COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PETITION OF ATMOS ENERGY CORPORATION	)	
FOR APPROVAL TO CONDUCT HEDGING	)	CASE NO.
PROGRAM FOR THE WINTER OF 2003-2004	)	2003-00192

O R D E R

On June 4, 2003, Atmos Energy Corporation (Atmos) filed its request for approval of a natural gas hedging plan for the 2003-2004 winter heating season.[1] The proposed hedging plan will consist of futures contracts and no-cost collars, which are the same hedging instruments that were used by Atmos to acquire a portion of its natural gas supply for the past two heating seasons. Atmos s hedging plan will follow the same general parameters that governed its hedging activities for the past two winters.

Both the Office of the Attorney General (AG) and Commission Staff submitted data requests to which Atmos responded on June 16, 2003. An informal conference was held June 20, 2003, the AG filed written comments June 26, 2003, and the case stands submitted for decision.

BACKGROUND

In Administrative Case No. 384, the Commission directed Kentucky s major gas distribution utilities to consider hedging alternatives as a means of addressing the

[1] Atmos conducted gas supply hedging plans for the 2001-2002 and 2002-2003 winter heating seasons with Commission approval.

significant price spikes and dramatic volatility in gas prices experienced during the 2000-2001 heating season.[2] As a result of that case, the Commission engaged The Liberty Consulting Group (Liberty) to conduct a focused management audit of those major gas utilities gas procurement practices. In response to our directive, Atmos proposed a hedging plan for the 2001-2002 heating season in May of 2001 and followed that with a similar hedging plan for the 2002-2003 heating season. Subject to some modification, the Commission approved both of Atmos s gas hedging plans.

In this case, Atmos proposes a gas hedging plan similar to what was approved for the past two heating seasons. Under the proposal, Atmos will hedge approximately 50 percent of its winter season supply through storage. It will hedge up to 25 percent of its winter season gas supply financially via futures contracts and no cost collars.

POSITIONS

In its application, Atmos proposes to financially hedge up to 25 percent of its total winter season supply requirements, while proposing no minimum percentage to be hedged. It proposes to employ a systematic, disciplined approach to layering in its hedging positions over the summer and fall of 2003. This is the approach Atmos used in its 2001-2002 hedging plan, although, based on Liberty s recommendations, it used an approach that responded to changes in market prices of natural gas in its 2002-2003 hedging plan. In order to optimize opportunities to stabilize gas prices for the upcoming winter, Atmos requests expedited consideration of its application.

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[2] Administrative Case No. 384, 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, Order dated January 30, 2001.

The AG takes issue with Atmos operating a hedging plan at the same time that it operates under a gas procurement performance based rate-making mechanism (PBR). The AG claims that the least cost pricing encouraged and rewarded by the PBR conflicts with the hedging plan s goal of reducing price volatility. He recommends that hedging be approved only if a cost benefit analysis can show that customers will not be paying more under the combination of hedging and a PBR than they would in the absence of both programs. Alternatively, the AG recommends approval of a smaller program that discourages mechanistic purchasing of the hedging instruments. The AG also recommends that some portion of the cost of any hedging program be assigned to Atmos to recognize that price hedging is designed to protect customers against the practice that Atmos is encouraged to pursue and from which it profits under the PBR.

DISCUSSION AND CONCLUSION

The Commission appreciates the positions of both Atmos and the AG. We find that Atmos s plan, subject to slight modification, should be approved. The type of cost benefit analysis suggested by the AG will only be as meaningful as the price volatility assumptions on which it is based. Since forecasting such volatility with any degree of accuracy has been virtually impossible for both industry and government forecasters, it appears that one set of reasoned assumptions could be judged to be no more, or no less, supportable than any other set of reasoned assumptions. While the AG points out that the overall result of Atmos s 2001-2002 and 2002-2003 hedging activities was that customers paid more than they would have otherwise paid, he fails to recognize that achieving price stability, not the lowest possible cost, is the goal of a hedging program.

The AG s concern about Atmos operating under a PBR while also operating a hedging plan is a concern he has raised in Atmos s prior hedging cases. The AG claims that the PBR encourages Atmos to remain in the market that is producing the price spikes and volatility that hedging is designed to prevent, but he fails to identify another market that would be available to Atmos if it were not under a PBR. While the PBR encourages least cost purchasing, both Atmos s and the state s other major gas utilities least cost procurement strategy were directed by the Commission in Administrative Case No. 297, which preceded Atmos s PBR by several years.[3]

Atmos s proposal to employ a systematic, disciplined approach to layering in its hedging positions over the summer and fall of 2003 is what the AG opposes in his statement that mechanistic purchasing should be discouraged. Atmos s results for the past two heating seasons do not support its preference for the use of this systematic, layering in approach. This approach also runs counter to what other gas utilities have identified as the preferred manner in which to arrange hedging transactions. For these reasons, we will require that Atmos respond to changes in market conditions, as it did for 2002-2003, in making arrangements for its hedging transactions.[4]

The Commission is not convinced that Atmos should be made to bear a portion of the cost of the hedging program. As stated in prior cases, the impetus for hedging is to provide insurance against an event such as price spikes, the cost of which would

[3] Administrative Case No. 297, An Investigation of the Impact of Federal Policy on Natural Gas to Kentucky Consumers and Suppliers, Order dated May 29, 1987.

[4] While this approach will not guarantee that the volumes hedged under Atmos s plan will be smaller than what it proposed, as advocated by the AG, that was the result for the 2002-2003 hedging plan.

likely be borne by customers since Atmos does not control the market that gives rise to such an event. Since it is customers, not the utility or its shareholders, who stand to receive the benefits realized through a hedging program, we continue to find that customers should bear the cost of such a program.

It was not set out in its application, but Atmos agreed at the informal conference to file the same reports on its hedging program that it has filed the past two years. The Commission finds that Atmos should continue to file those hedging reports according to the previously established filing requirements and filing schedule.

SUMMARY

1. Atmos s proposed plan, subject to the following modifications, should be approved as filed.

2. Atmos should enter its hedging arrangements in response to changes in market conditions rather than using its proposed systematic, layered in approach.

3. Atmos should file both an interim and a final report on its hedging plan with the interim report to be filed shortly after the November 1, 2003 beginning of the upcoming heating season and the final report filed shortly after the March 31, 2004 end of the upcoming heating season.

IT IS THEREFORE ORDERED that:

1. Atmos s natural gas hedging plan is approved, subject to the modifications set forth above, effective with the date of this Order.

2. Atmos shall file interim and final reports on its natural gas hedging plan as set forth in this Order.

Done at Frankfort, Kentucky, this July 22, 2003.

By the Commission

ATTEST:

Executive Director