ In making this determination, the Department is not improperly second guessing the Company's decisions based on what we know now about commodity prices during the period at issue. Locking in supply over nine weeks is insufficient to mitigate the impact of price volatility occurring in any one point in time, and based on prior Department decisions the Company should have known this time period was insufficient at the time it made the purchasing decisions.

b. Post-Purchasing Guidelines

After operating without any written guidelines since it began locking in gas prices to mitigate volatility in 2001, the Company implemented written Purchasing Guidelines in January 2008 which address the period over which the Company was to lock in prices and the amount of gas subject to lock in each month (Exhs. FGE/RSF-1, at 10; Att. DPU 1-2(a); DPU 2-4(2)). Specifically, the Purchasing Guidelines provide that the Company will lock in prices for one-tenth of its peak period baseload requirements each month from November through August preceding the peak period (Exh. Att. DPU 1-2(a)).

Although the Purchasing Guidelines state that the Company will begin purchasing gas for the peak period in the preceding November, the Company did not make any price-lock purchases for the 2008/2009 peak period until February 15, 2008 (Exh. DPU 1-3 Att. (rev.)). The Company secured 77.1 percent of its peak period gas requirements, including price locks and storage, from February 2008 to August 2008 (Exh. FGE/RSF-1, at 11).²⁸ While the seven-month purchasing period allowed the Company to obtain more pricing points than the nine-week purchasing period of 2007/2008, it is nonetheless inconsistent with Department findings on the period of time needed to effectively mitigate price volatility.

See D.T.E. 04-63, at 5 (purchasing gas in equal increments over a twelve-month period

²⁸ The 77.1 percent also includes a purchase in November 2008. The purchases for the 2008/2009 peak period were made over seven months prior to the start of the peak period, from February 2008 through August 2008, and an additional purchase was made in November 2008 for delivery in November 2009 through April 2010 (Exhs. FGE/RSF-1, at 11; DPU 3-7 Att.; RR-DPU-2 Att.).

mitigates price volatility because a lesser amount of gas is purchased in any given month);

D.T.E. 03-85, at 4-5 (same).

The Company contends that it should not be held accountable for the fact that it only made price-lock purchases over a seven month period for the 2008/2009 peak period because its Purchasing Guidelines were not implemented until January 2008 and because its supply contracts were not executed until February 14, 2008 (Company Brief at 31; Exhs. DPU 3-17; DPU 3-3). The Department disagrees. The Company decided when to put its written Purchasing Guidelines in place and when to execute its supply contracts. The fact that the Company did not have written Purchasing Guidelines did not prevent it from being able to make regular, scheduled purchases for the 2008/2009 peak period beginning in November 2008 or other time period that was sufficient to effectively mitigate price volatility. Further, the Company could have suspended its practice of locking in prices for the 2008/2009 peak season and, instead, could have begun executing price-locks prior to the start of the 2009/2010 peak season in order to ensure that it had a sufficient purchasing period to mitigate price volatility. For these reasons, the Department finds that Unitil's decision to lock in gas prices over a seven-month period for the 2008/2009 peak season was unreasonable and imprudent, based on what the Company knew or should have known at the time.²⁹

With only seven months remaining until the scheduled conclusion of the price-lock transactions for the 2008/2009 peak period, the Company locked in prices each month from

²⁹ The Department makes no findings on the risk-management program proposed by the Company and under review in D.P.U. 09-42.

February 2008 to August 2008 to meet its total projected peak period 2008/2009 requirements of approximately 981,331 Dth (Exh. DPU 3-1). However, rather than purchasing in uniform amounts during each of the seven months, which would have equaled 96,816 Dth, the Company made monthly purchases ranging from 83,175 Dth to 117,857 Dth (id.). Therefore, for the 2008/2009 peak period, the Company not only failed to make its price-lock purchases over a full ten months called for in its Purchasing Guidelines, the Company also did not follow the requirement of the Purchasing Guidelines to make uniform purchases in each month. For these reasons, the Department finds that the Company's decision to not implement its price-lock purchases in uniform amounts was unreasonable and imprudent, based on what the Company knew or should have known at the time it made its purchases in light of then-existing circumstances. See D.T.E. 01-100-A at 7-8, 7 n.7.

The Department also finds that the Company did not lock in an adequate number of prices during the time period in which it conducted price-locks. For example, the Company purchased the locked in portion of its gas supply requirements for the months of November 2007 and November 2008 on only two dates, July 9, 2007 and February 15, 2008, respectively (Exh. DPU 3-7 Att.). For the purchase made on February 15, 2008, the Company states that it only considered its total monthly usage and locked in volumes relative to monthly sendout and did not consider locking in at different pricing points (Exh. DPU 3-5). By purchasing a majority of its supply for one month on only one date, the Company's average locked-in price for that month did not reflect the highs and lows of the market sufficient to remove volatility and smooth prices. See D.T.E. 04-63, at 5; D.T.E. 03-85, at 4-5. Based on

all the Company knew or should have known at the time it purchased supply for the 2008/2009 peak period, the Department finds that the Company did not exercise reasonable or prudent business judgment because it did not employ a strategy which locked in a sufficient number of pricing points.

4. Conclusion

For the reasons stated above, and based on the information the Company knew or should have known at the time and in light of the then-existing circumstances, the Department finds that the Company acted imprudently in purchasing supply for the 2007/2008 and 2008/2009 peak periods by: (1) engaging in speculative purchasing; (2) failing to purchase supply over a sufficient period of time at a sufficient number of pricing points; (3) making price-lock purchases without a predetermined purchasing plan; and (4) failing to purchase in uniform increments.

D. Prior Disclosure of Risk-Management Program

Unitil argues that it disclosed to the Department that it was engaged in a physical, forward purchasing strategy in its long range forecast and supply plan (“FSP”) filings dated October 31, 2003, September 29, 2006, and September 30, 2008, and through a presentation the Company made at a public hearing in Unitil’s 2005 peak period GAF docket, Fitchburg Gas and Electric Light Company d/b/a Unitil, D.T.E. 05-GAF-P4 (Company Brief at 3, 35-38). Unitil contends that these disclosures prohibit the Department from now finding that it acted in bad faith or was otherwise imprudent because of its purchasing practices (Company Brief at 35, 42). For the reasons discussed below, we find that Unitil’s statements in its FSP

filings and at the GAF public hearing did not disclose to the Department that it was engaged in a risk-management program to mitigate price volatility. Furthermore, any such disclosure would not absolve the Company of its obligation to obtain prior Department approval of its purchasing plan and to purchase gas in a manner that is consistent with the public interest, nor would it permit the Company to collect gas costs from ratepayers that were not prudently incurred.

1. Forecast and Supply Plan Filings

In both its FSP filings dated October 31, 2003 (“2003 FSP”) and September 29, 2006 (“2006 FSP”), the Company stated that its “entire supply portfolio has commodity prices that are linked to published price indices that allow [Unitil] to lock in the price for any remaining term of the contract by notifying the supplier, confirming the price and committing to receive the volumes of locked in gas in accordance with the terms and conditions of each contract.” Fitchburg Gas and Electric Light Company d/b/a Unitil, D.T.E. 06-83, Company Filing at 86 (September 29, 2006); Fitchburg Gas and Electric Light Company d/b/a Unitil, D.T.E. 03-52, Company Filing at 66 (October 31, 2003). In its 2006 FSP, the Company added that it “periodically locks in a portion of its gas supply pricing under these contract provisions in order to mitigate retail price volatility.” D.T.E. 06-83, Company Filing at 86. These simple statements in the 2003 and 2006 FSPs were general in nature and did not provide any detail regarding the full extent of the Company’s gas purchasing strategy and risk-management program that it had been engaging in since 2001 on behalf of all of its gas supply customers.

Unitil cannot now claim that these two sentences represent full disclosure of a purchasing strategy that went far beyond traditional purchasing techniques.

In its most recent FSP filing on September 30, 2008 (“2008 FSP”), which addresses future gas purchases for Unitil, the Company provided additional details on its price-lock strategy, such as the time period over which the price-locks were to be executed, the purpose of the program, and that it was seeking prices indexed to the NYMEX futures.³⁰

D.T.E. 08-73, Company Filing at 63, 75 (September 30, 2008). The Company contends that, through these statements, it disclosed to the Department that it was purchasing gas using a forward purchasing strategy (Company Brief at 35-37).

³⁰ In its 2008 FSP filing, at 63, the Company states:

The Company periodically locks in a portion of its gas supply pricing under these contract provisions in order to mitigate retail price volatility. For natural gas deliveries beginning November 1, 2009, the Company will lock-in a portion of its expected natural gas requirements over the 10-month period of November 2008 through April 2009. This purchasing program ensures a diversity of pricing points under which [Unitil] is locking in commodity prices in order to prevent exposure to high market prices at a single point in time.

On page 75 of its 2008 FSP filing, the Company further clarifies, “In order to implement its program for locking in natural gas prices, the Company has elected to seek pricing indexed to the NYMEX natural gas futures contract for its baseload requirements in order to provide transparency as the Company locks in the NYMEX portion of the baseload prices.”

The 2008 FSP was under investigation by the Department at the time the Department opened the current investigation.³¹ In fact, the 2008 FSP was the first time the Company provided the Department with any details about its gas purchasing program, such as the specific period over which the Company was executing the price-locks and that the Company was locking in prices based on the NYMEX futures market. Prior to receiving such details, the Department did not know that the Company was executing the price-locks as part of a risk-management program to mitigate price volatility. In fact, as a result of D.P.U. 08-73 and this proceeding, the Company has suspended its purchasing practices until resolution of this matter (Exh. FGE/RSF-1, at 10).

2. GAF Public Hearing

Finally, the Company claims that it disclosed the extent of its gas purchasing practices to the Department at a public hearing. On October 26, 2005, the Department held a public hearing in Fitchburg, Massachusetts on the Company's peak period GAF filing (Exh. DPU 1-1(a) Att. (Supp.) at 1). The Department held the hearing as a result of significant increases in natural gas prices (*id.* at 2). The purpose of the hearing was to allow the public the opportunity to be heard on the Company's proposed gas charges and for the

³¹ Unitil made its 2008 FSP filing on September 30, 2008. D.P.U. 08-73. The Department issued a notice on November 18, 2008, held a public hearing on December 18, 2008, and discovery began on December 18, 2008. An evidentiary hearing was held on April 8, 2009 and a final Order was issued on October 2, 2009. In the final Order approving the 2008 FSP, the Department noted, "Regarding the Company's practice of locking-in prices, the Department opened a separate investigation into this issue on March 12, 2009. D.P.U. 09-09. Subsequent to the issuance of that Order, the Company has ceased locking-in prices pending the outcome of that proceeding (Company Brief at 17 n.17)." D.P.U. 08-73, at 38.

Company to provide information on the causes of the increase in commodity prices, its practices for acquiring gas, as well as managing winter heating costs, energy efficiency programs, and available payment programs and low-income discounts (id.; see also D.T.E. 05-GAF-P4, Notice of Filing, Public Hearing and Customer Information Session at 1 (October 5, 2005)).

At the hearing, George R. Gantz, senior vice-president of Unitil, made a presentation during which he made reference to a chart that illustrated the sources of the Company's gas supply (Exh. DPU 1-1(a) Att. (Supp.), at 4). The Company argues that it disclosed its program to the Department through this presentation and, therefore, the Department cannot find that the Company acted in bad faith or otherwise acted imprudently (Company Brief at 38-40; see also Exh. FGE/RSF-1, at 23).

This disclosure, at a single public hearing in 2005, neither provided sufficient information to the Department to understand the nature and extent of Unitil's gas purchasing practices, nor did or does it insulate the Company from seeking Department approval of a risk-management program. As stated above, the burden is on the gas company to inform the Department of a departure from traditional purchasing practices and seek Department approval.

Unitil's statements regarding its gas purchasing practices, which were among numerous other statements made by the Company at the public hearing, were broad, and in fact would not necessarily be interpreted to represent a deviation from the traditional practice of purchasing physical gas for placing into storage in advance of the peak winter season. In

fact, the Company stated only once that the advance procurements and filling of storage capacity provided a hedge against price increases (Exh. DPU 1-1(a) Att. (Supp.) at 4). The Company's description did not include information on the Company's practice of systematically locking in prices to mitigate price volatility.³²

3. Conclusion

For the reasons explained above, the Department finds that the Company's statements at the 2005 GAF public hearing or through its 2003 and 2006 FSPs were not sufficient disclosure to the Department that it had deviated from traditional gas purchases and were fully engaged in a risk management program.³³ Furthermore, such statements do not absolve the Company of its obligation to obtain Department approval of its risk-management program or to exercise prudent judgment in making its purchasing decisions. Silence on this matter from the Department should in no way be construed as Department acknowledgement or approval of the Company's purchasing program.

³² Additionally, statements made by an Assistant Attorney General from the Utilities Division of the Attorney General's Office present at the hearing suggest that she was unaware that Unitil was purchasing gas pursuant to a program aimed to mitigate price volatility. The Assistant Attorney General stated that Unitil was purchasing gas based on FOM and spot market prices and that NSTAR Gas and KeySpan were the only companies that had, up to that time, proposed programs aimed to reduce price volatility (Exh. DPU 1-1(a) Att. (Supp.) at 8). The Company did nothing to correct the Assistant Attorney General's characterization that Unitil did not have a risk-management program in place.

³³ The Department opened the current investigation shortly after Unitil disclosed the nature and scope of its gas purchasing practices for the first time in its 2008 FSP. Supra, at 49 n.31. Accordingly, the timing of this disclosure cannot insulate the Company from its imprudence in its purchasing practices from November 1, 2007 through April 30, 2009, the period of this investigation.

Consequently, the fact that the Department did not interpret the Company's previous statements in its FSPs and at the GAF public hearing as a notification that it was engaged in a risk-management program cannot immunize the Company from the consequences of having failed to seek approval and having acted imprudently. Fitchburg Gas and Electric Light Company, 440 Mass. at 636, citing LaBarge v. Chief Administrative Justice of the Trial Court, 402 Mass. 462, 468 (1988) (“ ‘[T]he doctrine of estoppel is not applied against the government in the exercise of its public duties.’ ”); Phipps Products Corporation v. Massachusetts Bay Transportation Authority, 387 Mass. 687, 693 (1982); Dorris v. Police Commissioner of Boston, 374 Mass. 443, 449 (1978). Gas companies have an obligation to comply with the law, whether set forth by statute, regulations, or Department directives in adjudicatory proceedings and a company cannot recover from its ratepayers costs incurred imprudently or in violation of a Department directive even if it claims the Department knew of the practices. See 440 Mass. at 635-636. Therefore, even assuming for the sake of argument that Unitil's previous statements to the Department adequately disclosed the nature and scope of its risk-management program, Unitil was still under an obligation to act within the bounds of applicable law and Department precedent and, thus, was required to seek Department approval of its risk-management program pursuant to D.T.E. 01-100-A, and procure its gas supplies in a prudent manner.³⁴

³⁴ Moreover, as discussed more fully in the section below, the fact that the Department did not know that the Company was engaging in a risk-management program until January 2009 does not mean that the Department cannot now remediate any injustices done to ratepayers as a result of the Company's imprudent actions, especially “where it is perpetrated through, and correctable by, a reconciling mechanism” — the CGAC.

Finally, we note that while Unitil vigorously argues that it disclosed its purchasing practices to the Department through its FSP filings and at a service territory public hearing, the Company cannot adequately explain why it failed to disclose its purchasing practices during the D.T.E. 01-100 investigation or in its comments in D.T.E. 03-85, where Unitil was engaged in the very same price-mitigation practices for which KeySpan was seeking Department approval (Exh. DPU-1; Tr. at 53-56; see also section V.B.3, above).

E. Remedy

Having found that Unitil engaged in a risk-management program that required Department approval under D.T.E. 01-100-A, and that Unitil's gas procurement practices for the peak periods 2007/2008 and 2008/2009 were imprudent, the Department must determine an appropriate remedy. The Department has an obligation to protect the public interest, which requires that ratepayers be made whole for any over-collection of costs due to a company's imprudent planning or actions. D.T.E. 99-66-A at 24; see also 440 Mass. at 634 (stating that the mission of the Department is "to protect ratepayers from overreaching by public utilities. . . and prevent overpricing by companies whose product is vital to the conduct of everyday life"), citing G.L. c. 164, § 76.

The Department has found that (1) the Company was not authorized to engage in a forward procurement strategy, and (2) the purchases made by the Company were imprudent.

D.T.E. 99-66-A at 24, aff'd, Fitchburg Gas and Electric Light Company v. Department of Public Utilities, 440 Mass. 625, 636 (2004) (rejecting argument that inventory finance overcharges were reasonable in light of the Department's repeated approval of the Company's CGAC during the relevant period).

Absent these purchases and absent a purchasing program authorized by the Department, Unitil would have purchased gas at monthly or daily market-based index prices at the time that the gas was needed for consumption. This was the Company's practice before it began its purchasing program in 2001, and is how Massachusetts LDCs without Department-approved risk-management programs should procure gas (Exhs. FGE/RSF-1, at 4; DPU 1-5; Att. DPU 1-5). D.P.U. 98-31, at 27 (1998) (noting that, as of 1998, the Department had not permitted the use of risk-management tools to reduce costs to ratepayers); see also D.T.E. 01-100, at 3 (opening a notice of inquiry into whether LDCs should be permitted to use risk-management tools to mitigate the volatility of natural gas prices); D.T.E. 01-49-A at 7-8 (requiring LDCs to file revised GAFs whenever their gas costs exceed or fall below a threshold level in order to lessen the impact to ratepayers of significant changes in the market prices of gas commodity costs). Accordingly, the Department finds that the amount the Company paid in excess of FOM market prices for supply for the 2007/2008 and 2008/2009 peak periods, \$4,648,075, is the amount of supply costs incurred without Department approval and attributable to Unitil's imprudent purchasing practices (Exhs. FGE/RSF-2 (rev.); DPU 3-7 Att.). This \$4,648,075 represents the amount charged by Unitil to its ratepayers in excess of what ratepayers otherwise would have paid during the period under investigation in the absence of a Department-approved risk-management program.

The Attorney General proposed an alternative method for determining the amount to refund ratepayers. The Attorney General recommends that the Department require the Company to refund \$863,368 in order to partially reimburse ratepayers for the excessively

high gas supply costs incurred because of the Company's purchasing decisions (Attorney General Brief at 8). The \$863,368 figure was determined by (1) calculating an amount of commodity costs by applying Unitil's risk-management program to the purchasing programs of LDCs with Department-approved programs;³⁵ and then (2) subtracting the actual commodity costs of Unitil during these same periods from this amount (Attorney General Brief at 6-8, 8 n.4, citing Exhs. AG 1-7, AG 1-8, AG 1-9). The \$863,368 represents an estimate of the additional amount Unitil paid under its risk-management program, on average, compared to the approved risk-management programs of the other LDCs³⁶ (id. at 6-8, 8 n.5, citing Exhs. AG 1-7, AG 1-8, AG 1-9).

We find that it is not appropriate to base the remedy in this case on the average costs of LDCs that had Department-approved programs. The risk-management programs of KeySpan, NSTAR Gas, and NEGC were fully reviewed by the Department and found to be in the public interest in consideration of the proposals and the unique circumstances of each company at the

³⁵ In response to the Attorney General's information requests, in making this estimate Unitil adjusted the total percentage of gas it locked in and the length of time over which it made purchases to account for differences between its program and the programs of LDCs with Department-approved risk-management programs (see Exhs. AG 1-7; AG 1-8; AG 1-9).

³⁶ Alternately, the Company argues that its customers were no worse off financially than customers of the three LDCs with Department-approved risk-management programs (i.e., KeySpan, NSTAR Gas, and NEGC) (Company Brief at 3-4, 24, 29, 34). Specifically, the Company argues that if it had purchased gas using the approaches of KeySpan, NSTAR Gas, and NEGC, it would have paid \$282,844 more for supply over the 2007/2008 and 2008/2009 peak periods (id. at 29, 34). To determine this figure, the Company used what it terms a dollar-cost averaging approach in which it assumed that the LDCs with approved programs purchased on the last day of each month in which they locked in prices (Exhs. FGE/RSF-1, at 13; DPU 2-14).

time of Department review. D.T.E. 06-3, at 5; D.T.E. 04-63, at 7; D.T.E. 03-85, at 6-7, modified, D.T.E. 06-65. Conversely, during the time period under investigation, Unitil's program had not been reviewed by the Department nor found to be in the public interest and, therefore, the Department finds that Unitil should not be given the benefit of assuming implementation of a Department-approved plan which did not exist.³⁷

The Company was authorized to purchase gas at FOM and spot market prices (Exhs. FGE/RSF-1, at 4; DPU 1-5; Att. DPU 1-5). See D.P.U. 98-31, at 27. Therefore, the Department concludes that it is appropriate to base the remedy in this case on the difference between what customers paid and what customers would have paid for gas supplies at FOM market prices, which is \$4,648,075 (Exhs. FGE/RSF-2 (rev.); DPU 3-7 Att.).

Unitil collected the supply costs incurred through the CGAC. Accordingly, the Department finds that the CGAC is the proper mechanism to refund ratepayers. D.T.E. 99-66-A at 25. The CGAC contains a reconciliation mechanism that is intended to ensure that an LDC fully recovers its approved gas supply costs and that only approved gas-related costs are recovered. Id., citing 220 C.M.R. §§ 6.06, 6.08; see also D.P.U. 555-C at 271 (explaining that costs collecting through the CGAC are "subject to refund with interest at the prime rate in the event that any portion of those costs [are] later identified by the Department to be the result of any imprudent action on the part of the Company"). Based on

³⁷ For these same reasons, we find that the approach used by the Company to compare its costs to the costs of LDCs with Department-approved risk-management programs is also inappropriate. See supra, at 55 n.36.

its findings in this Order, the Department finds that the Company shall refund \$4,648,075 in gas costs to ratepayers through the Company's CGAC.

In order to fully compensate the Company's ratepayers, an appropriate carrying charge must be added to the balance. D.P.U. 99-66-A at 28. The Department's CGAC regulations and the Company's CGAC tariff provide that the interest should be calculated based on the Bank of America prime lending rate. 220 C.M.R. § 6.08(2); Fitchburg Gas and Electric Light Company d/b/a Unitil, M.D.T.E. No. 123. Therefore, we direct Unitil to refund to its customers \$4,648,075 with interest applied on the average monthly balances calculated using the monthly weighted average Bank of America prime lending rate through its peak period GAFs. D.P.U. 99-66-A at 28.

In determining an appropriate amortization period, the Department must balance the interests of the Company and its ratepayers, taking into consideration such factors as the amount under consideration for amortization, the value of such an amount to ratepayers based on certain amortization periods, and the effect of the adjustment on the utility's finances and income. Id. at 28-29, citing Barnstable Water Company, D.P.U. 93-223-B at 14 (1994); Fitchburg Gas and Electric Light Company, D.P.U. 84-145-A at 54 (1985); Boston Edison Company, D.P.U. 906, at 244 (1982). Within twenty days of this Order, the Company shall propose the period over which it will make the refund to customers. Such proposal shall consider the factors discussed above.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, it is

ORDERED: That Fitchburg Gas and Electric Light Company d/b/a Unitil shall refund its gas customers \$4,648,075 with interest calculated using the Bank of America prime lending rate through its peak cost of gas adjustment clause filings; and it is

FURTHER ORDERED: That Fitchburg Gas and Electric Light Company d/b/a Unitil shall within twenty days of the date of this Order propose an amortization period over which to refund \$4,648,075 with interest to its gas customers through its peak cost of gas adjustment clause filings; and it is

FURTHER ORDERED: That Fitchburg Gas and Electric Light Company d/b/a Unitil shall comply with all other directives contained in this Order.

By Order of the Department,

/s/

Paul J. Hibbard, Chairman

/s/

Tim Woolf, Commissioner

/s/

Jollette A. Westbrook, Commissioner

An appeal as to matters of law from any final decision, order or ruling of the Department may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Department be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Department within twenty days after the date of service of the decision, order or ruling of the Department, or within such further time as the Department may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.