COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF COLUMBIA GAS OF	)	
KENTUCKY, INC. TO EXTEND ITS GAS	)	CASE NO.
PRICE HEDGING PLAN	)	2013-00354

ORDER

On September 25, 2013, Columbia Gas of Kentucky, Inc. ("Columbia") filed its request for approval to continue its existing gas cost hedging program for three years. Columbia has had a Commission-approved hedging program in place since March 2005. The most recent version of its hedging program was approved in Case No. 2010-00365.[1] There are no intervenors in this proceeding. Columbia has responded to two Commission Staff Requests for Information. On August 7, 2014, the Commission issued an Order giving Columbia seven days to request a hearing, or otherwise to have this matter submitted for decision. Columbia 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

[1] Case No. 2010-00365, *Application of Columbia Gas of Kentucky, Inc. to Extend its Gas Price Hedging Plan* (Ky. PSC Nov. 23, 2010).

[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).

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 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, Columbia has had a Commission-approved hedging program in place since 2005. Columbia proposes to continue its hedging activities with no modifications to its currently approved program for three years through March 31, 2018. Columbia's gas cost hedging program is described in its application and the

results are detailed in its initial (filed within 30 days of the November 1 start of the heating season) and final (filed annually on June 1) hedging reports, the most recent initial report having been filed November 26, 2013, and the most recent final report having been filed on June 2, 2014. During the course of the Commission's review of Columbia's pending request for extension of its hedging program, it considered information filed not only in the record of not only this case and previous Columbia hedging program cases, but also in the records of Admin. 384 and of Columbia's Gas Cost Adjustment ("GCA") cases which reflect Columbia's gas cost rates over the nine years that Columbia has employed its hedging program. The Commission notes that Columbia's hedging program is not designed to produce the lowest purchased gas cost, but to reduce the impact that potentially dramatic winter price spikes can have on the GCA price and to promote a level of price certainty and stability for Columbia's winter season gas supply. This has also been the Commission's primary stated objective, both in Admin. 384 and in past hedging plan cases involving Columbia and other Kentucky LDCs.

In support of its request for Commission approval to extend its hedging program for an additional three years, Columbia states in its application that the hedging program provides it with the ability to provide a more diversified portfolio approach to the pricing of its gas purchases. According to Columbia, the hedging program has been implemented without problem and has worked according to expectations by replacing winter purchases at market-based prices with hedged prices triggered during the prior 24-month period.

Based on the evidence of record of this and previous Columbia hedging program cases and that of Admin. 384 and Columbia's GCA cases, and being otherwise sufficiently advised, the Commission finds that Columbia's hedging program should not be extended. The Commission finds that current conditions and the outlook for future natural gas supplies and price are sufficiently different in 2014 from what they were in 2001 to allay our concern regarding the potential adverse impact of price volatility and extreme winter spikes on customer bills. We therefore conclude that it is no longer reasonable to impose the cost attendant to hedging, to the extent there is net cost rather than net savings, to be passed along to Columbia's customers as part of their gas cost. The Commission takes note that Columbia's hedging activities resulted in gas cost savings to its customers in 2005. Otherwise, since it was first implemented, Columbia'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 in the form of a mitigation of price spikes, a review of Columbia'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 began the heating season in November 2008 at $14.23 per thousand cubic feet ("Mcf"), Columbia's GCA rate steadily decreased to approximately $3.61 per Mcf in September 2009 and October 2009. Columbia's GCA rate then experienced price spikes at relatively low levels and volatility in a comparatively narrow range between $3.69 per Mcf at the lowest and $7.00 per Mcf at the highest between November 2009 and September 2014. Since the winter of 2010-2011, when the $7.00 per Mcf GCA rate occurred, the highest GCA rate

has been $6.67 per Mcf in September 2013. The volatility and price levels exhibited by Columbia's GCA rates from 2009 to the present are relatively low in contrast to those of 2005 through 2008, which saw GCA rates from $6.32 per Mcf at the lowest to a high of $14.64 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 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 Columbia with regard to these approaches, it meets approximately two-thirds of its winter heating requirements from gas withdrawn from interstate pipeline storage;[3] has a performance-based ratemaking mechanism, the Gas Cost Incentive Mechanism, approved by the Commission; and has a budget payment plan available to its customers. Furthermore, Columbia is unique among Kentucky LDCs in offering a Small Volume Gas Transportation Service, or Customer Choice Program, which allows customers to fix their gas cost with a participating marketer for some period of time if they so choose. For customers that choose to remain with Columbia for their natural

[3] Response to Item 1 of Commission Staff's Second Request for Information, Attachment A, filed Jan. 2, 2014.

gas supply, gas cost is passed through to them via the quarterly GCA mechanism, which naturally smooths potential volatility that would otherwise be introduced to their 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 Columbia's customers, current trends in customers' natural gas usage and changes in LDC rate design 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' future use of natural gas for space heating. Columbia also projected decreasing residential usage in its most recent rate case, Case No. 2013-00167,[4] in which it noted that its ten-year trend of customer usage showed an average decline in annual residential natural gas use of approximately 1.9 percent per year. 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 important to note when considering the future volatility and extreme levels of gas cost as they are translated into monthly bills for Columbia's customers. Since 2001, when the Final Order in Admin. 384 was issued, Columbia's rate design has changed from a minimum bill format to one containing a residential customer charge, which has risen from $9.30 when a customer charge was first implemented in 2007, to $15.00 per customer per month. The collection of more of Columbia'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.

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[4] Case No. 2013-00167, *Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates for Gas Service* (Ky. PSC Dec. 13, 2013).

While the Commission finds that any future benefit to customers in terms of reduced volatility and minimization of extreme price spikes does not appear to be sizable enough to justify extension of the hedging program, we also find that Columbia has made every reasonable effort to comply with the express direction contained in the Commission's Orders in Admin. 384. The Commission commends Columbia for those efforts. The Commission further finds that Columbia should file a revised GCA tariff to eliminate the reference to a hedging plan.

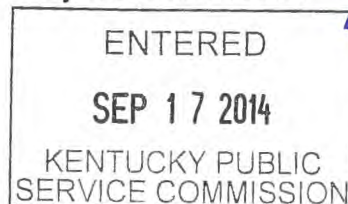
IT IS THEREFORE ORDERED that:

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

2. Columbia shall reflect in its GCA applications the remainder of any net cost and benefits of its approved hedging activities through the date of this Order.

3. Within 20 days of the date of this Order, Columbia shall file with this Commission, using the Commission's electronic Tariff Filing System, revised GCA tariff sheets reflecting the elimination of a hedging plan.

By the Commission



ATTEST:

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