MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2003-0311, Aquila-MPS

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/s/ Dave Sommerer 12/21/04	/s/ Thomas R. Schwarz 12/21/04
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff Recommendation in Aquila-MPS 2002/2003 Actual Cost Adjustment Filing.

DATE: December 21, 2004

The Procurement Analysis Department (Staff) has reviewed the 2002/2003 Actual Cost Adjustment (ACA) filing of Aquila, Inc. d/b/a Aquila Networks-MPS (MPS or Company). The 2002/2003 ACA filing was made on November 3, 2003, and was docketed as Case No. GR-2003-0311. The review consisted of an analysis of the billed revenues and actual gas costs for the period of September 2002 to August 2003. An examination of MPS's gas purchasing practices was performed to determine the prudence of the Company's purchasing decisions. The Company's recovery balances include the ACA, Take-or-Pay (TOP), Transition Cost (TC), Deferred Carrying Cost (DCCB), and Refund balances. Staff conducted a reliability analysis including a review of estimated peak day requirements and the capacity levels needed to meet those requirements. Staff also conducted a hedging review to determine the reasonableness of the Company's hedging policy for the 2002/2003 ACA.

MPS separates its gas operations into a Southern System, a Northern System, and an Eastern System. Southern Star Central (SSC), formerly Williams Gas Pipeline Central (WGPC), serves customers on the Southern System, while Panhandle Eastern Pipeline Company (PEPL) serves customers on the Northern and Eastern Systems. In addition to PEPL, Missouri Pipeline Company (MPC) and Missouri Gas Company (MGC) deliver gas to the Eastern System. For the 2002/2003 ACA review period, the number of sales customers was approximately 32,000 on the Southern System, 10,800 on the Northern System, and 4,200 on the Eastern System. Issued April 30, 2004, a Commission order was made effective May 1,2004, in Case No. GM-2004-0244, that approved the sale of the Company's Eastern System assets to AmerenUE.

REQUEST FOR PROPOSAL

The Company conducts a formal Request for Proposal (RFP) process for purchase transactions of greater than 31 days. The RFP process is currently not utilized by the Company for purchase transactions of less than 31 days. A detailed RFP process documents all supply requirements by the Company. Those requirements are issued to the various suppliers on the Company's RFP bid list. Although a formal RFP requirement may not be necessary for transactions of less than 31 days, Staff believes that written documentation of these purchase transactions should be made, at a minimum. This would include a description of each transaction and the contract terms and type of service required.

ACA BALANCE – PRIOR PERIOD ADJUSTMENTS

In review of the ACA balances for the Northern, Southern, and Eastern Systems, the following ACA settlement adjustments (adjustments settled prior to the 2002/2003 ACA) have been included in the Company's 2004 Winter PGA/ACA filing: ($74,956) (1999/2000 ACA) + ($370,517) (2000/2001 ACA) for the Southern System and ($5,364) (1999/2000 ACA) for the Northern System. These adjustments represent the remaining settlement adjustments prior to the 2002/2003 ACA to be included in rates. The following settlement adjustments on the Eastern System are included in AmerenUE's 2004 Winter PGA/ACA filing: ($100,000) (2000/2001 ACA) and ($13,670) (1999/2000 ACA). AmerenUE acquired the Eastern System assets of Aquila-MPS during this ACA period.

CAPACITY RELEASE

As a result of certain commodity cost allocation adjustments made by Staff in Case No. GR-2002-392 (December 2001), Staff's adjustments for transportation commodity, storage commodity, and capacity release are to be included in the current ACA filing. In doing so, the Company misstated the original filed amount when quantifying the adjustment in the current case. Company thus under-stated Staff's adjustment by ($5,195), which was indicated in the Company's response to Data Request (DR) No. 93.5. Staff believes the Company's adjustment should be revised as follows: ($6,608) + ($10,222) = ($16,830) revised amount less ($6,608) + ($5,027) = ($11,635) original filed amount equals ($5,195) additional gas cost reduction for Southern System customers.

IMBALANCES

Pipeline imbalances on WGPC were revised to reflect the proper pricing of imbalances from November 2002 to January 2003, proper allocation for MPS during September 2002, and to reflect the proper balances carried forward from August 2002. If monthly gas purchases do not meet current month requirements, as was experienced during this ACA period, then those volumes are owed the pipeline. The volumes owed to the pipeline are the first volumes purchased and paid back to the pipeline in the subsequent month (priced at Term Pool or Baseload Pool for the subsequent month). To reflect the changes described above, Staff believes that the cost of gas on the Southern System should be reduced by $13,306.

On the Eastern System, the Company recognized Staff's imbalance settlement adjustment of ($4,860) carried forward from the 1998/1999 ACA. In doing so, an entry of ($4,860) was made on the Company's September 2002 monthly summary sheet (tracker). This entry was not, however, included in the Company's filing ($132,473 filing less $127,613 tracker = $4,860). During October 2002, the Company reversed the September imbalance adjustment and in doing so increased imbalance gas costs by $4,845 per the Company's filing. In summary, the Company's imbalance adjustments increased gas costs by $4,845. Staff believes that the ($4,860) imbalance adjustment was not properly carried forward from the 1998/1999 ACA. Staff proposes to reduce gas costs by $9,705, ($4,845) to reverse the Company's adjustment + ($4,860) to restate the proper adjustment on the Eastern System, to properly reflect Staff's imbalance adjustment from the 1998/1999 ACA.

HEDGING

MPS delivered total supplies (storage withdrawals plus flowing supplies of gas) of about 3.95 billion cubic feet to customers in heating season (November through March) 2002/2003. The company supplied approximately one-half of the total winter supplies in the months of January and February. Weather was fairly cold during the heating season except for March. The company is made of three different systems, which have three distinctive gas supply portfolios.

MPS's Northern and Southern system's gas portfolios consisted of storage and flowing gas supplies while that of its Eastern system consisted only of flowing gas supplies. More than 60% of the actual deliveries to customers were hedged by the use of storage withdrawals and fixed price contracts for the Southern system. On the other hand, the Northern system was heavily dependent on storage utilization in its hedging strategy. It hedged about 65% of the actual deliveries by using storage withdrawals. The Eastern system had no storage and depended on flowing gas for its gas supply and nearly all of the actual delivered gas came from the flowing supplies that were based on fixed price contracts. The Company hedged about 97% of the actual deliveries on the Eastern System by using fixed priced contracts.

The Company seems to have a reasonably specific hedging strategy in place at its corporate level and it also appears that the Company monitors the market movement fairly closely by reading industry reports and publications. The overall hedging strategy of the Company was appropriate for the 2002/2003 ACA. It is recommended that the Company continue to keep abreast of the market developments to help its gas procurement decision-making.

RELIABILITY ANALYSIS

Staff has the following comments and concerns regarding the reliability analysis for the three MPS service areas - Southern System, Northern System, and Eastern System.

1. The Company states that first-of-month (FOM) winter requirements are determined by considering requirements for normal weather (obtained using National Oceanic and Atmospheric Administration (NOAA) normals and regression analyses results), review of previous two years of firm sales for each month, review of weather forecasts, and consideration of current storage levels. Other considerations are also listed by Aquila. Staff's concern is with the Company consideration of the previous two years of firm sales data. If the previous two years were cold, the firm sales would be overstated and if the previous two years were warm, the firm sales would be understated. There is no indication that Aquila revises the prior two years data for weather normalization. However, the previous year's data is already considered in the Aquila regression analysis which can be used to weather normalize the data. If Aquila wants to consider the previous two-years of firm sales instead of one-year, then Staff suggests that Aquila consider two years of data in the regression analyses so that the results can be used to weather normalize the estimates of usage. The regression analyses results can also be used to consider other weather conditions that present operational difficulties to the Company such as warmest month, so that too much base load gas is not scheduled, and coldest month, so that sufficient volumes of flowing gas can be made available through swing or daily purchases and so that flowing supply is managed to maintain sufficient storage balances for late winter cold snaps.

2. In the 2001/2002 ACA recommendation, Case No. GR-2002-392, Staff recommended that Aquila submit a more complete supply plan that considers usage for warmest weather and coldest weather, instead of just planning for normal weather. Staff stated that the plan should include details of demand variation for warm, normal and cold weather, and supply planning for these very different usage requirements, including an evaluation of how flowing gas (base load, term, swing, and spot) and natural gas from storage will be used to meet customer usage requirements and how cost is considered in this analysis. In its response to the Staff Recommendation, Aquila agreed to provide, effective with the winter plan year 2004/2005, a more detailed plan identifying customer usage requirements for warmer than normal, normal, and colder than normal weather and how these requirements will be met and an explanation of how cost is considered in this analysis. Staff will review this information in the 2004/2005 ACA.

   A related concern is that the Company plans to fill storage to 95% at the start of the heating season and to have 5% remaining in storage at the end of March for both the Northern and Southern systems for normal weather. The Company states that warmer than normal weather would be covered by flowing supply and a lesser than planned storage withdrawal. Colder than normal weather would be covered by flowing supply and more storage withdrawals, but attempting to stay within the storage guidelines, which show the storage balance at 55%, 30%, 5%, and 0% at the end of December, January, February, and March, respectively (DR Nos. 82 and 89). However, the plan is for winters that are only 10% warmer or colder than normal. A review of the past 31-years of weather data (1971/1972 – 2001/2002) shows that four of the winters were warmer and seven of the winters were colder than normal plus or minus10%. The first concern is that 35% of the winters were outside the limits considered by the Company. The second concern is that Aquila's plan considers pulling more storage in the earlier winter months for cold weather, and this would leave only 5% in storage for the month of March. For the Southern system this means that storage would only be available to meet 8.6% of normal March requirements. For the Northern system this means that storage would be available to meet 23.5% of normal March requirements. This must be considered in the Company's plans for flowing supplies.

3. The Southern System has a large reserve margin. However, transportation contracts do not expire until fall 2003, spring 2005, and fall 2006. Additionally, Aquila's current 2002/2003 peak day estimate is a 7.8% reduction over the prior estimate for 2002/2003. Aquila should consider this large shift in estimated peak day requirements and whether it is more reasonable to evaluate two years of data in the regression analysis instead of one year. The Company's decisions for capacity for the Southern System will be reviewed by Staff in more detail in the 2003/2004 ACA, when one of these contracts expires. Aquila should provide with the 2003/2004 ACA reliability review more support for its concern about constraints on SSG line segments 235 and 425.

4. As noted in the 2000/2001 and 2001/2002 ACA reviews, the volume of natural gas requirements that could be met by using storage seems high for the Northern System. As follow-up to the 2001/2002 ACA recommendation, Case No. GR-2002-392, Aquila evaluated the cost of natural gas from storage versus flowing supplies and determined from a review of commodity costs in the winter months of 2000/2001, 2001/2002, and 2002/2003 that the average annual savings was $113,070 to $215,842. However, Aquila's calculations are based on storage withdrawals that exceed that available under the contract. In one example Aquila assumes 541,953 MMBtu withdrawn for each month of November through March and this is 3.4 times that which could be placed in storage. Using the Aquila cost figures, but with revised storage withdrawals per Aquila's storage withdrawal plans, Staff calculates average annual savings of $22,073 to $61,875. Thus, there is a benefit to customers for the larger storage volumes. Staff recommends that the cost of storage continue to be monitored by Aquila prior to extending the storage contract term in future years.

SUMMARY

The Staff has addressed the following concerns regarding Case No. GR-2003-0311 for Aquila-MPS:

1. Staff believes that purchase transactions of less than 31 days should be documented in writing and include a description of each transaction and the contract terms and type of

service required.

2. ACA Balance - The following prior period Staff adjustments have been included in the 2003/2004 ACA balance as follows:
Southern System – ($74,956) + ($370,517)
Northern System – ($5,364)
Eastern System – ($100,000) + ($13,670) Included in AmerenUE's 2003/2004 PGA/ACA filing.

3. In compliance with the Stipulation and Agreement made in Case No. GR-2002-392, certain commodity cost allocation adjustments from Case No. GR-2002-392 (December 2001) were to be carried forward to the current ACA filing. To comply, Staff believes that Southern System gas costs should be reduced by an additional $5,196.

4. To reflect the proper pricing of imbalances and allocation of imbalance costs between Missouri and Kansas, Staff proposes to reduce the cost of gas on the Southern System by $13,306. Staff proposes to reduce the cost of gas on the Eastern System by $9,705 to properly reflect Staff's imbalance settlement adjustment carried forward from the 1998/1999 ACA.

6. Details of Company's hedging activity are described in the "Hedging" section of this recommendation. Staff believes that the Company should continue to pursue other hedging tools available to it. Overall, the Company's hedging strategy appears to be appropriate for the 2002/2003 ACA period.

7. Although there is no adjustment related to the MPS reliability analyses, Staff has concerns that are documented in the Reliability Analysis section of this recommendation.

RECOMMENDATIONS

The Staff recommends that the Commission issue an order requiring Aquila-MPS to:

1. Adjust the ACA balance in its 2002/2003 ACA filing to reflect the ending (over)/under recovery balances for the ACA, TOP, TC, DCCB, and Refund accounts per the following table:

Description (+) Under-recovery (-) Over-recovery	**Company Ending Balances Per Filing**	**Staff Adjustments**	**Staff Recommended Ending Balances**
Southern System: Firm ACA	$816,139	(A) ($463,975)	$352,164
Interruptible ACA	($9,563)	$0	($9,563)
Take-or-Pay	$0	$0	$0
Transition Cost	$0	$0	$0
Refund	($60,556)	$0	($60,556) (D)
Northern System: Firm ACA	$582,888	(B) ($5,364)	$577,524
Interruptible ACA	$104,100	$0	$104,100
Take-or-Pay	$0	$0	$0
Transition Cost	$0	$0	$0
Refund	($21,168)	$0	($21,168) (D)
Eastern System: Firm ACA	$348,353	(C) ($123,375)	$224,978 (E)

A) ($5,196) Capacity Release + ($13,306) Imbalance + ($74,956) prior period Staff adjustment + ($370,517) prior period Staff adjustment.
B) Prior period Staff adjustment
C) ($9,705) Imbalance + ($100,000) prior period Staff adjustment + ($13,670) prior period Staff adjustment.
D) Refund balances represents an amount due the customer.
E) AmerenUE's Eastern System 2003/2004 beginning ACA balance is $234,683 (which includes prior period Staff adjustments). $234,683 + ($9,705) = $224,978.

2. Submit information by March 9, 2005, to address Staff's comments and concerns listed in the Reliability Analysis section of this document.

3. Respond to recommendations included herein within 30 days.