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ARKANSAS PUBLIC SERVICE COMMISSION **FILED**

IN THE MATTER OF A NOTICE OF INQUIRY)
INTO WHETHER ARKANSAS GAS UTILITIES)
SHOULD INTEGRATE GAS PRICE HEDGING,)
FIXED PRICE OPTIONS, AND OTHER)
ALTERNATIVE MECHANISMS INTO GAS)
PROCUREMENT PLANS)

DOCKET NO. 01-023-NO1
ORDER NO. 1

ORDER

The Arkansas Public Service Commission ("APSC" or "Commission") is initiating this Notice of Inquiry ("NOI") in response to the significant increase in the market price that gas utilities must pay to purchase natural gas supplies and that customers must in turn pay to receive natural gas service. As a result of "colder than normal" winter temperatures and the sharp escalation in wholesale natural gas prices, Arkansas natural gas customers are now paying two to three times more for natural gas service than last winter. Because of this major increase in gas prices, the Commission believes it is important to explore alternative purchasing and regulatory mechanisms that could alleviate the impact of high gas prices on Arkansas consumers. The Commission is especially concerned about residential, fixed and low income customers who rely on natural gas for space heating, water heating and cooking. The Commission is also concerned about the uncertainty over gas prices for next winter.

The Commission is initiating this inquiry to solicit information and opinions on the use of alternative contracting practices as well as financial instruments to reduce both the level and

volatility of natural gas prices paid by Arkansas gas utility customers. The NOI poses questions to help the Commission determine whether Arkansas gas utilities should be required to use gas price hedging in their gas supply portfolios to reduce both the level of, and the volatility in, the cost of gas paid by utility customers. The Commission also wants to determine whether Arkansas gas utilities should offer a fixed cost of gas option to allow consumers to lock into a set commodity price during the winter heating season.

In this NOI, the Commission is seeking information about utility hedging programs on topics related to regulatory issues; hedging program procedures; financial accounting and reporting procedures; fixed gas price options; and other issues.

I. BACKGROUND

With the federal deregulation of the commodity or wholesale price for natural gas, beginning with the Natural Gas Policy Act ("NGPA") in 1978 and concluding with the Wellhead Price Decontrol Act of 1989, the natural gas wellhead market has been transformed from a physical supply market where prices were heavily regulated to a speculative commodity market consisting of futures trading, swaps, hedging, and other financial instruments. Today's gas market utilizes both the traditional physical supply contract for the receipt and delivery of natural gas as well as financial natural gas contracts where the primary function is to manage price risk for market players. In recent years, some gas utilities in other jurisdictions have incorporated gas price hedging into their procurement plans. States that have implemented some type of gas price hedging program include: Missouri, Kansas, New Hampshire, New Jersey, and Oregon.

The futures contract market was opened on the New York Mercantile Exchange ("NYMEX")

in April 1990. The NYMEX options contract on natural gas futures began in October 1992. Gas deliveries for the NYMEX futures contract takes place at the Henry Hub in Louisiana. The Kansas Board of Trade also offers trading in natural gas futures contracts that use a Waha Hub (West Texas) delivery point.

In addition to the implementation of a futures and options contract market for the wholesale supplies of natural gas, some gas utilities are now offering retail customers a fixed gas price option for the commodity portion of their natural gas service. Under this option, utility customers can receive a predetermined, guaranteed annual commodity cost for gas that does not change regardless of weather or energy prices. The sellers of fixed price services operate through arrangements with utilities and other energy providers. Kansas, New Jersey, and New Hampshire are some of the states where utilities are offering the fixed price option.

II. NOI QUESTIONS

Respondents to the NOI are invited to provide detailed responses and propose recommendations on the following topics and questions:

A. Regulatory Issues

1. Should Arkansas gas utilities be allowed or required to use a hedging program to mitigate price levels and volatility for gas sales customers?
2. If the APSC has the statutory authority to require hedging-related programs, please provide specific citations for the Commission's authority. If no statutory authority exists, please provide the statutory language that would be required and/or the existing statute that would require revision.
3. What types of hedging instruments are available to gas utilities?

4. Should gas utilities be limited to specific types of hedging instruments? If so, what type?
5. In what time frame should utility hedging programs be initiated?
6. Should utility hedging programs be initiated first utilizing pilot programs, specific test areas, and/or specific time periods before being used on a system-wide basis?
7. What type of Commission review should apply to the utility's initial hedging program? How should the Commission's review process for updates or revisions to hedging programs be conducted?
8. What other regulatory proceedings (rulemakings, collaboratives, workshops, etc.) may be appropriate before a gas utility hedging program can be implemented?
9. How would prudence reviews of utility hedging programs be conducted?

B. Hedging Program Procedures

1. Generally describe how you envision your utility would use a hedging program.
2. What portion (percentage) of a gas utility's supply portfolio should be hedged?
3. Should there be an annual cap on hedging program expenses?
4. What benchmarks should be used to measure hedging program performance?
5. How should hedging gains and losses be treated or shared between the shareholders and ratepayers?
6. Should a risk/reward incentive mechanism be used in conjunction with a hedging program?

C. Accounting and Reporting for Hedging Programs

1. How should the hedging program work in relation to the utility's Purchased Gas Adjustment ("PGA") tariff?
2. Should hedging fees (brokerage fees, etc.) be included in the PGA or accounted for separately?

from the PGA?

3. What Financial Accounting Standard Board or Internal Revenue Service requirements or regulations are applicable to hedging transactions?
4. What kind of reporting requirements (to the Commission and utility Board of Directors) should be required for hedging programs? How often should reports be required?

D. Fixed Price Option

1. Should Arkansas gas utilities be allowed or required to offer a fixed price option to their customers? Should this option be offered with or separate from the hedging program?
2. Is your utility familiar with the "WeatherProof" bill offered by WeatherWise or any other fixed price product and/or vendors? Would this be a beneficial option to make available to Arkansas consumers?
3. At what time during the year should customers be allowed to enroll and over what monthly period would customers be required to remain in the plan?
4. Should the utility fixed price option be initiated as a pilot program for specific test areas, and/or period of time?

E. Alternative Mechanisms

1. Are there any other mechanisms that could reduce either the net cost or level of fluctuation in natural gas prices?
2. If so, what are these mechanisms and how would those mechanisms work?

F. Other

Please raise and discuss any other relevant or related issues not covered in this NOI.

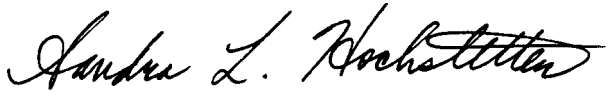
IT IS, THEREFORE, ORDERED:

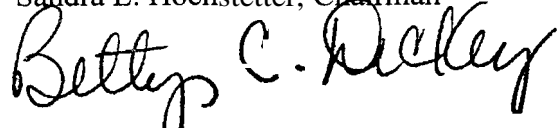
1. That all APSC jurisdictional natural gas utilities shall respond to the NOI in this docket no later than sixty (60) days from the date of the filing of this order. After the responses to the NOI are received and reviewed, the Commission will initiate rulemakings, collaboratives/workshops, or other proceedings as appropriate.


2. The General Staff of the Commission, all jurisdictional natural gas utilities, the Arkansas Gas Consumers, and the Attorney General of the State of Arkansas are hereby granted full **party** status in this proceeding.

BY ORDER OF THE COMMISSION.

This 31 day of January, 2001.


Sandra L. Hochstetter, Chairman


Betty C. Dickey, Commissioner


Lavenski R. Smith, Commissioner


Diana K. Wilson
Secretary of the Commission