BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Southern Missouri Gas Company, L.P.'s Purchased Gas Adjustment (PGA) Factors to be Reviewed in its 2004-2005 Actual Cost Adjustment.	)))	Case No. GR-2005-0279

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") and for its Recommendation in this case respectfully submits as follows:

1. On September 15, 2005, Southern Missouri Gas Company, L.P., a/k/a Southern Missouri Natural Gas (SMNG) of Mountain Grove, Missouri, filed a tariff sheet with the Commission to change its Purchased Gas Adjustment (PGA) factors as the result of estimated changes in the cost of natural gas for the remaining summer season and the upcoming winter season.

2. On September 26, 2005, the Staff filed its Memorandum and Recommendation. Staff recommended that the tariff sheets be approved interim, subject to refund only, pending final Commission decision in this case concerning the prudence of SMNG's gas purchasing practices.

3. On September 29, 2005, an evidentiary hearing was held at the Commission's offices.

4. On September 30, 2005, the Commission issued an Order Approving Interim Rates. The Order approved the rates, on an interim basis, subject to refund for service on and after October 1, 2005. The Commission ordered Staff's Procurement Analysis Department to file its results and recommendations regarding SMNG's 2004-2005 Actual Cost Adjustment (ACA) accounts on or before December 29, 2006.

5. For the 2004-2005 ACA review period, SMNG provided natural gas to a maximum of 7,745 sales customers in the southern portion of the state including communities in Greene, Webster, Wright, Howell, Douglas and Texas counties.

6. Staff's Procurement Analysis Department has completed an audit of SMNG's billed revenues and actual gas costs for the period September 1, 2004 to August 31, 2005 included in the Company's computation of the ACA rate. This case provides analysis of the situation due to a change in ownership in this Company that occurred on May 27, 2005. Staff also conducted a reliability analysis and a hedging review for SMNG to determine the reasonableness of the Company's gas planning and hedging policy.

8. In the attached Memorandum (Appendix A), Staff recommends that the Commission issue an order implementing Staff's Recommendations. Staff also recommends that the Commission order SMNG to respond to Staff's Memorandum within 30 days.

WHEREFORE, Staff recommends that the Commission issue its order in this case consistent with Staff's recommendations.

Respectfully submitted,

/s/ Robert V. Franson

Robert V. Franson
Senior Counsel
Missouri Bar No. 34643

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-6651 (Telephone)
(573) 751-9285 (Fax)
robert.franson@psc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered or transmitted by facsimile or electronic mail to all counsel of record this 13th day of April 2006.

/s/ Robert V. Franson

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Southern Missouri Gas Company, L.P.'s Purchased Gas Adjustment Factors to be Reviewed in its 2004-2005 Actual Cost Adjustment.	))))	Case No. GR-2005-0279

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David M. Sommerer, being of lawful age, on his oath states: that as Manager of the Procurement Analysis Department of the Utility Services Division he has participated in the preparation of the foregoing report, consisting of 10 pages to be presented in the above case, that he has verified that the following Staff Memorandum was prepared by Staff of the Procurement Analysis Department that have knowledge of the matters set forth as described below; that he has verified with each of the Staff members listed below that the matters set forth in the Staff Memorandum are true and correct to the best of his/her knowledge and belief,

Annell Bailey: Billed Revenues and Actual Gas Costs, ACA Account Balance
Lesa Jenkins: Reliability Analysis and Gas Supply Planning
Kwang Choe: Hedging

that he has knowledge of the matters set forth in such report and that such matters are true to the best of his knowledge and belief.

David M. Sommerer

David M. Sommerer

Subscribed and sworn to before me this 13th day of April 2006.

Toni M Charlton

Notary Public

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2005-0279, Southern Missouri Natural Gas

FROM: David M. Sommerer, Manager - Procurement Analysis Department
Annell Bailey, C.P.A., Regulatory Auditor - Procurement Analysis Department
Lesa A. Jenkins, P.E., Regulatory Engineer - Procurement Analysis Department
Kwang Choe, Ph.D., Regulatory Economist - Procurement Analysis Department

/s/ Dave M. Sommerer 4/13/06 — Project Coordinator
/s/Robert Franson 4/13/06 — General Counsel's Office

SUBJECT: Staff's Recommendation for Southern Missouri Natural Gas's 2004-2005 Actual Cost Adjustment Filing

DATE: April 13, 2006

The Procurement Analysis Department (Staff) has reviewed Southern Missouri Natural Gas's (SMNG or Company) 2004-2005 Actual Cost Adjustment (ACA) filing. This filing was made on September 15, 2005, for rates to become effective October 1, 2005, and was docketed as Case No. GR-2005-0279.

SMNG changed ownership on May 27, 2005, after the first eight months of the 2004-2005 ACA period. Sendero SMGC Limited Acquisition Company, L.L.C., purchased 98% of the partnership interests of DTE Enterprises, Inc., and DTE Ozark, Inc. The remaining 2% of the DTE partnership interests was purchased by a Sendero affiliate, Sendero SMGC GP Acquisition Company. Before the Sendero purchase, DTE Energy of Michigan owned 100% of both DTE Enterprises, Inc. and DTE Ozark, Inc.

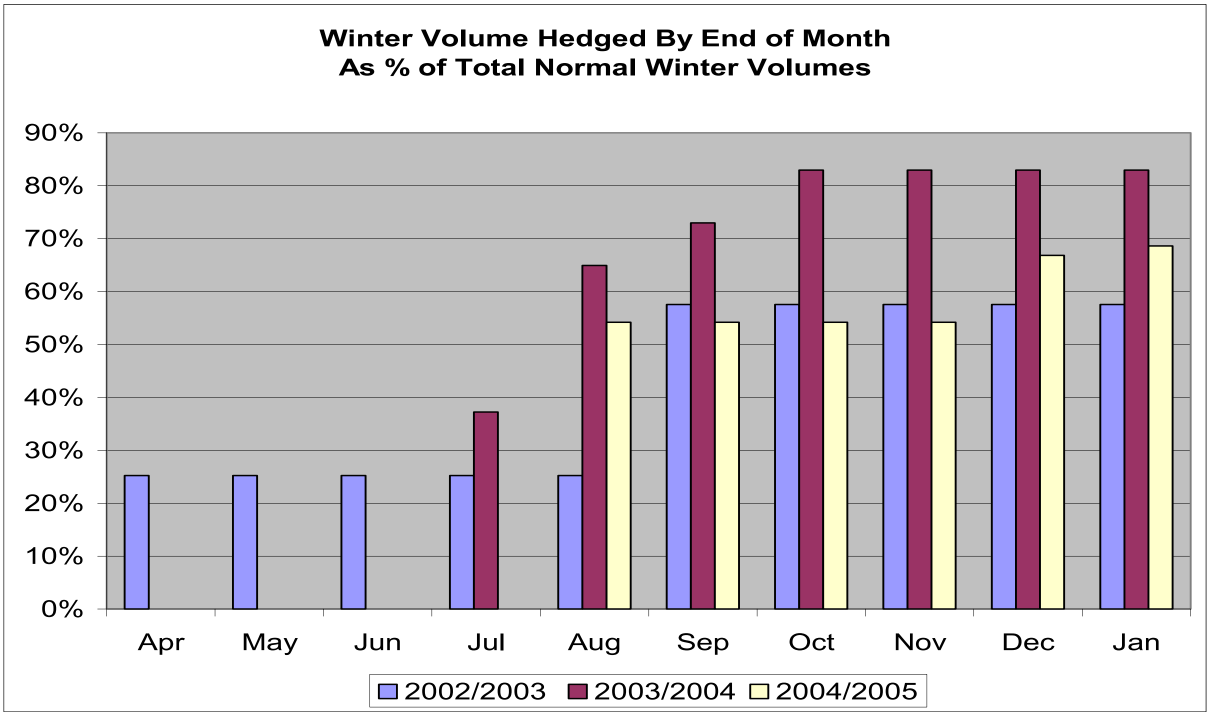
The change in ownership involved changes in key personnel. Before the Sendero purchase, the Vice President and General Manager was Scott Klemm, whose office was in Adrian, Michigan in the offices of Citizens Gas Fuel Co., another subsidiary of DTE Enterprises. The SMNG Gas Supply Manager was William Walker, whose office was in Mountain Grove, Missouri. Mr. Klemm and Mr. Walker were responsible for the gas supply planning and purchasing for the winter of the 2004-2005 ACA period. After the Sendero purchase, Mr. Klemm was replaced by a new General Manager, Jim Trent, who moved to the SMNG head office in Mountain Grove, Mo. Mr. Trent reports to Randal T. Maffett, President and C.E.O of Sendero Capital Partners, Inc. in Kingwood, Texas. Mr. Walker resigned effective February 17, 2006, and Michael Lumby was promoted to the position of Manager of Gas Supply.

Staff's review consisted of an audit and evaluation of the billed revenues and actual gas costs for the period of September 1, 2004, to August 31, 2005, included in the Company's computation of the ACA rate. A comparison of billed revenue recovery with actual gas costs will yield either an over-recovery or under-recovery of the ACA balance. Staff performed an examination of SMNG's gas purchasing practices to determine the prudence of the Company's purchasing decisions. Staff conducted a reliability analysis including a review of information required to be submitted in response to the reliability recommendations in the 2003-2004 Staff ACA recommendation, Case No. GR-2005-0064, estimated peak day requirements and the capacity levels needed to meet these requirements. Staff also conducted a hedging review to determine the reasonableness of the Company's hedging practices for this ACA period.

Southern Star Central Pipeline (SSCP) serves SMNG, which provided natural gas to a maximum of 7,745 sales customers in the southern portion of the state including communities in Greene, Webster, Wright, Howell, Douglas and Texas counties.

HEDGING

During the ACA period (September 2004 – August 2005), the Company hedged with fixed price purchases (contracts) from gas suppliers such as BP and Oneok. Their target for the winter (November 2004 through March 2005) hedge was between 60% and 65% of normal winter requirement, though these percentages are based on the Company's response to Staff's data requests without any documented hedging plan for this ACA period. It turned out that 56% (November), 43% (December), 92% (January), 82% (February), and 78 % (March) of the actually delivered gas were hedged with fixed price purchases. The Company purchased the hedged volume of gas in four increments from August 11, 2004, to January 5, 2005. However, the hedging from August 11, 2004 for the 2004-2005 winter was a late start compared to the previous winter periods. For example, for the 2003-2004 winter, the company started placing the hedges beginning in July 2003, and also beginning in September 2001 for the 2002-2003 winter season. Despite the company's fixed price hedging practice, the timing of the hedges varied from year to year and it looks as though the company made a hedging decision depending mostly on the market condition, which could potentially pose a price risk if the market assessment turns out to be wrong (See below chart showing a comparison of the company's hedging practices during the past three winter periods, 2002-2003, 2003-2004, and 2004-2005). Although the implementation of hedging occurred somewhat later than in previous periods, no disallowance is proposed for the 2004-2005 period since appropriate hedging earlier in the summer would not have resulted in materially lower costs. Therefore, it is recommended that the Company maintain a current hedging plan, start placing hedges early enough to hedge, for example, against potential hurricane-related price spikes during summer months, continue to evaluate the possibility of further diversifying its gas supply portfolios including a gas supply planning horizon of multiple years while keeping abreast of market developments to help its gas procurement decision-making.



RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

The Company is responsible for conducting reasonable long range supply planning and the decisions resulting from that planning. One purpose of the ACA process is to examine the reliability of the local distribution company's (LDC's) gas supply, transportation, and storage capabilities. For this analysis, Staff reviews the LDC's plans and decisions regarding estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and natural gas supply plans for various weather conditions.

Staff has the following comments and concerns regarding the Company's reliability and gas supply planning information:

1. The Company's Gas Supply Plans Contain Much Less Support than in the prior Case No. GR-2005-0064, the 2003/2004 ACA

   a. Heating Degree Day (HDD)
      The SMNG response does not indicate the HDD selected for its peak day analysis. However, the calculations in the DR26 response support 72 HDD as the peak, which is consistent with its practices in prior ACA reviews.

      SMNG's assumptions for its peak day planning must be documented.

b. Growth

SMNG assumes growth of 2.8% for Residential Heating, Residential Optional, and General customers and provides customer counts for 2004/2005, 2005/2006 and 2006/2007 based on this growth estimate. (DRs 24 and 26) However, the SMNG DR responses provide no rational for this growth estimate.

In a follow-up call with SMNG on 3/8/06, SMNG explained that it has more sales staff and expects the larger growth estimates were based on the increased sales staff. An after the fact analysis reveals customer count growth of 2.4% for Residential Heating, Residential Optional, and General customers from December 2004 to December 2005 (3/17/06 e-mail). In the 2003/2004 ACA, SMNG provided more detail for its growth estimates for Residential Heating (based on housing developments) and also explained that Residential Optional customers were switching to general residential and showed negative growth for Residential Optional in 2004 and 0% growth in 2005. Growth for General, or commercial customers, was 1.1% in 2004 and 1.3% in 2005.

SMNG's assumptions for growth for its peak day planning must be documented at the time the planning and analysis takes place, including supporting workpapers, not an after-the-fact analysis.

c. Peak Day Model

SMNG states that it evaluates historical monthly consumption. For the Residential Heating, Residential Optional and General classes, SMNG states that it divides total monthly usage by the number of customers to determine a weighted average usage, given normal weather patterns, per customer class. These average usages are multiplied by the number of customers to arrive at expected gas sales for each class. (DR24) However, the baseload and heatload factors used to calculate the peak day estimate do not match any of the supporting data provided by SMNG. No regression analysis results were included in the data responses provided by SMNG for this ACA period. SMNG explained that any regression analysis for 2004/2005 would have been performed by employees who no longer work at SMNG. In the 2003/2004 ACA, SMNG provided regression analyses and the peak day estimate was based on the regression analyses.

SMNG's assumptions for its peak day planning must be documented, at the time the planning and analysis takes place, including supporting workpapers. Employee turnover is not a reason to have insufficient documentation and does not excuse not doing the necessary work to enable the making of informed appropriate decisions. Controls must be in place to assure that proper documentation is maintained in the Company's files to respond to the ACA reviews. SMNG bears the responsibility of assuring that such documentation and analysis is properly done.

d. Peak Day Estimates for Large General (LG) and Large Volume (LVS) Customers

The Company provided projected peak usage for 14 customers. (DR 26) Details of actual usage are shown for only five of these customers. (DR25) The SMNG revised estimate for peak usage for firm industrial customers, LG & LVS, (Revised DR 26) is the same as the 2003/2004 ACA estimates, with the addition of one new LGS customer.

Staff recommended in the 2001/2002 ACA, Case No. GR-2002-440, and in the 2002/2003 ACA, Case No. GR-2004-0193, that the Company provide additional information for the peak day estimate for large general and large volume customers. The Company provided some additional detail in the 2003/2004 ACA, Case No. GR-2005-0064, and Staff commented that the evaluation of two data points was not sufficient for estimating peak day requirements for this group of customers. Since no new information was provided for this 2004/2005 ACA, the data is still not sufficient.

Staff again recommends, for the fourth time, that SMNG continue to make attempts to provide more data for large general and large volume customers for estimating peak day requirements. SMNG's assumptions for its peak day planning must be documented, including supporting workpapers.

e. Estimate of Normal Monthly Requirements

The only estimate of normal monthly requirements in the SMNG responses was in the DR 91 response comparing hedges to normal requirements. That response only listed normal requirements for November through March and the file only contained a number for each month. SMNG believes these estimates are based on a five- or six-year average for November through March volumes. The supporting information for how these were calculated was not provided. Thus, Staff could not evaluate the validity of the estimates.

SMNG's assumptions for its estimates of normal month requirements must be documented, at the time the planning and analysis takes place, including supporting workpapers.

2. SMNG Does Not Adequately Explain Its Planning for Capacity Levels for Future ACA periods

a. Market Area Capacity

For the ACA under review, the 2004/2005 ACA, and for the 2005/2006 ACA, there is insufficient transportation capacity for the usage requirements of SMNG's customers should a historic peak cold day occur.

The Company informed Staff in 2005 that it was pursuing additional pipeline capacity (SMNG emails dated 2/22/05 and 4/6/05). SMNG initially responded to a Southern Star open season for the Ozark Trails Expansion Project that would impact southwest Missouri, stating that it was interested in 5,000 Dth/day. This is an increase in capacity of 50% for SMNG, much in excess of that needed for a peak cold day. According to SMNG's 2004/2005 planning, it would go from having a shortage of capacity for peak day planning of about 5.5% in January 2005 to **an excess capacity of 35% in January 2007**.

The Company explained that interest in the Southern Star open season appeared to be greater than the capacity that SSC was proposing it make available. Thus, the Company stated that it decided to be aggressive with its initial response of 5,000 dekatherms/day because it believed the awards would be pro-rated downward and because SMNG believed that it would have another opportunity to modify the volumes. SMNG states that it agrees that a 5,000 increase in overall capacity seems high but that it is a preliminary number that can and probably will be modified before a binding bid would be made by SMNG. (4/6/05 e-mail)

Per SMNG, effective December 1, 2006, transportation capacity increases by 5,000 MMBtu/day from 10,100 MMBtu/day in the market zone to 15,100 MMBtu/day. This is a substantial increase in capacity beginning in December 2006. SMNG's support for this substantial increase will be reviewed by Staff no later that the 2006/2007 ACA, the first ACA impacted by the increased capacity. Staff will review SMNG's decisions for increased capacity in light of SMNG's evaluation of peak day requirements and the capacity options available to it and the associated cost to customers.

SMNG's assumptions and decisions for its peak day planning must be documented, including supporting workpapers.

b. Upstream Capacity

SMNG's justification for its upstream capacity was simply a reference to its supply and transportation contracts in DR 21 and to its peak day estimates. A concern about the SMNG peak day estimates is noted above. A peak day estimate does not explain what capacity is needed in the production zone. Currently the production zone and market area capacity are nearly the same. However, beginning in December 2006 this will change. Thus, an evaluation of upstream capacity requirements is more critical beginning with the 2006/2007 ACA.

SMNG's assumptions and decisions for its peak day planning must be documented, including supporting workpapers.

3. The Company Does Not Adequately Address Its Gas Supply Plans/ Reliability for Cold Weather

For the 2004/2005 ACA, SMNG first-of-month volumes represent only 20%, 39%, and 32% of the peak day requirements for December, January, and February, respectively. SMNG uses spot purchases to address colder weather requirements. However, there is no assurance that spot gas will be available on cold days and SMNG had no firm swing contracts for the 2004/2005 ACA. SMNG documentation indicates it was pursuing swing gas as call options for the 2005/2006 winter.

The lack of firm supply contracts for colder weather was documented as a concern to Staff in the 2002/2003 ACA, GR-2004-0193, and the 2003/2004 ACA, GR-2005-0064. The lack of firm supply contracts for colder weather continues to be a concern for the 2004/2005 ACA.

In the Company's log provided in DR 21 for Case No. GR-2005-0279 and in DR 41, Case No. GR-2005-0064, it was evident that there were some days when only one supplier quoted a price for natural gas during the winter months of 2004/2005 and 2003/2004. As noted in the 2002/2003 ACA, Case No. GR-2004-0193, on at least one occurrence it was difficult for SMNG to find any natural gas. Thus, there is a continued concern that SMNG will be unable to find sufficient volumes of natural gas when the pipeline issues an Operational Flow Order (OFO) or when the temperature is very cold. SMNG is relying on the gas being available for cold days, even though no contract exists requiring any supplier to provide gas to meet SMNG's cold day requirements.

There is no adjustment proposed for this ACA, but this is a great concern regarding the reliability of natural gas supplies for SMNG's customers for cold days.

In response to Staff reliability concerns in the 2002/2003 ACA, Case No. GR-2004-0193, the Company provided a response to Staff dated October 1, 2004. This response stated that it agrees with Staff that gas supply could be extremely tight during peak cold days when pipelines may be issuing OFOs and requiring LDC's to match nominations to deliveries. To address extremely cold days, the Company's response offered the following to assure the gas will actually be available on a firm basis:

a. The Company plans to monitor the weather and to make FOM and mid-month spot purchases for multiple days as appropriate.

Staff notes that the Company did provide information for the 2004/2005 ACA indicating that mid-month spot purchases were made for cold weather.

b. The Company is in dialogue with two additional suppliers and expects to have contracts executed with both prior to December 1, 2004.

Staff notes that contracts were initiated with two additional suppliers in July and August 2005, after the 2004/2005 winter heating season.

c. The Company is in dialogue with a current supplier about purchasing calls that would obligate the supplier to deliver certain volumes of gas on any given day at an agreed upon index.

Staff notes that these were not in place for the 2004/2005 winter heating season.

d. The Company is in dialogue with certain parties about acquiring some released capacity for this winter.

Staff notes that SMNG's statement does not address concerns related to commitments for natural gas supplies for cold days.

SMNG also provided a Gas Supply Plan dated August 26, 2005, the last few days of the 2004/2005 ACA. This plan provides general information. For purposes of the ACA review, Staff must have access to the SMNG data and analysis that it conducted in developing its plans for the ACA period.

Staff recommends that the Company's reliability analysis and gas supply plans continue to examine the issue of supply availability for extremely cold days and detail how the Company plans to structure its supply contracts to assure that the gas will actually be available on a firm basis for extreme cold days.

4. The Company Does Not Have Formal Capacity Release Procedures

The Company does not have a formal policy on capacity release (DR76). SMNG has made informal notification that it acquired additional capacity beginning in December 2006. Support for this additional capacity has not been provided to Staff. Detailed capacity release procedures and documentation of SMNG's efforts to release capacity may be more of an issue in future ACA reviews.

SUMMARY

The Staff has addressed the following concerns regarding Case No. GR-2005-0279 for Southern Missouri Natural Gas:

1. Staff reviewed and evaluated the billed revenues and actual gas costs for the period of September 1, 2004, to August 31, 2005, included in the Company's computation of the ACA rate and ACA account balance.

2. Staff reviewed and evaluated the Company's hedging activities that included fixed price purchases (contracts) from gas suppliers such as BP and Oneok.

3. Staff is proposing no dollar adjustments related to reliability and gas supply planning. However, Staff has expressed concerns regarding SMNG's planning and documentation. SMNG should address the Staff's concerns in the reliability analysis and gas supply planning section of this recommendation.

RECOMMENDATIONS

It is Staff's opinion that Southern Missouri Natural Gas should do the following:

1. Use $232,412, under-recovered, as the August 31, 2005, beginning ACA account balance in its next ACA filing. This was the ending balance in the Company's filing for Case No. GR-2005-0279, and was accepted by Staff with no adjustments, as shown in the following table:

Description	Company's Ending Balances Per Filing	Staff Adjustments	Staff Recommended Ending Balances
Prior ACA Balance 8/31/04	$417,867		$417,867
Cost of Gas	$4,508,788		$4,508,788
Cost of Transportation	$1,144,567		$1,144,567
Revenues	($5,805,417)		($5,805,417)
Pipeline Refunds Received	($38,947)		($38,947)
Interest on Under-recovered ACA Balance	$5,554		$5,554
Total ACA Balance 8/31/05	$232,412	$0	$232,412

2. Maintain a current hedging plan, start placing hedges earlier, continue to evaluate the possibility of further diversifying its gas supply portfolios including a gas supply planning horizon of multiple years, and keep abreast of the market developments to

help its gas procurement decision-making. The current hedging plan must include detailed plans to provide proper documentation of gas purchasing decisions at the time that such decisions are made.

3. Respond to the concerns expressed by Staff in the Reliability Analysis and Gas Supply Planning section within 30 days with a detailed plan of action to correct these deficiencies.

4. File a written response to the above recommendations within 30 days.