

Approved: February 12, 2004
Date

Carl D. Holmes

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairman Carl D. Holmes at 9:05 a.m. on January 23, 2004 in Room 231-N of the Capitol.

All members were present except: Representative Eric Carter
Representative Don Myers

Committee staff present: Mary Galligan, Legislative Research
Dennis Hodgins, Legislative Research
Mary Torrence, Revisor of Statutes
Jo Cook, Administrative Assistant

Conferees appearing before the committee: John Cita, Kansas Corporation Commission

Others attending: See Attached List

Chairman Holmes asked for bill introductions. Representative Sloan requested that a bill be introduced that dealt with energy conservation incentives. Representative Sloan moved to introduce the bill as a committee bill. Representative Kuether seconded the motion. The motion carried.

Chairman Holmes introduced John Cita, Chief Economist for the Kansas Corporation Commission. Mr. Cita provided a power point presentation on the 'History and Forecast of the Price of Natural Gas' (Attachment 1). Mr. Cita provided a historical view and forecasts of the price and production of natural gas. Additionally, he spoke on gas hedge programs and marketing research surveys. Mr. Cita responded to questions from the committee.

The meeting adjourned at 9:58 a.m.

The next meeting will be Tuesday, January 27, 2004.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: January 23, 2004

NAME	REPRESENTING
Judy Shaw	SWK/A
JOHN C. BOTTENBERG	Weston
Ron Seiber	Hein Law Firm
John Cita	KCC
Steve Johnson	Kansas Gas Service
TOM DAY	KCC
Margie Petty	KCC

Price of Natural Gas

History and Forecast Some Current Issues



John Cita, Chief Economist, Ph.D Kansas
Corporation Commission

1/22/2004

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HOUSE UTILITIES

DATE: 1-23-04

ATTACHMENT 1



Topics of Discussion

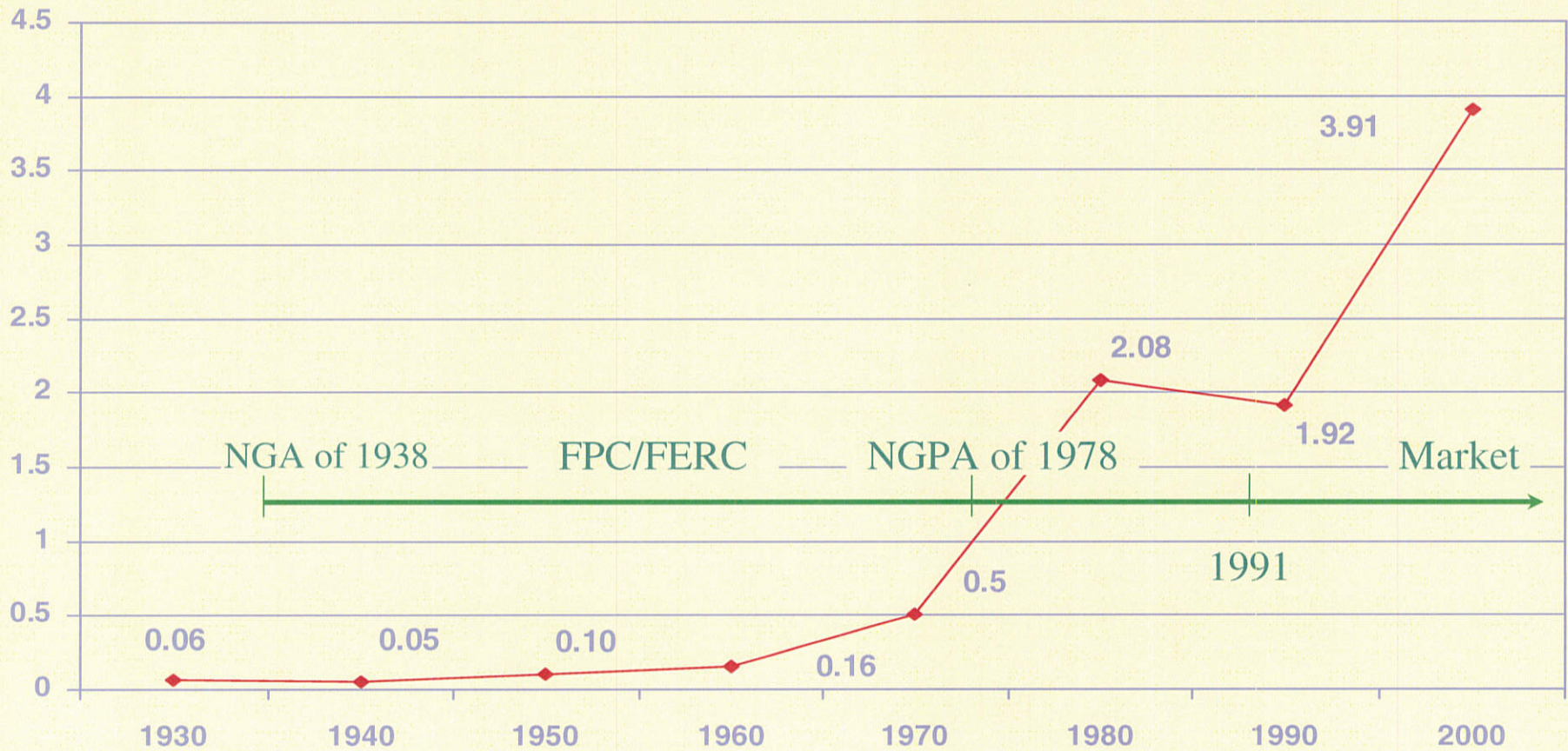
- A Look Back
- Current Gas Prices
- A look Ahead
- Gas Bill Affordability
- Price Volatility
- Gas Price Hedging

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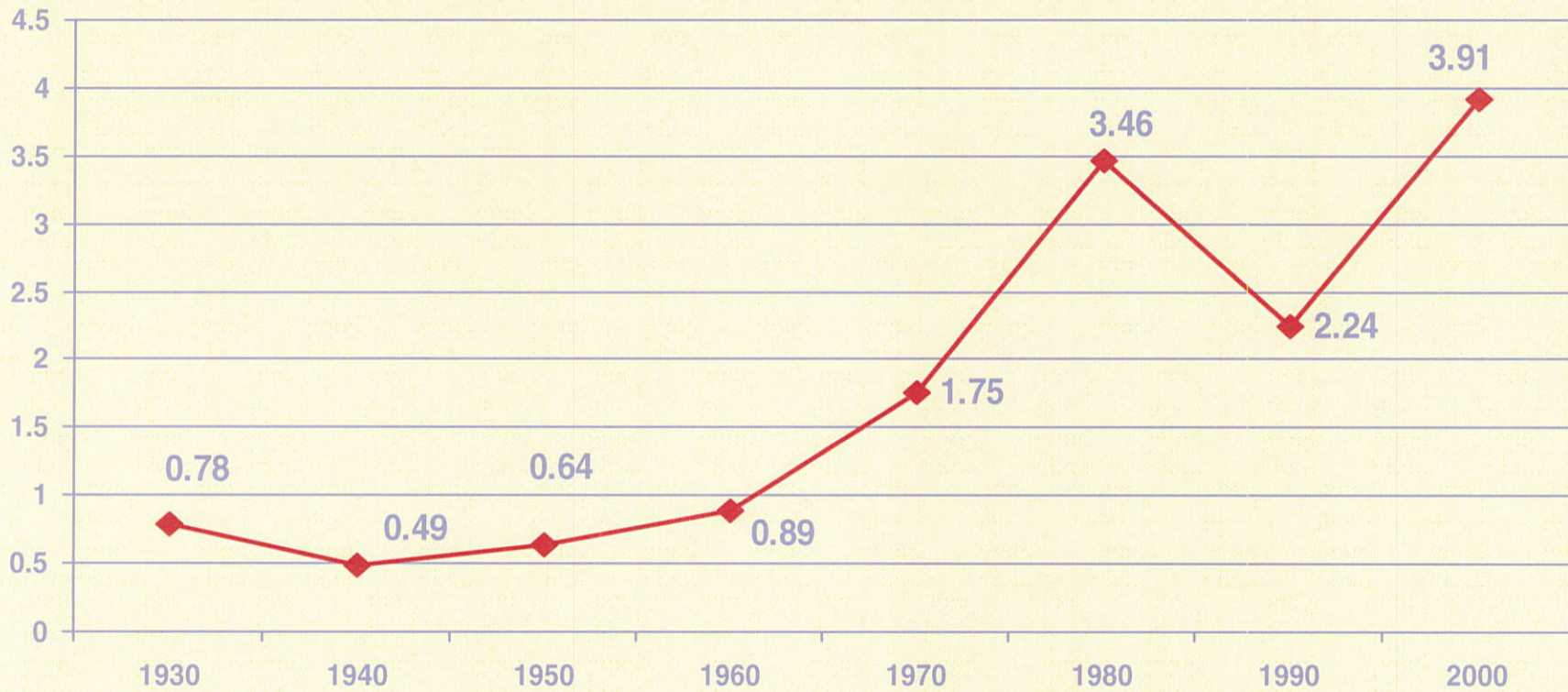
Price of Natural Gas: A Historical View

(Nominal Prices per Mcf)





Price of Natural Gas (Inflation Adjusted Prices)





Average Winter Prices: Mid-Continent Gas (Nominal Prices)

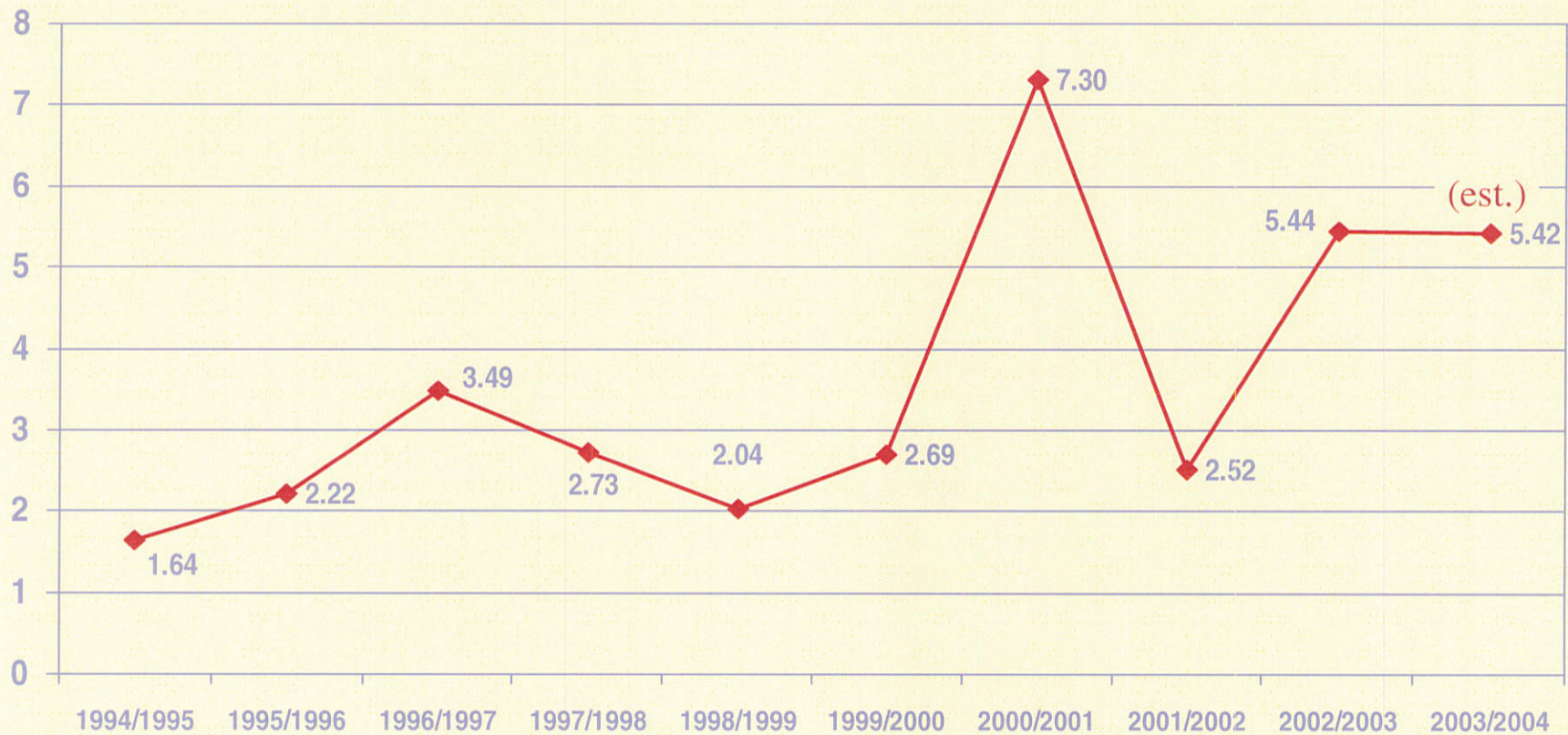


Source: Inside FERC's Gas Market Report, NYMEX

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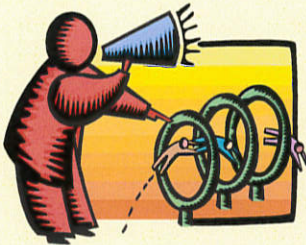


Average Winter Prices: Mid-Continent Gas (Inflation Adjusted Prices)

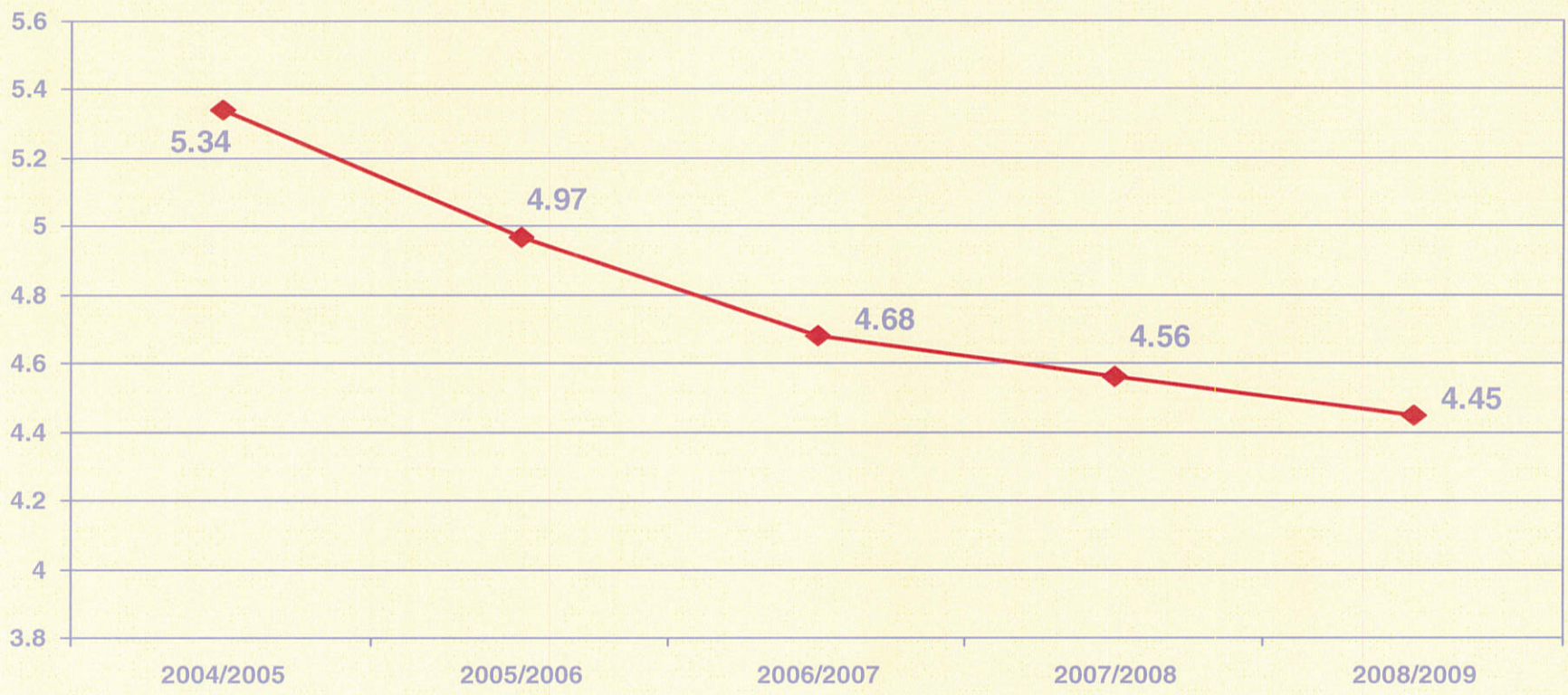


Source: Inside FERC's Gas Market Report, NYMEX

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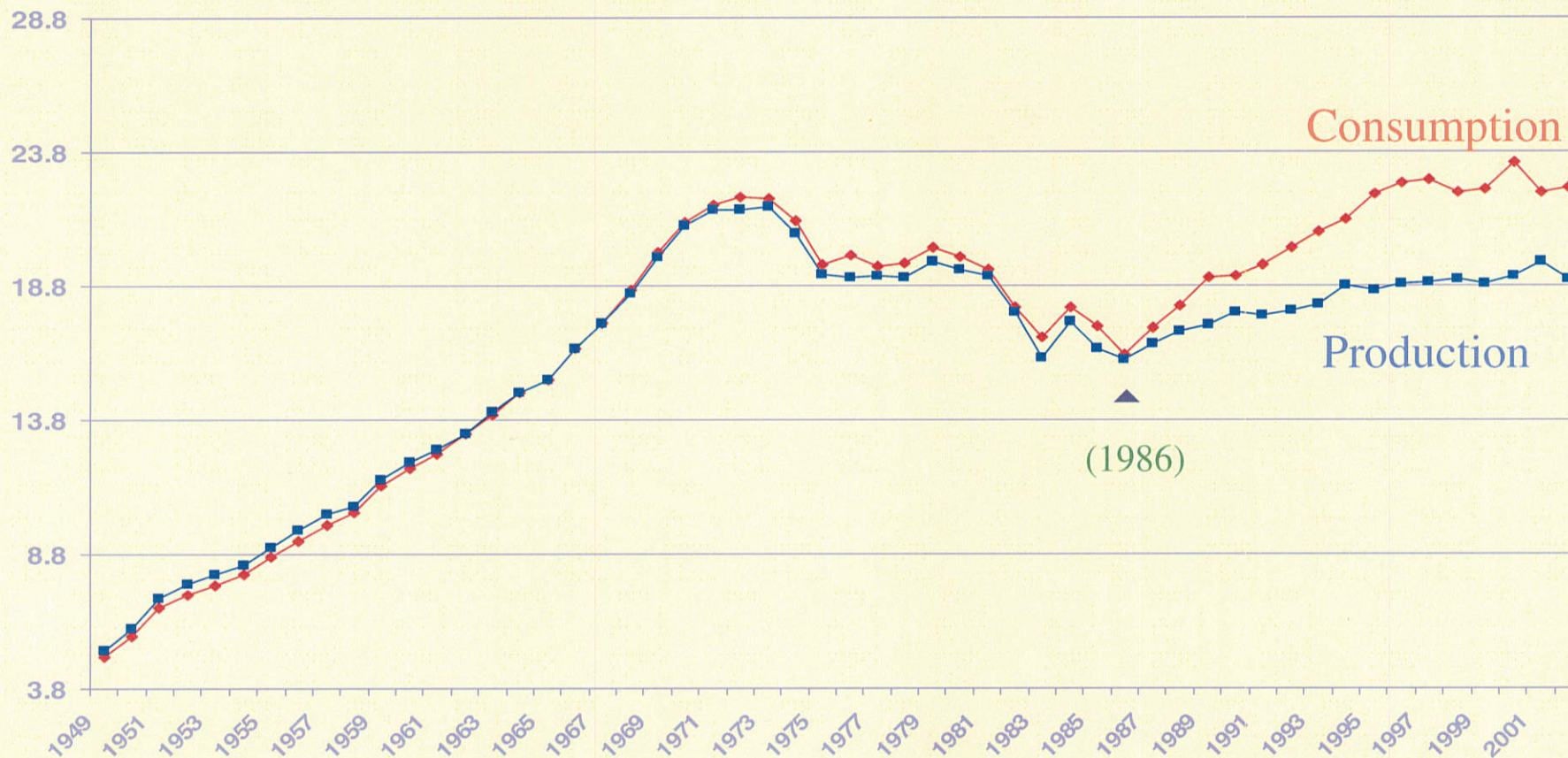
Winter Gas Price Forecast: Average Mid-Continent Prices (Based on Futures Prices at January 21, 2004 Close, 40 cent basis adj.)



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US Natural Gas Production/Consumption, 1949 – 2002 (Tcf)



1/22/2004

Source: EIA

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The Bundled Price of Gas/Mcf: Winter Average Delivered Price to Residential Customer (Based on KGS estimated charges, Non-hedged, futures prices as of January 21, 04, Close)



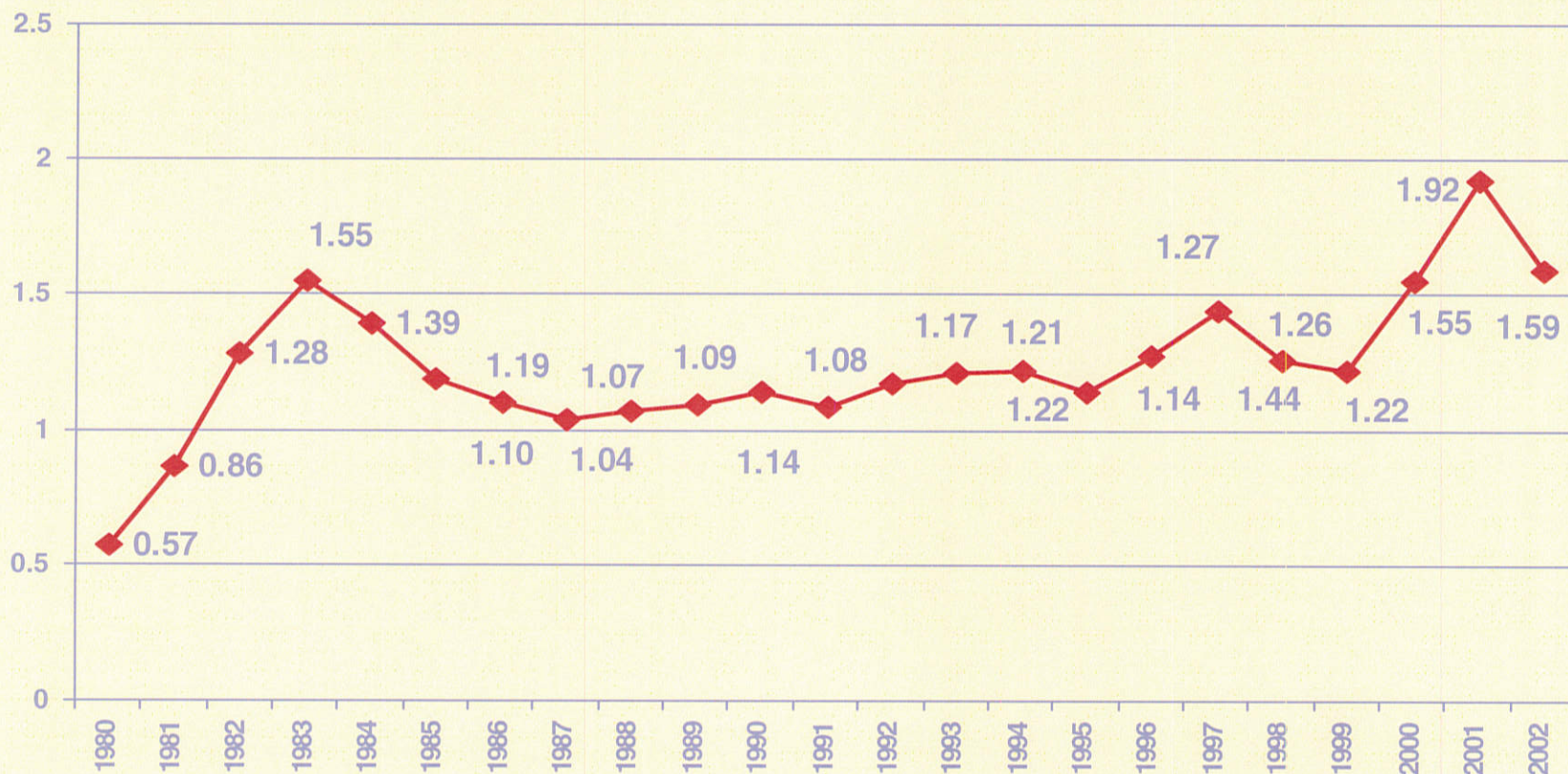
Source: Inside FERC's Gas Market Report, NYMEX

1/22/2004



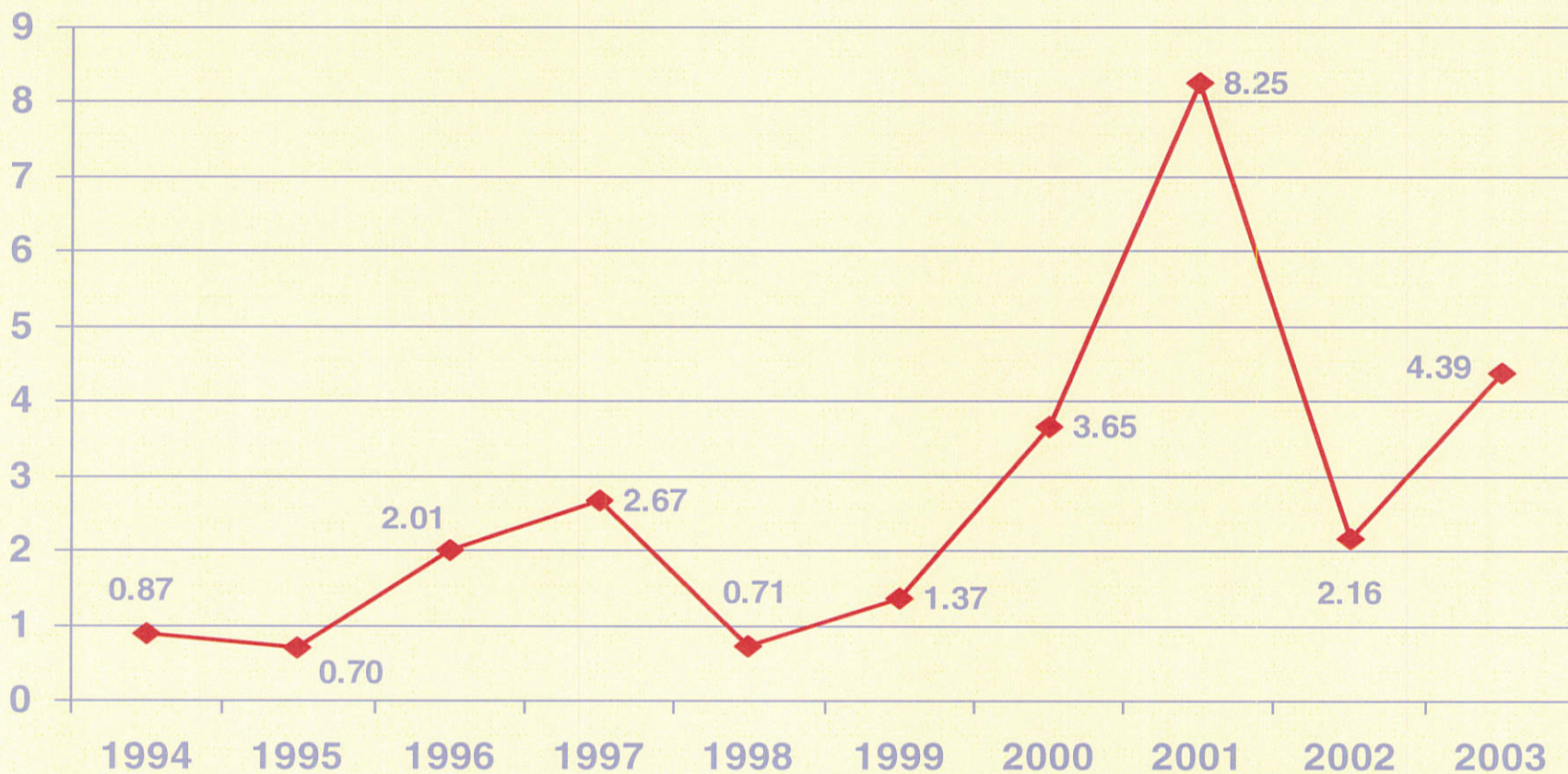
Affordability of Residential Gas Bills

(Average Annual Gas Bill / Average Household Income)





Natural Gas Price Volatility (Measured: High minus Low Price over Calendar Year)



Source: Inside FERC's Gas Market
Report



Gas Hedge Programs

- What does it mean to hedge?
 - A hedger seeks to shed or reduce risk exposure.
 - A speculator seeks to increase or take-on risk.
- In the context of natural gas consumers, what does it mean to hedge?
 - It means reducing gas price volatility. Using our measure of risk, it means reducing the possible range of prices.



Kansas Gas Utilities that have implemented Hedge Programs

- KGS: Approved March 1998
- Atmos Energy: Approved April 2001
- Aquila: Approved December 2001
- MWE: Indicates to Staff that it will apply for a Hedge Program fro the 04/05 winter.

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Focus Group Results: Some Marketing Research

In the fall of 2001, KGS and Atmos Energy sought to evaluate their customers' interests in gas price hedging. Through this marketing research they found:

- Customers want their utility to hedge on their behalf.
- Customers understand that hedging is a value-added service and, therefore, costs extra.
- Customers are not willing to spend a relatively large amount on hedging, however, appear willing to pay about \$1/month (\$12/year/customer).
- Customers are less concerned about downside risk, more averse to upside risk (have an asymmetric aversion to risk).

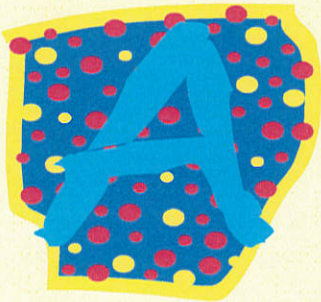
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How have the Utilities and the Commission responded to the Market Survey Results?

Companies have applied for and the Commission has approved Gas Hedge Program implementation.

- **Companies must seek Commission approval prior to any purchase/arrangement of hedging derivatives.**
- **Hedge Program budgets are limited to \$12/year per customer**
- **Hedge Programs are to be designed to establish protection from catastrophic prices, accordingly, the basic designs amount to price-cap-type designs. There are a number of different ways to establish price cap protection.**



Hedge Program Performance

- Protection from severe price spikes: *price caps* are implemented via the Hedge Programs

Example 1: KGS capped 100% of its March 03 purchases at approximately \$3.10. The March 03 market price was \$8.66. All KCC approved Gas Hedge Programs afforded significant protection from the March 03 price spike.



Hedge Program Performance

- Customer Savings: About zero in the (very) long run. Hedging is not a money making proposition. Total net savings from Hedge Programs is expected to be close to zero in the *long run*. This means, about half the time the hedge instruments yield a profit, the other half a loss. It is important to be aware that money can be expended on financial derivatives that ultimately yield no payoff.



Hedge Program Performance

- Reduce Price Volatility

Example 2: the December 2003 to January 2004 price volatility: Using the KGS Hedge Program results,

Hedged volatility: \$0.48

Non-hedged volatility: \$1.30