

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2007-0484, Southern Missouri Natural Gas

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

David M. Sommerer 08/13/08

Lera L. Shemwell 08/13/08

Project Coordinator/Date

Office of General Counsel/Date

SUBJECT: Staff's Recommendation for Southern Missouri Natural Gas's 2006-2007
Actual Cost Adjustment Filing

DATE: August 14, 2008

The Procurement Analysis Department (Staff) has reviewed Southern Missouri Natural Gas' (SMNG or Company) 2006-2007 Actual Cost Adjustment (ACA) filing. This filing was made on October 11, 2007, and docketed as Case No. GR-2007-0484. The 2006-2007 ACA filing rates became effective on November 1, 2007. During the 2006-2007 ACA, SMNG provided natural gas to a maximum of 7,912 sales customers in the southern portion of the state including communities in Greene, Webster, Wright, Howell, Douglas and Texas counties.

Staff reviewed and evaluated SMNG's billed revenues and actual gas costs for the period of September 1, 2006, to August 31, 2007. The Staff also reviewed SMNG's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions. Staff conducted a reliability analysis of estimated peak day requirements and the capacity levels needed to meet those requirements; peak day reserve margin and the reasons for this reserve margin; and a review of normal, warm and cold weather requirements. Staff also reviewed SMNG's hedging for the period to determine the reasonableness of the Company's hedging plans.

ACA APPROACH TO INTEREST CALCULATION

The Company used the 2005-2006 prime rates in its calculation of interest on the monthly ACA over/under-recovery balances. They should have used the 2006-2007 prime rates. After calculating interest using the proper 2006-2007 prime rates, Staff found no material differences so no adjustment was made.

HEDGING

SMNG hedged with fixed price purchases (contracts) from gas suppliers such as Oneok, Conoco Phillips, and BP for the winter heating season (November 2006 through March 2007). SMNG's target for its 2006-2007 winter hedging was to secure a minimum of 20, 40, and 55% of normal winter heating-season gas supply by no later than April 30, July 15, and October 1, 2006, respectively. This hedging target was implemented pursuant to the Commission's Order as a result of the unanimous stipulation and agreement between the Office of the Public Council, the Staff, and SMNG in case number GC-2006-0180. SMNG hedged more than required under the stipulation and hedged 56% of its normal winter heating-season gas supply with fixed price purchases by mid September 2006. In addition, the Company made fixed price purchases in early November 2006 for December 2006 through March 2007 when the prices stayed relatively lower compared to the previous fixed prices. This, combined with the 56%, resulted in a total of 73% hedge for its normal heating season (November 2006 through March 2007) gas supply.

Although the Company's hedging practice using fixed price purchases was pursuant to the Commission's Order, Staff recommends the company continue to maintain a current hedging plan, to evaluate the possibility of further diversifying its gas supply portfolios, including a gas supply planning horizon of multiple years, and keep abreast of market developments in order to make prudent gas procurement decisions.

RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

The Company is responsible for conducting reasonable long range supply planning to meet its customers' needs and is responsible for the decisions resulting from that planning. One purpose of the ACA process is to examine the reliability of the 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. Methodology Concerns for Peak Day Estimates and Monthly Estimates

For estimating peak day and monthly requirements for the 2006/2007 ACA, SMNG evaluated daily usage data for Residential Service (RS), General Service (GS) and Optional General Service (OG or OGS), and Large General Service (LGS) and Large Volume Service (LVS) customers for the time period of 1/1/2002 through 12/31/2007 (Data Request (DR) Nos. 1 and 2 and revised DR Nos. 1 and 2). The methodology has changed from the prior ACA, where SMNG stated that it

evaluated monthly data. SMNG's evaluation of daily data is acceptable to Staff, except SMNG's analysis should only include the data that is known for the review period, it should consider whether any of the data should be excluded, it should include complete data, and it should consider the reasonableness of the results. These items were discussed in detail in an email from Staff to SMNG dated February 22, 2008, and in a follow-up conference call on February 27, 2008.

No further response is requested from SMNG at this time.

2. Conflicting Estimates of Peak Day Requirements

SMNG estimates of peak day requirements in its DR Nos. 1 and 2 responses, and revised DR Nos. 1 and 2 responses, are much different from the estimates of peak day requirements in its Gas Supply Plans. SMNG does not provide the supporting documentation for the estimates in its Gas Supply Plans. SMNG explains that the Gas Supply Plan contained old information and that some of this planning took place when others were employed at SMNG and the data supporting those estimates could not be found.

Regardless of who is the General Manager, SMNG must retain its documentation for its Gas Supply Plans so that SMNG's work papers are available to Staff when conducting the ACA reviews. These items were discussed in detail in an email from Staff to SMNG dated February 22, 2008, and in a follow-up conference call on February 27, 2008. SMNG explained that in the future, the Gas Supply Plan will agree with the Data Request responses for gas supply planning.

No further response is requested from SMNG at this time.

3. Conflicting Estimates of Monthly Requirements

There are large differences in the normal estimate for November and the cold weather requirements for December among the three SMNG responses (DR No. 1-Revised, DR No. 82, and SMNG Gas Supply Plan in email dated May 11, 2006).

On a going forward basis, beginning with the 2008/2009 ACA, Staff recommends that SMNG re-evaluate its planning for normal, warm and cold weather and maintain sufficient documentation to support its estimates.

4. SMNG Capacity Levels

SMNG increases its capacity 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. The 2006/2007 ACA is the first ACA period impacted by the increase in capacity and as such, Staff considers 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.

Although Staff does not agree with all of SMNG's analyses, SMNG provided sufficient data for Staff to consider the SMNG peak day estimates for the existing service area, given the information that SMNG would have known at the time it committed to the additional capacity.

In determining whether the cost of this additional capacity is or is not justified, the following is considered:

- Historically, pipeline contracts have been for terms of one to five years, but some have been for longer periods of time for a pipeline entering a new service area.
- In more recent years, the terms of pipeline contracts have been for longer periods of time.
- There is no documentation or claim by SMNG that it attempted to negotiate less than 5,000 MMBtu/day with the pipeline. Likewise there is no documentation or claim by SMNG that the pipeline would have accepted a bid for less than 5,000 MMBtu/day.
- If the pipeline had allowed SMNG to contract for capacity in 1,000 MMBtu/day increments, SMNG would have required 4,000 of the 5,000 MMBtu/day within 10-years for the existing service area. The cost of the 1,000 MMBtu/day excess is approximately \$6.43/customer for the 9 months the contract was in effect for the 2006/2007 ACA period. This is a monthly cost of \$0.71 per customer.
- SMNG's decision making is based on capacity needs for the existing area as well as for growth in some areas. If the expansion area of Houston/Licking is considered, the additional capacity will be fully utilized within 10-years of start-up in that area. If the expansion area of Lebanon is also considered, along with the expansion area of Houston/Licking, the additional capacity would be fully utilized within one to two years of start-up in that area. These are based on customer numbers estimated at the time the decisions were being made. The capacity will need to be re-evaluated based on updated customer numbers and other assumptions on a moving forward basis.

Staff's review indicates SMNG's capacity decisions were not unreasonable. No further response is requested from SMNG at this time.

RECOMMENDATIONS

The Staff recommends that Southern Missouri Natural Gas:

1. Reflect the ACA account balance in its next ACA filing to include the (over)/under-recovered ACA balance in the "Staff Recommended" column of the following table:

Description (+) Under-recovery (-) Over-recovery	Company Ending Balances Per Filing	Staff Adjustments	Staff Recommended Ending Balances
Prior ACA Balance 8/31/06	\$14,126 (A)	\$0	\$14,126 (A)
Cost of Gas	\$5,826,023	\$0	\$5,826,023
Cost of Transportation	\$1,331,126	\$0	\$1,331,126
Revenues	(\$6,949,789)	\$0	(\$6,949,789)
ACA Approach for Interest Calculation	\$831	\$0	\$831
Total ACA Balance 8/31/07	\$222,317	\$0	\$222,317

(A) Does not include settlement adjustment of (\$75,000) and (\$209) that will be filed with Company's November 2008 PGA/ACA filing.

2. Maintain a current hedging plan and continue to evaluate the possibility of further diversifying its gas supply portfolios including a gas supply planning horizon of multiple years and evaluation of firm storage opportunities, 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 within 30 days to the concerns expressed by Staff in the Reliability Analyses and Gas Supply Planning section related to conflicting estimates of monthly requirements.
4. File a written response to the above recommendations within 30 days.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Southern Missouri Gas Company,)
L.P. d/b/a Southern Missouri Natural Gas')
Purchased Gas Adjustment Factors to be reviewed)
in its 2006-2007 Actual Cost Adjustment)

Case No. GR-2007-0484

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

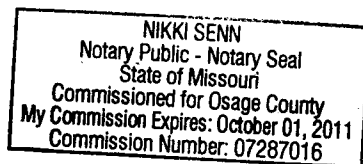
David M. Sommerer, being of lawful age, on his oath states: that as a utility Regulatory Manager in the Procurement Analysis Department of the Utility Services Division, he has participated in the preparation of the foregoing report, consisting of 5 pages to be presented in the above case; that he has verified that the following Staff Memorandum was prepared by himself and Staff of the Commission 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 knowledge and belief,


Phil Lock:	Billed Revenues and Actual Gas Costs
Lesa A. Jenkins:	Reliability Analysis and Gas Supply Planning
Kwang Y. 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

Subscribed and sworn to before me this 13th day of August 2008.




Notary Public