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TO: BOARD OF DIRECTORS MARCH 14, 2008

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 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 four hedge transactions with three counterparties, completing all of the hedging for FY08 and FY09. A summary of the currently outstanding hedge transactions is provided below.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of December 31, 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	25,480,000	($1,435,000)
FY09	Bear Energy	A+/A1/A+	$0.821	25,550,000	($1,080,000)
FY09	BP Corp.	AA+/Aa2/AA+	$0.817	13,505,000	($512,000)
FY09	Barclays	AA/Aa1/AA+	$0.742	14,543,000	$464,000
					($2,563,000)

Positive/(negative) market values above indicate the amount we 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 $1 million under budget for the quarter, inclusive of a favorable variance of $1.1 million provided by hedging. See Attachment B.

Hedge performance is our 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 the13.6 million planned therms, 95% hedged. Hedge performance was favorable because the hedge fixed rate is $0.86 per therm, which is slightly lower than the budgeted rate of $0.90. The fixed rate payment portion of the hedge resulted in a $694,000 favorable variance. Under the variable rate portion of the hedge, we paid $9.1 million for gas. Under the hedge agreement we received variable rate payments of $9.5 million. The $380,000 difference is referred to as "basis variance," in this case favorable. Therefore, the net hedge performance was a favorable $1.1 million.

The budget for the quarter included 685,000 unhedged therms while the actual amount of unhedged therms purchased was nearly 1.1 million. The unhedged therms were purchased at an average rate of $0.61 per therm versus $0.90 in the budget. The net effect of the overage in therms purchased and the lower actual price was a $69,000 unfavorable variance for the unhedged therms.

For information purposes only, if we had not hedged the CNG variance would have been $2.3 million favorable due to lower actual gas prices during the quarter.

NEXT STEPS

- Take bids on six dates over the calendar year to price the hedges for FY10
- Appoint replacement hedge consultant in April

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 96% 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 every other month.

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

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

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 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 12/31/2007.

Attachment B

Quarterly Summary of CNG Costs and Variances
FY 2008 Q2

	Budget	Actual	Difference Fav/(Unfav)
Hedged			
Therms	12,880,000	12,880,000	
Fixed Rate Payments	$ 11,592,000	$ 10,897,585	$ 694,415
Cost of Gas		$ 9,106,038	
Variable Rate Payment Received		$ (9,486,047)	
Basis Variance	$ -	$ (380,009)	$ 380,009
Hedge Performance	$ 11,592,000	$ 10,517,576	$ 1,074,424
Cost/Therm	$ 0.900	$ 0.817	$ 0.083
Unhedged			
Therms	684,762	1,117,730	(432,968)
Cost of Gas	$ 616,286	$ 685,440	$ (69,154)
Cost/Therm	$ 0.900	$ 0.613	$ 0.287
Total			
Therms	13,564,762	13,997,730	(432,968)
Cost of Gas	$ 12,208,286	$ 11,203,016	$ 1,005,270
Cost/Therm	$ 0.900	$ 0.800	$ 0.100
If No Hedging			
Therms	13,564,762	13,997,730	(432,968)
Cost of Gas	$ 12,208,286	$ 9,891,478	$ 2,316,808
Cost/Therm	$ 0.900	$ 0.707	$ 0.193

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