DG 05-127

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

Amendments to Fixed Price Option Program
& Natural Gas Risk Management Plan

Order Approving Amendments to the Fixed Price Option Program
& Natural Gas Risk Management Plan

O R D E R N O. 24,515

September 16, 2005

I. BACKGROUND

On August 2, 2005, 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) a petition to modify its Fixed Price Option (FPO) Program and its Natural Gas Price Risk Management Plan (Hedging Plan). KeySpan's filing included the direct testimony and supporting attachments of Ann E. Leary, Rates Manager. On August 9, 2005, the Office of the Consumer Advocate (OCA) filed a notice of intent to participate in this docket on behalf of residential utility consumers consistent with RSA 363:28.

On September 8, 2005, following discovery and discussions between KeySpan, the OCA and Commission Staff, KeySpan filed a letter with the Commission containing several proposed revisions to its FPO and Hedging Plan. The letter recites the OCA and Staff support of the revised FPO and Hedging Plan. On September 9, 2005, Staff filed a memorandum with the Commission explaining and confirming its support of the revised FPO and Hedging Plan. The memorandum included KeySpan's responses to Staff Data Requests propounded through discovery.

On September 9, 2005, Staff filed another memorandum with the Commission recommending KeySpan file a revised 2005-2006 Winter Cost of Gas (COG) on September 23, 2005 and that the proposed FPO rate calculation methodology be applied to the COG rates revised as of September 23. The memorandum confirms KeySpan's and OCA's support for this recommendation.

II. DESCRIPTION OF THE PROGRAMS

A. Hedging Plan

KeySpan implemented a Hedging Plan in 1997 designed to reduce price volatility for its customers. *EnergyNorth Natural Gas, Inc.*, 82 NH PUC 635 (1997). The original Hedging Plan was modified in 1998 and again in 2002 to expand the program and incorporate additional means of hedging against natural gas price spikes. *EnergyNorth Natural Gas, Inc.*, 83 NH PUC 261 (1998) and *EnergyNorth Natural Gas, Inc., dba KeySpan Energy Delivery New England*, 87 NH PUC 655 (2002), respectively.

The goal of the Hedging Plan is to provide firm sales customers with a level of protection from sudden or short-lived increases in commodity costs while allowing them to also benefit to some extent if prices decline during the winter period. The Hedging Plan is primarily intended to mitigate the effects of price spikes, rather than to obtain lower gas prices than customers would pay if gas prices were simply purchased at market prices. The Hedging Plan contemplates the use of various financial risk management tools and underground storage inventories in order to provide greater price stability in the Cost of Gas (COG) to firm sales customers and to fix the cost of gas for participants in the FPO Program.

KeySpan proposes the following changes to the Hedging Plan: inclusion of underground storage inventories in the Plan; revisions to the monthly hedging targets in the existing Plan; hedging up to 20% of underground storage by locking in prices for those volumes prior to the storage refill season; and revisions to the Transaction Execution Guidelines and Policies, Procedures, and Controls.

Under the proposed revisions to the Hedging Plan, KeySpan would hedge up to 67.5% of the Gulf Coast and Canadian index-priced supplies purchased for delivery during the months of November through April in accordance with targets contained in the Hedging Plan. The first target date is 15 months prior to the first delivery month and new cumulative targets are set for each three-month interval thereafter (hedged volumes can be up to 2% below target):

- August 1 (15 months prior) 19% of total strategy volume
- November 1 (12 months prior) 38% of total strategy volume
- February 1 57% of total strategy volume
- May 1 76% of total strategy volume
- August 1 95% of total strategy volume
- September 1 100% of total strategy volume

Due to the timing of the purchases made in 2005, for the 2005-2006 winter period beginning November 1, 2006, only 87% of the total strategy volume was hedged by August 1, 2005.

In addition, the percentage of index-priced supplies that would be hedged at any time will depend on the current natural gas market price trends relative to historical prices for winter period deliveries, forward price and volatility curves, and economic forecasts. KeySpan would hedge not less than 30% nor more than 80% of its index-based supplies forecasted for any month of the winter period.

KeySpan would continue to use its underground storage supplies to mitigate price volatility by purchasing gas in monthly increments during the April to October refill season at market prices. As previously agreed to with the OCA and Staff and as approved by Commission

Order No. 24,388 (October 29, 2004), KeySpan would maintain underground storage inventories as of each month-end that are at least equal to its annual "rule curve." KeySpan would also hedge the cost of its underground storage supplies by entering into arrangements between May of one year and April of the following year to fix the cost of up to 20% of the volumes to be injected into storage during the succeeding May through October injection period (i.e., volumes hedged in August are for injection into storage during the following May through October period). The revised Hedging Plan contains specific target dates and volumes for hedging those underground supplies (hedged volumes can be up to 2% below target):

- By August 1 — 25% of the hedged underground storage capacity
- By November 1 — 50% of the hedged underground storage capacity
- By February 1 — 75% of the hedged underground storage capacity
- By May 1 — 100% of the hedged underground storage capacity

Finally, the Transaction Execution Guidelines, Policy, Procedures and Controls have been updated to reflect corporate changes. KeySpan would maintain a utility Commodity Management Committee (CMC) and a Risk Management Committee. The CMC would recommend broad strategies for trading, hedging and other uses of derivatives, establish and recommend market risk limit structures, and review new products and activities involving trading. The CMC, which will be chaired by the Chief Risk Officer, will oversee the Risk Management Policy and will approve trading and hedging strategies, as well as compliance with approved guidelines.

B. Fixed Price Option Program

KeySpan implemented an FPO plan (initially titled the Gas Price Stability Plan) in 1998 designed to provide a set price during the winter season for residential customers seeking price certainty. *EnergyNorth Natural Gas, Inc.*, 83 NH PUC 344 (1998). The original FPO plan was modified in 1999 (renamed the Guaranteed Price Protection Program) and again in 2001, to expand the program and change the FPO rate calculation methodology. *EnergyNorth Natural Gas, Inc.*, 84 NH PUC 404 (1999) and *EnergyNorth Natural Gas, Inc., d/b/a KeySpan Energy Delivery New England*, 86 NH PUC 586 (2001), respectively.

The FPO rate calculation originally in effect was cost based and excluded specific margins that accrued to the COG as an offset to gas costs. The margins which accrue to the COG served as a built-in premium designed to ensure COG customers would not subsidize the FPO program. After the first year, the FPO rate calculation did not include prior period COG over or under-collection, as the expectation was that the cost of the program would be fully recovered through the cost based rates and built-in premium. The FPO program was favorably received and in the winter of 2000-2001 customer demand exceeded the supplies available under the program, in spite of the fact that the FPO and proposed COG rates were almost identical for the year. A number of the customers who had applied for the program were unable to participate.

In the early years of the hedging program, most of the hedges were made late in the summer and the FPO and proposed COG rates were nearly identical. As natural gas price volatility increased and hedging was performed over a longer period of time, the likelihood of a significant divergence between the rate options increased. In 2001, the Commission approved an FPO rate methodology that moved away from a strictly cost-based rate to one pegged to the COG rate, ensuring that the FPO rate would not be less than 95% of the proposed COG. *EnergyNorth Natural Gas, Inc., d/b/a KeySpan Energy Delivery New England*, 86 NH PUC at 588.

As natural gas prices climbed to historic highs leading up to the 2004-2005 winter period, the percentage difference allowable under the new FPO rate methodology resulted in (i) a significant real dollar difference between the proposed FPO and COG rates, with the proposed FPO rate being over four cents less, and (ii) increased publicity regarding the potential for further increases in the energy markets.

In the KeySpan 2004-2005 winter COG proceeding, Docket No. DG 04-152, the OCA expressed its concern that setting the FPO rate below the initial COG rate would give customers an inappropriate price signal and would likely lead to a significant oversubscription of the program. *See* Order No. 24,388 (October 29, 2004). In response to that concern, with the support of the OCA and Staff, KeySpan proposed a new rate methodology and an increase in the winter supplies available under the FPO Program for the 2004-2005 winter period. The new rate methodology set the FPO rate at $0.01 above the updated COG rate as calculated at that time and set the availability of FPO supplies at 40% of KeySpan's projected winter load. Commission Order No. 24,388 approved the proposed FPO rates based on the new rate calculation methodology.

In support of its present proposal to amend the FPO Program, KeySpan notes that the Commission had previously indicated that the purpose of the FPO was to provide rate stability. In support, KeySpan cites a 2002 Order, 87 NHPUC 655 at 658 (Commission noted that "a large number of customers are interested in stable prices, even when asked to pay a premium for that certainty…") and a 2001 Order 86 NHPUC 586 at 589 (Commission noted that it expected customer participation to "be determined by risk aversion rather than price differentials.").

With energy supply prices again setting historical highs and the attendant publicity, enrollment in the FPO may well exceed last year, given the same pricing relationship. Thirty percent of winter supplies were taken under the FPO program last winter, compared to approximately 24% for each of the three prior winters. To address that concern, KeySpan's proposed changes to the FPO Program set the FPO rates at $0.02 above the proposed COG per therm rates, rather than the $0.01 per therm premium applied last winter, and the volumes available under the FPO Program would be set at 35% of projected winter supplies. Increasing the volumes hedged under the FPO from 30% to 35% would increase the total amount of hedged supplies from 65% to 67.5%, while decreasing the COG hedge from 35% to 32.5%.

Under KeySpan's proposal, the revenue generated by the $.02 premium included in the FPO rates would be credited to the COG and, depending on enrollment, has the potential to offset gas cost by more than $500,000. Those revenues would reduce the risk of non-FPO participants subsidizing the FPO customers and replace the margins which were previously credited to the COG and not to the FPO. Those margins, intended to ensure that the FPO Program would not be subsidized by COG customers, are dependent on a number of variables and the margins can vary significantly from year to year. Consequently, there have been years in which the FPO Program was subsidized by non-participants. Under the proposed FPO rate calculation methodology, the premium provides greater certainty that the FPO Program will not be subsidized by non-participants. Also, the FPO Program would no longer be exempt from prior period under-collections and, thus, if an under-collection did arise from the FPO Program, the FPO participants would contribute to its recovery. As was the case last winter, any prior period over or under-collection would be included in the COG rate calculation on which the FPO rates are based and, therefore, a portion of any under-collection will be recovered from FPO participants.

As proposed to be revised, the FPO Program would be easier and less costly to administer than is now the case. KeySpan would no longer have to calculate the per therm cost of the FPO, compare that rate to the proposed COG rate and, if necessary, determine and apply the appropriate premium. A separate FPO filing, due September 15, would no longer be required. Along with eliminating the cost of the additional filing, the proposed FPO rates would be included in the COG filing due September 1 and enable KeySpan to notify customers of the FPO rate at a correspondingly earlier date and permit more time for customer enrollment. The proposed changes would also eliminate the need for KeySpan to perform a separate reconciliation of FPO costs and revenues. In spite of the reduced filing requirements, the reporting requirements detailed in the Hedging Plan will still enable KeySpan to perform a cost/benefit analysis of the FPO Program.

Lastly, the New York Mercantile Exchange (NYMEX) natural gas futures prices used in projecting KeySpan's indexed-priced natural gas supplies have increased by more than 20% since KeySpan calculated the proposed 2005-2006 average winter COG rate as filed in its 2005-2006 Winter COG, Docket No. DG 05-141. Unless there is a substantial drop in the NYMEX future prices prior to the Commission hearing in that proceeding, the increase in the natural gas futures prices will necessitate a revised COG filing with a significantly higher average COG winter rate. Therefore, it is recommended that KeySpan file a revised 2005-2006 Winter COG on September 23, 2005 and apply the proposed FPO rate calculation methodology to the updated COG rates in setting the 2005-2006 FPO rate.

III. COMMISSION ANALYSIS

A. Hedging Plan

We continue to believe that an important component of any energy supply portfolio policy includes hedging risks against a sharp run-up in prices. KeySpan's proposed revisions to its Hedging Plan appear to address that concern. The amounts to be hedged are expected to provide for a more stable winter COG rate based on average prices over a long period of time, providing greater price stability for all of KeySpan’s winter firm sales customers. The policy reduces the possibility of speculation by requiring that set amounts be hedged over a long period of time, so that even during a period of rising prices, KeySpan would secure a significant portion of its supply prior to setting rates.

Given our view that KeySpan’s hedging of indexed-priced pipeline supplies is in the public interest, and concluding that it reduces the speculative nature of commodity buying and contributes to more stable COG rates, we find that the policy should be extended to indexed-priced underground storage supplies to be injected during the non-peak season into underground storage for winter use. Therefore, we approve the revisions to the proposed Hedging Plan.

The results of the Hedging Plan should be monitored and evaluated to serve as a basis for continuing and improving the policy going forward. The reporting requirements detailed in the Hedging Plan provide for such monitoring and will enable KeySpan to perform the analysis necessary to determine the effectiveness of the program. Further, the Transaction Execution Guidelines and Policies, Procedures, and Controls provide safeguards to ensure compliance with the KeySpan’s hedging strategies presented in its Hedging Plan.

B. Fixed Price Option Program

The slight increase in hedged supplies necessary to make 35% of projected winter supplies volumes available for the FPO will significantly reduce the risk of KeySpan having to deny customer participation in the FPO program and customer dissatisfaction if such an event were to occur.

Following the recent events in the Gulf of Mexico, there have been significant, unanticipated price shocks in the energy markets since KeySpan made its initial 2005-2006

Winter COG filing. The average COG rate contained in the initial filing is not representative of current market conditions and projected winter costs for the upcoming winter. An updated filing that factors in recent market developments will provide KeySpan a better opportunity to match gas revenues and costs for the period by adjusting the COG rate and thus provide customers with more accurate information as to what their potential gas costs will be this winter and better reflect customer expectations regarding anticipated increases in energy bills. Given the run up in prices, we direct KeySpan to file a revised COG on September 23, 2005. We will also require KeySpan to set the 2005-2006 FPO rates at $.02 cents above the revised COG to be filed at that time. We find it is appropriate for KeySpan to use the most current information when setting the FPO rate and informing customers of their pricing options. In the future, the FPO and COG rate offerings will be as contained in the initial COG filing..

We find that a $0.02 per therm premium is a reasonable charge to enable customers to eliminate the price risk inherent in the COG. During the past four years of the FPO Program, the premium has ranged from one cent to over four cents with very little impact on participation levels. Clearly, customers who desire price certainty are willing to pay a premium for that service and with COG rates of over $1.00 per therm proposed for the 2005-2006 winter period, a $.02 premium represents less than 2% of the proposed COG rates.

Further, we note that the $0.02 per therm premium paid by FPO customers will reduce gas costs to be recovered through the COG rates. KeySpan's response to Staff Data Request 1-5 indicates a potential reduction in gas costs of over $500,000 for the upcoming winter. Under these circumstances, we approve the proposed revisions to the FPO program.

As has been the case throughout the existence of the FPO Program, the Program should be closely monitored and the results reviewed and evaluated to serve as a basis for continuing and improving the Program. We direct KeySpan to report the results of the Program in its winter COG filings. Specifically, KeySpan is to report participation levels, the cost or savings realized by FPO program participants and revenues derived from the FPO premium. Such information will assist the Commission in evaluating the programs and may also assist customers in their decision as to whether to participate in the FPO program.

Based upon the foregoing, it is hereby

ORDERED, that the Amendments to the Fixed Price Option Program and Natural Gas Price Risk Management Plan, filed on August 2, 2005 and revised as agreed upon by KeySpan, the OCA and Staff and filed with the Commission in a letter from KeySpan on September 8, 2005 are hereby APPROVED; and it is

FURTHER ORDERED, that the 2005-2006 Winter FPO rate calculation shall be filed no later than September 23, 2005 in accordance with the approved FPO Program.; and it is

FURTHER ORDERED, that KeySpan file a revised 2005-2006 Winter COG on September 23, 2005 and that the approved FPO rate calculation methodology be applied to the updated 2005-2006 Winter COG rates to determine the 2005-2006 Winter FPO rate.

By order of the Public Utilities Commission of New Hampshire this sixteenth day of September, 2005.

Thomas B. Getz Chairman	Graham J. Morrison Commissioner	Michael D. Harrington Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary