LAW OFFICES

BRYDON, SWEARENGEN & ENGLAND

PROFESSIONAL CORPORATION

312 EAST CAPITOL AVENUE
P.O. BOX 456
JEFFERSON CITY, MISSOURI 65102-0456
TELEPHONE (573) 635-7166
FACSIMILE (573) 635-3847
E-MAIL: DCOOPER@BRYDONLAW.COM

July 2, 2003

Secretary
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Case No. GX-2002-478

Dear Mr. Roberts:

Enclosed please find an original and eight copies of Aquila's Initial Comments in the above-referenced case. Please file stamp the enclosed extra receipt copy and return to me for my records.

If you have any questions concerning this matter, then please do not hesitate to contact me. Thank you very much for your attention to this matter.

Sincerely,

BRYDON, SWEARENGEN & ENGLAND P.C.

By:

Dean L. Cooper

DLC/tli
Enclosures
cc: General Counsel's Office
Doug Micheel
Robert J. Hack
James M. Fischer
Thomas M. Byrne
Michael C. Pendergast
Dennis Odell

BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of a Proposed Rulemaking Concerning Mitigation of Natural Gas Price Volatility	))	Case No. GX-2002-478

AQUILA'S INITIAL COMMENTS

Comes Now Aquila, Inc. d/b/a Aquila Networks - MPS and Aquila Networks - L&P ("Aquila"), by and through counsel, and hereby respectfully submits its initial comments to the Missouri Public Service Commission ("Commission"):

Introduction

Aquila would like to thank the Commission for this opportunity to comment on Proposed Rule 4 CSR 240-40.018 (*Natural Gas Price Volatility Mitigation*). This is a timely topic, and the proposed rule recognizes the importance of natural gas utilities' efforts to limit the price exposure of their sales customers while providing the utilities with increased certainty that their efforts will not result in disallowed gas costs.

Background

Natural gas prices, while always somewhat volatile relative to many other commodities, enjoyed a period of price stability in the early and mid 1990's. In fact, when the New York Mercantile Exchange (NYMEX) natural gas futures contract closed near $4.00 per MMBtu in 1996, it represented a previously unseen high for natural gas prices. The natural gas market in recent years, however, has become increasingly volatile, with daily prices exceeding $20.00 per MMBtu in some markets.

As the price of natural gas has increased, along with the volatility of prices, traditional sales customers of natural gas utilities have had limited options. Other than decreasing their usage in the face of these higher prices[1], there was little that a utility customer could do. That left it to the utility itself to use the hedging tools available in the market to mitigate the high prices and volatility on behalf of the customer. This approach, however, was not without risk to the utility. There are many examples of utilities facing disallowance of gas costs when the results of their hedging programs led to higher prices than might have existed absent such a program.

Proposed Rule

Aquila supports the proposed rule. Aquila believes that the rule accomplishes two important goals. First, it makes clear to all natural gas utilities in the state that the Commission believes prudent gas supply planning requires that a utility take steps to mitigate price volatility. This clear statement is necessary in order to protect sales customers from a risk against which they cannot adequately protect themselves. It is easy, for utilities and regulators both, to fall into a status quo that does not recognize the changing marketplace. This proposed rule makes it clear that a gas purchasing effort that does not take gas price volatility into account may not be prudent.

Second, this proposed rule shines light on an issue that has restrained many utilities from taking appropriate action. Specifically, it recognizes that a balanced portfolio may sometimes lead to higher prices. This is a crucial and accurate recognition. No single tool will result in the lowest price in all situations. By the same token, speculating on which tool will be most effective in any particular period is a game better left to traders than to prudent gas utilities. Therefore, a balanced portfolio is the best approach. However, this approach will inevitably lead

[1] Even this is difficult for the customer as existing mechanisms for passing through gas costs do not provide real time pricing signals.

to an average price that is higher than index in a decreasing-price market and higher than fixed prices in an increasing-price market. On average, however, this balanced portfolio should, over a period of several years, yield a price that is consistently between the two extremes. Doing this should stabilize prices for consumers, which is the ultimate goal.

Aquila's Hedging Program

Over the last several years Aquila has undertaken and refined a hedging program that it believes effectively mitigates the price volatility for its customers while still bearing a relationship to market prices as they decrease. This program is designed to utilizes many of the tools listed in the proposed rule. It works by developing a portfolio of different hedging products, consistent with the requirements of the proposed rule, rather than depending purely on fixed or index prices.

At its most basic, Aquila's hedging program uses some fixed price contracts and storage to set a fixed price. This price is set, regardless of whether the market price increases or decreases. Next, Aquila uses options to cap prices on some of its purchases. These caps provide a ceiling on prices in an increasing market while, unlike fixed price contracts, allowing the portfolio to take advantage of lower prices in a decreasing market. Finally, Aquila uses index contracts to completely match the market, whether it increases or decreases.

Aquila has engaged in this hedging program for several years, and the Commission and Staff have been generally supportive of our efforts. Aquila intends to continue with its hedging program, all the while refining it as Aquila gains experience and new hedging tools become available. Aquila looks forward to the continued support of the Commission and Staff in this regard, as evidenced by this proposed rule.

Conclusion

The proposed rule is timely and necessary. It provides natural gas utilities with an increased understanding of what the Commission deems to be required of a prudent utility, and recognizes that a balanced portfolio is reasonable, even though it may not result in the lowest gas cost. Aquila supports this proposed rule, and recommends its acceptance.

Lastly, Aquila is aware of the technical drafting issues raised by other Missouri gas utilities. Aquila agrees with the comments of the utilities regarding these issues, and believes that the changes they recommend would be beneficial.

WHEREFORE, Aquila respectfully requests that the Commission consider Aquila's above comments in addressing the proposed rule.

Respectfully submitted,

Dean L. Cooper MBE #36592
BRYDON, SWEARENGEN & ENGLAND P.C.
312 E. Capitol Avenue
P. O. Box 456
Jefferson City, MO 65102
(573) 635-7166
(573) 635-0427 facsimile
dcooper@brydonlaw.com

ATTORNEYS FOR AQUILA, INC. D/B/A
AQUILA NETWORKS - MPS AND
AQUILA NETWORKS - L&P

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered this 2nd day of July, 2003, to:

Robert J. Hack
3420 Broadway
Kansas City, MO 64111

Michael C. Pendergast
720 Olive St. Suite 1520
St. Louis, MO 63101

James M. Fischer
Fischer & Dority, P.C.
101 Madison, Suite 400
Jefferson City, Missouri 65101

Douglas E. Micheel
Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

General Counsel's Office
MOPSC
P.O. Box 360
Jefferson City, MO 65102

Thomas M. Byrne
AmerenUE
P.O. Box 66149
St. Louis, MO 63166