COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY TO IMPLEMENT A NATURAL GAS SUPPLY HEDGE PLAN	)))	CASE NO. 2004-00198

O R D E R

On May 26, 2004, Louisville Gas and Electric Company ("LG&E") filed its Natural Gas Supply Hedge Plan for the winter of 2004-2005. LG&E requested expedited treatment and approval to continue the plan after the 2004-2005 heating season without annual approval from the Commission. There are no intervenors in this case.

PROPOSAL

LG&E currently obtains its winter supply needs through a portfolio of supplier contracts and stored gas, which its Natural Gas Supply Hedge Plan proposes to continue. Although LG&E refers to its proposal as a hedging plan, it does not involve the use of any financial hedging instruments. The plan focuses on providing low cost gas to customers as well as providing some bill stabilization through its quarterly gas cost adjustment ("GCA") and its budget billing option.

LG&E prefers to forgo using financial hedging instruments for several reasons. Financial hedging may reduce exposure to price volatility, but it cannot be used as a means for routinely procuring gas at or below market prices. Therefore, customers may, under certain circumstances, see higher bills even with hedging. LG&E states that its gas acquisition strategies have produced rates that are below both Kentucky and national averages without the use of financial hedging. LG&E performed a Monte Carlo analysis that measured its price volatility under different scenarios, using combinations of storage, hedging, and GCA filing frequencies. The analysis indicates that LG&E's current program produced the lowest mean volatility in price. LG&E believes that if it implements financial hedging, it will have to forgo its least-cost acquisition strategy and incur costs that may or may not yield benefits.

DISCUSSION

LG&E's proposal does provide some of the advantages of hedging without the associated cost. The quarterly nature of LG&E's GCA allows its customers to see changes in gas costs on the bill only four times a year, which provides price stability. The fixed price nature of LG&E's storage withdrawals during the winter heating season also helps mitigate price fluctuations to the customer. LG&E's history of low gas costs as compared to Kentucky's other major local distribution companies ("LDCs") supports approving LG&E's proposal.

Despite the advantages of LG&E's proposal, the Commission does have some concern with forgoing the use of financial hedging. A financial hedging plan can mitigate the effect on customers of a rapid run-up in prices. Not only does hedging provide protection to customers during a price spike, but mitigating price spikes can help avoid the increases in uncollectible accounts and delays in collecting increased gas costs, via GCA filings, that LG&E and Kentucky's other LDCs have experienced on some occasions in recent years.

The Commission has also taken note of the absence of any opposition to LG&E's proposal. Although the Attorney General ("AG") did not intervene in this case, he has participated in prior LG&E hedging cases. In those cases, the AG expressed his preference for no financial hedging activity in order to keep the long-term costs to consumers as low as possible.

FINDINGS AND ORDERS

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

1. LG&E's proposed Natural Gas Supply Hedge Plan should be approved.

2. LG&E's request to continue its proposed plan without annual Commission review should be approved.

IT IS THEREFORE ORDERED that:

1. LG&E's request to implement its Natural Gas Supply Hedge Plan is approved.

2. LG&E's request to continue its proposed plan without annual Commission review is approved.

Done at Frankfort, Kentucky, this 6th day of August, 2004.

By the Commission

ATTEST:

Executive Director