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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 Aquila, Inc., d/b/a Aquila Networks-KGO, for Approval of an Accounting Order to Permit Aquila, Inc., d/b/a Aquila Networks-KGO to Recover Amounts Necessary to Expend in Order to Establish and Maintain a Gas Hedge Ceiling Price for the 2005-2006 Heating Season.	)	Docket No. 05-AQLG-616-HED

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 Aquila, Inc., d/b/a Aquila Networks-KGO ("Aquila" 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 28, 2005, Aquila filed its Application seeking an order approving its request for an accounting order to permit Aquila to recover such amounts of its funds as may be necessary to expend in order to establish and maintain a gas ceiling price for the 2005-2006 heating season under the Gas Hedge Program and for approval to continue with its "Gas Hedge Program" tariff. In support of its Application, Aquila filed the direct testimony of Mr. Shawn L. Gillespie, its Director of Gas Supply Planning and Operations for the South Region.

2. On January 31, 2005, CURB filed a Petition to Intervene seeking a Commission order granting CURB leave to intervene as a party in this matter. On February 2, 2005, the Commission issued its Order granting CURB's intervention.

3. On February 2, 2005, the Commission entered an Order suspending operation of the changes proposed in Aquila's Application for a period of two hundred forty (240) days from the date of filing the Application, January 28, 2005, until September 25, 2005.

4. On June 7, 2005, Aquila, 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 June 7, 2005 (Stipulation and Agreement).

5. On June 7, 2005, Staff filed its Memorandum prepared by Dr. John Cita, Chief of Economic Policy and Planning, supporting approval of the Stipulation and Agreement.

II. DISCUSSION

6. Aquila's "Gas Hedge Program", first implemented in Docket No. 02-AQLG-950-ACT covering the 2002-2003 heating 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. Aquila's instant Application is very similar to its applications of the past. However, Aquila's current proposal requests an increase in the Company's Gas Hedge Program budget from $1.2 million for the 2004-2005 heating season to $2.1 million for the 2005-2006 heating season. Aquila's

Application requests the Commission issue an accounting order authorizing the Company to: 1) record those monies expended by Aquila in establishing a gas ceiling price for the 2005-2006 heating season in an account to accrue interest at the Commission approved interest rate for customer deposits; 2) recover the program costs from all of its sales customers (except irrigation customers) on a volumetric basis through a separate line item on Aquila's monthly PGA filings during the months of April through October; and 3) to make such report or reports deemed necessary by the Commission regarding such account. Application at ¶4.

7. Aquila's stated goal for its 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 ¶7. In testimony filed in support of the Application, Mr. Gillespie provides the Company's reasons for the requested increase in annual hedge spending. According to Mr. Gillespie, the Company's proposal is consistent with the results of the 2004 LDC joint effort Focus Group Study and the amount sales customers are willing to expend for such price protection. Gillespie Direct at page 5. Mr. Gillespie further states that given the increased volatility in the natural gas market over the last several years, the cost of call options has increased significantly and the proposed increase in the budget amount will allow Aquila to attempt to maintain the level of budgeted winter purchase volumes to be protected by a price cap. Gillespie Direct at page 5. For the 2005-2006 program year, Aquila plans to concentrate on managing the price risk for the period between November and March attempting to protect approximately fifty-five percent (55%) or more of the normal November through March flowing volumes. Aquila intends to use all of its requested budget in straight call

options. Gillespie Direct at page 4. Notwithstanding Aquila's recognized need for flexibility in choosing the appropriate risk management tool(s), the Company remains committed to consulting with Staff and CURB in developing and selecting the risk management strategy to utilize. According to Staff, these meetings have been a standard component of Aquila's implementation process starting with the Company's first Hedge Program. Staff Memorandum at page 3. Elevating the Program to "permanent" status eliminates the need for successive annual applications. Program integrity is retained through meetings between Aquila, Staff, and interveners for the purpose of discussing any proposed changes in the Program. The Commission continues to have oversight regarding proposed changes in the Program, including whether or not the Program should be continued. Staff Memorandum at page 3.

8. The Stipulation and Agreement presented by Joint Movants for the Commission's consideration and approval, 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. Joint Movants constitute all of the parties in this docket and all are signatories to the Stipulation and Agreement. Staff's Memorandum prepared by Dr. Cita supports approval of the Stipulation and Agreement. Joint Movants stipulate and agree that the Gas Hedge Program as requested and filed by Aquila in its Application should be made permanent and shall be modified and conditioned as follows:

A. The budget for Aquila's Gas Hedge Program shall not exceed $2.3 million annually. All Hedge Program costs incurred by Aquila, such as transaction costs, interest on margin accounts and the direct costs of financial derivatives are to be covered by the approved budget. 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. Aquila may file a Motion to adjust the approved budget depending on market conditions.

B. All payoffs, positive or negative, associated with the settlement of financial derivatives shall be passed-through to Aquila's PGA clause customers, except for its irrigation-class customers, in accordance with the clause's provisions.

C. Consistent with the findings from the Summer 2004 focus group sessions, Aquila's preferred hedge strategy is the placement of a price cap. Aquila 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 (and possibly floor) level;
4. hedge instruments to be used to set the cap;
5. timing of hedge placement.

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

D. Aquila shall have full discretion over selection of the final Gas Hedge Program parameters. Aquila 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.

E. Aquila shall recover the program costs for each Gas Hedge Program year from its PGA customers, except irrigation, during the months of April through October on a volumetric basis. Aquila shall maintain a monthly balance for amounts spent on hedge costs compared to amounts recovered from customers through the hedge charge. To the extent the net monthly balance shows that Aquila's expenditures on hedges exceed the amounts recovered from customers, Aquila 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 Aquila's expenditures on hedges are less than the amounts recovered from customers through the hedge charge, Aquila shall accrue interest on the shortfall during the following month at the Commission's approved rate for customer deposits. Aquila 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 E are separate from the interest on margin accounts described in paragraph A, which are treated separately. Aquila shall show the amounts collected from customers through the hedge charge as a separate line item on the customer's bill during the months of April through October.

F. Aquila 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, Aquila shall also submit a report on the cumulative, historical performance of its hedge program efforts.

G. Aquila shall retain all information and records necessary to verify derivative transactions performed either by Aquila or on its behalf so that Staff or CURB may perform an audit of those transactions.

H. 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.

9. Aquila must file its revised Gas Hedge Program tariff (SCHEDULE V: Purchased Gas Adjustment (PGA); SECTION 3 - PURCHASED GAS COST SURCHARGES; A. Gas Hedge Program) with the Commission for approval within thirty (30) days of the date of the Order approving this Stipulation and Agreement. Stipulation and Agreement at paragraph 6.

10. The Stipulation and Agreement expresses the parties' agreement with regard to certain modifications and conditions applied to the Gas Hedge Program as requested in Aquila's Application. Although Staff recognizes that the parties' jointly proposed $2.3 million annual budget for the new program is significant, Staff maintains

that the proposed increase is very much in line with other recent cost increases, namely the increased cost of natural gas. Staff Memorandum at page 2. Staff sees the proposed increase as reasonable if Aquila'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, approximately 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

11. Aquila provides retail natural gas service to over 100,000 customers in the State of Kansas. Aquila is a certificated natural gas public utility subject to regulatory jurisdiction of the Commission. The Application, as modified and conditioned 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 Aquila and the subject matter herein.

12. 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.

13. The Gas Hedge Program proposed in the Application, as modified and 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 Aquila's Gas Hedge Program on a permanent basis will afford the Company's customers 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.

14. The Stipulation and Agreement provides that Aquila'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.

15. 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) Aquila's Application, as modified and conditioned by the Stipulation and Agreement, is hereby granted.

(C) Aquila shall file its revised Gas Hedge Program tariff referenced in paragraph 9 above with the Commission for approval within thirty (30) days from the date of this Order.

(D) 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.

(E) 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: JUN 1 4 2005

ORDER MAILED

JUN 1 4 2005

Susan K. Duffy Executive Director

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Executive Director

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