

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: MIDAMERICAN ENERGY COMPANY	DOCKET NO. SPU-04-31
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**ORDER APPROVING SECOND AMENDMENT TO LONG-TERM
GAS PROCUREMENT PLAN AND LEAVING DOCKET OPEN**

(Issued February 21, 2005)

PROCEDURAL BACKGROUND

On December 16, 2004, the Utilities Board (Board) approved a First Amended Long-Term Gas Procurement Plan (First Amended LGPP) filed by MidAmerican Energy Company (MidAmerican) that authorized MidAmerican to enter into a 14-year hedging plan for the purchase of natural gas, to create an associated regulatory asset, and to recover the asset through the purchased gas adjustment (PGA) factor as part of the price of gas. MidAmerican filed for initial approval of the Long-Term Gas Procurement Plan (LGPP) on November 5, 2004, and filed the First Amended LGPP on December 13, 2004. The Consumer Advocate Division of the Department of Justice (Consumer Advocate) supported the LGPP and the First Amended LGPP.

MidAmerican proposed the plan in response to increased natural gas commodity price volatility during the winter heating season. MidAmerican pointed out that its current strategy includes injecting gas into storage, purchasing physical supply on the daily market, and utilizing various financial instruments and hedging techniques. MidAmerican suggested that although this current strategy has been

successful in reducing price volatility for a given winter heating season, natural gas customers are still experiencing price fluctuations from one heating season to the next due to macroeconomic factors.

The components of the First Amended LGPP approved by the Board in the December 16, 2004, order are as follows:

1. Applies to all Iowa PGA customers of MidAmerican.
2. Initially, MidAmerican proposed that the plan end on October 31, 2018, with the regulatory asset account balance reduced to zero on March 31, 2019. Under the First Amended LGPP, the term of the plan was extended through March 31, 2019. This extension would have allowed MidAmerican to implement the market hedge strategy throughout the entire 2018-2019 winter heating season. MidAmerican still expected the regulatory asset account balance to be reduced to zero no later than March 31, 2019.
3. MidAmerican proposed to hedge a maximum of 600,000 MMBtu monthly during the plan. Initially, MidAmerican had proposed that the 600,000 MMBtu level would be reached in year four of the plan. Under the First Amended LGPP, MidAmerican proposed that beginning January 1, 2005, it would hedge 300,000 MMBtu of natural gas on a monthly basis. MidAmerican anticipated that the cumulative monthly aggregate of hedged volumes of 600,000 MMBtu would be achieved as early as 2005-2006 winter heating season.
4. Initially, MidAmerican proposed that the regulatory asset be accumulated over a four-year period. Under the First Amended LGPP,

MidAmerican proposed that the creation of a regulatory asset occur over a one-year period for the cost deferred from the 2004-2005 winter heating season. The difference between MidAmerican's actual hedged cost of gas and the cost recovered through the PGA would be deferred and accrued on MidAmerican's books and recorded as a regulatory asset.

Under the First Amended LGPP, MidAmerican would accumulate the regulatory asset by the amount the PGA price of gas exceeded the capped price for the 300,000 MMBtu during the 2004-2005 winter heating season. MidAmerican's actual hedged cost of gas would include any gains and losses associated with optimizing the value of the financial hedges and the cost of the physical gas. The regulatory asset would then be recovered through the PGA during the remaining term of the plan. The PGA cost charged to the customers in the future would be an amount slightly greater than the actual cost at that time, reflecting the amortization of the regulatory asset.

5. The regulatory asset would earn a return at an annual rate of 8.654 percent throughout the term of the plan, which is the rate for the third quarter 2004 allowance for funds used during construction for gas plant. This return component would be included in the balance of the regulatory asset and recovered through the PGA.

In the December 16, 2004, order, the Board recognized that the goal of the plan was to provide some stability for natural gas prices over a 14-year period. The Board indicated that the regulated gas utilities and the Board had been discussing solutions for limiting price volatility and stabilizing natural gas prices for Iowa

customers over the past several years and that the approved plan was a unique proposal that attempted to address price volatility over a longer period than the usual hedging strategies.

The Board expressed some reservations in approving the First Amended LGPP, since there were some unanswered questions about the overall effect on customer bills of the plan and whether the cost of the plan would ultimately outweigh the benefits of the plan. The Board pointed out that the proposal involves estimates of future gas prices, so some uncertainty is unavoidable. The Board approved the First Amended LGPP subject to investigation and complaint, as it does with all PGA filings. The Board stated that unforeseen circumstances could require the Board to review the plan at some point during the next 14 years.

On December 22, 2004, MidAmerican filed a report on implementation of the First Amended LGPP and a request to leave this docket open. MidAmerican stated in the report that it had requested the bidders refresh their bids and based upon the refreshed bids, MidAmerican determined that it could not implement the plan at this time. Consumer Advocate agreed with MidAmerican's decision. MidAmerican indicated that it would continue to monitor the natural gas market to determine whether the LGPP could be implemented as some future date.

SECOND AMENDMENT TO LGPP

On January 14, 2005, MidAmerican filed a Second Amendment to the LGPP. MidAmerican requested that the LGPP be approved with the proposed revisions in the Second Amendment and that MidAmerican still have authority to create a

regulatory asset and to recover the balance of the asset through the PGA.

MidAmerican indicates it could have a very short period, minutes or hours, to respond to a bid to provide the hedge for the LGPP and the proposed revisions in the Second Amendment are designed to provide MidAmerican the flexibility to act quickly.

MidAmerican then suggests that the LGPP needs to be very flexible so that MidAmerican can act when it finds a bid that is favorable.

To provide the necessary flexibility in the LGPP, MidAmerican proposes the following revisions as a Second Amendment to the LGPP.

1. MidAmerican proposes that it be authorized to begin hedging the monthly quantities of natural gas under the LGPP either during the 2004-2005 winter heating season or the 2005-2006 winter heating season.
2. MidAmerican proposes to revise the schedule of monthly quantities to be hedged so that there is a maximum of 600,000 MMBtu possible but no schedule is specified. MidAmerican indicates that it will endeavor to reach the 600,000 MMBtu level by the fourth year, but is not required to do so if market conditions are not favorable.
3. MidAmerican then proposes to remove the specific time period of the LGPP. As approved by the Board, the LGPP would have extended for 14 years. Under the Second Amendment, the LGPP could be any number of years up to 14 years.
4. MidAmerican states that in all other aspects the LGPP and the creation and operation of the associated regulatory asset will be as described in the November 4, 2004, filing as amended on December 13, 2004.

MidAmerican states that it will work closely with Consumer Advocate and will obtain agreement and consent of Consumer Advocate prior to acceptance of any pricing proposals. MidAmerican states that it will file a report detailing the terms and conditions of the pricing proposal with the Board within five business days of acceptance of a hedging proposal. MidAmerican states that Consumer Advocate supports the revisions in the Second Amendment.

BOARD DISCUSSION

The Board has reviewed the proposed revisions in the Second Amendment and has determined that the flexibility provided by the Second Amendment revisions raises concerns when comparing the benefits with the cost of the regulatory asset. In the December 16, 2004, order approving the First Amended LGPP, the Board stated that it was approving the LGPP even though there are some unanswered questions about the overall effect on customer bills of the plan, especially whether the costs of the plan will ultimately outweigh the benefits. The Board pointed out that the LGPP involves estimates of future gas prices, so some uncertainty is unavoidable. The Board approved the First Amended LGPP subject to investigation and complaint to allow the opportunity for the Board to review the plan at some point during the 14 years of the plan, if necessary.

The additional flexibility requested by MidAmerican in the Second Amendment would remove any limit on the total amount of the regulatory asset to be accumulated and would not provide a minimum period over which the regulatory asset would be recovered. Under the original proposal, the total accumulated size of the regulatory

asset was estimated to be approximately \$15 million and the LGPP would continue for 14 years. Under the First Amended LGPP, the size of the regulatory asset was to be significantly less, since it was to accumulate over only the 2004-2005 heating season and that recovery was still over 14 years.

The Second Amendment also does not provide any indication of the bid price that would be acceptable for the hedge and no indication of the capped price of gas for creation of the regulatory asset. This flexibility could allow the regulatory asset to grow to an unreasonable size and since recovery could be for any number of years up to 14, the additional cost for customers during the recovery period could have a significant effect on the total price of gas during that time. The Board is concerned that the recovery of the regulatory asset could potentially have a greater effect on the cost of gas in the recovery years than the benefit from the capped price in the years when the asset was accumulated.

Board staff met with MidAmerican and Consumer Advocate to discuss the concerns expressed above. As a result of these discussions, it is the Board's understanding that MidAmerican recognizes the need for some parameters on the total exposure of PGA consumers and considers a limit on the total amount of the regulatory asset that could be accumulated to be the least restrictive parameter discussed. It is also the Board's understanding that Consumer Advocate would use a limit on the size of the regulatory asset as a parameter in reviewing any offers. Based upon these considerations, the Board finds that a limit of \$15 million should be set for the total amount of regulatory asset that can be accumulated under the LGPP. The regulatory asset could be accumulated over however many years MidAmerican

determines is reasonable, based upon market conditions and pricing offers.

Adoption of the limit on the size of the regulatory asset will give MidAmerican the necessary flexibility for responding quickly to bids while allowing the Board to fulfill its regulatory responsibility to establish limits on ratepayer exposure.

The limit of \$15 million is approximately what MidAmerican estimated would be the maximum accumulation of the regulatory asset under the original proposal and the Board considers this to be a reasonable limit. It is the Board's understanding that the \$15 million also comes within the limit on the regulatory asset that Consumer Advocate believed to be reasonable.

The other main concern of the Board is the recovery period for the regulatory asset. As stated above, the Board is concerned that the addition to gas prices in the years of recovery should not be a significant factor in the final price of the gas. Under the First Amended LGPP approved by the Board, the recovery would have been over 14 years, which reduced the projected amount to be recovered each year from customers to a very small amount. With the proposed flexibility with the Second Amendment, recovery could be for a period significantly shorter than 14 years, resulting in the additional charge being a significant factor in the overall price of gas.

It is the Board's understanding that MidAmerican is very likely to only accept a hedge that extends for at least ten years. This goes out beyond the New York Mercantile Exchange (NYMEX) strip price and allows MidAmerican to obtain a hedge based upon factors other than the NYMEX strip. This should extend the recovery period of the regulatory asset out a sufficient number of years to keep the additional charge from becoming a significant factor in the price of gas during the recovery

period. The Board understands that the number of years in the recovery period is also an issue that Consumer Advocate will consider when deciding whether to approve any offer proposed to be accepted by MidAmerican.

The Board will approve the Second Amended LGPP as proposed by MidAmerican with the one condition that the total amount of the regulatory asset that can be accumulated is limited to \$15 million. The Board recognizes that this is an innovative approach to stabilizing the price of gas and may help MidAmerican reduce long-term price volatility in the future. If MidAmerican is able to purchase a hedge under the LGPP, then it will also provide more diversity to MidAmerican's gas purchasing portfolio.

As stated in the December 16, 2004, order, the Board considers the LGPP to be similar to a pilot project that requires some latitude in order to determine whether the benefits outweigh the costs. Based upon the limits on the volumes to be hedged, as proposed by MidAmerican, and the limit on the total amount that can be accumulated in the regulatory asset, as established by the Board in this order, the Board considers the Second Amended LGPP to be reasonable. The terms of the Second Amended LGPP approved in this order are set out below.

1. Applies to all Iowa PGA customers of MidAmerican.
2. MidAmerican would begin hedging the monthly quantities of natural gas under the Second Amended LGPP either during the 2004-2005 winter heating season or the 2005-2006 winter heating season.
3. There would be no set schedule for the monthly quantities to be hedged. The maximum amount to be scheduled in any one month would be

600,000 MMBtu. MidAmerican indicates that it will endeavor to reach the 600,000 MMBtu level by the fourth year, but is not required to do so if market conditions are not favorable.

4. There would be no specific time period for the number of years to be hedged under the Second Amended LGPP. The Second Amended LGPP could be established for any number of years up to 14 years.

5. The total amount of regulatory asset to be accumulated would be no more than \$15 million. The regulatory asset would earn a return at an annual rate of 8.654 percent throughout the term of the Second Amended LGPP, which is the rate for the third quarter 2004 allowance for funds used during construction for gas plant. This return component would be included in the balance of the regulatory asset and recovered through the PGA.

6. In all other aspects, the Second Amended LGPP and the creation and operation of the associated regulatory asset will be as described in the November 4, 2004, filing as amended on December 13, 2004, and approved by the Board on December 16, 2004.

The Board will approve the Second Amended LGPP subject to complaint and investigation as it did with the First Amended LGPP. This will allow the Board the opportunity to review the plan if there are unforeseen circumstances that occur during the term of the plan. In addition, the Board will hold this docket open for the filing of the terms and conditions of any bid accepted by MidAmerican.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The Second Amendment to the Long-Term Gas Procurement Plan filed by MidAmerican Energy Company on January 14, 2005, is approved, subject to the condition described in this order and subject to investigation and complaint.
2. MidAmerican Energy Company is authorized to establish a Deferred Gas Cost Regulatory Asset and to earn a return on the balance as described in the Second Amended Long-Term Gas Procurement Plan approved in this order. The maximum total amount of the regulatory asset that can be accumulated under the Second Amended Long-Term Gas Procurement Plan is \$15 million.
3. Docket No. SPU-04-31 will remain open until closed by Board order.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 21st day of February, 2005.