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NOVEMBER 27, 2012

TO: **BOARD OF DIRECTORS**

THROUGH: **ARTHUR T. LEAHY** by
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 to report 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 improve budget certainty for fuel costs and to help establish the CNG budget for the upcoming year by capping the cost in advance or otherwise reducing the effects of price increases on the budget. Budget certainty was improved through FY11 by utilizing a hedging instrument known as a commodity swap to hedge most of the planned volume for each fiscal year. In January 2011, the Board approved the updated CNG Hedging Program, adding commodity options and the use of cost stabilization reserves in addition to the continued use of commodity swaps. The addition of commodity options and cost stabilization reserves enhances the mix of tools we will use to hedge under various market conditions to reduce the potential for budget variances.

Beginning with FY12 we began using a "costless collar" strategy to facilitate better participation when rates are lower. With a costless collar there is no upfront cash outlay, as the purchase price of the "ceiling", the upper limit, is exactly offset by the sale price of the "floor", the lower limit.

As of September 30, 2012, we had five costless collar hedge transactions outstanding, hedging about 95% of our currently planned CNG volume for FY13 and about 12% of the planned FY14 volume. The table below provides a summary of the currently outstanding hedge transactions. Positive/(negative) market values indicate the amount we would receive/(pay) on an early termination at the specified valuation date. The table also lists the hedge contract rates, also known as "strike prices", for the ceilings and floors. Values in the table are market values and exclude the Gas Company's delivery costs and state mandated charges, which are currently $0.108 per therm.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of September 30, 2012

Period Hedged	Provider	Credit Ratings (S&P, Moody's, Fitch)	Contract Rate per Therm	Remaining Therms	Current Market Value*
FY13	RBC Capital	AA-/Aa3/AA	Ceiling / Floor $0.542 / $0.445	6,825,000	$(548,500)
FY13	Citibank NA	A/A3/A	Ceiling / Floor $0.489 / $0.38	6,825,000	(141,846)
FY13	Citibank NA	A/A3/A	Ceiling / Floor $0.413/ $0.275	9,828,000	189,606
FY13	Bank of America	A/A3/A	Ceiling / Floor $0.435/ $0.28	12,196,000	(113,848)
FY 14	Bank of America	A/A3/A	Ceiling / Floor $0.450/ $0.298	5,840,000	(156,483)
Total				41,514,000	$(771,071)

*Monthly LIBOR rate used.

Compliance

Subsequent to the Board's approval of the updated hedging program in January 2011 and following discussions with the Office of Management and Budget, it was determined that a costless collar strategy would be used to hedge 90% to 95% of our planned FY13 CNG volumes. The four hedges for FY13 were priced in November, December, January, and February of FY12. The first hedge for FY14 was priced in April, 2012.

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 $1.4 million under budget as a result of paying a rate lower than the budgeted rate and lower usage than budgeted. For the quarter, 12.5 million therms were hedged out of 12.2 million therms actually consumed, for a realized hedge ratio of 102.8%. For the remaining quarters in FY13, the hedge ratio will be lower because prior to executing subsequent hedges the estimated quantities were decreased to reflect lower budgeted total consumption. See Attachment B. For information purposes only, if we had not hedged there would have been an additional favorable variance of $565,900, which is equal to the amount we paid to the hedge providers as a result of the market rate being lower than the floor rate of the collar.

In the first quarter of FY13, the hedging program performed as intended, providing a cap on our risk of increased rates, while allowing us to continue participating in the current low rate environment.

NEXT STEPS

- Manage program and provide reporting
- Hire hedging consultant
- Execute additional hedges for FY14

ATTACHMENTS

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

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Attachment A

Program Compliance

Maximum Trade Maturity – The guidelines specify that hedges will settle or expire not more than 30 months from the date they are acquired. – All trade maturities are in compliance.

Maximum Trade Amount – Number of therms in CNG forecast times the Hedge Ratio divided by value for Frequency of Trades. At the time of each trade total therms hedged for the year may not exceed the Hedge Ratio. All trade amounts have been in compliance with the Hedging Program Guidelines.

Hedge Ratio - Limited to 100% of planned volume when based solely on the volume, but may be increased by up to an additional 10 percentage points as determined by staff, not to exceed 110% of planned volume - All trade amounts have been in compliance with the Hedging Program Guidelines.

Frequency of Trades: From 2 to 6 per year. – Four trades were made to hedge FY13. One trade has been made as of September 30, 2012 for FY14.

Timing of Trades: Trades will generally be executed in advance of the budget year and have at least 28 days separation between trades.

Counterparty Credit Ratings – There have been no changes in the counterparty credit ratings since the last quarterly report.

Summary of Credit Ratings-September 30, 2012

Provider	Credit Ratings (S&P/ Moody's / Fitch)
Bank of America	A/A3/A
Citibank NA	A/A3/A
RBC Capital	AA-/Aa3/AA

Collateral Requirements – Requirements to post collateral are based on credit ratings of the counterparties. The threshold is $25 million for counterparties rated "A-/A3" 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. However, there has been a trend for the past several years where the Gas Company's rates have moved slightly higher relative to the hedge index, resulting in a small cost variance. To date, the Gas Company has not been able to provide a good explanation for this trend.

Re-Confirmation of Therms - The amount of therms was reconfirmed with the Operations staff prior to entering into the first hedge for FY14 and will be reconfirmed prior to entering into additional hedges for FY14.

All information is as of the report date for the end of the quarter, unless otherwise specified.

Attachment B

Quarterly Summary of CNG Costs and Variances
FY 2013 Q1

		Budget	Actual	Difference Fav/(Unfav)	
Hedged					
	Therms	12,361,744	12,512,000	(150,256)	(1)
	Cost of Gas		$ 4,908,034		
	Hedge Settlements		$ 565,900		
	Total Cost	$6,832,439	$5,473,934	$1,358,505	
	Cost/Therm	$0.55	$0.44	$0.12	
Unhedged					
	Therms	60,872	-	60,872	(2)
	Cost of Gas	$33,480	$0	$33,480	
	Cost/Therm	$0.55	$0.00	$0.55	
Total					
	Therms	12,422,616	12,167,101	255,515	(3)
	Cost of Gas	$6,865,918	$5,473,934	$1,391,984	
	Cost/Therm	$0.55	$0.45	$0.10	
	Hedge Ratio	99.5%	102.8%		
If No Hedging					
	Therms	12,422,616	12,167,101	255,515	
	Cost of Gas	$6,832,439	$4,908,034	$1,924,405	
	Cost/Therm	$0.55	$0.40	$0.15	
	Hedged vs. Un-hedged Difference - Fav/(Unfav)		($565,900)		

Note: All per therm amounts include $0.108 for mandated fees and delivery costs

(1) Budgeted amount of therms to be hedged was greater than the actual amount hedged because of changes to the budget after hedges were executed.

(2) No gas was unhedged in the first quarter because of lower consumption.

(3) Actual amount was lower than budgeted because of decrease in actual consumption.