Columbia Gas® of Kentucky
A NiSource Company
P.O. Box 14241
2001 Mercer Road
Lexington, KY 40512-4241

December 13, 2007

RECEIVED
DEC 13 2007
PUBLIC SERVICE COMMISSION

Ms. Beth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P. O. Box 615
Frankfort, KY 40602

RE: New Case – ***In the Matter of Columbia Gas of Kentucky, Inc. to Extend its Gas Price Hedging Plan*** 2007 00517

Dear Ms. O'Donnell:

Columbia Gas of Kentucky, Inc. hereby submits and original and ten copies of its application in the above matter.

If you have questions, please don't hesitate to contact me at 859-288-0242 or jmcoop@nisource.com.

Sincerely,

Judy M. Cooper
Director, Regulatory Policy

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DEC 13 2007
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:	)	
	)	
THE APPLICATION OF COLUMBIA GAS OF KENTUCKY, INC. TO EXTEND ITS GAS PRICE HEDGING PLAN.	)	Case No. 2007-00517

APPLICATION OF COLUMBIA GAS OF KENTUCKY, INC.

The petition of Columbia Gas of Kentucky, Inc. ("Columbia") respectfully states:

(a) That applicant is engaged in the business of furnishing natural gas service to the public in certain counties in the Commonwealth of Kentucky, pursuant to authority granted by the Commission.

(b) That Columbia's full name and post office address are:

Columbia Gas of Kentucky, Inc.
2001 Mercer Road
P.O. Box 14241
Lexington, KY 40512-4241

(c) That Columbia's Articles of Incorporation have previously been filed with the Commission in Case No. 2000-129 and are incorporated herein by reference.

(d) That by this Application Columbia seeks authorization to extend its gas price hedging plan, for the reasons described below. The purpose of this request is to continue to employ hedging strategies to mitigate the potential adverse impacts of winter period natural gas price spikes, minimizing price volatility and maintaining reliability of supply.

(e) In Administrative Case No. 384, the Commission directed Kentucky's major gas distribution utilities to consider hedging options in response to significant price spikes and volatile gas prices experienced during the 2000-2001 heating season. *An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of Such Increases on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies*, Administrative Case No. 384, Order (January 30, 2001). As an outgrowth of that case, the Commission engaged The Liberty Consulting Group ("Liberty") to conduct a focused management audit of the gas procurement practices of the major gas utilities. In Liberty's final report with regard to Columbia's gas procurement practices Liberty recommended that Columbia work with the Commission and others "to establish a common foundation of objectives for natural gas hedging programs." Final Report, Audit of Five Major Kentucky Gas Local Distribution Companies Presented to the Kentucky Public Service Commission by The Liberty Consulting Group, November 15, 2002, Recommendation No. A.3.3. at page A.3.9. Subsequent to the issuance of the Commission's Order in Administrative Case No. 384, the Commission has approved various forms of hedging programs for all five of the major Kentucky gas utilities, including Columbia.[1]

(f) As part of its Application filed in Case No. 2004-00462, filed on November 30, 2004, Columbia proposed its initial Gas Price Hedging Plan ("the Plan") for a three-year period. The Commission approved Columbia's proposal in an Order dated March 29, 2005. Under the initial Gas Price Hedging Plan, Columbia was authorized to hedge gas supplies through the winter of 2008-2009. However, in order to hedge gas supplies for subsequent winters, the Commis-

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[1] *In the Matter of: the Application of Louisville Gas and Electric Company to Implement a Natural Gas Supply Hedge Plan,* PSC Case No. 2004-00198, Order (August 6, 2004); *In the Matter of: the Final Report of Atmos Energy Corporation on its Hedging Program for the 2003-2004 Heating Season and Motion to Conduct a Hedging Program for the 2004—2005 Heating Season*, PSC Case No. 2004-00142, Order (July 20, 2004); *In the Matter of: the Application of Delta Natural Gas Company, Inc. for Commission Approval of a Natural Gas Purchasing Plan to Mitigate Price Volatility*, PSC Case No. 2003-00172, Order (August 4, 2003); *In the Matter of: the Application of*

sion must authorize Columbia to extend the Plan. This authorization is needed as soon as possible because now is the time that Columbia, pursuant to the rules of an extended Plan would be able to hedge gas supplies for the winter of 2009-2010.

(g) In its 2004 Application, Columbia recommended, and received approval, for the Plan to be implemented as a pilot so that the last month where gas costs could be impacted by hedging under the Plan is March 2009. This meant that the last month in which a future contract might be triggered under the pilot would be October 2008. It also meant that the last time that new Trigger Prices would be developed for a new future winter season would be November 2006 for the 2008-2009 winter. As a result, beginning with November 2007, Columbia did not develop or implement Trigger Prices for the winter of 2009-2010, which would have been the case had the Plan not been limited in duration. In order to adopt the new Trigger Prices and begin hedging the winter of 2009-2010, the Commission must approve an extension of the Plan. Columbia therefore proposes the Plan be extended for three years. If so extended, the last winter month to be hedged pursuant to the Plan would be March 2012, and the last month in which a hedge could be placed on that winter period would be October 2011.

(h) Columbia is not recommending any revisions to details of the Plan itself at this time. The Plan sets forth the rules that Columbia would continue to follow in setting, in advance, gas purchase prices on a portion of Columbia's winter period gas supply requirements. The purpose of the Plan continues to be to reduce the impact that potentially dramatic winter price spikes can have on the Gas Cost Adjustment price and to promote a level of price certainty and stability for Columbia's winter season gas supply.

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the Union Light, Heat and Power Company for Approval of a Natural Gas Purchase Hedging Plan for the 2003-4004 Heating Season, PSC Case No. 2003-00151, Order (June 19, 2003).

(i) The Plan provides Columbia with the ability to provide a more diversified portfolio approach to the pricing of its gas purchases. The approach to setting future prices described in the Plan is designed to make up only one portion of Columbia's gas price portfolio. Columbia continues to recognize the importance of buying a portion of its supply at winter market price, and of buying gas in the summer at market prices for injection into storage, for use during the following winter.

(j) Under the Plan, Columbia fixes price on a portion of its gas purchase volumes that are required in future winter periods. Columbia may implement the Plan through the direct use of New York Mercantile Exchange ("NYMEX") gas futures contracts or through over the counter financial contracts ("futures contracts"). As an alternative, Columbia has the ability to set prices by negotiating fixed prices in physical gas supply contracts with suppliers.

(k) Columbia's Plan is well-documented and incorporates a measured, rules-based approach to diversifying the pricing of Columbia's gas supply portfolio. In order to implement the hedging program using financial contracts, Columbia has set up a specific account with a broker that carries out Columbia's instructions. The Energy Supply Services ("ESS") Department, which is responsible for acquiring Columbia's gas supply, has experience in this process. Equally important and critical in the use of financial derivatives is a carefully managed and controlled corporate risk management program. In addition to the Columbia Gas of Kentucky Gas Price Hedging Plan, the NiSource Corporate and the ESS Risk Management Policy clearly define a set of procedures that must be followed in order to properly monitor and control the use of derivatives. By adhering to these procedures, ESS ensures that all hedging programs will be executed in a controlled and compliant environment.

(l) The initial Plan was and in place for the winters of 2005-2006, 2006-2007, 2007-2008, and will remain in place for the winter of 2008-2009. During this time, the Plan has been implemented without problem and has worked according to expectations. In effect, the volumes purchased by Columbia during the winter at current market prices has been reduced and replaced with hedged prices triggered during the prior twenty-four month period pursuant to the Plan. There has been no change in circumstances that would cause Columbia to recommend changes to the Plan at this time. Therefore, Columbia is recommending the extension occur without modification to the Plan itself.

(m) Columbia's Plan operates as follows. Initially, a historically based Benchmark Price is derived from winter period price information. Trigger Prices are then determined based on the Benchmark Price. When the NYMEX winter strip price is less than or equal to a Trigger Price, Columbia will set the price on specified gas quantities that are to be purchased in those future winter months. Each Trigger Price has a specified quantity of Columbia's winter gas purchase requirements associated with it. If, by a specified date, prices have not been set on a specified minimum gas quantity, then Columbia will set the price on a predetermined volume so that a minimum level of price diversification is in place for each winter. The Plan, which provides a more detailed description, is attached hereto as Attachment A.[2]

(n) The Plan provides for a two-year window period in which prices may be fixed for a given winter. For example, under this Plan, as of November 1, 2006, Columbia had the ability to hedge prices for the winter period November 2008 through March 2009. This window period provides Columbia a much better chance that futures prices will drop to the point of allowing

[2] The copy of the Plan attached hereto as Attachment C is a redacted copy of the Plan, because Columbia considers the Trigger Price information to be confidential and proprietary. Simultaneously with the filing of this Application, Columbia is filing a motion that seeks confidential treatment of this type of information in the Plan.

prices to be set using the Plan's Trigger Prices than would a Plan with a shorter window in which to price supplies. Columbia proposes that the use of gas futures contracts be accepted as appropriate tools for Columbia to use for hedging its system supply gas prices, where the resulting costs would be considered part of the normal definition of gas costs.

(o) If Columbia's request to extend the Plan is approved and implemented, the results of the purchase and sale of the NYMEX contracts would continue to be treated as credits or debits to gas cost to be recovered in the GCA process in the same way that Columbia recovers other gas cost charges received from gas suppliers and pipelines. The resulting gains and losses from the settlement of the NYMEX futures contracts will continue to be specifically tracked and accounted for as part of Columbia's purchase gas cost adjustments. The resulting credit or debit to gas costs will include all transaction fees and other brokerage fees associated with buying and selling natural gas futures contracts.

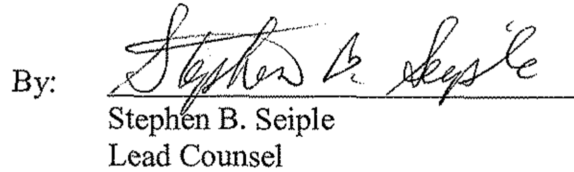
(p) Columbia recognizes however, that without a full understanding by interested parties of the concepts and purpose of such programs, disagreements over gas cost may occur eventually. Only after the Commission approves the extension to the Plan would Columbia move forward to implement it. Upon such approval, Columbia would implement the Plan based upon the Trigger Price calculations as described in the Plan. The only deviation from the original design of the Plan would be that instead of implementation on November 1, 2007 for the winter of 2009-2010, Columbia would implement such hedging immediately after Commission approval of the extension requested herein.

(q) Columbia will continue to file reports with the Commission on the same schedule as set forth in the Commission's Order dated March 29, 2005, in Case No. 04-00462.

Dated this 13th day of December 2007.

Respectfully submitted,

COLUMBIA GAS OF KENTUCKY, INC.

By: 

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ATTACHMENT A

GAS PRICE HEDGING PLAN

(redacted version; unredacted version filed along with Petition for Confidential Treatment)

CONFIDENTIAL DOCUMENT

Columbia Gas of Kentucky, Inc.
Gas Price Hedging Plan

November 30, 2007

This Gas Price Hedging Plan ("Plan") sets forth rules that Columbia Gas of Kentucky, Inc. ("Columbia") will follow in setting gas purchase prices in advance on a portion of Columbia's winter period gas supply requirements in advance. The remainder of Columbia's winter period gas purchases will continue to be closely linked to winter market prices. Implementation of the Plan is intended to reduce the impact that potentially dramatic winter price spikes could have on the Gas Cost Adjustment price and to promote a level of price certainty and stability for Columbia's winter season gas supply.

Columbia will follow this Plan when setting natural gas prices for future deliveries of gas purchased to meet a portion of its firm demand requirements. This Plan includes the following sections.

- OVERVIEW
- PRICE
- VOLUME
- TIMING
- FIXED PRICE METHOD
- RECOVERY OF GAS COSTS
- ADMINISTRATION & CONTROLS
- IMPLEMENTATION

OVERVIEW

This Plan is intended to provide Columbia with the ability to provide a more diversified portfolio approach to its gas purchases. By engaging in a more diversified pricing approach, Columbia can reduce the impact that winter price spikes can have on its customers' bills. The approach to setting future prices described in this Plan is designed to make up only one portion of Columbia's gas price portfolio. As part of its portfolio, Columbia continues to recognize the importance of buying a portion of its supply at the then current market price, and of buying gas in the summer at market prices for injection into storage, for use the following winter.

Under this Plan, Columbia will set a fixed price on a portion of its gas purchase volumes that are required in future winter periods. Columbia may implement this Plan through the direct use of New York Mercantile Exchange ("NYMEX") gas futures contracts or through over the counter financial

contracts ("futures contracts"). Columbia may also set prices by negotiating fixed prices in physical gas supply contracts with suppliers.

This Plan incorporates a measured, rules based approach to diversifying the pricing of Columbia's gas supply portfolio. Initially, a historically based Benchmark Price is derived from winter period price information. Five Trigger Prices are then determined based on the Benchmark Price. Columbia will set the price on specified gas quantities that are to be purchased in future winter months when the NYMEX winter strip price is less than or equal to a Trigger Price. Each Trigger Price has a specified quantity of Columbia's winter gas purchase requirements associated with it.

If, by a specified date, prices have not been set on a specified minimum gas quantity, then Columbia will set the price on a minimum volume so that a minimum level of price diversification is in place for each winter.

PRICE

Two specific types of pricing data are used to develop the Benchmark Price. One set of data, called the Historic Strip Price, represents a futures market view of the specific winter period for which gas is to be priced. The second type of price data, called the Historic Settlement Price, represents the market price of gas bought and sold in past winters.

The Historic Strip Price equals the average of the NYMEX closing prices during a specific window period for the future winter period in question. The window period begins on the first trading day that the NYMEX gas futures contract for delivery during the last month of the future winter period is listed as the [redacted] contract month among all available NYMEX gas futures contracts. The window period ends on the last trading day that the NYMEX gas futures contract for delivery during the first month of the future winter period is listed as the [redacted] contract month among all available NYMEX gas futures contracts. Determining the Historic Strip Price in this manner results in a window period for triggering prices that is [redacted] years in length, beginning in the November [redacted] years prior to the winter period in question, and ending on the last day of trading for the winter in the October immediately prior to the winter period.

The Historic Settlement Price shall be determined at the same time as the Historic Strip Price and is the average of the final NYMEX price, or settlement price, for each month of the [redacted] prior winter periods. Since there is only one settlement price for each futures contract, this involves only the simple averaging of [redacted] prices, those being the [redacted] winter month prices over the previous [redacted] winters.

The Benchmark Price is the simple average of the Historic Strip Price and Historic Settlement Price, and is calculated each November, when a Historical Strip Price for a new winter period can be calculated. Therefore, the Benchmark Price incorporates expectations for the specific future winter period in question, as well as actual historic winter month prices.

Once the Benchmark Price is established, five Trigger Prices will be calculated, each as a percentage of the Benchmark Price, so that they create a group of prices situated around the Benchmark Price. The Trigger Prices will be equal to [redacted] and [redacted] of the Benchmark Price. The Trigger Price, therefore, can be considered the maximum price in a price band that is [redacted] percent wide, with each price band being symmetrically situated around the Benchmark Price.

Trigger Prices will be compared to the winter strip price of the futures contracts for the winter in question. When the winter strip price is equal to or lower than a Trigger Price, Columbia will set the price on gas quantities equal to the Volume Band associated with that Trigger Price.

VOLUME

Forecasts of non-storage firm demand will be developed and incorporated into the implementation of the Plan once each year. If a forecast of non-storage firm demand for a future winter period changes, Columbia will, if necessary, adjust the size of unused Volume Bands to limit the total volume hedged to [redacted] of its non-storage firm demand.

If changes in the non-firm demand forecast or changes in actual consumption changes such that Columbia has set the price on a quantity greater than [redacted] of the non-storage firm demand, Columbia will hold that position as originally planned, throughout the Plan timetable.

The gas quantity associated with each Trigger Price is a Volume Band. Each Volume Band will be equal to [redacted] of Columbia's non-storage firm demand, rounded to the nearest quantity that will allow for the purchase of an equal number of futures contracts for each of the five winter months.

The first Volume Band will be matched to the highest Trigger Price, the second Volume Band will be matched up with the second highest Trigger Price, and so on through the [redacted] Volume Bands and [redacted] Trigger Prices. When setting the price on a Volume Band, equal quantities will be set for each month of the winter period, with the total five-month quantity being equal to the Volume Band.

If Columbia elects to set prices by negotiating prices in physical gas supply contracts with suppliers, it will first determine the minimum base load demand for each month of the winter. Columbia will not fix the price on volumes in this manner to the extent that such volumes would exceed the minimum base load demand for any month in the winter period.

TIMING

Prices for a winter period may be set beginning in the November, [redacted] years prior to the winter period, when the Benchmark and Trigger Prices are established, and may continue through the last day on which the five-month strip trades for that winter, which will be near the end of the October immediately preceding the winter period being hedged.

If, by the end of the April immediately preceding the winter period, Columbia has not set the price on at least [redacted] of the non-storage firm demand, Columbia will set the price on [redacted] of the shortfall below [redacted] in each of the months of [redacted] of that same year. This will assure that a minimum level of hedging takes place. Volume Bands priced to meet the minimum level of price diversification will not be associated with specific Trigger Prices. If, subsequent to the triggering of transactions for the purpose of meeting the minimum level of price diversification, but before the end of the window period for triggering prices, the future winter strip price drops below the next applicable Trigger Price(s), then additional transactions will take place up to [redacted] of the forecasted non-storage firm demand.

FIXED PRICE METHOD

Columbia will use a fixed price method, as opposed to other methods such as collar prices or ceiling prices, for all volumes priced under this plan. The fixed price method may involve the purchase and ultimate sale of natural gas futures contracts. The purchase of such futures contracts will occur when winter futures strip prices are lower than a Trigger Price as described above. The sale of the futures contract occurs immediately prior to the contract month, at approximately the same time that physical spot prices are traded for that month.

In lieu of the purchase and sale of natural gas futures contracts, Columbia may fix the price of a physical supply through direct negotiation with the gas supplier. In this case, the negotiated fixed price will normally take the place of a market index price in a firm gas supply contract. If Columbia elects to fix prices on a portion of its supply by negotiating prices in physical gas supply contracts with suppliers, Columbia will commit to a price based on the then-current futures price that meets Plan requirements. As is the case when hedging with futures contracts, hedging the basis is not part of Trigger Price calculation. However, in order to complete a physical price hedge, Columbia will negotiate basis for the contractual delivery point location prior to delivery of the gas.

RECOVERY OF GAS COSTS

When setting prices using gas futures contracts, all costs associated with the purchase and sale of those financial trades will be treated as gas costs for purposes of recovery through the Gas Cost Adjustment mechanism in Columbia's tariff. Financial product-related costs shall include, but not be limited to, the cost of the futures contracts, the sale price of the futures contracts (as a credit), broker commission fees and premiums, transaction execution costs, margin account interest, monthly service fees, and other similar external account related fees and charges.

When setting prices with physical gas supply contracts, the supplier includes all related transaction costs in the gas price.

ADMINISTRATION & CONTROLS

All price setting will conform to the Plan. A decision to vary from the Plan will be made only if confirmed in writing by the Vice President of Energy Supply Services. All appropriate and relevant information necessary to provide a clear audit trail will be maintained. Documentation will be kept showing the determination of the Benchmark, Settlement, Strip, and Trigger Prices. Records will be kept showing when prices are set, the volumes involved, along with other relevant information that defines the transaction. If prices are set using futures contracts, those transactions will be completed within an account unique to Columbia's Gas Cost Adjustment hedges. Columbia will monitor data and information pertaining to implementation of the Plan and associated transactions on at least a monthly basis.

IMPLEMENTATION

Columbia will implement this Plan only following approval by the Kentucky Public Service Commission ("PSC"). When all of the necessary approvals have been obtained, Columbia will initiate the Plan using the historic data that would have been used as if the Plan had been in place all along. If for example, the Plan were to be approved on January 15, 2008, Columbia would calculate Benchmarks and Trigger Prices for the winter of [redacted] as if those calculations had taken place in November of [redacted].

If this Plan is terminated at any point in time as a result of actions taken by the PSC, Columbia will cease implementation of further price setting, and will request direction from the PSC and other interested parties regarding the appropriate timing of the sale of futures contracts already acquired at that time for future winter periods.