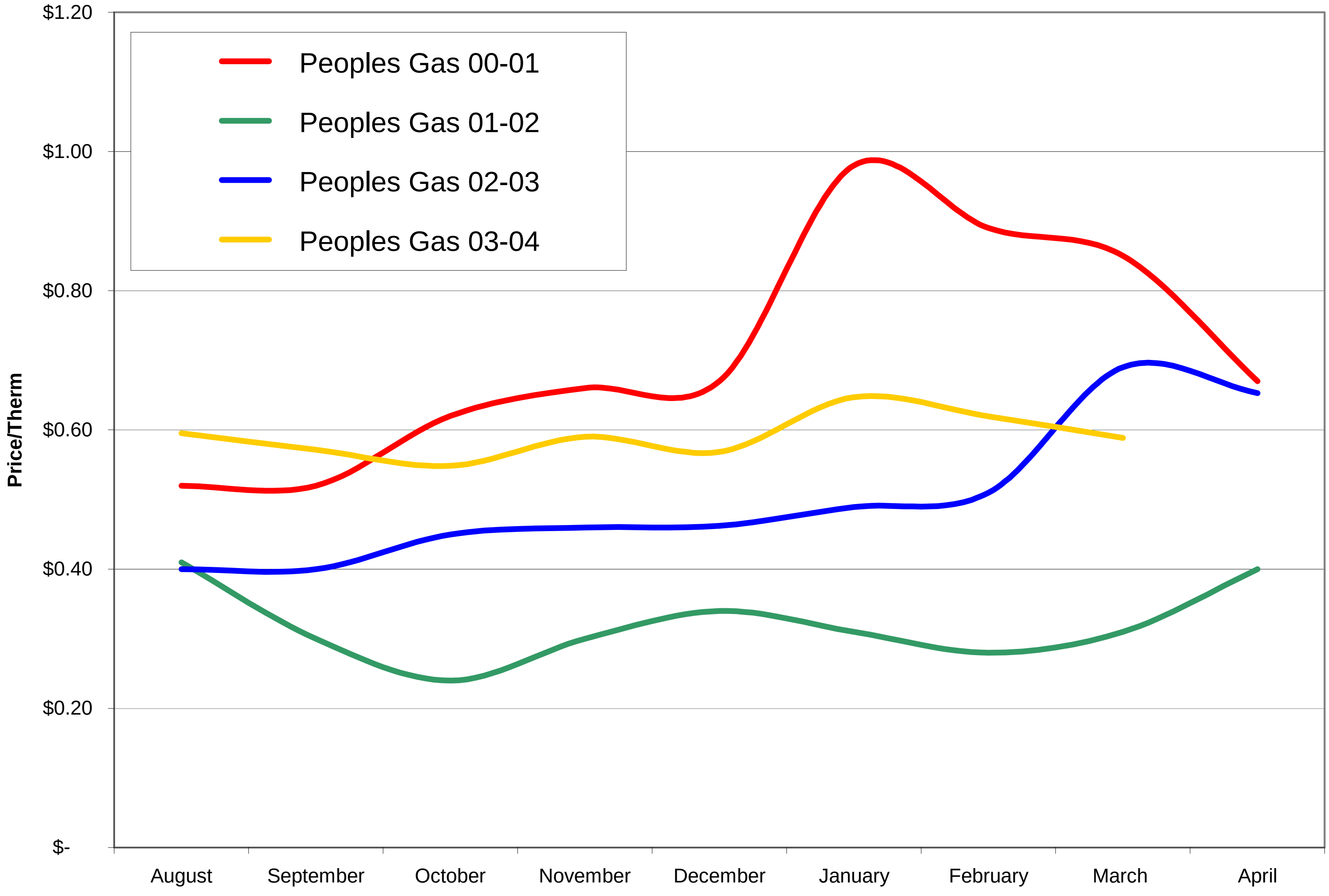
Why Price Insurance?

- Increasing volatility in the price of natural gas is an increasing hardship on consumers.
- PIP program shifts the risk of that volatility from the participant in LIHEAP to the State.
- Without some form of insurance, the potential liability to the State is uncapped.
- We can’t make gas cheaper then the what it costs. We can only hope to manage the uncertainty of price.

Four Years of Gas Prices



How to Get Price Insurance

- We considered various models including:
  - Bulk purchase of natural gas.
  - Bidding out the purchase to suppliers.
  - Using financial hedging tools. (Futures and options.)
- Using options provides the best model.
- There exists a robust financial market in natural gas. Financial hedging tools are well established and are used by utilities and large consumers.

Hedging With Options

- Requires regular, planned upfront investments to purchase options contracts.
- Outcomes
  - **Low priced months.** Options contacts expire unrealized.
  - **High priced months.** Options contracts sold at expiration for difference between options strike price and futures market price of gas.
- Hedging requires a long-term view since some years provide a payback, others don't.
- Properly structured hedging is a good investment over time; it levels out and stabilizes costs.
- A PIP with hedging built into it will control the State's program costs.

Other Key Points

- This plan does not risk state funds.
  - The state buys insurance for its vehicle fleets, healthcare, etc. This is the equivalent for the PIP program. There is no additional liability to the state beyond the options purchase.
- This plan is not speculating on gas price.
  - This plan uses options as an insurance policy.
  - This strategy does not try to ‘play the market’.
  - This strategy commits some funds upfront to ensure that if needed, additional funds become available from the market.

Affordable Energy Plan: Hedging Component

- Funds from State-collected LIHEAP funds used to purchase options contracts. Funding limited to 15% annually (approximately $10 million).
- State in consultation with PAC will develop plan each year. (Adjust cap level, quantity of therms, etc.)
- Competitive bidding for implementation of hedging strategy.
- If hedging generates excess funds, they can be used for the cost of hedging in following years (freeing up LIHEAP funds).