DG 02-149

ENERGYNORTH NATURAL GAS, INC.
D/B/A KEYSPAN ENERGY DELIVERY NEW ENGLAND

Petition to Terminate the Fixed Price Option Program and Modify the Cost of Gas Hedging Plan

Order Denying Termination of the Fixed Price Option Program and Approving Modification of the Hedging Plan

O R D E R N O. 24,059

September 27, 2002

APPEARANCES: McLane, Graf, Raulerson, and Middleton by Steven V. Camerino, Esq. on behalf of EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England; Office of the Consumer Advocate by Kenneth E. Traum on behalf of residential utility consumers; and Marcia A.B. Thunberg, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. BACKGROUND AND PROCEDURAL HISTORY

On August 9, 2002, EnergyNorth Natural Gas, Inc. d/b/a KeySpan Energy Delivery New England (KeySpan), a public utility engaged in the business of distributing natural gas in southern and central New Hampshire and the City of Berlin in northern New Hampshire, filed with the New Hampshire Public Utilities Commission (Commission) petition to terminate its Fixed Price Option (FPO) Program and modify its hedging policy. KeySpan's filing included the direct testimony and supporting attachments of Stephen A. McCauley, Director of Energy Risk Management for KeySpan Corporate Service LLC.

An Order of Notice was issued on August 27, 2002, and published in the *Union Leader* on August 29, 2002 scheduling a technical session for September 5, 2002 and a hearing for September 23, 2002. On September 5, 2002, a technical session was held and data requests were promulgated by Staff.

On September 6, 2002, the Office of the Consumer Advocate (OCA) filed a Notice of Intent to Participate in this docket on behalf of residential utility consumers pursuant to the powers and duties granted to the OCA under RSA 363:28,II. There were no other intervenors in this docket.

On September 19, 2002 settlement discussions were held between the Staff, KeySpan and the OCA and an agreement in principal was reached. Following further settlement discussions on September 23, 2002, prior to the hearing, an oral settlement was reached.

At the hearing KeySpan presented the oral settlement and requested Commission approval from the bench. Following the hearing and deliberations, the Commissioners approved the settlement from the bench.

II. PETITION TO TERMINATE FPO AND MODIFY HEDGING POLICY

In its original filing to the Commission, dated August 9, 2002, KeySpan proposed to eliminate its FPO program and modify its hedging policy.

A. Fixed Price Option

KeySpan has had a form of a FPO program in effect for the past four winter seasons. This program was initially approved by the Commission in Order No. 22,953, *Re EnergyNorth Natural Gas, Inc.*, 83 NH PUC 344, dated June 8, 1998. The FPO program has also been known as the Gas Price Stability Plan and the Guaranteed Price Protection Plan. Under the FPO plan, customers are able to purchase natural gas based on commodity prices that have been locked in prior to the winter heating season. The program insures a set price during the winter season for customers seeking price certainty.

B. Hedging Policy

KeySpan hedges its portfolio of gas purchases to achieve price stability. KeySpan states that the proposed modified hedging plan is an alternate method to achieve the same if not greater price stability for all customers, rather than just FPO participants. The modified hedging plan would use financial instruments to lock in 50 percent of its winter upstream pipeline capacity that is priced against monthly indices. Combined with its natural gas storage, propane and liquid natural gas supplies (LNG), KeySpan will have hedged approximately 70 percent of its winter supply portfolio prior to setting winter Cost of Gas rates, thereby, providing price stability for all customers.

The current hedging policy allows KeySpan to hedge 100 percent of index-priced supplies using calls and puts options to hedge the price of supplies and establishes a ceiling of $500,000 for the amount of premiums that the Company may pay for options. The review committee (Risk Management Committee) consists of the following; senior vice president and Chief Financial Officer, Senior Vice President of Corporate Development and Energy Services, Controller, Internal Auditor, Tax/Securities and Exchange Commission Accountant, and Rate Analyst.

III. SETTLEMENT AGREEMENT

KeySpan witnesses Stephen A. McCauley and A. Leo Silvestrini, Director of Rates and Regulatory Affairs, presented the oral settlement agreement, the terms of which are described below:

1. Withdrawal of Petition to Terminate the FPO Program

> KeySpan withdraws its petition to terminate its FPO program for the 2002/2003 winter period. With the exception of the amount of winter supplies available for the FPO program, currently 50 percent, the program will be administered as approved by Commission Order No. 23,774 (September 7, 2001).

2. Supplies Available Under the FPO Program

The amount of supplies available under the FPO program will be limited to 30 percent of anticipated winter (November thru April) supplies. KeySpan will lock in prices for 30 percent of its pipeline supplies (i.e., those supplies that have prices determined by monthly market price indices) and allocate 30 percent of storage, DOMAC LNG and LNG/propane supplies(supplies that are either already purchased or have fixed prices) for the FPO program.

2. Expanded Hedging for Cost of Gas Customers

KeySpan will hedge 35 percent of the anticipated 2002/2003 winter (November thru April) pipeline supplies for Cost of Gas (COG) customers (defined as firm sales customers not enrolled in the FPO program). In the event the FPO program is not fully subscribed, the unsubscribed supplies will be assigned to the COG.

3. Hedging Summer Gas Supplies

With the exception of October 2002, KeySpan will hedge 50 percent of pipeline supplies for the months of October and May under the proposed hedging plan, with any costs or savings to be included in the summer COG calculation.

4. Additional Means of Executing Financial Hedges

In addition to the purchase of futures contracts, KeySpan will now use swaps and call options in the over-the-counter market as part of its hedging program. As with futures contracts, swaps obligate the buyer to buy a specific volume, at a specific price, in a given month and year. For a call option, the buyer of the option has the right, but not the obligation, to buy gas at a specific price. For a put option, the seller of the option has the right, but not the obligation, to sell gas at a specific price. Premium costs are not to exceed $750,000 per year.

5. Specific Dates to Hedge Monthly Volume Targets

Monthly volume targets are to be hedged according to the following schedule:

By June 1	15% - 30% of hedged supplies
By July 1	30% - 60% of hedged supplies
By August 1	45% - 90% of hedged supplies
By September 1	60% to 100% of hedged supplies

By October 1	80% to 100% of hedged supplies
By November 1	100% of hedged supplies.

6. Hedging Review Committee

A Derivative Management Committee to oversee hedges and hedging policies will be comprised of the following KeySpan personnel; Senior Vice President of Finance Operations and Regulatory Affairs, Vice President of Energy Supply, Chief Accounting Officer, Chief Risk Officer and Vice President of Sales and Marketing.

7. Reporting

KeySpan's monthly COG report will include the status of KeySpan's hedged positions and KeySpan will provide a summary of hedging results when filing the summer and winter cost of gas reconciliation reports.

8. Review of the Program

KeySpan reserves the right to petition for termination of the FPO program at some future date following a review of the 2002/2003 winter period program results.

IV. COMMISSION ANALYSIS

We have reviewed the terms of the Settlement Agreement as well as KeySpan's filing and the supporting testimony and exhibits presented at the September 23, 2002 hearing. Based on our review of the record, we find that continuing the FPO at a reduced level and the modifications to KeySpan's hedging policy to be in the public good.

The FPO program has proved to be a popular option for customers, as participation has grown in each of the four years the program has been in existence to a high of 23% last winter.

The growth in participation demonstrates that a large number of customers are interested in stable prices, even when asked to pay a premium for that certainty (FPO prices are pegged to the proposed COG rate; the 2001/2002 winter FPO rates were 5 percent greater than the COG rates at the time of the FPO offering). The popularity is notwithstanding that, in 3 of the 4 years the program was offered, a customer electing the FPO rate would have paid more than if they had not participated. Customers, however, who did participate in each of the four years experienced greater savings as a result of the program, because in one particular year, their savings more than offset the three cumulative years of additional costs. As was indicated at the hearing, in that one year there was an extremely sharp run-up in natural gas prices and, consequently, COG rates.

The Commission agrees with the Staff and Parties that there are valid reasons for continuing the FPO for another year. Uncertainty exists among consumers at this time, as the result of events in the Middle East. Also, the cost to administer the program is relatively small, with a typical residential heating customer paying less than a dollar per year for the opportunity to lock in a fixed winter rate. For those reasons, we believe it is both reasonable and prudent to continue the program at this time.

KeySpan indicated in its filing that the program participation rate had peaked at 23%. Based on the participation in prior years and experiences of the other New Hampshire gas utilities offering similar programs, it appears that a 30 percent cap on winter supplies available for the FPO is sufficient to meet the demand for the program and will reduce the amount of unsubscribed FPO supplies, thereby, reducing the impact on COG rates which utilize unsubscribed FPO supplies at the fixed prices.

We believe the agreed upon changes to the hedging policy provides KeySpan with better hedging opportunities and that the change in the hedging oversight committee will continue to insure that the hedging policy is carried out as intended. Allowing for an increase in the amount of premiums that may be paid reflects the increase in volumes to be hedged and allows for a greater use of options. This will allow KeySpan’s customers to realize savings in the event of declining market prices while placing a ceiling on rates in the event of climbing prices.

We view Keyspan’s proposed hedging policy favorably and believe that it reduces the speculative nature of commodity buying and will contribute to more stable COG rates. For this reason, we agree that the modified hedging policy should be extended to cover a portion of the summer period as well. KeySpan's summer portfolio is primarily made up of pipeline supplies and over half of the summer supply is purchased in May and October. Clearly, price spikes in either of those months may well have a profound impact on the summer rates if a portion of those supplies are not hedged.

The FPO program has evolved and grown since its inception, with KeySpan hedging an increasingly large portion of its winter supply portfolio and using a greater number of financial tools to hedge those supplies. Because more of KeySpan's portfolio is now hedged, we would expect the volatility of COG rates to be greatly reduced now and in the future. A more stable COG rate, along with the premium built into the FPO rate, are factors to consider when weighing whether the FPO should be continued beyond this winter. It may well be that the FPO program is no longer necessary to provide KeySpan's customers a reasonable level of price stability.

We agree that the need to continue the program should be re-evaluated following the results of this winter's program, particularly in light of the changes in the hedging policy and volumes hedged. The agreed upon filing requirements should assist in the re-evaluation of the FPO program and hedging policy.

Based upon the foregoing, it is hereby

ORDERED, that the Settlement Agreement between Staff, KeySpan and the OCA, described above, is **APPROVED**; and it is

FURTHER ORDERED, that the 2002/2003 Winter FPO rate calculation will be filed for inclusion in KeySpan's 2002/2003 Winter COG filing (Docket No. DG 02-170).

By order of the Public Utilities Commission of New Hampshire this twenty-seventh day of September, 2002.

Thomas B. Getz Chairman	Susan S. Geiger Commissioner	Nancy Brockway Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary