STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF INDIANA GAS COMPANY, INC. AND SOUTHERN INDIANA GAS & ELECTRIC COMPANY, INC., BOTH D/B/A VECTREN ENERGY DELIVERY OF INDIANA, INC., FOR APPROVAL OF POTENTIAL USE OF ADDITIONAL APPROACHES TO GAS HEDGING, INCLUDING LONGER-TERM CONTRACTS, AND THE POTENTIAL PRE-APPROVAL THEREOF, PURSUANT TO IND. CODE 8-1-2-42 OR, IN THE ALTERNATIVE, 8-1-2.5 ET SEQ.	)	CAUSE NO. 44021 APPROVED: AUG 08 2012

ORDER OF THE COMMISSION

Presiding Officers:
David E. Ziegner, Commissioner
Jeffery A. Earl, Administrative Law Judge

On April 28, 2011, Indiana Gas Company, Inc. and Southern Indiana Gas and Electric Company, both d/b/a Vectren Energy Delivery of Indiana, Inc. ("Vectren") filed a Verified Petition with the Indiana Utility Regulatory Commission ("Commission"). The petition requests approval of the use of additional methods to hedge gas costs, including long-term purchase contracts, and a pre-approval framework to allow implementation of such hedges.

On June 16, 2011, the Commission issued a Prehearing Conference Order approving the Stipulation and Agreement Regarding Procedural Schedule. Pursuant to proper 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, the Commission held a Technical Conference at 9:30 a.m. on July 28, 2011, in Hearing Room 222, 101 West Washington Street, Indianapolis, Indiana. Vectren, the Indiana Office of Utility Consumer Counselor ("OUCC"), and Commission staff attended and participated in the Technical Conference.

Pursuant to proper 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, the Commission held an Evidentiary Hearing at 9:30 a.m. on February 16, 2012, in Hearing Room 224, 101 West Washington Street, Indianapolis, Indiana. Vectren and the OUCC appeared and participated at the Evidentiary Hearing. Vectren's and the OUCC's testimony and exhibits were admitted into the record.

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

1. **Notice and Jurisdiction**. Due, legal, and timely notice of the Evidentiary Hearing in this Cause was given and published by the Commission as required by law. Vectren is a public utility as defined in Ind. Code § 8-1-2-1(a) and is subject to the jurisdiction of the

Commission to the extent provided by Indiana law. Therefore, the Commission has jurisdiction over the parties and the subject matter of this Cause.

2. **Vectren's Characteristics.** Indiana Gas Company, Inc. is a public utility incorporated under the laws of the State of Indiana with its office at One Vectren Square, Evansville, Indiana. It is engaged in the business of rendering gas distribution service to approximately 565,000 customers in 49 counties in north central, central, and southern Indiana. Vectren owns, operates, manages, and controls plant and equipment used for distributing and furnishing such service.

Southern Indiana Gas and Electric Company is a public utility incorporated under the laws of the State of Indiana with its office at One Vectren Square, Evansville, Indiana. It is engaged in the business of rendering both gas and electric public utility service to approximately 145,000 electric customers and 110,000 gas customers in southwest Indiana. Vectren owns, operates, manages, and controls plant and equipment used for the production, transmission, delivery, and furnishing of such service.

3. **Relief Requested.** Vectren requests authority to use additional gas-price-hedging tools, including multi-year gas supply purchase contracts. Vectren also requests the establishment of a regulatory pre-approval framework that would allow Vectren to proceed with execution of a contract before the specific purchase opportunity expired. Under Vectren's proposal, after pre-approval, the contract decisions would not be subject to further review. The Commission would retain authority to determine reasonableness of all gas purchases and any pre-approval would be made after the Commission and other interested parties had the opportunity to assess the prevailing facts and circumstances supporting Vectren Energy's recommendation to proceed with the particular contract purchase.

4. **Evidence Presented.**

A. **Vectren's Direct Evidence.** Vectren submitted testimony from Perry M. Pergola, Director of Gas Supply, and Michael A. Gettings, Principal Owner and Senior Consultant of RiskCentrix, LLC.

1) **Modifications to Vectren Energy's Gas Hedging Program.** Mr. Pergola testified that over the last six years, rapid development and production of natural gas from numerous shale gas basins has led to a steep, upward slope of daily production from 50 BCF per day in 2005 to nearly 70 BCF per day today. The geographic diversity of the domestic shale gas supplies has decreased the price risks associated with potential supply disruptions due to hurricanes in the Gulf of Mexico. The abundance of natural gas and the diversity in location of gas supplies have diminished much of the seasonal price and basis differentials that existed in the market just a few years ago. Increased gas supplies from shale regions have resulted in less volatility and lower natural gas pricing over the last three years and lower long-term pricing on the NYMEX.

Mr. Pergola discussed the public policy support for using various gas-price-hedging tools. The March 2011 Bipartisan Policy Center and American Clean Skies Foundation report entitled *Task Force on Ensuring Stable Natural Gas Markets* ("Market Report") urged the industry and regulators to re-evaluate the scope of using long-term gas purchasing arrangements for managing price risk in the context of a diversified supply portfolio. Mr. Pergola testified that the July 20, 2011 Policy Resolutions passed by the National Association of Regulatory Utility Commissioners ("NARUC") Board of Directors encourage state Commissions to consider the merits of diversified natural gas portfolios, including hedging and longer-term natural gas contracts.

Mr. Pergola said that in light of the existing pricing of natural gas, the potential for continued reduced volatility in price, and public policy support for using innovative gas hedging tools, Vectren reviewed its current Gas Hedging Program. The goal of the current Vectren hedging program is to mitigate price volatility, not to beat the market. Vectren employs a portfolio approach to gas supply acquisition, which blends the following: fixed-priced physical gas purchased in advance of the month of delivery; financial hedges that cap, collar, or fix gas prices on a portion of future purchases; summer-purchased storage gas to be withdrawn in winter months; and gas purchased at the time of delivery at current market prices (the "Portfolio Approach"). Vectren makes advance purchases using a structured process to purchase a targeted quantity of base load requirements at targeted times up to six quarters in advance of the month of delivery. The gas is purchased at then-current market prices for the future months of delivery.

Mr. Pergola testified that the Portfolio Approach does not eliminate the possibility of a spike in customers' gas bills, but it does significantly mitigate the adverse effects of a quick increase in gas prices. The sum effect of the advance purchases, financial hedges, and the use of storage withdrawals in winter means that 75% of the gas delivered to customers during a normal winter season has been purchased or hedged at various times up to 18 months in advance of the quarter, at then-current market prices, achieving an averaging effect that can mitigate the impact of a price spike in any given quarter. Vectren developed and continually updates the VUHI Natural Gas Risk Management Policy and Procedures to oversee the Gas Hedging Program.

Mr. Pergola explained that Vectren's hedging program would be modified to change the level of hedged gas and to include long-term purchases as another component of the portfolio. Under the modified approach, Vectren will seek to hedge fifty percent of the annual purchases and seventy percent of the projected winter deliveries for each utility. Vectren would also increase the duration of the Advance Purchase Plan from eighteen months (six calendar quarters) to twenty-four months (eight calendar quarters). The targeted quantities and timing for this proposed Advance Purchase Plan are listed on the following table:

Vectren's Proposed Advance Purchases Plan

Targeted Quantities and Timing

GCA Quarter	Example	Percentage of Volumes to be Fixed by the end of the current quarter
Current	Sep/Oct/Nov 2011	70-100%
1st Succeeding	Dec/Jan/Feb 2012	40-80%
2nd Succeeding	Mar/Apr/May 2012	20-60%
3rd Succeeding	Jun/Jul/Aug 2012	10-40%
4th Succeeding	Sep/Oct/Nov 2012	0-40%
5th Succeeding	Dec/Jan/Feb 2013	0-40%
6th Succeeding	Mar/Apr/May 2013	0-40%
7th Succeeding	Jun/Jul/Aug 2013	0-40%

Mr. Pergola testified that Vectren requested both a slight decrease in hedge targets and an extension in duration of the Advance Purchase Plan in response to reduced volatility in pricing over the last few years and the continuous flattening of the NYMEX forward price curve.

The following table lists the volumes of advance purchase, financial hedges, and storage withdrawals needed to meet the modified hedge targets requested by Vectren for each utility:

	Vectren North		**Vectren South**	
	Bcf	%	Bcf	%
Annual Advance Purchases	24.65	80%	5.04	100%
Storage Refill (Financial)	6.00	20%	0.00	0%
Total Hedged	30.65	100%	5.04	100%
Total Annual Purchases	61.30		10.10	
Annual Purchases Hedge %	**50%**		**50%**	
Winter Advance Purchases	16.09	48%	2.47	45%
Company Storage w/d's (80% of SCQ)	4.32	13%	2.72	49%
Contract Storage w/d's (80% of SCQ)	13.20	39%	0.34	6%
Total Winter Volumes Hedged	33.61	100%	5.53	100%
Normal Winter Sales	48.00		7.90	
Winter Deliveries Hedge %	**70.0%**		**70.0%**	

Mr. Pergola testified that Vectren reviewed other hedging tools that could be added to its Portfolio Approach, including a highly structured Advance Purchases component of the Portfolio that would allow Vectren to execute defensive hedges. Ultimately, Vectren decided against implementing a defensive hedge strategy at this time because of a lack of experience in defensive hedging. Vectren will continue to study this hedging model.

Mr. Gettings conducted a risk-reward analysis of 3-, 5-, and 10-year-term commitments in the current market. He opined that the current market is characterized by low risk and high rewards. Mr. Gettings's analysis concluded that a 3-year commitment carries a reward to risk ratio of 44.8 to 1, a 5-year commitment carries a reward to risk ratio of 8.3 to 1, and a 10-year commitment carries a reward to risk ratio of 2.9 to 1. Mr. Gettings surmised that the current market fits a top 10% opportunity to accumulate gas purchase hedges.

2) **Establishment of a Pre-Approval Framework.** Mr. Pergola described Vectren's proposed regulatory pre-approval framework for long-term contracts. Vectren would provide a copy of the filing to the OUCC three business days prior to filing with the Commission. Within ten calendar days from the initial filing, the OUCC would have the right to file any comments in response to the Vectren's filing. If the OUCC does not file an objection, Vectren's filing will be decided upon by the Commission within fourteen calendar days after the initial filing date. If the OUCC files an objection within ten calendar days, the Commission will consider the objection and make a final decision no later than thirty calendar days after the date Vectren makes the initial filing. If approval is not provided within thirty calendar days, the proposal would expire.

Mr. Pergola said that Vectren expects multi-year commitments of two to five years to be no more than twenty percent of its annual supply purchases for each Indiana gas utility. Vectren expects that multi-year commitments beyond five years to be no more than ten percent of the projected annual supply purchases for each Indiana gas utility. Vectren Energy will continuously analyze natural gas pricing and market conditions in order to determine if/when the opportunity exists to propose a long-term transaction.

According to Mr. Pergola, the regulatory pre-approval framework proposed by Vectren effectively creates a coordinated process between the OUCC, the Commission, and Petitioner with the common goal to provide incremental price stability for sales to customers. Vectren will assist the OUCC by providing information to show that the proposed long-term transaction represents a reasonable hedge transaction based on current market conditions.

B. OUCC's Direct Testimony. Bradley E. Lorton, Utility Analyst in the OUCC's Natural Gas Division, acknowledged that hedging natural gas prices is beneficial to customers and agreed with the modifications proposed by Vectren to its Gas Hedging Program. Mr. Lorton said that the OUCC has consistently argued that it is reasonable to expect utilities to engage in price volatility mitigation efforts.

Mr. Lorton cited difficult economic conditions as the single greatest factor that has contributed to the fairly stable low price of natural gas. Mr. Lorton agreed that locking in relatively low prices in future supply portfolios will have benefits for consumers. The OUCC does not oppose Vectren's request to adjust the percentage of fixed/hedged gas for winter supplies, and the OUCC's standard remains reasonable price volatility mitigation.

However, Mr. Lorton recommended that the Commission deny Vectren's request to establish a pre-approval framework. The OUCC has long opposed a pre-approval process related to gas commodity hedging. Vectren's proposed pre-approval process would short-circuit Indiana's statutory gas cost adjustment ("GCA") process in Ind. Code § 8-1-2-42. Mr. Lorton also opined that the pre-approval process would increase the OUCC's caseload and put additional strain on already limited resources.

Mr. Lorton said that the OUCC instead recommends a policy of prudency review without hindsight review and enhanced communications regarding the hedging instruments employed. A prudency review involves examining the reasonableness of a purchase based upon information that was known or should reasonably have been known by the utility at the time of the gas purchase. Mr. Lorton said that prudency review does not involve holding the utility accountable to performance based on 20/20 hindsight review. Mr. Lorton emphasized the importance of conducting on-going communications before seeking Commission approval to use new types of financial instruments or other methods of risk mitigation, especially with derivatives and structured deals used in long-term supply contracts. Mr. Lorton believes that prior discussions can be critical to avoiding misunderstandings and disagreements during subsequent prudency reviews.

C. Vectren's Rebuttal Testimony. Mr. Pergola stated that the OUCC agreed with, or at least did not expressly oppose, several modifications to the Gas Hedging Program proposed by Vectren. First, the OUCC agreed with Vectren's proposed adjustment to the percentage of hedged gas for winter deliveries from 75% to 70%. Second, the OUCC did not expressly oppose Vectren's proposed adjustment to the percentage of hedged annual gas supply purchases from 60% to 50%. Third, the OUCC did not directly oppose Vectren's proposed increase in the number of months for Advance Purchases from 18 to 24 months. Therefore, Vectren included these changes in its modified Gas Hedging Program.

Mr. Pergola testified that Vectren agrees with the OUCC that a process to periodically review Vectren's use of financial hedges should be established. Vectren agrees to conduct meetings no less often than semi-annually with the OUCC and Commission Staff to discuss all aspects of its Gas Hedging Program. In addition, both the OUCC and Vectren agree that meetings to discuss Vectren's use of new financial products, like derivatives or structured products, should be conducted prior to Vectren Energy entering into any such new financial products.

Mr. Pergola testified that the parties were unable to reach agreement on the establishment of a pre-approval framework for long-term, fixed-price gas purchase contracts. Mr. Pergola said that given the total dollar commitment of a long-term, fixed-price purchase contract, certainty is needed in the process. Mr. Pergola acknowledged the significant caseload shouldered by the OUCC, but opined that the pre-approval framework proposed by Vectren should not increase the OUCC's caseload any more than a later prudency review. According to Mr. Pergola, the key difference between the pre-approval framework proposed by Vectren and the prudency review proposed by the OUCC is when the review takes place. In Vectren Energy's pre-approval framework, the review takes place prior to entering into the transaction. Any review that takes place after the commitment is already made could place Vectren at risk. While the OUCC's prudency review would not include hindsight review, the risks associated with the proposed process could be significant.

Mr. Pergola said that Vectren Energy is not asking the Commission and the OUCC to become partners in procurement but, rather, is requesting approval of a framework whereby the OUCC and Commission staff could conduct a prudency review of the negotiated contract prior to the time Vectren becomes obligated to a multi-year commitment, as opposed to after the commitment is made. In this way, any problems with the negotiated contract would be identified and dealt with prior to finalizing Vectren's long-term commitment.

5. Commission Discussion and Findings.

A. Gas Hedging Program Modifications. Ind. Code § 8-1-2-42(g)(3)(A) requires gas utilities to make "every reasonable effort to acquire long term gas supplies so as to provide gas to its retail customers at the lowest gas cost reasonably possible." Similarly, the Commission states in its GCA orders: "Indiana's gas utilities should make reasonable efforts to mitigate gas price volatility. This includes a program that works to mitigate gas price volatility and considers market conditions and the price of natural gas on a current and forward-looking basis." *See, e.g., S. Ind. Gas & Elect. Co.*, Cause No. 37366 GCA 114, 2012 Ind. PUC LEXIS 135, at *4 (IURC Apr. 25, 2012).

Based upon the evidence above, the Commission finds that it is reasonable for Vectren to adjust the hedging percentages associated with its fixed winter gas supply purchases and annual fixed gas supply purchases. Allowing the proposed modifications will give Vectren the flexibility to take advantage of favorable market conditions when the opportunity is available. In addition, we find that it is reasonable for Vectren to be able to enter into long-term contracts with terms of up to ten years. This will allow Vectren to take advantage of low prices available for future gas supply when the future price is expected to rise.

Therefore, we approve Vectren's proposal to adjust its hedging program as follows: Vectren may adjust the percentage of hedged gas for winter deliveries from 75% to 70%; Vectren may adjust the percentage of hedged annual gas supply purchases from 60% to 50%; and Vectren may increase the number of months from Advance Purchases from 18 to 24 months. In addition, we encourage Vectren and the OUCC to meet semi-annually to review Vectren's gas hedging program and to consider the possible use of other hedging options in the future.

B. Pre-Approval of Long-Term Contracts. As discussed above, Ind. Code § 8-1-2-42(g)(A) not only allows but requires gas utilities to acquire long-term gas supplies in an effort to provide gas to retail customers at the lowest gas cost reasonably possible. The statute does not limit the length of a long-term gas supply contract. As Mr. Gettings's analysis shows, under certain market conditions, the purchase of long-term gas contracts may provide a favorable reward to risk ratio. In GCA 54, we set forth the standard for reviewing gas supply purchases in the context of GCA proceedings. We review the reasonableness of specific gas cost transactions and the prudence of the timing and terms of such transactions in subsequent GCA proceedings. *Ind. Gas Co., Inc.*, Cause No. 37394 GCA 54, slip op. at 4 (IURC May 28, 1997). We do not engage in a hindsight or second-guess review process; rather, our evaluation must consider the context of the conditions that existed at the time that individual transactions were consummated. *Id.*, *See also Duke Energy Ind., Inc.*, Cause No. 38707 FAC 76 S1, 2009 Ind. PUC LEXIS 400, at

*46 (IURC Oct. 21, 2009).

This standard of review applies and is sufficient whether a gas contract has a term of one year or a term of ten years. As we explained in GCA 86, we do not intend "to reconstruct what would have been a prudent portfolio or to *specify the composition of future portfolios*." *Ind. Gas Co., Inc.*, Cause No. 37394 GCA 68, slip op. at 10 (IURC Jan. 4, 2001) (Interim Order) (emphasis added). Requiring the OUCC and this Commission to provide direction on what specific actions Vectren should take with respect to its portfolio would reduce the flexibility necessary to make gas purchasing decisions that are in the best interests of retail customers. *Id.* Instead, Vectren must be prepared to demonstrate, with each GCA filing, that its purchasing strategy, including long-term gas supply purchases, was reasonable, and that its planning process was extensive, rigorous, and robust.

We conclude that the GCA process already provides a mechanism for the OUCC and this Commission to review gas supply purchases. We do not believe that the pre-approval process proposed by Vectren would allow sufficient time for a meaningful review of proposed contract purchase. At the same time, creating a longer pre-approval process could compromise Vectren's ability to take advantage of favorable market conditions. Therefore, we reject Vectren's proposed pre-approval framework.

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

1. The modifications proposed by Vectren Energy to its Gas Hedging Program are approved.

2. Vectren's proposal to establish a pre-approval framework is denied.

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

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

APPROVED: AUG 08 2012

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

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission