



STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

APPLICATION OF INDIANA GAS COMPANY,)
 INC. D/B/A VECTREN ENERGY DELIVERY OF)
 INDIANA, INC. (“VECTREN NORTH”) FOR) CAUSE NO. 37394 GCA 116 S1
 APPROVAL OF CHANGES IN ITS GAS RATES)
 THROUGH A GAS COST ADJUSTMENT IN) APPROVED: MAR 21 2013
 ACCORDANCE WITH IND. CODE § 8-1-2-42(g))
 AND 8-1-2-42.3)

ORDER OF THE COMMISSION

Presiding Officers:

James D. Atterholt, Chairman

David E. Veleta, Administrative Law Judge

On November 28, 2012 the Indiana Utility Regulatory Commission (“Commission”) issued an Order in Cause No. 37394 GCA 116 pursuant to which this subdocket was established to consider approval of two long-term gas purchase transactions proposed by Indiana Gas Company, Inc. d/b/a Vectren Energy Delivery of Indiana Inc. (“Vectren North” or “Petitioner”). The Commission scheduled a technical conference, which occurred on December 18, 2012, where questions related to the proposed long-term gas purchase contracts were raised and discussed. At that technical conference, a procedural schedule was established for the subdocket proceeding.

On January 16, 2013, Petitioner pre-filed the direct testimony and exhibits of Perry M. Pergola. On January 23, 2013, the OUCC pre-filed the direct testimony of Leja D. Courter. On January 25, 2013, Petitioner pre-filed rebuttal testimony of Mr. Pergola.

Pursuant to notice published as required by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, a public hearing was held in this Cause at 9:30 a.m., on January 30, 2013 in Room 222, PNC Center, 101 West Washington Street, Indianapolis, Indiana. At the hearing, Petitioner and the OUCC appeared by counsel. Petitioner and the OUCC offered their respective prefiled testimony and exhibits which were admitted into evidence without objection.

Based upon the applicable law and the evidence presented herein, the Commission now finds:

1. **Statutory Notice and Commission Jurisdiction.** Due, legal and timely notice of the hearing in this Cause was given and published by the Commission as required by law. Petitioner is a public utility as that term is defined in Indiana Code § 8-1-2-1(a). Under Indiana Code § 8-1-2-42(g), the Commission has jurisdiction over changes to Petitioner’s rates and

charges related to adjustments in gas costs. Therefore, the Commission has jurisdiction over Petitioner and the subject matter of this Cause.

2. Petitioner's Characteristics. Petitioner is a corporation duly organized and existing under the laws of the State of Indiana. Petitioner has its principal office at One Vectren Square, Evansville, Indiana. Petitioner is engaged in rendering natural gas utility service to the public within the State of Indiana; and owns, operates, manages, and controls plant and equipment used for the distribution and furnishing of such services.

3. Evidence on Long-Term Contracts. Mr. Pergola testified that the current natural gas environment provides an opportunity to place some longer-term supply commitments into Petitioner's portfolio of gas supplies. Mr. Pergola opined that ample volumes of low-priced gas production from numerous thriving domestic shale gas supply basins has allowed for lower annual commodity prices and the flattening of the differential between summer and winter monthly pricing. Mr. Pergola stated that this current price environment is providing opportunities that have not been available for many years in regards to multi-year pricing commitments. Specifically, he explained that long-term gas contracts address the risk of price escalation and volatility at a level that should never be far above current market price. Mr. Pergola explained that Vectren North has analyzed the New York Mercantile Exchange ("NYMEX") strip to assess the market's view of future gas prices. He explained that the current market is in contango, meaning that current prices reflect a discount which dissipates over time. This discount has been driven by the existence of excess supply. Based on this opportunity to obtain discounted pricing, as well as reference to recent price forecasts by external experts such as PIRA Energy Group and IHS CERA that support the reasonableness of the proposed pricing, Vectren North proposes to enter into two transactions: a five-year contract for the term of April 2013 – March 2018 at a fixed price not to exceed \$4.50/Dth for 500,000 dth per month, (approximately 10% of its annual supply), and a ten-year contract for the term of April 2013 – March 2023 at a fixed price not to exceed \$5.00/Dth for slightly more than one BCF per year.

Before proceeding with these transactions, Vectren North seeks input and a determination that the contracts, in light of current market conditions, represent a reasonable approach to gas procurement to mitigate price volatility. Vectren North points out that since all purchases are reviewed based on conditions at the time of the transactions, it is not changing the standard of review, but instead is seeking a determination using this standard now, at the front end of the transactions, rather than at some time after the commitments have been made and cannot be terminated. If the transactions are not supported as being reasonable, Vectren North likely will not proceed.

In response, OUC witness Courter recommended that the Commission deny pre-approval of the two contracts proposed by Petitioner. Mr. Courter stated that pre-approval of the contracts would allow Petitioner to purchase and require its customer to pay natural gas commodity prices that exceed the current market prices for a considerable portion of the time periods involved. Mr. Courter further explained that Petitioner could use annual and monthly futures contracts to purchase natural gas at market based rates for the next four to six years at less cost than in the proposed five and ten-year contracts. Mr. Courter testified that neither the NYMEX settlement prices for the last five years nor price forecasts and projections from PIRA, Wood Mackenzie

Research and Consulting and IHS CERA are relevant to the analysis. Mr. Courter said that the OUCC will not engage in a hindsight review of gas costs. He also said that gas costs purchases should be evaluated based on facts and circumstances that are known or reasonably should have been known at the time the gas was procured. Mr. Courter explained the basis for his opinion that Petitioner has a risk of disallowance of gas costs if it signs the proposed five-year and ten-year contracts without pre-approval, if they are priced above market prices. Mr. Courter indicated that Vectren could minimize its risk of disallowance if it continued to procure gas at prices tied to natural gas futures and spot market indices. During the hearing, in response to bench questions, Mr. Courter explained that he did not support entry into purchase contracts longer than two years in duration because market conditions become more uncertain as more time passes.

On rebuttal, Mr. Pergola denied that Petitioner is proposing to enter into long-term transactions at prices in excess of those now available in the market, based on prevailing NYMEX futures contract pricing. He explained that the “not to exceed” or “ceiling” price is different from the actual price Vectren would pay for the term of each proposed long-term transaction. He went on to say that when the time comes to execute a transaction, Vectren North will look at the then-current NYMEX futures pricing and use that pricing as the basis for the contracts it will pursue. He said that, as proposed, the average of the five year pricing at that time would dictate the price to be paid under the five-year contract. However, he agreed with Mr. Courter that as an alternative to entry into a single five year averaged price contract, Vectren could enter into five annual contracts with a different fixed price for each year of the term. At the hearing, Mr. Pergola confirmed that under either approach, customers would ultimately pay the exact same amount during the contract term.

Mr. Pergola confirmed that Petitioner and OUCC are in agreement that NYMEX prices below the ceiling will actually be used to complete the transaction. Mr. Pergola discussed the risk-reward analysis previously detailed in his direct testimony in Cause No. 37394 GCA 116 and this proceeding. He confirmed that the current price environment is highly contango, which reflects a relative discount driven by transient conditions, such as current supply exceeding demand. He said that all prices along the curve reflect a discount to the equilibrium price; a discount that dissipates with longer dated contracts. Mr. Pergola explained the reasons historical actual NYMEX settlements, current NYMEX futures pricing and projections from industry experts should all be considered when making decisions regarding short-term and long-term hedge transactions. Mr. Pergola said that pre-approval of the five year and ten year transactions proposed in this proceeding tied to NYMEX natural gas futures could provide certainty for a portion of the Company’s gas supply portfolio for years to come. Furthermore, at the hearing in this Cause, Mr. Pergola said that the Commission previously has found it reasonable for Petitioner to enter into long-term contracts, with terms up to ten years.

At the hearing, in response to bench questions, Mr. Pergola testified that given the production costs associated with shale gas, the prices proposed by Petitioner in these two long-term contracts are closer to the market’s floor than the ceiling. He said that the cost of production is such that prices are not likely to go much lower, but, given the potential uses of natural gas and the possibility of increased regulation, they could go higher. These long-term contracts are designed to mitigate potential future volatility.

4. Commission Discussion and Findings. Indiana Code § 8-1-2-42(g)(3)(A) requires Petitioner to make every reasonable effort to acquire long-term natural gas supplies in order to provide service to its customers at the lowest gas cost reasonably possible. The Commission has indicated that Indiana's gas utilities should make reasonable efforts to mitigate gas price volatility. This includes use of a portfolio approach to procurement that works to mitigate gas price volatility and considers market conditions and the price of natural gas on a current and forward-looking basis.

Based on the testimony submitted, we find that we are able to review the proposed contracts based on market conditions and that, at this time, the proposed transactions represent a reasonable approach to volatility mitigation. Growing shale gas production has driven market prices down. In this environment, it is possible to execute gas contracts with five and ten year terms that address the risk of price escalation and volatility at prices that likely will not greatly exceed prevailing market price. We agree with both parties that market conditions over time remain uncertain, which supports continued efforts to consider hedging so customers are not completely exposed to market conditions at any point in time.

The OUCC and Petitioner both correctly note that, in reviewing the propriety of entering into long term contracts, we consider the facts as they were known at the time the decision was made to enter into the agreements. Here, where a new approach to hedging is proposed, it is appropriate to consider the concept and provide guidance, based on the record, prior to use of longer term contracts before commitments are made. Because markets change over time, Petitioner will always bring us any such proposals for review and each proposal will be reviewed based on the then- current circumstances. Having reviewed the facts known to the parties at the time these transactions are being considered, we find it is prudent for the Petitioner to enter into the contracts described in Mr. Pergola's testimony. The facts highlighted by the OUCC in opposition to approval of the agreements are not convincing evidence that Petitioner would be imprudent to enter into these agreements. Mr. Courter contends that the ceiling price of the proposed contracts exceeds the current futures prices at the Henry Hub. This evidence is unpersuasive for two reasons. First, the ceiling price presented by Petitioner is the maximum price it will strike for the agreements described by Mr. Pergola. The prices may well be lower. Second, Mr. Courter's criticism misunderstands the benefit of hedging a portion of gas supply. Hedging is not intended to guarantee prices at or below the market price prevailing during the time protected by the hedge. Its purpose is to protect retail gas users from the risk of spiking gas prices. The evidence presented by Petitioner demonstrates that the contracts it has proposed will protect customers from price spikes at a price that is reasonable given NYMEX futures prices, past history, and projections. Furthermore, the proposed long term contracts would be a small portion of a portfolio program that works to mitigate gas price volatility on a current and forward-looking basis and thus, represents an ideal opportunity to protect retail gas users from the risk of increasing prices with relatively little risk.

For these reasons, we find that Petitioner may proceed with these contracts provided that it can do so within the parameters prescribed by witness Pergola in his testimony. Given either successive annual contracts or a single averaged price contract result in the same cost to customers, we will not dictate which approach Petitioner must use. However, in the event that a price difference does occur, Petitioner shall use the lowest cost approach.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION THAT:

1. Petitioner's proposed entry into two long-term contracts consistent with the terms and conditions set forth in Finding Paragraph No. 4 is hereby found to be part of a reasonable approach to mitigating price volatility as part of its Advance Purchases Plan.

2. Upon entering into the contract(s), Petitioner shall file with the Commission under this Cause the final terms of the contract(s).

3. This Order shall be effective on and after the date of its approval.

ATTERHOLT, BENNETT, LANDIS AND ZIEGNER CONCUR; MAYS NOT PARTICIPATING:

APPROVED: MAR 21 2013

I hereby certify that the above is a true and correct copy of the Order as approved.



Shala M. Coe
Acting Secretary to the Commission