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Kansas Corporation Commission
/S/ Susan K. Duffy

**THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

Before Commissioners: Brian J. Moline, Chair
Robert E. Krehbiel
Michael C. Moffet

In the Matter of the Application of	)	
Kansas Gas Service, a Division of ONEOK, Inc.	)	Docket No. 05-KGSG-580-HED
For Approval of a Hedge Program for Gas	)	GAS
Purchased for the Winter Heating Season.	)	

ORDER GRANTING JOINT MOTION AND APPROVING STIPULATION AND AGREEMENT

NOW, the above-captioned matter comes before The State Corporation Commission of the State of Kansas (Commission) on the Joint Motion for an Order Approving Stipulation and Agreement filed by Kansas Gas Service, a Division of ONEOK, Inc. ("Kansas Gas Service" or "Company"), the Commission Staff (Staff), and Citizens' Utility Ratepayer Board (CURB). Having examined its files and records and being duly advised in the premises, the Commission finds and concludes as follows:

I. BACKGROUND

1. On January 14, 2005, Kansas Gas Service filed its Application seeking an Order from the Commission approving its request to establish a Gas Hedge Program that will enable the Company to take the necessary steps to limit the volatility of gas prices during the winter heating season. The Company's Application seeks authority to collect $14.0 million annually from its customers to purchase hedging instruments to limit the volatility of the price of gas to its customers during the winter heating months of November through March. In support of its Application the Company filed the direct testimony of Mr. Richard H. Tangeman, its Director, FERC Regulatory & Strategy.

2. On January 18, 2005, CURB filed a Petition to Intervene seeking a Commission order granting CURB leave to intervene as a party in this matter. Subsequently, on January 21, 2005, the Commission issued an Order granting CURB's Petition to Intervene.

3. On March 18, 2005, Kansas Gas Service, Staff, and CURB (collectively, "Joint Movants") filed their Joint Motion for an Order Approving Stipulation and Agreement (Joint Motion), including as Attachment A thereto the Stipulation and Agreement entered into by Joint Movants on March 18, 2005 (Stipulation and Agreement).

4. On March 23, 2005 Staff filed its Memorandum prepared by Dr. John Cita, Chief of Economic Policy and Planning, in support of the Stipulation and Agreement.

II. DISCUSSION

5. Kansas Gas Service's "Gas Hedge Program", first implemented in Docket No. 98-KGSG-475-CON covering the 1998-1999 winter season has been perpetuated through successive winter seasons by the Company's annual filings with the Commission seeking continuation of the Program. In each case, the Company's request, with some modification, was approved by the Commission. Kansas Gas Service's instant Application filed under a new docket represents a departure from the practice of filing annual renewals under Docket No. 98-KGSG-475-CON and requests that the Company's Gas Hedge Program be made permanent. Another significant difference is the Company's current request for authority to increase its annual hedge spending from $7.3 million to an annual amount of $14.0 million. Application at pages 2 and 3. Consequently, Kansas Gas Service's Application proposes for Commission approval implementation of a permanent Gas Hedge Program wherein the Company will: (1) purchase, sell or otherwise arrange financial derivatives for the purpose of establishing a price ceiling for its COGR customers; (2) expend no more than $14.0 million annually for the purpose of

establishing that ceiling; (3) record those monies expended by Kansas Gas Service in an account to accrue interest at the rates and pursuant to the methodology set forth in paragraph 6 of the Application; (4) recover the balance of such account through the Company's COGR for gas sold in the months of April through October; (5) pass through all the derivative payoffs, both positive and negative, through the COGR during the winter months of November through March; and (6) make monthly reports throughout the Program year to apprise the Commission of both the Program's implementation and performance. Application at pages 4 and 5.

6. Kansas Gas Service's stated goal for the Gas Hedge Program is that the Company's actions will mitigate price volatility, at a reasonable cost, relative to the Company's traditional operations. Application at page 5. In his testimony filed in support of the Application, Mr. Tangeman provides the Company's reasons for its requested increase in annual hedge spending from $7.3 million to $14.0 million. According to Mr. Tangeman, the results of the LDC joint effort Focus Groups conducted during the summer of 2004 revealed that customers prefer that their gas utility cap the gas price at reasonable levels for as much volume as possible while preserving the benefit of any downward price movement. Tangeman Direct at page 5. Increased volatility in the natural gas market and the resulting increased cost of call options allows less of the budgeted winter purchase volumes to be protected by a price cap, thus the Company's requested budget increase for the purchase of options. Tangeman Direct at page 5. The Company indicates its belief that the Program, as it now exists, with the ability to use various financial risk management tools, including call options, put options and swaps or a combination of these tools provides the opportunity to reduce the risk that catastrophic prices will result. Tangeman Direct at pages 4 and 6. Notwithstanding Kansas Gas Service's recognized need for flexibility in choosing the appropriate risk management tool(s), the

Company reaffirms its commitment to consult with Staff and CURB in developing the strategy to utilize, given the then existing circumstances. Tangeman Direct at page 6. According to Staff, these meetings have been a standard component of Kansas Gas Service's implementation process starting with the first Hedge Program. Staff Memorandum at page 3. Kansas Gas Service will invest such additional funds to reach the target price cap expenditure *only* if the Commission authorizes recovery of the funds expended through the Company's COGR. Included in the budgeted funds to be expended are transaction costs and interest on margin if swaps are utilized, which the Company estimates could total approximately $250,000. Application at page 3.

7. The Stipulation and Agreement presented by Kansas Gas Service, Staff, and CURB for the Commission's consideration together with Staff's Memorandum, reflect Staff's investigation of the Company's Application, as well as extensive negotiations between the parties in this matter. Kansas Gas Service, Staff, and CURB constitute all of the parties in this docket and all are signatories to the Stipulation and Agreement. Staff's Memorandum dated March 23, 2005, prepared by Dr. John Cita supports approval of the Stipulation and Agreement. Joint Movants stipulate and agree that the Gas Hedge Program as requested and filed by Kansas Gas Service in the Application shall be modified and conditioned as follows:

A. The budget for Kansas Gas Service's Gas Hedge Program shall not exceed $13.3 million annually. All costs incurred by Kansas Gas Service, such as transaction costs, interest on margin accounts and the direct cost of financial derivatives are included in the approved budget. All payoffs, positive or negative, associated with the settlement of financial derivatives shall be passed-through to Kansas Gas Service's COGR customers in accordance with the rider's provisions. The rate of interest on margin accounts will be the prime rate as published in the *Wall Street Journal.* An interest charge will be assessed on the initial margin amount, starting from when the account is first established through the expiration of the swap or futures contract, as the case may be. Kansas Gas Service may file a Motion to adjust the approved budget depending on market conditions.

B. Consistent with the findings from the Summer 2004 focus group sessions, Kansas Gas Service's preferred hedge strategy is the placement of a price cap. Kansas Gas Service will meet and consult with Staff and CURB prior to program implementation for the purpose of setting a planned program design, which includes specifying the following parameters:

1. quantity or volume of gas to hedge;
2. winter, and possibly summer months to be hedged;
3. price cap level;
4. hedge instruments to be used to set the cap;
5. timing of hedge placement.

For each of the listed parameters, Kansas Gas Service shall describe its decision-making process and the analysis it used to support that process.

C. Kansas Gas Service shall have full discretion over selection of the final Gas Hedge Program parameters. Kansas Gas Service shall also meet with Staff and CURB throughout the implementation period, as needed, for the purpose of discussing significant changes from the planned hedge program.

D. Kansas Gas Service shall recover the program costs for each Gas Hedge Program year from its COGR customers during the months of April through October on a volumetric basis. Kansas Gas Service shall maintain a monthly balance for amounts spent on hedge costs compared to amounts received from customers through the COGR. To the extent the net monthly balance shows that Kansas Gas Service's expenditures on hedges exceed the amounts received from customers through the COGR, Kansas Gas Service shall accrue interest on the excess amount during the following month at the prime rate as published in the *Wall Street Journal.* To the extent the monthly balance shows that Kansas Gas Service's expenditures on hedges are less than the amounts received from customers through the COGR, Kansas Gas Service shall accrue interest on the shortfall during the following month at the Commission's approved rate for customer deposits. Kansas Gas Service shall recover or pay interest pursuant to the methodology above through a charge to or credit to the approved budget. The interest charges set forth in this paragraph D are separate from the interest on margin accounts described in paragraph A, which are treated separately. Kansas Gas Service shall show the amounts collected from customers through the COGR as a separate line item on the customer's bill during the months of April through October.

E. Kansas Gas Service shall submit monthly hedge reports to Staff and CURB throughout the program year. Reports during the implementation months shall detail actual implementation of the program while reports during the winter months will detail actual program performance. Monthly reports will be submitted electronically and during the first week of each month. The implementation reports will describe all activity during the prior calendar month while the performance reports will summarize performance for the instant calendar month. At the end of each program year, Kansas Gas Service shall also submit a report on the cumulative, historical performance of its hedge program efforts.

F. Kansas Gas Service shall retain all information and records necessary to verify derivative transactions performed on its behalf so that Staff or CURB may perform an audit of those transactions.

G. The parties agree that the Gas Hedge Program shall be made permanent. To the extent that the Company, Staff or CURB believe that modifications to the previously approved program are necessary, such as a change in the budget, it shall file a Motion in this Docket requesting such changes as it deems necessary.

8. The Stipulation and Agreement expresses the parties' agreement with regard to certain modifications and conditions applied to the Gas Hedge Program as requested in Kansas Gas Service's Application. Although Staff recognizes that the parties' jointly proposed $13.3 million budget for the new program is significant, given current gas price forecasts, Staff sees the proposed increase as reasonable if Kansas Gas Service's COGR customers are to continue receiving the same level of protection from price spikes. Staff Memorandum at page 3. Staff further states that with the currently proposed budget, the assessment will be about $1.75 per month per customer, or about $21 per year per meter. Based on the summer 2004 Focus Group

results, about 89% of the surveyed customers indicated that spending $21 per year *or more* would be "reasonable". Staff Memorandum at page 2. All parties support the Company's implementation of a permanent Gas Hedge Program, as modified and conditioned by the Stipulation and Agreement, and take the position that the Stipulation and Agreement is reasonable and could be found by the Commission to be in the public interest.

III. FINDINGS AND CONCLUSIONS

9. Kansas Gas Service provides retail natural gas service to approximately 630,000 customers in the State of Kansas. Kansas Gas Service is a certificated natural gas public utility subject to regulatory jurisdiction of the Commission. The Application, as modified by the Stipulation and Agreement, affects the cost of gas as allowed under the monthly COGR; therefore, the Commission, pursuant to K.S.A. 66-104, K.S.A. 66-117, K.S.A. 66-131, and K.S.A. 66-1,200, *et seq.* has jurisdiction over Kansas Gas Service and the subject matter herein.

10. Settlements are favored in the law, *Bright v. LSI Corporation*, 254 Kan. 853, 86 P.2d 686 (1994). However, the Commission must make an independent judgment concerning whether the settlement is in the public interest and should be approved. In making this assessment, the Commission takes into consideration the immediate and future effects on consumers.

11. The Gas Hedge Program proposed in the Application, as conditioned by the Stipulation and Agreement, is likely to mitigate against winter price volatility. Price volatility exposes consumers to unpredictably high gas bills, such as those resulting from the price spikes of the winter of 2000-2001. Implementing the Gas Hedge Program on a permanent basis will afford consumers a measure of protection against such price volatility during future heating

seasons. The Commission concludes that the Gas Hedge Program is a reasonable means of providing each customer an absolute increase in the level of price spike protection.

12. The Stipulation and Agreement provides that Kansas Gas Service's activities will be effectively monitored by Staff through monthly reporting and consultation. The reporting requirements of the Stipulation and Agreement will facilitate Staff keeping the Commission apprised of all program developments, particularly in the event that immediate corrective action is needed.

13. For the foregoing reasons, the Commission finds that the Stipulation and Agreement is reasonable, in the public interest, and should be approved.

IT IS THEREFORE, BY THE COMMISSION ORDERED:

(A) The parties' Joint Motion is hereby granted and the Stipulation and Agreement is hereby approved and incorporated in this Order by reference.

(B) Kansas Gas Service's Application, as modified and conditioned by the Stipulation and Agreement, is hereby granted.

(C) The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering such further order or orders, as it may deem necessary and proper.

(D) A party may file a petition for reconsideration of this Order within fifteen (15) days from the date of service of this Order. If service is by mail, service is complete upon mailing, and three (3) days shall be added to the above time frame.

BY THE COMMISSION IT IS SO ORDERED.

Moline, Chr.; Krehbiel, Com.; Moffet, Com.

Dated: MAR 2 4 2005

ORDER MAILED

MAR 2 4 2005

Susan K. Duffy Executive Director

Susan K. Duffy
Executive Director

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