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Senior Counsel

VIA OVERNIGHT DELIVERY

July 8, 2005

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

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JUL 11 2005

PUBLIC SERVICE
COMMISSION

Re: The Application of The Union Light, Heat and Power Company to Implement a hedging Program to Mitigate Price Volatility in The Procurement of Natural Gas. Case No. 2005-00191

Dear Ms. O'Donnell:

I have enclosed an original and 12 copies of The Union Light, Heat and Power Company's Reply Comments in Support of Application for Approval of New Hedging Plan.

Please date stamp and return the two extra copies in the enclosed, self-addressed envelope.

If you have any questions, please do not hesitate to contact me at (513) 287-3601.

Sincerely,

John J. Finnigan, Jr.
Senior Counsel

JJF/sew

cc: Hon. Elizabeth Blackford (w/encl.)

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

JUL 14 2005

PUBLIC SERVICE
COMMISSION

In the Matter of the:

APPLICATION OF THE UNION LIGHT,)
HEAT AND POWER COMPANY TO)
IMPLEMENT A HEDGING PROGRAM)
TO MITIGATE PRICE VOLATILITY IN)
THE PROCUREMENT OF NATURAL GAS)

CASE NO. 2005-00191

* * * * *
THE UNION LIGHT, HEAT AND POWER COMPANY'S
REPLY COMMENTS IN SUPPORT OF
APPLICATION FOR APPROVAL OF NEW HEDGING PLAN
* * * * *

The Attorney General objects to ULH&P's proposed new hedging plan on three grounds: (1) the Commission should not approve hedging plans for LDCs; (2) the Commission should not approve longer-term purchases as part of ULH&P's hedging plan; and (3) the Commission should not approve minimum volumes as part of ULH&P's hedging plan. ULH&P will address each of the Attorney General's objections.

The Commission should reject the Attorney General's initial objection that the Commission simply shouldn't approve hedging plans for LDCs. The Commission initially approved a pilot hedging program for ULH&P for the 2001-2002 heating season.¹ The Commission has approved hedging plans for ULH&P which have been in effect continuously since that date. Additionally, the Commission has approved hedging

¹ *In the Matter of Application of The Union Light, Heat and Power Company to Implement a Pilot Program to Evaluate the Use of a Hedging Program to Mitigate Price Volatility in the Procurement of Natural Gas*, Case No. 2001-128 (Order) (July 16, 2001).

programs for other LDCs.² The purpose for these hedging plans is to mitigate price volatility for customers. In its reports to the Commission on its hedging plans' performance since 2001-2002, ULH&P has demonstrated that its hedging plans have been effective in reducing volatility. Natural gas prices likely will remain volatile for the foreseeable future because demand is expected to increase and domestic production is expected to decrease.³ The Commission should therefore continue to approve hedging plans for LDCs so customers can continue to receive the benefits of reduced volatility in their rates.

The Commission should also overrule the Attorney General's objection to ULH&P's proposed use of longer-term purchases for its hedging plan. The new plan permits ULH&P to hedge a portion of its gas supply for up to 36 months following the time period covered by the hedging plan. This is only twelve months longer than the 24-month hedging purchases which the Commission approved in ULH&P's current hedging plan. The 36-month hedging purchases will give ULH&P more flexibility to stagger its hedging purchases, and to benefit from any price dips for a longer period of time. This should better enable ULH&P to mitigate price volatility for its customers.

The Attorney General concedes that 36-month hedging purchases "makes sense" if price volatility or upward prices are expected to continue into the future.⁴ The report by the Commonwealth Energy Policy Task Force suggests that this will be the case,⁵

² See, e.g., *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*, Case No. 2003-00172 (Order) (August 4, 2003).

³ *Kentucky's Energy Opportunities for Our Future: A Comprehensive Energy Strategy*, Commonwealth Energy Policy Task Force (Report at p. 34) (February 7, 2005).

⁴ *In the Matter of Application of The Union Light, Heat and Power Company to Implement a Pilot Program to Implement a Hedging Program to Mitigate Price Volatility in the Procurement of Natural Gas*, Case No. 2005-00191 (Comments of the Attorney General at p. 2) (June 30, 2005).

⁵ See footnote 3, *supra*, and accompanying text.

therefore, the Commission should approve purchases up to 36 months as part of ULH&P's hedging program.

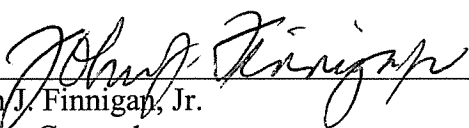
Finally, the Commission should reject the Attorney General's objection to the use of minimum levels of hedging purchases in ULH&P's proposed new hedging plan. The Attorney General objects to the minimum purchases because it results in a "mechanistic approach to hedging" which would effectively "constrain the exercise of prudent purchasing practice."⁶ ULH&P submits that this objection is without merit. The minimum hedging volumes are relatively low, and do not significantly constrain ULH&P's flexibility to make purchasing decisions. The minimum volumes will provide clearer parameters for the hedging program, and will ensure that ULH&P makes at least some hedging purchases, thus ensuring that customers will receive some degree of protection from price volatility.

⁶ *In the Matter of Application of The Union Light, Heat and Power Company to Implement a Pilot Program to Implement a Hedging Program to Mitigate Price Volatility in the Procurement of Natural Gas*, Case No. 2005-00191 (Comments of the Attorney General at p. 3) (June 30, 2005).

Based on the foregoing, ULH&P respectfully requests that the Commission approve its proposed new hedging plan.

Respectfully submitted,

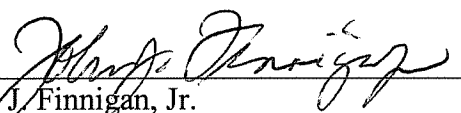
THE UNION LIGHT, HEAT AND POWER
COMPANY



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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing pleading was served of the parties listed below by regular United States mail, postage prepaid, this 8th day of July, 2005.



John J. Finnigan, Jr.

Hon. Elizabeth E. Blackford
Assistant Attorney General
Capital Center Drive, Suite 200
Frankfort, Kentucky 40601-8204