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Elizabeth A. Noël
People's Counsel

July 18, 2008

Ms. Dorothy Wideman
Commission Secretary
Public Service Commission of the
District of Columbia
1333 H Street, NW, 2d Floor, West Tower
Washington, D.C. 20005

Re: Gas Tariff 01-1–(Washington Gas' 2007-2008 Hedging Report)

Dear Ms. Wideman:

Enclosed please find for filing an original and fifteen (15) copies of the "Comments of the Office of the People's Counsel Regarding Washington Gas Light Company's 2007-2008 Hedging Report" **(Public Version)** in the above-referenced proceeding.

Please contact the undersigned if you have questions regarding this matter.

Sincerely yours,

Barbara L. Burton
Assistant People's Counsel

Enclosures
cc: All parties of record

BEFORE THE
PUBLIC SERVICE COMMISSION
OF THE DISTRICT OF COLUMBIA

In the Matter of the Application of	)	
Washington Gas Light Company, District	)	
of Columbia Division, For Authority	)	Gas Tariff 01-1
to Amend its General Service Provisions	)	**(PUBLIC VERSION)**

COMMENTS OF
THE OFFICE OF THE PEOPLE'S COUNSEL
REGARDING WASHINGTON GAS LIGHT COMPANY'S
2007-2008 HEDGING REPORT

Pursuant to Order No. 14836 issued by the Public Service Commission of the District of Columbia ("Commission" or "PSC") on June 18, 2008, in the above-captioned proceeding,[1] the Office of the People's Counsel ("OPC" or "Office") hereby submits its Comments regarding the annual report filed by Washington Gas Light Company ("WG") on May 30, 2008, addressing its District of Columbia hedging program.

I.

SUMMARY OF OPC'S POSITION

While WG has had some success limiting exposure to price spikes pursuant to its pilot hedging program during the last winter, OPC does not believe the hedging program sufficiently embraces the goal of minimizing gas costs. OPC is concerned WG's 2007-2008 hedging has over relied on the fixed-priced hedging option and also that WG undertook its fixed-price hedging purchases at locations that are higher cost than alternative markets. OPC urges the Commission to direct WG to adopt more aggressive approaches to reducing overall gas costs in conjunction with its efforts to stabilize prices and avoid price spikes through hedging activity.

[1] *In the Matter of the Application of Washington Gas Light Company, District of Columbia Division, for Authority to Amend its General Service Provisions*, GT01-1, Order No. 14836 (June 18, 2008).

Specific Recommendations

- WG should consider modifying its approach to hedging to evaluate and rely more on hedging alternatives that allow falling prices to flow through to customers and take advantage of variations in gas prices during the hedging purchase period.

- WG should be required to explain why it used a pricing point for its hedges exceeding the price of other alternatives. Similarly, WG should be required to explain why it focused all its fixed priced hedging at this expensive supply location when other alternatives, likely at lower costs, were available.

- OPC urges the Commission to encourage WG to take a more flexible and nimble approach in its hedging activity and to consider making hedged purchases in response to downward market movement during the purchase period.

II.

BACKGROUND

The Commission initially authorized WG to conduct a one-year pilot hedging program in Order No. 12201 in Case No. GT01-1.[2] In that order, the Commission established an aggregate volumetric limit on the pilot hedging program for WG's District of Columbia sales service and established five parameters: (1) WG must only use a price cap product, price band product, fixed price product, or some combination of each for hedging transactions in connection with physical gas purchases; (2) WG is prohibited from engaging in excessively speculative hedging; (3) subject to the normal prudency review of all the Company's purchased gas costs, WG may only recover through the Purchased Gas Charge ("PGC") the costs associated with gas price hedging transactions; (4)WG's hedging transactions should only be conducted with suppliers meeting the Company's Energy Acquisition Credit Policy; and (5) WG must structure all hedging transactions to make them transparent so the cost of gas under the hedging contract can be

[2] *In the Matter of Washington Gas Light Company, District of Columbia Division, for Authority to Amend its General Service* Provisions, GT01-1, Order No. 12201 at pp. 20-23 (Oct. 5, 2001).

distinguished from the cost to have the gas transported over the interstate transmission pipeline system from the point of purchase to the Company's city gate.[3]

In a series of orders, the Commission authorized WG to extend its gas hedging pilot program for additional annual periods.[4] On December 16, 2005, WG requested authorization to convert its pilot hedging program into a permanent program. In Order No. 13870, the Commission denied WG's request, ruling it was premature to approve the hedging program on a permanent basis until after WG filed the hedging report for the preceding winter period. The Commission granted WG's alternative request to extend its pilot hedging program for the 2006-2007 period.[5]

On May 30, 2006, WG submitted a renewed request for authorization of a permanent hedging program that WG combined with its annual hedging report for the 2005-2006 winter. In Order No. 14231, issued on March 6, 2007, the Commission accepted WG's 2005-2006 report but denied its request to make the hedging program permanent. Instead, the PSC directed WG to conduct a simulation of its proposed financial hedging program and directed WG to file an additional annual report on the pilot program. In addition, the Commission requested responses from WG on a series of questions pertaining to its hedging program, which culminated in the submission by the Gas Procurement Working Group of responses to the Commission's questions on March 31, 2008. On February 26, 2008, WG filed a request for an additional extension of its

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[3] Id. at pp. 20-21.

[4] *In the Matter of Washington Gas Light Company, District of Columbia Division, for Authority to Amend Its General Service* Provisions, GT01-1, Order No. 12327 at p. 26 (Sept. 10, 2002) (authorizing a three-year extension with minor modifications to the structure of the previously approved pilot hedging program); Id., Order No. 13654 at p. 5 (Aug. 8, 2005) (extending the pilot program through the 2005-2006 winter); and Id., Order No. 13870 at p. 5 (Feb. 3, 2006) (extending the pilot program through the 2006-2007 winter).

[5] Id., Order No. 13870 at pp. 4-6 (Feb. 3, 2006).

pilot hedging program. On March 7, the Commission issued an order extending the pilot hedging program through the 2008-2009 winter season.[6]

On May 30, WG submitted its annual report on its 2007-2008 pilot hedging program ("Hedging Report"). In Order No. 14836, the Commission directed interested parties to file comments with respect to the Hedging Report within 30 days of its order. OPC submits these comments to provide its views on the 2007-2008 hedging activity.

II.

COMMENTS

As it has stated in previous comments, the Office does not support hedging in isolation. OPC believes hedging is appropriate, but only to the extent it is part of a *balanced energy supply portfolio*. A balanced energy supply portfolio is a mix of natural gas supply, storage, and transportation assets that does not overly rely on any single component to meet the objective of providing a reliable, affordable, and low-cost source of natural gas supply to consumers in the District of Columbia. The components of the energy supply portfolio should include long-term gas purchases, short-term gas purchases (both monthly and daily), hedged gas supply purchases, peaking gas supply purchases, short-term gas transportation capacity, long-term gas transportation capacity, storage capacity, and peaking facilities (e.g., propane air plants and on-system LNG storage facilities). The appropriate balance is one that optimally balances the objectives of reliability and affordability.

The mix of long- and short-term gas commitments to purchase and store should reflect the relationship of base and weather-related gas consumption. Long-term commitments should be limited to base gas consumption plus the minimum likely requirement for weather-related gas.

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[6] Id., Order No. 14755 at p. 6 (Mar. 7, 2008).

Short-term purchases and peaking resources should cover foreseeable variations in demand up to the most adverse weather conditions.

The role of storage is to provide sources of supply in peak periods and to levelize gas purchases and transportation capacity use throughout the year. Off-season (April-October) gas tends to be less costly than peak season (November-March) gas. The more balanced the monthly acquisition of gas, the greater the utilization of pipeline transportation capacity and the lower the unit cost of that capacity.

Hedging plays a role in a balanced gas energy portfolio because it provides protection from price spikes during periods of extraordinary high gas prices. However, because hedging can also increase gas costs in comparison to non-hedged purchases, an appropriate balance must be struck to avoid imposing increased natural gas supply costs on consumers that would result from over-reliance upon hedging.

The risk that gas costs can be driven higher by hedging has become apparent in the years WG has conducted its pilot program and that trend has continued in the most recent winter period. Given the outcome of WG's hedging pilot program, the Commission must evaluate whether the costs and burdens of the hedging activity are justified, and whether, to what extent, and in what form the hedging activity is an appropriate component of WG's energy supply portfolio.

As is evident from recent experience, hedged purchases in and of themselves do not assure a least-cost gas supply. It is also clear that, in principle, hedging reduces the risk that gas costs will balloon if severe price volatility results from weather conditions or disruptions in the natural gas market. In recent years there have been periodic but somewhat isolated spikes in natural gas prices. Prices spiked in December 2000 through the beginning of January 2001 (before WG initiated its hedging program) and in late February and March 2003. Prices also rose appreciably across the board after Hurricanes Katrina and Rita disrupted Gulf Coast gas production in the fall of 2005. In several of the months during the pilot program when prices increased appreciably, the hedged purchases reduced WG's gas costs in comparison to market-priced purchases. However, measured over the span of time in which WG has hedged its gas acquisition for the District of Columbia, the hedged purchases have increased gas costs. If WG unduly relies on hedged purchases, then to the extent hedged purchases expose District of Columbia consumers to higher costs, they should not be required to bear the burdens associated with those risks.

The overarching objective of WG's gas procurement practices must be to procure natural gas for its firm sales customers on a least-cost, most reliable basis. In doing so, WG must develop and prudently implement a well-balanced portfolio of energy supply resources enabling it to fulfill its statutory obligation to provide safe, adequate and reliable energy at reasonable and affordable rates to District of Columbia energy consumers. As part of this effort, OPC believes it is appropriate to hedge a portion of WG's natural gas purchases, provided the hedging activity is undertaken appropriately. As we will discuss below, the Office believes WG's hedging activity can be improved.

1. Summary of 2007-2008 Hedging.

WG's Hedging Report provides a summary of its hedging activity for the 2007-2008 winter period. The Hedging Report provides a description of the hedging formula that WG applies to establish the upper limit on the gas it may purchase on a forward basis to hedge its gas costs, a description of the purchases made in May, June, July and August of 2007 to hedge winter price exposure, and an economic analysis of the results of its hedged purchases in comparison to market-based purchases at first-of-the-month index prices at pricing points associated with the transportation capacity that was used to transport the hedged purchases.

As in the past, WG engaged only in the Commission-approved bundled hedging products (forward physical gas purchases, purchases with price caps, and purchases with a price collar). It did so purchasing gas on ***[This portion contains information which Washington Gas alleges to be proprietary. Please contact Washington Gas for an appropriate confidentiality agreement or file with the Commission for a Proprietary Information Determination. Parties may seek a Commission ruling on confidentiality at any time in this proceeding.]***

Generally, WG's hedging program for the 2007-2008 winter was undertaken based on the pilot program parameters established in Order Nos. 12201 and 12327, as modified in Order No. 13221 to eliminate the restriction on hedged quantities. Applying its internal hedging formula using current data, WG established monthly target purchase quantities that, in the aggregate, amounted to ***[CONFIDENTIAL INFORMATION DELETED]***.[7] WG's hedged purchases were actually below the target quantity in each month of the 2007-20008 winter period.[8] As a result, hedged purchases in the 2007-2008 winter period amounted to approximately ***[CONFIDENTIAL INFORMATION DELETED]*** of the forecasted normal winter firm sendout of WG's firm sales customers. WG explains in the Hedging Report it has adopted a policy of limiting the price-protected purchases to ***[CONFIDENTIAL INFORMATION DELETED]*** of its average winter sendout, and it combines gas purchased and injected into storage in the summer months with its forward purchases of hedged gas when it applies this limitation on

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[7] This figure derives from the monthly limits under WG's established hedging formula as set out at page 4 of its Confidential Hedging Report. The daily limits by month are as follows: November - ***[CONFIDENTIAL INFORMATION DELETED]***; December - ***[CONFIDENTIAL INFORMATION DELETED]***; January - ***[CONFIDENTIAL INFORMATION DELETED]***; February - ***[CONFIDENTIAL INFORMATION DELETED]***; and March - ***[CONFIDENTIAL INFORMATION DELETED]***.

[8] ***[CONFIDENTIAL INFORMATION DELETED].***

price-protected purchases. Of the hedged (forward purchased) quantities, WG purchased ***[CONFIDENTIAL INFORMATION DELETED]***.

WG reports its hedged purchases on a system-wide basis cost ***[CONFIDENTIAL INFORMATION DELETED]*** than the cost of that quantity of gas would have been based on the actual 2007-2008 winter-period first-of-the-month index prices. Similarly, the hedged purchases resulted in an increase in District of Columbia gas costs of approximately $1 million in comparison to purchases at the prevailing first-of-the-month index prices at the locations where WG purchased the hedged gas quantities. The cost of the fixed price hedged purchases was ***[CONFIDENTIAL INFORMATION DELETED]*** the market price of gas in three months and ***[CONFIDENTIAL INFORMATION DELETED]*** the market price of gas in two months.[9] The market price of gas under capped transactions was ***[CONFIDENTIAL INFORMATION DELETED]*** the capped price in each month. The market price of gas purchased under collar transactions was ***[CONFIDENTIAL INFORMATION DELETED]*** the ceiling in each month and ***[CONFIDENTIAL INFORMATION DELETED]*** the cost floor under those transactions.[10] WG further states the above-market cost of the hedging program during the 2007-2008 period increased the average annual bill for District of Columbia ratepayers by $9 and increased the average winter bill amount by $8.

2. OPC Response to the 2007-2008 Hedging Activity.

As OPC has stated in the past, the fact that gas costs were higher as a result of the hedging activity does not in and of itself mean WG acted imprudently in undertaking the hedged purchases. OPC recognizes the principal purpose of hedging is to provide shelter against potential price spikes and upward price volatility and to avoid consumers being unduly exposed

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[9] On a system-wide basis, WG reports the ***[CONFIDENTIAL INFORMATION DELETED]***.

[10] ***[CONFIDENTIAL INFORMATION DELETED]***.

to upward price volatility in winter months. Given the lingering after effects of major hurricanes in 2005, concerns raised about the availability of gas supplies, and the impact of world oil prices on the natural gas market, the potential for volatile gas prices continues to be present. Hedging in the immediate past winter afforded consumers protection from potentially higher gas costs that might have occurred had weather and market conditions been more severe. In addition, the incremental cost of hedging to customers in the most recent winter was dramatically lower than the cost in the preceding winter.

WG's report shows its hedges reduced gas costs modestly in comparison to first-of-the-month index-priced purchases in two of the winter months and increased gas costs in comparison to first-of-the-month purchases in three months.[11] If weather conditions during the winter had been more severe, or had hurricanes occurred and impacted prices the following winter, and had gas prices had spiked as they had in winter months in prior periods, the hedged purchases WG consummated would have further offset price spikes and resulted in gas cost savings. The hedged purchases would have provided "insurance" against harmful impacts if weather and market conditions had been different.

Consistent with the objectives of the pilot hedging program, OPC discusses below the extent to which the hedged purchases yielded protection from price spikes and reduced volatility in gas costs. OPC further will discuss the burden the hedged purchases have imposed on ratepayers to achieve the benefits associated with reduced exposure to price spikes and less

[11] WG's hedging report shows the following net results for its hedged purchases in comparison to market priced purchases:

	November	December	January	February	March
Cap	*[CONFIDENTIAL INFORMATION DELETED]*				
Collar	*[CONFIDENTIAL INFORMATION DELETED]*				
Fixed	*[CONFIDENTIAL INFORMATION DELETED]*				
Total	*[CONFIDENTIAL INFORMATION DELETED]*				

volatility in gas prices and will conclude with recommended changes in WG's hedging activity designed to reduce, where possible, the cost of hedging purchases.

a. Hedged Purchases Did Not Offset Large Price Spikes Because Market Prices in the 2007-2008 Winter Were Not Appreciably Above the Anticipated Winter-Period Prices that Formed the Basis for the Hedged Purchases Made in the Summer of 2007.

As will be shown below, market expectations regarding gas prices for the then-upcoming winter during the summer of 2007 when WG made its hedging purchases varied significantly from the prices that existed in the market during the 2007-2008 winter. As a result, the market did not experience price spikes that would have been avoided by the hedged purchases. Set forth in the table below are the closing prices for NYMEX futures contracts for each of the 2007-2008 winter months that were recorded on the first and mid-month trading days in the summer months of 2007. As shown in the table, expected future gas prices (based on the NYMEX contract prices) were relatively stable in the early part of the summer and declined in the later part of the summer.

Summer 2007 NYMEX Closing Prices for 2007-2008 Winter Months

	5/1	5/15	6/1	6/15	7/2	7/16	8/1	8/15
Nov. 07	$8.84	$8.97	$8.903	$9.031	$7.799	$7.457	$7.484	$7.837
Dec. 07	$9.525	$9.625	$9.593	$9.765	$8.549	$8.182	$8.369	$8.537
Jan. 08	$9.865	$9.955	$9.935	$10.119	$8.909	$8.537	$8.764	$8.902
Feb. 08	$9.855	$9.94	$9.933	$10.111	$8.909	$8.539	$8.782	$8.909
Mar. 08	$9.615	$9.714	$9.705	$9.884	$8.694	$8.339	$8.622	$8.669
Average	$9.54	$9.641	$9.6138	$9.782	$8.572	$8.211	$8.404	$8.571

WG made its hedged purchases in May, June, July and August, when expected prices based on the NYMEX were generally below $10 per Dth. As shown above and in the table below, however, the NYMEX closing prices for the 2007-2008 winter contracts declined in the late summer and then declined further after the summer as mild weather, high storage inventories, and market conditions yielded falling gas prices. Generally, in late summer and early fall the expectations concerning future gas prices, as evidenced by NYMEX prices, were that prices would be lower than the prices that had been expected over the earlier summer months.

Fall 2007 NYMEX Closing Prices for 2007-2008 Winter Months

	9/4	9/17	10/1	10/15	Sept.-Oct. Average	May-Aug. Average
Nov. 07	$6.576	$7.317	$7.050	$7.445	$7.097	$8.29
Dec. 07	$7.463	$7.932	$7.797	$8.012	$7.801	$9.018
Jan. 08	$7.858	$8.272	$8.163	$8.333	$8.156	$9.373
Feb. 08	$7.833	$8.292	$8.193	$8.363	$8.170	$9.372
Mar. 08	$7.725	$8.097	$8.001	$8.173	$7.999	$9.155
Average	$7.491	$7.982	$7.841	$8.065	$7.845	$9.042

The market prices for physical gas purchases during winter months in 2007-2008 were lower than the prices that were expected for the winter during the preceding summer trading as demonstrated by NYMEX closing prices. As shown in the table below, the first-of-the month index prices over the 2007-2008 winter period varied from month to month at the various pricing points where gas supplies feed WG's transportation services. Prices were relatively flat from November to January, but prices rebounded in February and March as late-season cold weather and depleted storage inventories affected market prices. But in general, the trend of reduced prices observed in the NYMEX contract prices during the fall of 2007 was observed in the early winter months. Prices increased in February and March, approximately reaching prices anticipated during the previous summer NYMEX trading period when WG entered into its hedged transactions.

Winter 2007-2008 First-of-the-Month Index Prices

Pricing Point	Nov.	December	January	February	March
Colombia Gulf	$7.19	$7.16	$7.15	$7.98	$8.89
Columbia Appalachia	$7.55	$7.46	$7.42	$8.29	$9.38
DTI Appalachia	$7.59	$7.69	$7.73	$8.53	$9.45
Transco Zone 3	$7.39	$7.36	$7.35	$8.31	$9.09
Transco Zone 6, non-NY	$7.85	$8.37	$9.28	$10.66	$9.98
Average	$7.514	$7.608	$7.786	$8.754	$9.358

As a result of the flat gas prices in the early part of the 2007-2008 winter and the modest increase in prices in the late winter, significant price spikes did not materialize. As shown above, the hedged purchases yielded modest reductions in comparison to market purchases in the late winter. Thus, the hedged purchases provided protection against higher prices in some months, but overall the protection against dramatic price spikes was not necessary because market conditions did not result in dramatically higher prices than those expected when WG entered into its hedged transactions.

b. **Price Volatility of WG's Hedged Gas Purchases for the 2007-2008 Winter Was Slightly Lower Than the Volatility Experienced for First-of-the-Month Market Prices in the Winter Months.**

While gas prices did not spike to the degree experienced during the most volatile of recent winter periods, the highest and lowest prices at each of the respective pricing points linked to WG's transportation capacity over the 2007-2008 winter varied by 23.7 to 35.8 percent. WG purchased its hedged gas supply from only ***[CONFIDENTIAL INFORMATION DELETED]***. The volatility in market prices from the highest to the lowest prices among these two locations over the winter period was 49.1 percent. This relatively large variation is partly the result of Transco non-New York Zone 6 price generally trading at a higher price than the Columbia Gulf mainline price, but it also reflects the variability of prices over the winter, particularly in March 2008.

It is apparent from WG's Hedging Report its hedged purchases exhibited a reduced degree of price variation in comparison to winter market prices. ***[CONFIDENTIAL INFORMATION DELETED].*** Under a winter strip purchase, the price for each purchase is the same in each winter month and month-to-month volatility is eliminated for each transaction. WG appears to have entered into ***[CONFIDENTIAL INFORMATION DELETED]***.[12]

Similarly, WG entered into capped purchases with ***[CONFIDENTIAL INFORMATION DELETED]*** gas suppliers for multi-month periods.[13] WG entered into multi-month collar transactions with ***[CONFIDENTIAL INFORMATION DELETED]*** suppliers.[14] The fixed price hedged gas purchases resulted in relative price stability and protection (in theory) against price spikes, while the purchases subject to collars and price caps were more volatile, but with such volatility largely benefitting WG's customers because the gas price was able to decline as market prices were reduced from the prices that were anticipated in the summer when WG made its purchases. WG's hedged purchases on the ***[CONFIDENTIAL INFORMATION DELETED].*** The highest and lowest cost hedged purchases showed a comparable degree of price variability (54.5%) to that experienced in the market between the highest and lowest physical gas prices. ***[CONFIDENTIAL INFORMATION DELETED]***. But variability among the categories of hedged products showed modestly reduced volatility in relation to the physical market prices over the winter.

c. WG's Hedged Purchases in 2007-2008 Cost More Than Purchases at First-of-the-Month Index Prices, But Not to the Degree Experienced in Recent Winters.

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[12] Attachment A to the Hedging Report shows ***[CONFIDENTIAL INFORMATION DELETED].***

[13] Attachment A to the Hedging Report shows ***[CONFIDENTIAL INFORMATION DELETED].***

[14] Attachment A to the Hedging Report shows ***[CONFIDENTIAL INFORMATION DELETED].***

As shown in WG's Hedging Report, the experience of the most recent winter continues a trend where the first-of-the-month prices, on balance, were lower than the cost of hedged purchases. In the 2007-2008 winter, WG's hedged purchases were more than ***[CONFIDENTIAL INFORMATION DELETED]*** expensive than what would have been incurred had WG made baseload purchases at first-of-the-month index prices immediately before the month of delivery. As shown in the table below, the experience from the most recent winter is consistent with the previous winters when hedged purchases were made. The cost of hedged purchases was ***[CONFIDENTIAL INFORMATION DELETED]***. However, the degree to which the hedged purchases ***[CONFIDENTIAL INFORMATION DELETED]***.

Monthly and Aggregate Annual Costs of WG's Hedging Pilot Program

	November	December	January	February	March	Total
2001-02	***[CONFIDENTIAL INFORMATION DELETED]***					
2002-03	*NA*	*NA*	*NA*	*NA*	*NA*	*NA*
2003-04	***[CONFIDENTIAL INFORMATION DELETED]***					
2004-05	***[CONFIDENTIAL INFORMATION DELETED]***					
2005-06	***[CONFIDENTIAL INFORMATION DELETED]***					
2006-07	***[CONFIDENTIAL INFORMATION DELETED]***					
2007-08	***[CONFIDENTIAL INFORMATION DELETED]***					
Total	***[CONFIDENTIAL INFORMATION DELETED]***					

As is evident from WG's actual hedging experience, its fixed price gas purchases, purchases at capped prices, and purchases with a floor and cap have resulted in an overall ***[CONFIDENTIAL INFORMATION DELETED]*** over the six winters in which District of

Columbia customers received the benefits from and bore the cost burden of hedged natural gas purchases.[15]

While hedging in the early winter months has generally tended to reduce gas costs, over the balance of the winter period, hedged purchases have tended to be more expensive than baseload gas purchases at prevailing first-of-the month index prices. The experience in the most recent winter was contrary to the general trend because hedged gas costs were higher in comparison to first-of-the-month prices in the early winter and fell below market prices in the late winter.

In Order No. 14231, the Commission declined to approve WG's request to convert its pilot hedging program into a permanent program, in part on grounds WG had not shown the benefits associated with its program outweigh the costs.[16] The Commission further expressed concern about whether the protection against price volatility places a reasonable burden on ratepayers. Given the magnitude of the increase in gas costs resulting from the WG's hedging activity, the Commission's concerns are well founded.

In the most recent winter, WG's customers paid ***[CONFIDENTIAL INFORMATION DELETED].***[17] By comparison, the weighted average first-of-the-month winter price on Columbia Gulf was $7.674 per Dth, and the weighted average winter price on Transco (at the non-New York Zone 6 pricing point) was $9.228. In effect, the concern expressed by the

[15] During the 2002-2003 winter period, WG did not engage in hedged purchases for its District of Columbia customers. The hedging it undertook for its Maryland and Virginia customers resulted in a reduction to gas costs in comparison to purchases at first-of-the month prices. An analysis of the WG hedging including the 2002-2003 hedging is as follows:

	November	December	January	February	March	Total
2002-03	***[CONFIDENTIAL INFORMATION DELETED]***					

[16] Order No. 14231 at p. 10.

[17] ***[CONFIDENTIAL INFORMATION DELETED].***

Commission in Order No. 14231 – that customers could be locked into high prices to avoid extreme prices and to avoid volatility – was born out. OPC is concerned the hedged purchases resulted in higher gas costs and believes additional efforts are needed to avoid this result in the future.

d. WG Should Consider Modifying Its Approach to Hedging to Evaluate and Rely More on Hedging Alternatives That Allow Falling Prices to Flow Through to Customers and to Take Advantage of Variations in Gas Prices During the Hedging Purchase Period.

As noted previously, WG based its hedging for the 2007-2008 winter on the output of the formula the Company has previously used to determine volume limits on hedged natural gas purchases, with an additional constraint that hedged purchases and stored gas, in combination, ***[CONFIDENTIAL INFORMATION DELETED]***. WG established the target purchase volume ***[CONFIDENTIAL INFORMATION DELETED]*** and limited its actual purchases to approximately ***[CONFIDENTIAL INFORMATION DELETED]***. WG undertook its hedging by purchasing three hedged products in the months of May, June, July and August 2007.

WG relied most extensively on ***[CONFIDENTIAL INFORMATION DELETED]***. It is evident, therefore, WG's hedging, in retrospect, relied most heavily on the most expensive of the options available to it when it entered into hedging transactions. In addition, ***[CONFIDENTIAL INFORMATION DELETED].***

Given the very high prices of the hedged purchases at ***[CONFIDENTIAL INFORMATION DELETED]***, use of alternative pricing options allowing for costs to be reduced if the market did not experience upward price volatility was certainly appropriate. ***[CONFIDENTIAL INFORMATION DELETED]. [CONFIDENTIAL INFORMATION DELETED]. [CONFIDENTIAL INFORMATION DELETED].*** Given the fact that ***[CONFIDENTIAL INFORMATION DELETED]*** by their nature do not allow ratepayers to benefit if gas prices decline, in a period of high gas prices, it would seem hedging products with a greater degree of downward price flexibility could be more advantageous. OPC is concerned WG over-relied on ***[CONFIDENTIAL INFORMATION DELETED]*** for its 2007-2008 hedging activity and that this resulted in unnecessarily high gas costs.

The Commission should evaluate WG's reliance upon ***[CONFIDENTIAL INFORMATION DELETED]*** and consider requiring WG to focus during periods of high gas costs on hedging with the potential to produce lower gas costs if prices decline in relation to the expectations at the time the hedges are undertaken. While the use of collars and, to a larger extent, the use of caps may not have as significant of an effect on reducing price volatility in the winter months as ***[CONFIDENTIAL INFORMATION DELETED]*** do, volatility associated with declining gas costs is not adverse to ratepayers and should be pursued.

Likewise, OPC is concerned WG's hedging is being done ***[CONFIDENTIAL INFORMATION DELETED]***. The winter-period average prices for the supply points feeding WG's transportation contracts are as follows:

Columbia Gulf	$7.674
Columbia Appalachia	$8.02
DTI Appalachia	$8.19
Transco Zone 3	$7.90
Transco Zone 6 non-NY	$9.228

Assuming the forward basis prices implicit in the forward fixed price purchases reflect the market price differential between these pricing points, the forward purchases would reflect a NYMEX price plus a basis parallel to the actual price spread between the Henry Hub and these various markets. ***[CONFIDENTIAL INFORMATION DELETED]***. Based on actual winter 2007-2008 prices, this point was $1.32 more expensive than the price at a Gulf Coast location on the same pipeline. It was also considerably more expensive than the Gulf Coast prices on

Columbia Gulf or the Appalachian prices on other pipelines that could have been used for fixed price hedging.

WG claims it purchases gas at Leidy on Transco to avoid force majeure risk. But it is apparent other locations in the Appalachian area have traditionally had lower priced gas. WG should be required to explain why it used a pricing point for its hedges exceeding the price of other alternatives. Similarly, WG should be required to explain why it focused all its fixed priced hedging at this expensive supply location when other alternatives that likely would have been lower cost were available to it. From its Hedging Report, it would appear WG over-relied on an expensive pricing point.

In addition, WG has explained in the past it undertakes its gas purchases through a bidding process at fixed intervals during the summer period. In a sense, this is a dollar-cost-averaging approach in which WG purchases gas over the course of the summer to produce a blend of market prices over the purchase period. It is OPC's understanding WG does not seek to time its purchases in an attempt to make such purchases at what might be considered optimal times. For example, if a down dip in the forward market prices occurred, WG does not seek to time its hedged purchases to take advantage of price movements.[18]

Given the high cost of gas experienced in recent years and the fact that hedged purchases have been made at costs that have driven up gas costs, OPC urges the Commission to encourage WG to take a more flexible and nimble approach in its hedging activity and to consider making hedged purchases in response to downward market movement during the purchase period. For example, if a market event such as the release of the Department of Energy's gas storage report, coupled with mild summer weather, results in significant downward price movement and a

[18] However, WG may avoid making purchases when it is a demonstrably inopportune time to make such purchases. In prior hedging reports, WG indicated it avoided making purchases in some months that were unduly affected by hurricanes.

corresponding decline in the forward price curve that tends to set the price of its hedged purchases, WG should consider options that would enable it to capture favorable pricing for its hedged purchases.

Under market conditions existing in most recent years, hedging did not reduce the cost of gas to consumers. While OPC does not object *per se* to the fact that hedging failed to reduce gas costs relative to the costs that could have been experienced in unhedged purchases, OPC remains concerned. OPC is cognizant that properly made hedged purchases need not necessarily reduce gas prices on an absolute basis to be beneficial and to yield independent, insurance-type protection against price spikes afforded by hedging. Had the recent winters been colder than that actually experienced, and in particular, had the winters been colder in the later months when WG's storage resources typically are more depleted, the hedged purchases would have moderated what could have been substantial or even catastrophic price spikes. That is precisely what happened in February and March 2003 when WG's hedged purchases for Virginia and Maryland customers ***[CONFIDENTIAL INFORMATION DELETED]***.

As OPC has consistently maintained, the Office is not a proponent of hedging *per se*. Rather, OPC submits over-reliance on hedging can expose WG's energy supply, its costs, and ultimately, rates, to unnecessary risks. This is a cost burden. District of Columbia consumers should not be required to assume or should they be asked to underwrite the risks associated with WG's reliance on hedging or upon any single element in an energy portfolio.

OPC reiterates its position that hedging is merely one component of a balanced energy supply portfolio, which should also include the use of storage resources, short-term baseload and spot purchases, peaking resources, and other gas supply options. The role of hedging as part of a balanced portfolio could be enhanced by refining the Company's focus to maximize opportunities to reduce gas costs in conjunction with hedging activity.

OPC urges the Commission to direct WG to undertake such refinements to its hedging program as discussed above.

III.

CONCLUSION

WHEREFORE, for the foregoing reasons, the Office urges the Commission to diligently review the Hedging Report and to consider requiring modifications consistent with the comments presented above.

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Dated: July 18, 2008

CERTIFICATE OF SERVICE

Gas Tariff 01-1

I hereby certify that on this 18th day of July, 2008, a copy of the foregoing "Comments of the Office of the People's Counsel Regarding Washington Gas Light Company's 2007-2008 Hedging Report" **(Public Version)** were served on the following parties of record by hand delivery, electronic mail, or first class mail, postage prepaid:

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