COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ATMOS ENERGY CORPORATION FOR CONTINUATION OF ITS HEDGING PROGRAM	)))	CASE NO. 2013-00421

ORDER

On December 2, 2013, Atmos Energy Corporation ("Atmos") filed its request for approval to continue its existing gas cost hedging program for five years, through March 31, 2019. Atmos has had a Commission-approved hedging program in place since June 2001. The most recent version of its hedging program was approved in Case No. 2012-00440.[1] In that case, Atmos requested a five-year extension of its hedging program through March 31, 2018. The Commission approved an extension of only one year, instructing Atmos to file no later than November 30, 2013, if it desired to extend its gas cost hedging program past March 31, 2014. On December 2, 2013, Atmos filed its application in this proceeding requesting continued approval of its gas cost hedging program, with no change in the features of its program, through March 31, 2019. Atmos filed with its application certain information required by the Commission in its final Order in Case No. 2012-00440.

On March 10, 2014, the Commission issued an Order in this proceeding approving the continuation of Atmos's hedging program pending the issuance of a final Commission Order. There are no intervenors in this proceeding. Atmos has responded

[1] Case No. 2012-00440, *Application of Atmos Energy Corporation for Continuation of its Hedging Program* (Ky. PSC Mar. 28, 2013).

to one Commission Staff Request for Information. On August 7, 2014, the Commission issued an Order giving Atmos seven days to request a hearing, or otherwise to have this matter submitted for decision. Atmos made no such request, and this matter now stands submitted for Commission decision.

BACKGROUND

On September 12, 2000, the Commission issued an Order initiating Administrative Case No. 384[2] ("Admin. 384") to investigate increases in wholesale natural gas prices which had recently occurred and the impacts of such increases on the retail customers served by Kentucky's jurisdictional natural gas local distribution companies ("LDCs"). In that Order, the Commission identified several specific issues it intended to explore, one of which concerned possible strategies the LDCs could use to mitigate higher natural gas prices. The Commission's January 30, 2001 Order in Admin. 384 referenced the LDCs' indication that, although hedging strategies would not necessarily be a means of reducing prices, they could be used as a means of reducing the volatility in prices. The Commission stated in that Order that the use of storage facilities, performance-based ratemaking, hedging strategies, and budget payment plans were the most prominent approaches identified as ways of mitigating the impact of higher prices on retail customers. The Commission found that the LDCs should be encouraged to pursue these options in order to ensure that all reasonable efforts were being made to provide natural gas service in a cost-effective, efficient manner. It also required each LDC to file a detailed report describing, among other things, the results of

[2] Administrative Case No. 384, *An Investigation of Increasing Wholesale Natural Gas Prices and the Impact of Such Increases on the Retail Customers Served by Kentucky Jurisdictional Natural Gas Distribution Companies* (Ky. PSC Sept. 6, 2001).

an investigation of financial hedging practices that the Commission directed each of the LDCs to perform. The Commission's July 17, 2001 Order in Admin. 384 found that LDCs should consider limited hedging programs as one means of attaining the objectives of obtaining low-cost gas supplies, minimizing price volatility, and maintaining reliability of supply.

DISCUSSION

As mentioned previously, Atmos has had a Commission-approved hedging program in place since 2001. Atmos proposes to continue its hedging activities with no modifications to its currently approved program for five years through March 31, 2019. Atmos's gas cost hedging program is described in its interim (filed within 30 days of the November 1 start of the heating season) and final (filed within 30 days of the end of the heating season on March 31) hedging reports, the most recent interim report having been filed with Atmos's December 2, 2013 application and the most recent amended final report having been filed on July 16, 2014. During the course of the Commission's review of Atmos's pending request for extension of its hedging program, it considered information filed in the record not only of this case and previous Atmos hedging program cases, but also in the records of Admin. 384 and of Atmos's Gas Cost Adjustment ("GCA") cases which reflect Atmos's gas cost rates over the 13 years that Atmos has employed its hedging program. The Commission notes that Atmos's hedging program is not designed to produce the lowest purchased gas cost, but to help stabilize gas costs for customers. This has also been the Commission's primary stated objective, both in Admin. 384 and in past hedging plan cases involving Atmos and other Kentucky LDCs.

Atmos's substantial company-owned gas storage capacity, along with its hedging program, can provide for a majority of its winter gas needs at costs that are not subject to the market pressures that often exist during the winter heating season. In support of its request for Commission approval to extend its hedging program for an additional five years, Atmos provides a discussion of potential changes to the supply and demand for natural gas that could impact gas prices in the future. In response to a Commission Staff request for information, Atmos discussed the colder-than-normal weather and attendant price increases during the winter of 2013-2014, which it said proved that volatility is still occurring in the natural gas market. Because of this, according to Atmos, it is still convinced that that a disciplined hedging strategy is essential risk management for its Kentucky ratepayers with regard to natural gas price volatility.[3]

Based on the evidence of record of this and previous Atmos hedging program cases and that of Admin. 384 and Atmos's GCA cases, and being otherwise sufficiently advised, the Commission finds that Atmos's hedging program should not be extended. In approving only a one-year extension of the program in Case No. 2012-00440, the Commission's expressed concern was that continued low and stable gas prices could obviate the need for financial hedging, and that is the conclusion we have now reached. The Commission finds that current conditions and the outlook for future natural gas supplies and prices are sufficiently different in 2014 from what they were in 2001 to allay our concern regarding the potential adverse impact of price volatility on customer bills. We therefore conclude that it is no longer reasonable to impose the cost attendant to

[3] Response to Item 1 of Initial Request for Information of Commission Staff, filed Jan. 31, 2014.

hedging, to the extent there is net cost rather than net savings, to be passed along to Atmos's customers as part of their gas cost. The Commission takes note that Atmos's hedging activities resulted in gas cost savings to its customers from 2002 through 2005 and during the most recent winter. Otherwise, since it was first implemented, Atmos's hedging program has caused an increase in gas costs that has been passed through to its customers. While this result is not contrary to the goal of decreased volatility, a review of Atmos's GCA rates beginning with the winter of 2008-2009 does not support the need for continued pursuit of that goal through the use of hedging.

Following the winter of 2008-2009, during which time it was approximately $11.00 per thousand cubic feet ("Mcf"), Atmos's GCA rate steadily decreased to approximately $5.00 per Mcf in August through October 2009. Atmos's GCA rate then exhibited volatility in a relatively narrow range between $6.49 per Mcf at the highest and $4.11 per Mcf at the lowest between November 2009 and April 2014. The highest GCA rate since the winter of 2008-2009 was $7.05 per Mcf during the GCA quarter May through July 2014. The volatility and price levels exhibited by Atmos's GCA rates from 2009 to the present are relatively low in contrast to those of 2004 through 2008, which saw GCA rates from $8.22 per Mcf at the lowest to a high of $15.67 per Mcf following Hurricane Katrina. While there is no guarantee that comparable prices and volatility will not recur, current projections from the United States Energy Information Administration's ("EIA") 2014 Annual Energy Outlook indicate prices not to exceed $8.00 per Mcf through 2040 using the reference case and not to exceed $8.15 per Mcf using the High Growth scenario. More importantly with regard to volatility, the trend in price increases is projected by EIA to be gradual and steady in the long run.

As mentioned previously, the Commission's January 30, 2001 Order in Admin. 384 noted that the use of storage facilities, performance-based ratemaking, hedging strategies, and budget payment plans were the most prominent approaches identified as ways of mitigating the impact of higher prices on retail customers. In the case of Atmos with regard to these approaches, it meets approximately one-third of its winter heating requirements from company-owned storage; has a performance-based ratemaking mechanism approved by the Commission; and has a budget payment plan available to its customers. Furthermore, its gas cost is passed through to its customers via a quarterly GCA mechanism, which naturally smooths potential volatility that would otherwise be introduced to customer bills by following the changes in market prices as they occur.

In addition to the factors discussed above that tend to moderate gas cost as it is passed on to Atmos's customers, current trends in customers' natural gas usage and changes in LDC rate design since 2001 also tend to mitigate the impact of gas cost on customer bills. EIA's 2014 Annual Energy Outlook indicates a gradual decline through 2040 in residential customers' use of natural gas for space heating. Atmos also projected decreasing residential usage in its most recent rate case, Case No. 2013-00148,[4] in which it noted that its ten-year trend of customer usage showed an average decline in use of approximately 0.9 Mcf per year per residential customer for the period ending in 2012. The documented historical trend of declining sales and projections for the trend to continue into the future have been two reasons the Commission has approved increasingly higher monthly customer charges for gas utilities. This is

[4] Case No. 2013-00148, *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC Apr. 22, 2014).

important to note when considering the future volatility of gas cost as it is translated into monthly bills for Atmos's customers. Since 2001 when the Final Order in Admin. 384 was issued, Atmos's residential customer charge has risen from $7.50 to $16.00 per customer per month. The collection of more of Atmos's revenue requirement through the fixed monthly customer charge, as customers are using fewer volumes to which the GCA rate will be applied, provides a stabilizing impact on bills in and of itself.

While the Commission finds that any future benefit to customers in terms of reduced volatility does not appear to be sizable enough to justify extension of the hedging program, we also find that Atmos has made every reasonable effort to comply with the express direction contained in the Commission's Orders in Admin. 384. The Commission commends Atmos for those efforts.

IT IS THEREFORE ORDERED that:

1. Atmos's request to extend its hedging program is denied, and it shall cease hedging activities as of the date following the date of this Order.

2. Atmos shall reflect in its GCA applications the net cost and benefits of its approved hedging activities associated with its natural gas procurement and supply performed through the date of this Order for the winters of 2014-2015 and 2015-2016.

By the Commission

ENTERED
SEP 18 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

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