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AUGUST 15, 2008

TO: BOARD OF DIRECTORS

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 in 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 our compressed natural gas (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 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, we had executed three hedge transactions with various counterparties, completing all of the hedging for FY09 and have executed three transactions out of a planned six to complete the FY10 hedging.

A summary of the currently outstanding hedge transactions is provided below. The positive/(negative) market values indicate the amount we would receive/(pay) on termination. The rates listed in the table reflect the hedge contract fixed rates and exclude the delivery cost and state mandated charges, which are currently $0.104 per therm.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of June 30, 2008

Period Hedged	Provider	Credit Ratings (S&P, Moody's, Fitch)	Contract Fixed Rate per Therm	Remaining Therms	Current Market Value
FY09	Bear Energy/ JP Morgan	AA-/Aa2/AA-	$0.8210	25,550,000	$8,450,113
FY09	BP Corp.	AA+/Aa2/AA+	$0.8165	13,505,000	$4,517,085
FY09	Barclays Bank PLC	AA/Aa1/AA	$0.7410	14,543,000	$5,781,873
FY10	Bank of America, N.A.	AA+/Aaa/AA-	$0.8500	8,760,000	$1,854,802
FY10	BP Corp.	AA+/Aa2/AA+	$1.0120	8,760,000	$696,859
FY10	BP Corp.	AA+/Aa2/AA+	$1.0650	8,760,000	$318,026
FY10	BP Corp.	AA+/Aa2/AA+	$0.9420	8,760,000	$1,197,205
Total				88,638,000	$22,815,963

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

For the quarter, CNG costs were $2.3 million over budget as a result of a $1.0 million unfavorable variance for hedge performance and $1.3 million of unhedged purchases above the budgeted volume. See Attachment B.

For the quarter, 12.7 million therms were hedged out of 13.0 million budgeted, for a 98% hedge ratio. The target hedge ratio of 95% was exceeded as a result of reductions in planned service that were implemented after the FY08 hedges were acquired.

Hedge performance for the quarter was unfavorable by $1.0 million because the variable rates received from the hedge were less than the monthly rates paid to the Gas Company, resulting in an unfavorable variance of $1.5 million. This difference is referred to as "basis variance". The unfavorable basis variance was partially offset by a $470,000 favorable variance on our fixed rate payments compared to the budget. Hedge performance is our fixed rate payments to the hedge provider, plus actual payments for gas purchases, minus variable rate payments received from the hedge provider at the monthly index rates.

The budget for the quarter included 300,000 of 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 $1.145 per therm versus $0.90 in the budget. The combined impact of the higher rate and increased amount of therms resulted in an unfavorable variance of $1.3 million for unhedged therms.

For information purposes only, if we had not hedged the CNG variance would have been an unfavorable $5.2 million, as opposed to an unfavorable $2.3 million. The difference is the result of the higher market rate of $1.20 during the quarter compared to the budgeted rate of $0.90. Therefore, hedging saved $2.9 million for the quarter.

For FY08 the hedging program performed as intended and stabilized the budget at an actual cost just under the budgeted rate of $0.90 per therm. See Attachment C. During the year prices in the spot market ranged from $0.65 to $1.35 per therm. The hedge program produced a cost about 2%, or $1.1 million greater than if we had not hedged due to lower actual prices early in the fiscal year. Total CNG cost for the year exceeded the budget by $3.2 million as a result of increased consumption above the budgeted level of therms.

NEXT STEPS

- Take bids on three dates over the calendar year to price the hedges for FY10

ATTACHMENTS

A. Program Compliance
B. Quarterly Summary of CNG Costs and Variances
C. Fiscal Year-to-date 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 2007 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 of bidding was quarterly for FY09 hedges, but will be 6 times per year for the FY10 hedges. The policy provides a range of 2 to 6 bids per year.

Timing of Trades – Timing will be equally spaced and occur approximately every other month.

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

	(S&P, Moody's, Fitch)
Barclays	AA/Aa1/AA
BP	AA+/Aa2/AA+
JP Morgan / Bear Energy	AA-/Aa2/AA-
Bank of America, NA	AA+/Aa2/AA+

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 FY09 and FY10 remain unchanged from the values provided by the Operations staff based on the projected service levels.

All information is as of 6/30/2008.

Attachment B

Quarterly Summary of CNG Costs and Variances
FY 2008 Q4

	Budget	Actual	Difference Fav/(Unfav)
Hedged			
Therms	12,740,000	12,740,000	
Fixed Rate Payments	$ 11,466,000	$ 10,995,656	$ 470,344
Cost of Gas		$ 15,382,422	
Variable Rate Payments Received		$ (13,894,216)	
Basis Variance	$ -	$ 1,488,206	$ (1,488,206)
Hedge Performance	$ 11,466,000	$ 12,483,862	$ (1,017,862)
Cost/Therm	$ 0.900	$ 0.980	$ (0.080)
Unhedged			
Therms	296,729	1,377,901	(1,081,172)
Cost of Gas	$ 267,056	1,577,966	$ (1,310,910)
Cost/Therm	$ 0.900	$ 1.145	$ 1.212
Total			
Therms	13,036,729	14,117,901	(1,081,172)
Cost of Gas	$ 11,733,056	14,061,828	$ (2,328,772)
Cost/Therm	$ 0.900	$ 0.996	$ 2.154
If No Hedging			
Therms	13,036,729	14,117,901	(1,081,172)
Cost of Gas	$ 11,733,056	$ 16,960,388	$ (5,227,332)
Cost/Therm	$ 0.900	$ 1.201	$ 4.835
Hedged vs. Un-hedged Difference - Fav/(Unfav)		$ 2,898,560	

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

Attachment C

Fiscal Year to Date Summary of CNG Costs and Variances
FY 2008 Q4

	Budget	Actual	YTD Difference Fav/(Unfav)
Hedged			
Therms	51,240,000	51,240,000	-
Fixed Rate Payments	$ 46,116,000	$ 44,224,272	$ 1,891,728
Cost of Gas		$ 44,845,295	
Variable Rate Payments Received		$ (43,078,092)	
Basis Variance		$ 1,767,203	$ (1,767,203)
Hedge Performance	$ 46,116,000	$ 45,991,475	$ 124,525
Cost/Therm	$ 0.900	$ 0.898	
Unhedged			
Therms	1,469,341	5,261,194	(3,791,853)
Cost of Gas	$ 1,322,407	4,583,078	$ (3,260,671)
Cost/Therm	$ 0.900	$ 0.871	$ 0.860
Total			
Therms	52,590,024	56,501,194	(3,911,170)
Cost of Gas	$ 47,331,022	50,574,553	$ (3,243,531)
Cost/Therm	$ 0.900	$ 0.895	$ 0.829
If No Hedging			
Therms	52,590,024	56,501,194	(3,911,170)
Cost of Gas	$ 47,331,022	$ 49,428,373	$ (2,097,351)
Cost/Therm	$ 0.900	$ 0.875	$ 0.536
Hedged vs. Un-hedged Difference - Fav/(Unfav)	$ -	$ (1,146,180)	

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