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Metro

TO: BOARD OF DIRECTORS DECEMBER 7, 2007

THROUGH: ROGER SNOBLE
CHIEF EXECUTIVE OFFICER

FROM: TERRY MATSUMOTO
CHIEF FINANCIAL SERVICES OFFICER AND TREASURER

SUBJECT: NATURAL GAS HEDGING PROGRAM

ISSUE

The Natural Gas Hedging Program (the "Hedging Program") requires that reports be provided to the Board quarterly on compliance with the Hedging Program guidelines and performance of the program.

DISCUSSION

The purpose of this report is to present the status of compliance and performance for the hedged portion of Metro's CNG budget. Operations related variances are presented in order to provide an overall perspective for CNG costs.

The objective of the Hedging Program is to provide "budget certainty" for compressed natural gas (CNG) fuel and to help establish the CNG budget in the upcoming year by locking in most of the cost in advance. Budget certainty is accomplished by utilizing a hedging instrument known as a commodity swap for most of the planned volume for each fiscal year.

As of the report date, Metro had executed three hedge transactions with two counterparties, completing all of the hedging for FY08 and 75% of the hedging for FY09. A summary of the currently outstanding hedge transactions is provided below.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of September 30, 2007

Period Hedged	Provider	Credit Ratings (S&P, Moody's, Fitch)	Contract Fixed Rate per Therm	Remaining Therms	Current Market Value
FY08	BP Corp.	AA+/Aa2/AA+	$0.759	38,360,000	($1,831,000)
FY09	Bear Energy	A+/A1/A+	$0.821	25,550,000	($1,299,000)
FY09	BP Corp.	AA+/Aa2/AA+	$0.817	13,505,000	($629,000)
					($3,759,000)

Positive/(negative) market values above indicate the amount Metro would receive/(pay) on termination. The rates listed in the table reflect the hedge contract rates and exclude the delivery cost and state mandated charges, which are currently $0.104 per therm.

Compliance

As of the date of this report the Hedging Program is in compliance with all the specified limitations and requirements. The individual compliance items are listed on Attachment A.

Performance

Overall, CNG costs were $432,000 over budget for the quarter, net of a favorable variance of $269,000 provided by hedging. See Attachment B for precise amounts.

Hedge performance is Metro's fixed rate payments to the hedge provider plus actual payments for gas minus amounts received under the hedge at the respective variable hedge (index) rates.

12.9 million therms were hedged out of the 13.1 million planned therms, 98% hedged. Hedge performance was favorable because the hedge fixed rate is $0.88 per therm, which is slightly lower than the budgeted rate of $0.90. The fixed rate payment portion of the hedge resulted in a $475,000 favorable variance. Under the variable rate portion of the hedge, Metro paid $8.9 million for gas. Under the hedge agreement Metro received variable rate payments of $8.7 million. The $206,000 difference is referred to as "basis variance," in this case unfavorable. Therefore, the net hedge performance was a favorable $269,000.

The budget for the quarter included 270,000 unhedged therms while the actual amount of unhedged therms purchased was nearly 1.4 million. The unhedged therms were purchased at an average rate of $0.69 per therm versus $0.90 in the budget. The net effect of the overage in therms purchased and the lower actual price was a $700,000 unfavorable variance for the unhedged therms.

For information purposes only, if we had not hedged the CNG variance would have been $2.0 million favorable due to lower actual gas prices during the quarter.

NEXT STEPS

- Take bids for hedge of final 25% of FY09 therms in December 2007
- Initiate FY10 hedging in January
- Issue an RFP to select/renew hedge consultant

ATTACHMENTS

A. Program Compliance
B. Summary of CNG Costs and Variances

Prepared by: Michael J. Smith, Assistant Treasurer

Attachment A

Program Compliance

Maximum Trade Maturity - was 24 months vs. policy max of 30

Hedge Ratio - is 98% vs. policy range of 90% to 100%

Maximum Trade Amount – All trade amounts have been in compliance with the Hedging Program guidelines. The two initial trades made in June were larger than the average directed by the policy because they included hedge amounts that would normally have been spread across multiple periods. The larger trades were necessary in order to get the program on schedule to have the rates locked in prior to the budget development process. The authorization for the Hedging Program provided an exception for the size and timing of the initial trades.

Frequency of Trades – Frequency is on a quarterly schedule, vs. policy range of 2 to 6 per year.

Timing of Trades – Subsequent to the initial trades, timing will be equally spaced by quarter.

Counterparty Credit Ratings – Credit ratings have remained stable over the quarter.

BP	AA+/Aa2/AA+	(S&P, Moody's, Fitch)
Bear Energy	A+/A1/A+	(S&P, Moody's, Fitch)

Collateral Requirements – Requirements to post collateral are based on credit ratings of the counterparties. The threshold is $25 million for counterparties rated "A-/Aa3" or better. The current market values of the trades are under the $25 million threshold, so no collateral is required.

Re-Confirm Assumptions – Assumptions have been reconfirmed for factors that would affect the Gas Company's cost of gas and reduce the correlation between the Gas Company's cost and the pricing index the hedges are tied to. There have not been any changes that would cause us to change our assumptions.

Re-Confirmation of Therms - The officially planned amount of therms for FY08 remains unchanged from the FY08 Adopted Budget and the planned FY09 therms remain unchanged from the value provided by the Operations staff based on the projected service levels.

All information is as of 9/30/2007.

Attachment B

Summary of CNG Costs and Variances

	Budget	Actual	Difference Fav/(Unfav)
Hedged			
Therms	12,880,000	12,880,000	
Fixed Rate Payments	$ 11,592,000	$ 11,116,466	$ 475,535
Cost of Gas		$ 8,885,203	
Variable Rate Payments Received		$ (8,678,925)	
Basis Variance		$ 206,277	$ (206,277)
Hedge Performance	$ 11,592,000	$ 11,322,743	$ 269,257
Cost/Therm	$ 0.900	$ 0.879	$ 0.021
Unhedged			
Therms	267,506	1,365,216	(1,097,710)
Cost of Gas	$ 240,756	$ 941,787	$ (701,032)
Cost/Therm	$ 0.900	$ 0.690	$ 0.210
Total			
Therms	13,147,506	14,245,216	(1,097,710)
Cost of Gas	$ 11,832,756	$ 12,264,530	$ (431,774)
Cost/Therm	$ 0.900	$ 0.861	$ 0.039
If No Hedging			
Therms	13,147,506	14,245,216	(1,097,710)
Cost	$ 11,832,756	$ 9,826,990	$ 2,005,766
Cost/Therm	$ 0.900	$ 0.690	$ 0.210

Note: All per therm amounts include $0.104 for mandated fees and delivery costs