COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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

O R D E R

On May 9, 2003, Delta Natural Gas Company, Inc. (Delta) filed its natural gas price mitigation plans for the upcoming heating season. On July 1, 2003, representatives of Delta, the Office of the Attorney General (AG), and Commission Staff (Staff) met at the Commission s offices to further discuss the details of Delta s proposal.

Delta plans to use storage and forward contracts to mitigate price volatility. Delta would rely primarily on stored gas, which supplies approximately 55 percent of its winter load. Delta states that it might enter into forward contracts for summer purchases injected into storage, but only if the price of natural gas falls below $5.00 during the injection season. Delta also proposes the $5.00 threshold for entering into forward contracts for winter flowing gas.

Woodward Marketing, LLC (Woodward) is currently managing Delta s gas supply. The Woodward contract allows Delta to fix the price for a certain level of volume without any penalties or additional cost. Delta s proposal contains no minimum volume to hedge, but does propose limiting the combined volume of storage and forward contracts to 80 percent of its winter needs. Delta has agreed to report to the

Commission if it enters into any forward contracts and also agreed to file a final report on its hedging activities at the end of the winter season.

The AG filed comments in this case in which he suggested that Delta maintain better records for comparing locked in prices to the market price. He questioned whether the cost of financial hedges is greater than or less than the cost of gas purchased at a fixed price for physical delivery at a future date. The AG agrees that the reports mentioned above would provide valuable information on determining the ultimate effect of Delta s hedging activities.

DISCUSSION

Delta s proposal would not involve any of the additional transaction fees or premiums incurred with financial hedging instruments, but would obtain the mitigation of price volatility that is Delta s stated goal. Delta has experience with forward contracts from the winter of 2001-2002, when it used forward priced contracts to lock in a price for approximately one million Mcf.[1] Delta s Gas Cost Recovery (GCR) rate between August 2001 and April 2002 ranged between $5.5682 and $5.3142, indicating that it did achieve price stability. In this case, however, the fixed price was above the market price at the time the gas was delivered to customers.

The AG, the only intervenor in this case, did not state an objection to Delta s plan. The Commission acknowledges the AG s argument that fixing a price, whether with financial hedges or forward priced contracts, can result in a price that is different than the market price at the time of delivery. If the fixed price is above the market price, then the difference would constitute additional cost for the consumer. The final price to

[1] Delta response to Commission Order dated May 23, 2003 at 2.

the customer, however, is affected more by the weight of the price of storage gas in the portfolio than it is by the price fixed by the forward contract.

Delta s stated goal is to keep rates as low as possible while endeavoring to stabilize rates. Delta s storage and quarterly GCR are already contributing to its goal of stabilizing prices, and we find that its goal would be further enhanced with forward contracts. Given the recent decline in natural gas prices, Delta s stated intent to engage in forward contracts only if the price falls below $5.00 per unit should help keep the price to the consumer as low as possible. The Commission acknowledges that Delta will not be able to accurately forecast the exact market price at the time of delivery and should take reasonable precautions against locking in at a high price in a market that has recently seen decreasing prices.

FINDINGS AND ORDERS

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Delta s natural gas price mitigation plan should be approved.

2. Delta should notify the Commission if it enters into any forward contracts, stating the price, volume, delivery date, and counterparty contained in the contract.

3. No later than May 15, 2004, Delta should file a report with the Commission detailing the effect of any forward contracts that Delta entered into and an analysis of the impact on the price of gas to its customers.

IT IS THEREFORE ORDERED that:

1. Delta s natural gas price mitigation plan is approved.

2. Delta shall comply with the requirements contained in Finding Paragraphs 2 and 3 as if the same were individually so ordered.

Done at Frankfort, Kentucky, this 4th day of August, 2003.

By the Commission

ATTEST:

Executive Director