MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2012-0123, Southern Missouri Gas Company
d/b/a Southern Missouri Natural Gas

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

/s/ David M. Sommerer 05/24/12	/s/ Lera Shemwell 05/24/12
Project Coordinator / Date	Staff Counsel's Office / Date

SUBJECT: Staff Recommendation in Case No. GR-2012-0123, Southern Missouri Natural Gas 2010-2011 Actual Cost Adjustment Filing

DATE: May 24, 2012

EXECUTIVE SUMMARY

On October 21, 2011, Southern Missouri Natural Gas (SMNG or Company) filed its Actual Cost Adjustment (ACA) for the 2010-2011 annual period for rates to become effective November 4, 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:

	Ending Balances per Filing	**Adjustments prior to 2010-2011 ACA**	**Staff Adjustments for 2010-2011**	**Staff Recommended Ending Balances**
Prior ACA Balance 8-31-10	$252,212	($4,346)	$0	$247,866
Cost of Gas	$4,439,882	$2,790	($5.988)	$4,436,684
Cost of Transportation	$1,596,076	($8,429)	($17,154)	$1,570,493
Revenues	($5,946,074)	($1,515)	$0	($5,947,589)
ACA Approach for Interest	$1,864	$0	$0	$1,864
Unbilled Revenue/Imbalance	($139,246)	$0	$139,246	$0
Total ACA Balance 8-31-11	$204,714	($11,500)	$116,104	$309,318

Staff has no adjustments related to reliability analysis and gas supply and planning, however Staff's recommendations regarding this topic are discussed within the Reliability Analysis and Gas Supply and Planning section of the memorandum. **Staff recommends the Commission order the Company to respond to these concerns within 30 days and provide the information requested by 9/15/2012.**

Staff has no adjustments related to hedging; however Staff's concerns/comments are addressed in the Hedging 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 which explain Staff's concerns and recommendations:

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

I. OVERVIEW

During the 2010/2011 ACA, SMNG provided natural gas service to customers in the south and south-central portion of the state including communities in Greene, Webster, Wright, Howell, Texas, Douglas, Laclede, Stone and Taney counties. During this ACA period, SMNG's service area was expanded to include Branson/Hollister and surrounding areas (Stone and Taney counties) in Southwest Missouri. Interstate pipeline, Southern Star Central Gas Pipeline (SSCGP) serves all customers on SMNG.

II. BILLED REVENUE AND ACTUAL GAS COSTS

Storage

On April 1, 2011 SMNG entered into a storage agreement with SSCGP. From June 2011 to August 2011 SMNG injected gas into their storage. During this ACA, demand and commodity related charges associated with storage inventory (gas supply, transportation and storage charges) 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 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.

COMPLIANCE ADJUSTMENTS

Line Pack

January 2011 is the first full month that SMNG began serving customers in the Branson area. Starting in November 2010, SMNG tested its pipeline and gas was injected into the line serving Branson (Aurora to Branson). Some of the gas was lost as a result of the system testing and these losses were included as PGA expenses. Some of the gas remained in the line and was used as line pack. Line pack may be described as gas that is maintained in a gas transmission or supply line at all times to maintain pressure and flow of gas to its customers at all delivery points. As such, this is gas that must be maintained in SMNG's pipeline at all times for the pipeline's system integrity. This gas is not consumed. SMNG has agreed that the gas related to line pack will be re-classified as a capital asset (non-gas cost recovery) and removed from the PGA. SMNG had booked line pack as a PGA expense in the current filing. Line pack was valued at $5,988. Staff recommends that the Company reduce its PGA expense by $5,988.

Unbilled Revenue & Transportation Imbalances

In their response to Data Request (DR) No. 103(2), SMNG made several adjusting entries to reconcile its revenue recovery and imbalances to its books as of August 31, 2011. In the process SMNG included unbilled revenue as part of its total revenue recovery and transportation imbalances as part of its billed gas cost expenses. The Company's tariffs describe revenue recovery in terms of "billed" Ccf sales. The Company has already included its "billed" sales revenues in the calculation of its August 31, 2011 ending ACA balance (prior to its adjustments for unbilled revenues and transportation imbalances), so SMNG's process of adjusting entries for unbilled revenues is not necessary.

SMNG also made several adjustments to their ACA balance to reconcile imbalance gas costs to their books as of August 31, 2011. These adjustments are not included as corrections on the customers' bills.

Staff believes that SMNG's unbilled revenue and imbalance adjustments are not in accordance with the Company's tariffs. Staff recommends an adjustment of $139,246 ($343,960 - $204,714) to remove the unbilled revenue and imbalance adjustments included in the Company's ACA balance.

Missouri School Pilot Program, Transportation Service, Capacity Release Adjustment

In the Reliability Analyses and Gas Supply Planning section of this memorandum, there is discussion regarding SMNG's capacity release for the school aggregation program. SMNG releases capacity it holds on the interstate pipeline to permit the schools' pool operator, Seminole Energy Services, to transport natural gas to the schools. SMNG then receives credits from the schools in the form of capacity release credits. Staff's adjustment compares a reasonable market area capacity release to the actual capacity released. SMNG's actual market area capacity release for the school aggregation program was $17,154 ($28,418 - $11,264) less than it should have been for the 2010-2011 ACA.

SMNG's calculation of the prior years' peak day usage did not include the appropriate peak day usage during the summer months (April-October) or winter months (November-March). This is discussed in more detail in the Reliability Analyses and Gas Supply Planning section of this memorandum. Staff's adjustment includes a larger capacity release credit for the system sales customers of SMNG and that reflects a $17,154 reduction in the cost of gas.

III. RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

As a regulated gas corporation and a Local Distribution Company (LDC) providing natural gas service to Missouri customers, assuring the reliability of its natural gas supply is an essential company function. This means the Company is responsible for conducting reasonable long-range supply planning and for its decisions resulting from that planning. One purpose of the ACA review process is to examine the Company's analysis and decisions to assure reliability of its gas supply, transportation, and storage capabilities. For this analysis, Staff reviews: the LDC's plans, methods of calculating, and decisions regarding its estimated peak day requirements and the capacity levels to meet those requirements, the LDC's peak day reserve margin and its rationale for this reserve margin, and the Company's natural gas supply plans for various weather conditions.

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

1. Capacity Planning

The Company generally provides an annual Gas Supply Presentation to address gas supply planning issues. Staff recommends that, no later than 9/15/2012, Summit Natural Gas of Missouri provide documentation to address the following peak day estimate and reserve margin issues.

a. Peak Day Estimate.

As follow-up to the 2009/2010 ACA, GR-2010-0218, SMNG made an EFIS filing on 9/30/11 that includes peak day planning for 2011/2012 and future years. SMNG does not consider standard error or the upper 95% confidence interval factors to consider higher estimates for peak day as agreed in its response to the 2009/2010 ACA recommendations.

b. Consideration of Transportation Customers in Peak Day Estimate and Reserve Calculation

SMNG conducts a calculation of reserve, the difference between the contracted transportation capacity and the peak day estimate for its gas sales customers. SMNG refers to this as "excess (deficient) capacity" in its estimates for the 2011/2012 winter and forward.

Transportation customers are not gas sales customers and thus their usage should not be included in the SMNG peak day estimate. Likewise, it may not be appropriate for SMNG to include its entire contracted capacity in its capacity reserve calculation if some of that capacity is released and is non-recallable. However, SMNG would still need to show that its contracted capacity decisions are prudent.

Although schools in the aggregation program are transport customers, capacity release provisions for school aggregation states the release will be made on a recallable basis, but the Company agrees not to recall capacity unless requested to do so by Customer (Tariff Sheet 18.5). Thus, this capacity is essentially non-recallable.

SMNG's calculation of peak day and reserve should clearly explain how it considers transportation customers.

2. Company Support for Monthly Normal, Warm, and Cold Weather Estimates

Lack of information for SMNG's monthly planning has been an ongoing issue. Staff had recommendations pertaining to SMNG's normal estimate methodology in the 2007/2008 ACA, 2008/2009 ACA, and 2009/2010 ACA. Staff had recommendations for SMNG's monthly planning for warm and cold weather in the 2006/2007 ACA, 2007/2008 ACA, 2008/2009 ACA, and 2009/2010 ACA.

In its response to the 2009/2010 ACA, GR-2010-0218, SMNG replied, "In accordance with Staff's recommendation, the Company will provide updated monthly estimates for normal, warm and cold weather for 2011/2012 by 9/1/11." On 8/30/11, SMNG requested a one-month extension and Staff agreed.

SMNG provided updated monthly estimates for normal, warm and cold weather for 2011/2012 in its filing dated 9/30/2011, but the files were not complete. The files referred to CY2012 Budget workpapers, which were provided 10/5/11 in response to a 10/4/11 Staff follow-up email. SMNG's workpapers were not sufficient to support SMNG's monthly estimates, mainly because the source of some of the information was not provided. It was simply hard-coded in the files without providing sufficient supporting source information.

Staff and the Company have discussed this issue and the Company has assured Staff that the files and all supporting documentation will be provided in its planning for the upcoming 2012/2013 winter and calendar year 2013 planning.

Staff recommends once again that SMNG provide its updated monthly estimates for normal, warm, and cold weather. Because of the timing of the ACA reviews, the next time that SMNG could provide information pertaining to its planning for the winter will be for the 2012/2013 winter, which it states will be prepared for Summit-Missouri by May 2012. Such analysis should incorporate items it previously agreed to evaluate. SMNG's analysis should also include SMNG's estimated requirements for each take point for 2012/2013 and all supporting workpapers and documentation regarding monthly estimates for normal, warm, and cold weather, not just hard-coded numbers. Staff recommends SMNG provide this information no later than 9/15/2012.

3. Concerns with Supply Agreements

Staff has concerns with a base supply agreement and a peak contract in effect for this ACA period.

a. Base Agreement

SMNG signed a new base supply agreement with BP dated 7/1/2009 (GR-2012-0123, DR No. 14), that replaced its April 2003 agreement. There are some concerns with the Special Provisions, Section 3.5 of this agreement.

> Special Provisions: Performance Obligation, Section 3.5, add: pertains to fixed price transactions with firm performance obligation, for a delivery period of at least 1-month: (i) if upon the occurrence of a Force Majeure event, (a) Seller is unable to sell and deliver or (b) Buyer is unable to purchase and receive, the contract quantity either in whole or part, (ii) then, for duration of Force Majeure event, for each day that Seller is unable to sell and deliver, or Buyer is unable to purchase and receive, such Fixed Price Gas, the following settlement obligations shall apply: (a) if the first-of-month (FOM) Price exceeds the Fixed Price, Seller shall pay Buyer the difference between the FOM Price and the Fixed Price for each MMBtu of gas not delivered and/or received on that Day, or (b) if the Fixed Price exceeds the FOM Price, Buyer shall pay Seller the difference between the Fixed Price and the FOM Price for each MMBtu of such Gas not delivered and/or received on that Day.

SMNG does not show any occurrences in the 2010/2011 ACA where this special provision was utilized. However, because the provision is still in effect for future ACAs, Staff is concerned that the Company would agree to the pricing-related special provisions of this supply agreement that requires the following:

- SMNG to pay the difference in the FOM and Fixed price to Supplier if the FOM price higher, when the Supplier doesn't deliver gas during a Force Majeure

- The Supplier only has to pay the difference in FOM and Fixed to SMNG, when SMNG may be buying higher price gas in daily market because of a Force Majeure

b. Peaking Contract

SMNG had no written contract for peaking/call/swing supplies for 2010/2011 winter months. SMNG DR No. 6.2 response states: a) The Company was unable to find a contract regarding a peaking agreement, and contacted BP to inquire about the contract. A representative from BP told us that there was no written documentation for the peaking agreement between SMNG and BP for the 2010-2011 winter period, but that a verbal agreement existed and the structure was similar to the 2009-2010 winter (with the exception of the adder as follows). The verbal agreement was handled with the following understanding: 1) BP would sell additional volumes up to 5,000 dth/day into the Production Zone to SMNG on an as needed basis at a GD Southern Star Midpoint Index plus $0.02/dth, and 2) No Demand Charge would be assessed.

As discussed with the Company in a 3/1/2012 conference call, Staff is concerned with SMNG's reliance on a verbal peaking supply agreement, with undocumented firm commitments and undocumented pricing provisions, for the 2010/2011 winter months. The pricing of the verbal agreement appears more favorable because it has no fixed demand/reservation charges in the 2010/2011 winter months.

SMNG did not use the pricing terms in the verbal peaking supply agreement for many days in December 2010 even though the pricing of the peaking contract was more favorable than SMNG's purchases (as shown on the invoices and transaction confirmations) of some of the spot supplies. However, no adjustment is proposed because the dollar amount is not material. Had the winter been colder with more need of spot supply in other winter months, the cost could have been material.

Staff recommends SMNG evaluate its processes to assure: (1) controls are in place to document firm agreements; (2) it nominates gas based on lowest price dispatching of its available supply.

4. Storage

SMNG adds a pipeline storage contract in this ACA period. It began injections in June 2011 and was charged for reservation costs beginning in April 2011. Withdrawals will begin in the fall/winter of the 2011/2012 ACA period. Because reservation charges are part of the pipeline's storage charges and could be recovered in the 2010/2011 ACA, it is appropriate to review the SMNG storage decision beginning with the 2010/2011 ACA.

SMNG does not adequately document its reasons for purchasing storage.

One of SMNG's justifications is that it is further diversifying its gas supply portfolio. The gas supply is still sourced on the same pipeline, but is put in storage in the non-winter months for withdrawal in the winter months. SMNG has not reasonably demonstrated its claim that it is diversifying its supply.

One of SMNG's justifications is a price comparison to propane. It is not adequate support for its decision to purchase natural gas storage to calculate an equivalent cost to propane. Existing customers will pay for the fixed cost of storage and are relying on SMNG to make prudent decisions regarding natural gas options, not just comparing the price to propane, which the customers do not use.

Another of SMNG's justifications is that the differential between summer spot gas pricing and the winter NYMEX strip provided additional incentive for the use of storage. SMNG does not provide any data supporting its claim that the differential between summer and winter pricing justifies the added storage costs. Staff's review of summer and winter pricing that would have been known when SMNG was negotiating this storage agreement with the pipeline, shows that the differential between summer and winter pricing does not make up for the added storage costs.

Because SMNG was planning to use storage to cover part of its winter hedging, SMNG could have compared the costs of storage to that of its historical method of hedging. SMNG provided no such analysis. Staff's review of data known by SMNG prior to its storage decision shows that storage costs, including pipeline charges for storage, are lower than SMNG's other sources of hedging.

Although SMNG has not reasonably explained why it chose storage over other options, Staff has determined that the cost to SMNG's customers is not detrimental when the cost of storage is compared to other hedging options.

5. Missouri School Pilot Program, Transportation Service (School Aggregation)

In 2010/2011 there were eleven schools participating in this program, an increase from 2009/2010 that had nine participating schools (DR No. 78). Staff included comments regarding capacity release for the school aggregation program in the 2007/2008 and 2008/2009 ACA, GR-2008-0379 and GR-2009-0268, and recommended an adjustment in the 2009/2010 ACA, GR-2010-0218.

a. Concerns with School Aggregation Market Zone Capacity Release

SMNG's capacity release summary (DR No. 80 amended response) for schools for Market Zone Contract Number TA-797 shows the Company released volumes of capacity which varied from 231 to 577 MMBtu per day during the winter months of November 2010 through March 2011. For the summer months of October 2010 and April 2011 through August 2011, the Company released volumes of capacity which varied from 86 to 147 MMBtu per day. The summary shows no capacity was released in September 2010.

SMNG estimates the summer and winter capacity requirements for school aggregation as 848 MMBtu/day for winter market area capacity and 98 MMBtu/day for summer market area capacity (amended DR No. 80). SMNG's data does not support its estimates for the summer and winter capacity requirements for school aggregation.

Staff's comparison of a reasonable market area capacity release to the SMNG actual capacity release for the ACA period shows SMNG capacity release credit for the school aggregation program was $17,154 less than it should have been. SMNG's firm customers should have been credited this additional amount so that they were not subsidizing the peak day capacity for other customers (the schools) in the aggregation program. The recommended adjustment is discussed further in the section, Missouri School Pilot Program, Transportation Service – Compliance Issues.

b. Concerns with School Aggregation Production Zone Capacity Release

SMNG's capacity release summary (DR No. 80 amended response) for schools for Production Zone Contract Number TA-814 shows it released volumes varying from 234 to 585 MMBtu per day for the winter months of November 2010 through March 2011, zero for September 2010, 142 for October 2010, 149 for April 2011, and varying volumes from 10 to 34 for May 2011 through August 2011.

Staff is not proposing an adjustment for the Production Zone capacity release for the 2010/2011 ACA, but reiterates its concerns expressed in prior ACAs for SMNG to address going forward. Generally when capacity is released, the volume of the capacity release is negotiated up front and the acquiring shipper pays for that capacity for each day of the term of the contract, not a varying capacity for each month, unless the contract explicitly states the capacity to be released (such as a specific release volume for the winter months and another specific release volume for the summer months). For the winter months, the capacity specified should allow the schools sufficient pipeline capacity to flow the volume of natural gas required for very cold days so that gas supply volumes to the schools is not interrupted for insufficient firm pipeline capacity.

In the 2009/2010 ACA, GR-2010-0218, Staff recommended SMNG address this Production Zone capacity release issue on a moving forward basis, prior to its contracts for the 2011/2012 period.

IV. HEDGING

SMNG hedged with fixed price purchases (contracts) from gas suppliers such as BP, and Conoco Phillips for the winter heating season (November 2010 through March 2011). SMNG's target for the winter (November 2010 through March 2011), implemented as a result of a settlement in GC-2006-0180, was to secure hedging of a minimum of 20%, 40%, and 55% of normal winter heating–season gas supply no later than April 30, July 15, and October 1, 2010, respectively, unless good cause is shown for deviating from this benchmark. SMNG hedged, with fixed price purchases, 65% by early September 2010.

Despite SMNG's hedging practice using fixed price purchases, Staff recommends the company continue to stay current with market developments in order to make prudent gas procurement decisions. SMNG should use market based, as well as dollar-cost-averaging approaches, to implement a reasonable hedging strategy that considers changing market dynamics. In particular, Staff recommends that the company evaluate its hedging strategy in the changed market conditions where the market prices have become less volatile. Staff further recommends the Company carefully plan the diversification in its gas supply portfolio as it includes storage as part of hedging instruments starting the 2011-2012 heating season. SMNG should evaluate how best to balance the fixed price purchases in its gas supply portfolio, given the storage capacity, to achieve a cost effective hedging outcome including evaluating the option of hedging some storage injections. Additionally, SMNG should evaluate further diversification of its gas supply portfolio and include a gas supply planning horizon of multiple years.

V. RECOMMENDATIONS

The Staff recommends that Southern Missouri Natural Gas:

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

TABLE 1

Description (+) Under-recovery (-) Over-recovery	Ending Balances Per Filing	Commission Approved Adjustments prior to 2010-2011 ACA (A)	Staff Adjustments For 2010-2011 ACA		Staff Recommended Ending Balances
Prior ACA Balance 8/31/10	$252,212	($4,346)	$0		$247,866
Cost of Gas	$4,439,882	$2,790	($5,988)	(1)	$4,436,684
Cost of Transportation	$1,596,076	($8,429)	($17,154)	(2)	$1,570,493
Revenues	($5,946,074)	($1,515)	$0		($5,947,589)
ACA Approach for Interest Calculation	$1,864	$0	$0		$1,864
Unbilled Revenue/Imbalances	($139,246)	$0	$139,246	(3)	$0
Total ACA Balance 8/31/11	$204,714	($11,500)	$116,104		$309,318

A) Order effective March 16, 2012 (thus no adjustment adopted in 2010-2011 ACA)
1) Line Pack – Branson
2) Capacity Release – School Aggregation
3) Unbilled Revenue & Transport Imbalances

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

3. Staff recommends that SMNG respond within 30 days to the concerns expressed by Staff in the Reliability Analyses and Gas Supply Planning section related to (1) concerns with supply agreements, and (2) Missouri School Pilot Program, Transportation Service (School Aggregation). In addition, <u>Staff recommends SMNG provide no later than 9/15/2012 its 2012/2013 updated estimates for peak day and capacity planning and its monthly estimates for normal, warm and cold weather as detailed in the Reliability</u>

Analyses and Gas Supply Planning section, including all supporting documentation and workpapers, in Excel where possible. [1]

4. Respond to Staff's recommendations in Section IV - Hedging.

5. Respond to recommendations included herein within 30 days.

[1] The 9/15/2012 deadline coincides with SMNG's reporting requirements for the Branson area for reliability and gas supply planning in the GA-2007-0168 Report and Order issued 2/5/2008 that refers to the Stipulation and Agreement in GA-2006-0561. Paragraph III.M. 19 of the GA-2007-0168 Stipulation and Agreement requires no later than September 15 each year for the first 5-years of operation and at least every 3-years thereafter, the Company shall provide updated reliability information addressing all the items in the Reliability and Natural Gas Supply Planning requirements section, paragraph III.M. 18.

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's Winter Purchased Gas Adjustment Filing.	)))	Case No. GR-2012-0123

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 Utility Services Department, he has participated in the preparation of the foregoing report, consisting of 13 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 S. Lock, Regulatory Auditor:	Billed Revenues and Actual Gas Costs
Lesa A. Jenkins, P.E., Regulatory Engineer:	Reliability Analysis and Gas Supply Planning
Kwang Y. Choe, Regulatory Economist:	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 24th day of May, 2012.

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

D Suzie Mankin

Notary Public