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JUNE 18, 2015

TO: BOARD OF DIRECTORS

**THROUGH: PHILLIP A. WASHINGTON
CHIEF EXECUTIVE OFFICER**

**FROM: NALINI AHUJA
EXECUTIVE DIRECTOR, FINANCE AND BUDGET**

SUBJECT: NATURAL GAS HEDGING PROGRAM

ISSUE

The Natural Gas Hedging Program (the "Hedging Program") requires that we report compliance with the Hedging Program Guidelines and program performance to the Board on a quarterly basis. This report is provided for the quarter ended March 31, 2015.

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 determine the CNG budget for the upcoming year by establishing a portion of the cost in advance or otherwise reducing the effects of price volatility on the budget. The Hedging Program allows us to use commodity swaps, commodity options and cost stabilization reserves.

Currently, the natural gas hedging program uses financial swaps where the index price used to value the swaps is based on the wholesale price of natural gas at the California-Arizona border on a monthly basis. Swaps effectively "lock-in" our cost for a volume of natural gas that is equivalent to the volume of the swap. When prices end up being higher than the swap price, we pay more to the natural gas supplier and receive a payment from the swap to offset the higher cost of natural gas. When prices end up being lower than the swap price, we pay less to the natural gas supplier and make a payment to the swap to offset the lower cost of gas. As of March 31, 2015, we had entered into one swap for the second half of fiscal 2015 and three swaps for fiscal 2016.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of March 31, 2015

Period Hedged	Provider	Credit Ratings (S&P, Moody's, Fitch)	Contract Fixed Rate per Therm	Market* Rate per Therm as of 3/31/15	Remaining Therms	Current Market Value
FY15	RBC	AA-/Aa3/AA	$0.3695	$0.2495	2,100,000	$-252,000
FY16	Citibank	A/A1/A+	$0.3872	$0.2903	8,400,000	$-813,960
FY16	RBC	AA-/Aa3/AA	$0.3349	$0.2903	8,400,000	$-374,640
FY16	RBC	AA-/Aa3/AA	$0.3055	$0.2903	8,400,000	$-127,680
Total				-	27,300,000	$-1,568,280

*Market price derived by adding henry hub natural gas futures prices to SoCal Basis swap prices as reported by Bloomberg.

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 approximately $795,000 under budget, including the $158,550 cost of the hedge, and the actual average gas price of $0.513 was lower than the per therm budget price of $0.60. The actual usage was higher than budgeted by 317,660 therms. See Attachment B.

The natural gas market has returned to its normal state of plentiful inventories and stable to decreasing prices with a positively sloped forward pricing curve meaning that prices that can be locked in for the future are higher than the spot market price. The 2014-2015 winter heating season was very normal and did not unexpectedly draw down on natural gas inventories. Consequently, wholesale spot prices have remained relatively steady since February. Natural gas supply increased by 6.19% on a year over year basis which indicates that supply is increasing to meet increasing demand which will keep prices relatively low except when inventories become unexpectedly depleted. As production grows, price spikes due to unexpectedly depleted inventories will be less severe since producers will be able to more quickly replenish inventories to their normal levels.

Given the budget of $0.60 per therm in fiscal 2015, the hedge for the remainder of fiscal 2015 for approximately 18% of the projected consumption, at under $0.50 per therm, provides budget protection while allowing participation in lower prices when they occur. Hedging for fiscal 2016 and fiscal 2017 will be assessed and entered into as market conditions warrant in order to establish the degree of cost certainty necessary with respect to the budgeting process while considering price.

NEXT STEPS

- Enter into additional hedges for fiscal 2016 and fiscal 2017 as warranted.

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 the maximum trade maturity for hedges is 30 months forward to coincide with the last business day of the fiscal year being hedged. – Hedges are less than 30 months forward.

Hedge Ratio - Limited to 100% of planned volume –FY15 and FY16 hedges are less than 100%, in compliance with the Hedging Program Guidelines.

Counterparty Credit Criteria – Requirements to post collateral are based on credit ratings of the counterparties and volume of hedges; in compliance.

- Aa3/AA- or better — No collateral required
- A3/A- or better — $25 million limit without collateral
- Baa1/BBB+ — $15 million limit without collateral
- Baa2/BBB — $10 million limit without collateral
- Baa3/BBB- — $ 2.5 million limit without collateral

Re-Confirm Assumptions –Before entering into new hedges we will reconfirm assumptions with our hedging advisor.

Re-Confirmation of Therms - The amount of therms will be reconfirmed with Operations prior to entering into new hedges.

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

Quarterly Summary of CNG Costs and Variances
FY 2015 QTR 3

Performance vs. Budget	Price per Therm		Volume in Therms	Total Cost	
Budget	$	0.6000	11,079,251	$	6,647,551
Actual therms consumed	$	0.4996	11,396,911	$	5,693,412
Variance to Budget excluding hedge: Fav (Unfav)	**$**	**0.1004**	**(317,660)**	**$**	**954,139**
Variance Analysis:					
Actual volume vs budget variance fav (unfav)	$	0.6000	(317,660)	$	(190,596)
Actual price vs budget variance fav (unfav)	$	0.1004	11,396,911	$	1,144,735
Variance to Budget excluding hedge: Fav (Unfav)				**$**	**954,139**
Therms Hedged and net receipts (payments) for hedge (a)			2,100,000	$	(158,550)
% of budgeted therms hedged			18.95%		
Total variance to budget including hedge				**$**	**795,589**
Total cost of gas including hedge	**$**	**0.513**		**$**	**5,851,962**
Actual cost as a percentage of budget					88.0%

(a) One hedge was in place for 3rd quarter FY15.