BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Utility's Purchased Gas Adjustment Tariff Filing.	))	**Case No. GR-2012-0115**

STAFF RECOMMENDATION REGARDING MISSOURI GAS UTILITY'S 2010-2011 ACTUAL COST ADJUSTMENT

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and for its Recommendation, states as follows:

1. On October 14, 2011, Missouri Gas Utility (MGU) filed its Actual Cost Adjustment (ACA) for the 2010-2011 annual period for rates to become effective November 1, 2011.

2. The Procurement Analysis Unit (Staff) has reviewed the Company's ACA filing and submits its recommendation as explained in Staff's Memorandum attached hereto as Appendix A. Staff's review included a comparison of billed revenue recovery with actual gas costs to determine whether there exists an over-recovery or under-recovery of the ACA balance.

3. Staff's review identified one cost adjustment to MGU's Northern System that resulted in an over-recovery as a result of the Company's reliance on an incorrect listing of bid results. See Staff's Memorandum pp. 4 -6. Staff's recommendations are contained in Section V. on pp. 9-10.

4. Staff suggests the Commission order MGU to respond to the Staff's recommendations within 30 days of this filing.

WHEREFORE, based on the reasons stated above and explained in Staff's Memorandum, the Staff recommends the Commission order MGU to respond to Staff's Recommendation within 30 days.

Respectfully submitted,

/s/ Robert S. Berlin
Robert S. Berlin
Senior Counsel
Missouri Bar No. 51709

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 526-7779 (Telephone)
(573) 751-9285 (Fax)
email: bob.berlin@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 30th day of August, 2012.

/s/ Robert S. Berlin

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2012-0115, Missouri Gas Utility, Inc.

FROM: David M. Sommerer, Manager – Procurement Analysis
Phil Lock, Regulatory Auditor – Procurement Analysis
Kwang Choe, Ph.D., Regulatory Economist – Procurement Analysis
Derick Miles, P.E., Regulatory Engineer – Procurement Analysis

/s/ David M. Sommerer 08/30/12	/s/ Robert S. Berlin 08/30/12
Project Coordinator / Date	Staff Counsel's Office / Date

SUBJECT: Staff Recommendation in Case No. GR-2012-0115, Missouri Gas Utility 2010-2011 Actual Cost Adjustment Filing

DATE: August 30, 2012

EXECUTIVE SUMMARY

On October 14, 2011, Missouri Gas Utility, Inc. (MGU or Company) filed its Actual Cost Adjustment (ACA) for the 2010-2011 annual period for rates to become effective November 1, 2011. The Procurement Analysis Unit (Staff) of the Missouri Public Service Commission has reviewed the Company's ACA filing. A comparison of billed revenue recovery with actual gas costs will yield either an over-recovery or under-recovery of the ACA balance.

Staff conducted the following analyses:

- a review of billed revenue compared with actual gas costs,
- a reliability analysis including a review of estimated peak-day requirements and the capacity levels needed to meet these requirements
- a review of the Company's gas purchasing practices to evaluate the prudence of the Company's purchasing decisions for this ACA period; and
- a hedging review to evaluate the reasonableness of the Company's hedging practices for this ACA period.

Based on its review, Staff recommends the following adjustments to the Company's filed ACA balances:

Description **NORTHERN SYSTEM**	**Company's ACA Balance**	**Staff Adjustments**	**Staff Recommended ACA Balance**
Beginning ACA Balance @ 9/1/10 – (Over-recovered)/Under-recovered	($23,840)	$0	($23,840)
Total Cost MGU Gas Delivered to City Gate	$909,289	($8,820)	$900,469
Total Revenue Recovery	($905,356)	$0	($905,356)
Ending ACA Balance @ 8/31/11- (Over-recovered)/Under-recovered	($19,907)	($8,820)	($28,727)
Description **SOUTHERN SYSTEM**	**Company's ACA Balance**	**Staff Adjustments**	**Staff Recommended ACA Balance**
Beginning ACA Balance @ 9/1/10 – (Over-recovered)/Under-recovered	$63,872	$0	$63,872
Total Cost MGU Gas Delivered to City Gate	$711,760	$0	$711,760
Total Revenue Recovery	($779,583)	$0	($779,583)
Ending ACA Balance @ 8/31/11- (Over-recovered)/Under-recovered	($3,951)	$0	($3,951)

Staff has no adjustments related to hedging; however Staff's concerns/comments are addressed in the Hedging section of the memorandum.

Staff's concerns/comments regarding reliability analysis and gas supply planning are addressed in that section of the memorandum. Staff recommends the Commission order the Company to respond to Staff's concerns/recommendations within 30 days.

STAFF'S TECHNICAL DISCUSSION AND ANALYSIS

Staff's discussion of its findings is organized into the following five sections:

I. Overview
II. Billed Revenue and Actual Gas Costs
III. Reliability Analysis and Gas Supply Planning
IV. Hedging
V. Recommendations

Each section explains Staff's concerns and recommendations.

I. OVERVIEW

In the Southern system, Southern Star Central Gas Pipeline (SSCGP) provides gas to nearly 1,000 sales customers in the west-central portion of the state including the communities of Green Ridge, Cole Camp, Lincoln and Warsaw. In the Northern system, ANR Pipeline Company (ANR) serves nearly 1,500 sales customers in the northern Missouri communities of Coffey, Jameson, Gallatin, Hamilton, Jamesport, Ridgeway and Pattonsburg. Premium Standard Farms is the only transportation customer served in the Northern system.

II. BILLED REVENUE AND ACTUAL GAS COSTS

Storage

During this ACA, demand and commodity-related charges associated with storage inventory (gas supply, transportation and storage) were included in the Company's storage inventory. Demand charges are fixed monthly charges that are incurred regardless if gas is consumed or not. Staff recommends that all prudently incurred demand charges (transportation and storage) be recovered in the PGA/ACA filing in the month the expense occurred. Staff also recommends that all demand-related charges be excluded from storage inventory on a going forward basis. Staff does not propose any adjustment on this issue.

III. RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

As a gas corporation providing natural gas service to Missouri customers, Missouri Gas Utility is responsible for conducting reasonable long-range supply planning to meet its customer needs. MGU must make prudent decisions based on that planning. One purpose of the ACA audit process is to examine the reliability of the Local Distribution Company's (LDC) gas supply, transportation, and storage capabilities. For this analysis, Staff reviewed the LDCs' plans and decisions regarding estimated peak-day requirements and the LDC's pipeline 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.

Request for Proposals (RFPs)

Staff's audit revealed that the Company relied on incorrect bid summary information. As a result of that error, the Company imprudently awarded a gas supply contract to the highest bidder because of its reliance on an incorrect bid result entry. The incorrect bid results table, relied on by the Company, was provided to Staff in Data Request (DR) No. 0085:

MGU - Bid Results **GR-2012-0115** **DR 0085 Bid Results Summary** **NYMEX Basis Differentials**			
Delivery Point	**Anadarko**	**Asgard**	**Seminole**
ANR SW Headstation	$ (0.03)	$ (0.02)	$ 0.17
REX West Interconnect	No Offer	$ 0.31	No Offer
KMIGT-Cass	No Offer	No Offer	$ 0.02

The Company's consultant, KTM Inc., performed the natural gas supply bidding and purchases on behalf of MGU for this ACA period. The Company's request for proposal resulted in receiving bid offers from three different suppliers for three different delivery points (as can be seen in the table above). A review of the Company's bid results showed that the Company's summary of the received quotes (bids) for the highlighted numbers were reversed. (Seminole had no offer for ANR SW Headstation and bid NYMEX Index plus $0.17 for REX West Interconnect.) The lowest bid received for the Northern system at the REX West Interconnect was the bid from Seminole for NYMEX plus $0.17, not the bid from Asgard for NYMEX plus $0.31. KTM stated that the bid result numbers were reversed and provided a corrected table via response to DR 0085.1, as follows:

MGU - Bid Results REVISED (CORRECTED) BID RESULTS **NYMEX Basis Differentials**			
Delivery Point	**Anadarko**	**Asgard**	**Seminole**
ANR SW Headstation	$ (0.03)	$ (0.02)	**No Offer**
REX West Interconnect	No Offer	$ 0.31	**$ 0.17**
KMIGT-Cass	No Offer	No Offer	$ 0.02

The Company did not provide adequate justification for why it chose the higher bid from Asgard over Seminole.

Staff's inquiry into this scenario resulted in the Company's response to DR 0085.2:

> Data Request:
> 1. Please provide copies of all documentation (emails, text or instant messages, phone logs, etc.) of MGU (KTM on behalf of MGU) requests for refreshed bids and the supplier responses for the MGU 2010/2011 winter month supply for the Northern system, including any responses that indicated a supplier would not be providing a bid. 2. Please provide the Company's (or KTM's) analysis of the original bid offers and the refreshed bid offers for the suppliers in the MGU 2010/2011 winter month supply for the Northern system , including the evaluation of the bids in the Bid Results Matrix provided in DR85 [and 85.1]. 3. For the Company's analysis of the bid offers, please provide all documentation explaining how it valued the REX West Interconnect offers versus offers for deliveries from ANR SW Headstation for the Northern system for the 2010/2011 ACA.
>
> Company Response:
> 1) Please note that initial bid responses were submitted on March 12, 2010. However, the actual transaction did not occur until March 17, 2010. Thus, a request for bid refresh is **presumed**. **No such documentation or other form of record keeping exists for the request of refreshed bid price offers.** Thus, it is **presumed such request and request to fill such transaction was completed via phone conversations** which has been standard practice for the company. Furthermore, when fixing a price in a somewhat volatile market, pricing offers are often extremely time sensitive. Thus, company based its decision to award on all available refreshed offers at the desired time of transaction rather than risk a possible missed opportunity. 2&3) No such evaluation of bid results exists. It is clear however that based on initial NYMEX Basis Differential bid offers which resulted in a $ .20/dth spread (minus $ 0.03/dth at ANR SW Headstation and plus $ 0.17/dth at REX West) is more than recovered in the nearly $ 0.30/dth savings in transportation costs for deliveries at the REX West/ANR interconnect.
> *(Emphasis added)*

There is no evidence to show that MGU requested or received refreshed bids. The Company presumed it requested refreshed bids. There is no evidence of a refreshed Asgard bid at the same price and there is no evidence of MGU contacting the low-bidder Seminole to determine whether the bid was the same. It is not known whether MGU requested a "refreshed bid", "any changes to the bid", or how it worded its "presumed" request for bid refresh. If the Company requested refreshed bids, it should have documentation of the request and the responses. If the request and responses are made via phone calls, MGU should maintain a log of the request and the responses to the bid. It did not maintain a log. A large difference was evident in the initial documented bid from Seminole and Asgard. If the Company had requested refreshed bids and if it had received only one refreshed bid from the higher bidder, it is logically expected that it would follow-up with the lower bidder to determine whether Seminole was going to provide a refreshed bid. Perhaps Seminole did not respond because its bid did not change.

Lacking any MGU documentation for a request for a refreshed bid or updates from the bidders, the documentation MGU maintained shows it awarded the supply to Asgard based on its initial summary table, which incorrectly shows Asgard as the low bid. (See above.) Asgard was not the low bid, it was the high bid.

The difference between the two bids received was $0.14/dth. Both bids were based on a NYMEX plus a premium. For the volumes flowed from Asgard (600 dth/day for Dec through Feb and 300 dth/day for Nov), for a total of 63,000 dth, there was an additional cost of $8,820 for the months of November through February for the Northern system customers. There were 1,531 customers, thus the added costs was approximately $5.76 per customer, for the months of November through February.

Staff recommends an adjustment of $8,820 that reduces the cost of gas for the Northern system.

The Company used a consultant, KTM, Inc. for management of its gas procurement function. Staff recommends Summit Utilities (previously MGU) review the supply bid, approval, and award process to ensure it keeps appropriate contemporaneous documentation and that it has appropriate procedures and internal controls in place to ensure the accuracy of its bid recording and award processes.

Peak Day Supply Planning –Southern System

The Company has documented sufficient capacity on the respective pipelines to meet peak day requirements. However, Staff has concerns regarding the Company’s supply plans for a peak day.

The lack of supply plans for peak day was an issue in the 2009/2010 ACA. The Company’s response for the 2009/2010 ACA stated that it locks in 50% of a peak day load for the Southern system, and 84% for the Northern system. Staff is concerned with the lower target of 50% for the Southern system. The Company further states that it relies on closely monitoring weather forecasts and has five suppliers available if more gas is needed in either division. However, MGU provides no evidence of any firm peaking or swing contracts with these suppliers for the Southern system. Staff is concerned that during of periods of extreme colder weather these supplies may not be available unless the Company has some guarantees in place for firm natural gas supplies.

For the Southern system, MGU has <u>no</u> contracted storage for its swing supply needs. Thus all supplies to serve the Southern system are currently flowing supplies. Because there is no contracted storage, the Company must have flexible supply plans for the Southern system.

For the 2010/2011 winter, MGU had a fixed contract with Concord Energy for fixed volumes which were delivered to the PMI Interface at KMIGT-Cass at the Southern Star Gas Pipeline Interconnect. The winter daily volumes are shown in the table below:

Southern System		
Supplier	Month	Qty/day
Concord Energy	November	267
Concord Energy	December	318
Concord Energy	January	453
Concord Energy	February	442
Concord Energy	March	298

The 453 dth/day in January meets 36% of the estimated peak day (1,242 dth/day for its upper 95% confidence level estimate) for the Southern system supply. The Company did not have any mechanisms (swing contracts, peaking contracts, etc.) for the Southern system that would guarantee supply delivery during periods of colder weather. Thus, the Company is not following its plan to have 50% of its supply locked in for a peak day. As the Southern system continues to experience growth, with the additional Lake of the Ozarks service area, the importance of having firm gas supplies under contract for the winter becomes even more crucial.

As in the 2009/2010 ACA period, Staff restates its concern that the Company does not demonstrate how it would meet its peak day requirements on its Southern system. Staff recommends the Company re-evaluate its lower target for the Southern system. Additionally, prior to the Company's 2012/2013 Winter PGA filing, Staff recommends the Company provide Procurement Analysis Staff with information to show how the Company would meet its peak day requirements on its Southern system.

IV. HEDGING

MGU's winter hedging plans are primarily designed to protect its customers against price spikes. The hedging plan for the Northern system calls for the Company to fill storage as close to capacity as possible by November 1. Additionally, fixed price purchases are a part of the hedging plan for the Northern system.

For the Southern system, the hedging plan calls for using fixed price purchases. The Company has no storage capacity contracted for the Southern system.

In the Northern system, MGU's maximum storage quantity (MSQ) represents about 40% of normal winter weather requirements. For delivery during the winter periods, November 2010 - February 2011, MGU purchased fixed price volumes in March 2010. Additionally, the Company purchased fixed price volumes in February 2011, after fixing a basis a few days earlier in the month, for delivery in March 2011. These fixed price volumes, combined with storage at the beginning of the winter season, represents 93% of customers' normal winter weather requirements for the Northern system.

For the Southern system, MGU purchased fixed price volumes in August 2010, after locking in a basis in June 2010, for delivery in November 2010 through March 2011. The fixed price volumes represent about 59% of normal winter weather requirements. The lower percentage of the hedged priced volumes for the Southern system reflects the uncertainty of customers' normal winter weather requirements in the new service territory.

Conclusion

Despite MGU's overall hedging practices for this winter's ACA period (2010-2011), utilizing storage and fixed price purchases, Staff has the following comments about the Company's hedging practice for this winter's ACA period:

1. It is important for the Company to evaluate the expected level of the customers' natural gas requirements that are reasonably protected (hedged) under warmer than normal, normal, and colder than normal weather scenarios. Additionally, the Company should evaluate its hedging strategy in response to the changing market dynamics as to how much the existing hedging strategy actually benefits its customers while achieving the goal of stable price level. Although Staff is not necessarily suggesting that the Company should develop its hedging strategy in order to beat the market, part of the Company's hedging plan should be flexible enough to incorporate the changing market circumstances where the market prices have become less volatile.

2. A part of MGU's hedging practice essentially calls for purchasing gas whenever it is less expensive compared to the current storage WACOG, and injecting the gas into storage. However, this market-timing approach in filling storage can lead to a situation where MGU waits too long for natural gas prices to go down, though Staff recognizes MGU's past efforts in reducing gas costs by utilizing this method.

3. MGU utilized a basis differential for part of the fixed price purchases. A basis differential is the difference in natural gas price from one delivery location to another. In this case, it is the difference between the MGU's

delivery locations, the ANR pipeline for the Northern system and the SSCG pipeline for the Southern system, and the Henry Hub in Louisiana which is the delivery point of the NYMEX natural gas futures. Although MGU eventually established the complete hedged price by fixing the NYMEX futures portion of the hedge for the winter season, the Company should use caution in utilizing basis differential as a hedging method since the Company might indefinitely delay triggering the NYMEX fixed price until the NYMEX futures prices become more favorable. Because there is no guarantee that the NYMEX futures prices move in the Company's favor, Staff recommends the Company should not be overly reliant on a "price view" that may prove wrong and ultimately expose its customers to potentially significant price increases. This is especially true of the Southern system where there are no other planned hedges (e.g., storage).

Hedging Recommendations

Staff recommends, for the 2011-2012 ACA period and beyond, that the Company:

(a) Establish and maintain a current and consistent hedging policy with stated objectives based on month-specific normal weather requirements while also considering the impacts of warmer and colder than normal weather scenarios,

(b) Consider a combination of various alternatives such as storage withdrawals, call options, and other fixed price purchases for effective hedging during the winter months.

(c) Continue to document its reasoning for executing any hedging transactions or decisions, whether by means of storage, fixed price contracting or other financial hedging instruments.

V. RECOMMENDATIONS

The Staff recommends that MGU:

1. Adjust the balances in its next ACA filing to reflect the Staff recommended ending (over)/under recovery ACA balances per the following table:

Description **NORTHERN SYSTEM**	**Company's ACA Balance**	**Staff Adjustments**	**Staff Recommended ACA Balance**
Beginning ACA Balance @ 9/1/10 – (Over-recovered)/Under-recovered	($23,840)	$0	($23,840)
Total Cost MGU Gas Delivered to City Gate	$909,289	($8,820) (A)	$900,469
Total Revenue Recovery	($905,356)	$0	($905,356)
Ending ACA Balance @ 8/31/11- (Over-recovered)/Under-recovered	($19,907)	($8,820)	($28,727)
Description **SOUTHERN SYSTEM**	**Company's ACA Balance**	**Staff Adjustments**	**Staff Recommended ACA Balance**
Beginning ACA Balance @ 9/1/10 – (Over-recovered)/Under-recovered	$63,872	$0	$63,872
Total Cost MGU Gas Delivered to City Gate	$711,760	$0	$711,760
Total Revenue Recovery	($779,583)	$0	($779,583)
Ending ACA Balance @ 8/31/11- (Over-recovered)/Under-recovered	($3,951)	$0	($3,951)

(A) Gas Supply Cost Adjustment - Northern System

2. Respond to Staff's recommendations in Section II – Billed Revenues and Actual Gas Costs and Compliance section.

3. Prior to the Company's 2012/2013 Winter PGA filing, Staff recommends the Company provide Procurement Analysis Staff with information to show how the Company will meet its peak day requirements on its Southern system.

4. Staff recommends Summit Utilities (previously MGU) review the supply bid, approval, and award process to ensure it keeps appropriate contemporaneous documentation and that it has appropriate procedures and internal controls in place.

5. Respond to Staff's recommendations in the Hedging section.

6. Respond to recommendations included herein within 30 days.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Utility's) Purchased Gas Adjustment)	Case No. GR-2012-0115

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 a Utility Regulatory Manager in the Procurement Analysis Unit of the Regulatory Review Division - Utility Services Department, he has participated in the preparation of the foregoing report, in memorandum form, consisting of 10 pages to be presented in the above case; that he has verified that the foregoing 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, Regulatory Auditor	Billed Revenues and Actual Gas Costs
Kwang Choe, Ph.D., Regulatory Economist	Hedging
Derick Miles, P.E., Regulatory Engineer	Reliability Analysis and Gas Supply Planning

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 30th day of August, 2012.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

Notary Public