BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

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

APPLICATION

COMES NOW Kansas Gas Service, a Division of ONEOK, Inc. ("Kansas Gas Service" or "Company") and pursuant to K.S.A. 66-117 and the Kansas Corporation Commission's ("KCC" or "Commission") Order in Docket No. 106,850-U dated April 19, 1977 files this Application with the KCC for an order approving its request to establish a Gas Hedge Program which will enable the Company to take the necessary steps to limit the volatility of gas prices during the winter heating season. Pursuant to this Application, the Company requests the authority to collect $14.0 million dollars 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, Kansas Gas Service states as follows:

1. Kansas Gas Service is a natural gas public utility operating in the State of Kansas pursuant to certificates of convenience and necessity issued by the Commission. Kansas Gas Service's principal place of business within the state of Kansas is located at 7421 West 129th Street, Overland Park, Kansas 66213.

2. Pleadings, notices, orders and other correspondence and communication regarding this Application should be sent to:

John P. DeCoursey
Walker Hendrix
Kansas Gas Service
A Division of ONEOK, Inc.
7421 W. 129th Street
Overland Park, Kansas 66213

Larry G. Willer
Director of Rates and Regulations
Kansas Gas Service
A Division of ONEOK, Inc.
7421 W. 129th Street
Overland Park, Kansas 66213

3. On January 29, 1998, Kansas Gas Service filed its Application with the Commission in Docket No. 98-KGSG-475-CON (the "475 Docket"). Pursuant to the Application and several subsequent Motions filed in the 475 Docket, Kansas Gas Service requested and received Commission authorization to expend certain funds and recover such funds through its Cost of Gas Rider (COGR) to purchase various financial hedging instruments to reduce the price volatility of natural gas for its customers. These financial hedging programs covered each of the winters from 1998-1999 through 2004-2005. Rather than recite the lengthy history of the 475 Docket, Kansas Gas Service incorporates said docket in this Application as if fully set forth herein.

4. Consistent with its Application and subsequent annual Motions to extend its Hedge Filing in the 475 Docket, Kansas Gas Service believes that the price protection afforded to its customers by reducing price volatility on a significant percentage of its projected sales volumes in the winter heating season is something that the Commission wants the Company to maintain. There are two differences between this Application and Kansas Gas Service's annual

renewals in the 475 Docket. First, Kansas Gas Service is requesting authority to increase its annual hedge spending from $7.3 million to an annual amount of $14.0 million. Second, the Company is requesting that the Hedge Program be made permanent. The full extent of the current Application is set forth in the paragraphs below.

5. The reasons for the increase and the overall strategy for the upcoming year are set forth in the testimony of Mr. Richard Tangeman whose testimony is being filed in support of this Application. The goal of the Program is to mitigate price volatility. This will be accomplished primarily by using various financial instruments to establish a cap on the price of natural gas at a reasonable level for as much volume as possible while preserving the benefit of any downward price movement. As stated in the testimony of Mr. Tangeman, Kansas Gas Service has not yet adopted a specific strategy to achieve the goal of reducing price volatility for the upcoming year because of current market conditions, higher pricing levels, and uncertainty about supply and demand. Kansas Gas Service will develop a strategy utilizing various risk management tools, which include call options, put options and swaps or a combination of those tools, after consultation with Staff and CURB as to the desired strategy.

6. Kansas Gas Service is willing to invest such funds, as needed, to establish a ceiling price. However, Kansas Gas Service will invest such additional funds to reach the target price cap expenditure only if the Commission authorizes the recovery of the funds expended through the Company's COGR. The funds will be recovered through the COGR during the months of April through October. Among the $14.0 million in funds to be expended are transaction costs and interest on margin if swaps are utilized which Kansas Gas Service estimates could total to approximately $250,000. Kansas Gas Service proposes to charge the prime rate as published in the Wall Street Journal for interest on margin when swaps are utilized. Additionally,

Kansas Gas Service will potentially incur carrying costs for hedging instruments purchased. The Company proposes that for overall hedge program expenditures and receipts, the Company will 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 $14.0 million annual budget. The carrying charges and methodology set forth above are the same as approved by the Commission for the 2004-2005 hedge program year.

7. The Company requests the Commission to issue an order authorizing Kansas Gas Service to implement a permanent Gas Hedge Program. To implement that program Kansas Gas Service 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 above; (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) to make monthly reports throughout the Program year to apprise the Commission of both the Program's implementation and performance.

8. The authorization requested by this Application will allow Kansas Gas Service to take actions that are reasonably designed to mitigate the volatility of gas prices during the winter heating season. It is the goal of the Gas Hedge Program that these actions will mitigate price volatility, at a reasonable cost, relative to Kansas Gas Service's traditional operations. Therefore, the Company believes that the Commission should find the authority requested is in the public interest.

WHEREFORE, Kansas Gas Service respectfully requests that the Commission issue its Order granting this Application and to grant such other relief as the Commission may deem appropriate.

Respectfully submitted

KANSAS GAS SERVICE,
A DIVISION OF ONEOK, INC.

John P. DeCoursey

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ITS ATTORNEYS

VERIFICATION

STATE OF KANSAS)
) ss
COUNTY OF JOHNSON)

The undersigned, upon oath first duly sworn, states that he is the attorney for Kansas Gas Service, a Division of ONEOK, Inc., that he has read the foregoing **Application**, that he is familiar with the contents thereof, and that the statements contained therein are true and correct to the best of his knowledge and belief.

John P. DeCoursey
John P. DeCoursey

Subscribed and sworn to before me this 14th day of January, 2005.

Jo M. Smith
Notary Public

My Appointment expires: 9/28/08

NOTARY PUBLIC -- State of Kansas
JO M. SMITH
My Appt. Exp. 9/28/08

DIRECT TESTIMONY

OF

RICHARD H. TANGEMAN

KANSAS GAS SERVICE

DOCKET NO. 05-KGSG-580 -HED

Q. Please state your name and business address.

A. My name is Richard H. Tangeman. My business address is 7421 W. 129th Street, Overland Park, Kansas 66213.

Q. By whom and in what capacity are you employed?

A. I am employed by Kansas Gas Service, a Division of ONEOK, Inc. (Kansas Gas Service), as Director, FERC Regulatory & Strategy.

Q. Please describe your educational background and professional experience.

A. I graduated from Kansas State University in 1972 with a Bachelor of Science degree in Mechanical Engineering. I began my employment with The Kansas Power and Light Company (now Kansas Gas Service) in 1972 in an engineering function. I have worked in various areas of engineering and operations. In 1990 I joined the Gas Supply Department, which has now become the Gas Strategy Department. I assumed my current responsibilities and title in November 1997 with the sale of Western Resources, Inc.'s gas properties to ONEOK, Inc.

Q. Have you ever testified before this Commission?

A. Yes, I have submitted testimony in proceedings before the Kansas Corporation Commission, the Federal Energy Regulatory Commission and the Missouri Public

Service Commission. I most recently filed testimony in proceedings before this Commission in Docket No. 03-KGSG-602-RTS.

Q. What is the purpose of your testimony?

A. I will describe the results of the Gas Hedge Program for 2004-2005 through December of 2004. I will also explain the Gas Hedge Program we are proposing as a permanent program.

Q. What is the purpose of the Gas Hedge Program?

A. The primary purpose of the program is to mitigate gas price volatility by providing price protection for the natural gas purchased for the winter season on behalf of the customers of Kansas Gas Service.

Q. How does the Gas Hedge Program achieve this goal?

A. Pursuant to the Commission's Order, dated March 19, 2004, a budget of up to $7.3 million was established for the April 2004 through March 2005 program year. Following discussions with Commission Staff and representatives of CURB, the Company pursued a three-component risk management strategy that included purchasing calls to establish a price cap on a portion of our gas supply, obtaining swaps to effectively fix the price for a portion of our gas supply and selling put options to provide additional revenue to purchase additional calls. This risk management strategy was applied to gas to be purchased during the winter months of November through March, which represents approximately 72% of our anticipated supplies of gas for winter use (the "budgeted winter purchase volumes"). The remaining 28% of gas supply comes from storage gas, which is bought in periods of time when the price of gas is usually less than the price of winter gas and represents a physical hedge on gas costs.

Q. How did Kansas Gas Service utilize the $7.3 million of budgeted monies?

A. Kansas Gas Service purchased calls on approximately 28% of the budgeted winter purchase volumes to establish a price cap. Swaps were also obtained on approximately 14% of the budgeted winter purchase volumes to establish a swap fixed price. In addition, put options were sold at a strike price below the market price to generate additional revenue for the purchase of additional call options, which are included in the 28% above. The combined call options and swaps covered approximately 42% of the budgeted winter purchase volumes. The remaining 58% of the budgeted winter purchase volumes have no financial hedge.

Q. Will the customers benefit from the Gas Hedge Program this program year?

A. Yes. The hedge program obtained this year plus the storage physical hedge will protect 58% of the total winter demand volumes from higher prices if prices increase above the call option cap price and the swap fixed price. Likewise, if the prices fall below the call option cap price and the swap fixed price, the reduced price will be received by the customers on 62% of the total winter demand volumes. Kansas Gas Service has received revenue from the settlement of call options and swaps for November, December and January totaling $5,721,220, which was passed on to customers.

Q. Are there any changes proposed for the Gas Hedge Program?

A. We believe that the program as it now exists, with the ability to use various financial risk management tools, provides the best opportunity to reduce volatility and mitigate potentially high gas costs. The risk management tools, which include call options, put options and swaps or a combination of these tools, provide the opportunity to reduce the risk that catastrophic prices will result. We believe it is important to establish a priority for using these risk management options, but it is equally important that the Company be able to retain the flexibility to use whichever tool is most appropriate at the time that a risk management contract is obtained.

Q. Please explain why you have not identified a specific risk management strategy for the upcoming program year.

A. The natural gas market is very volatile and can move as the result of perceptions and forecasts as well as actual occurrences. Some of the major drivers are winter weather (heating demand), economy (industrial demand), storage levels (supply or demand depending on season) and production levels (supply). These drivers and the perception of the direction of their future movement influence the type of risk strategy that would be best employed in a hedge program.

Q. What are the current perceptions and what kind of risk management strategy would appear to be best?

A. Production levels had been declining since mid-2001 and current industry information gives no clear indication if that trend has reversed. Storage levels are at an all time high. This combination gives no clear supply side directional driver for prices in the short term. The economy has not rebounded to its full strength, however, predictions continue for a stronger economy and increased industrial demand. The greatest demand side question currently is this winter's heating demand level. The current drivers don't give any clear perception of direction for prices. Also, the current NYMEX price levels for the summer of 2005 and the winter of 2005-2006 are similar to those prices last summer when the call options and swaps were obtained for the current hedge year.

Q. Can you describe the general type of risk management strategies that will be used?

A. Focus Groups held during the summer of 2004, indicated that customers prefer that we cap the price at reasonable levels for as much volume as possible while preserving the benefit of any downward price movement. We can implement this strategy by fixing prices with swaps and purchasing puts to protect against downward price movement or by using straight calls to establish a price cap. We have not yet determined which of these strategies to use, how much volume to cover and which months to cover. We propose to consult with Staff and CURB to define the specifics of the strategy before implementation.

Q. Please explain your proposal for the Gas Hedge Program.

A. First, we are requesting approval of a $14.0 million budget for purchase of options, which is almost twice the amount the Commission has approved for the last three program years. The increased volatility in the natural gas market during the past three years has resulted in an increased cost for call options, which allows less of the budgeted winter purchase volumes to be protected by a price cap. The Focus Groups, a market research study conducted during the summer of 2004, indicated that 89% of the focus group customers would be willing to pay approximately $21.00 or more annually for price protection. The focus groups included customers from all gas utilities in Kansas and was a combined effort of

KGS, Aquila, Midwest Energy and Atmos. In addition to the utilities participation, Dr. John Cita of the KCC Staff as well as some of his departmental Staff members were also actively involved in the research. The $14.0 million equates to approximately $18.70 annually or slightly more than $1.50 per month for an average residential customer.

Second, we propose to develop a risk management strategy utilizing the tools identified earlier. We will consult with Staff and CURB in developing the strategy to utilize, given the then-existing conditions. At the present time we have not determined which risk management strategy will best fit those future conditions.

Third, we request that the Commission approve the recovery of the Gas Hedge Program costs as set out in our Application. Included in the $14.0 million will be transaction costs and interest on margin if swaps are utilized, which Kansas Gas Service estimates could total to approximately $250,000.

Q. Does this conclude your testimony?

A. Yes. Thank you.

VERIFICATION

STATE OF KANSAS)
) ss.
COUNTY OF JOHNSON)

Richard H. Tangeman, being duly sworn upon his oath, deposes and states that he is the Director, FERC Regulatory & Strategy for Kansas Gas Service, a Divison of ONEOK, Inc.; that he has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information, and belief.

Richard H Tangeman

Richard H. Tangeman

Subscribed and sworn to before me this 14 day of January 2005.

Jo M. Smith

Notary Public

My Appointment Expires:

9/28/08

NOTARY PUBLIC -- State of Kansas
JO M. SMITH
My Appt. Exp. 9/28/08