MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2014-0060, Liberty Energy (Midstates) Corporation

FROM: 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 12/18/14
Project Coordinator/ Date

/s/John Borgmeyer 12/18/14
Staff Counsel's Office/ Date

/s/ Lesa Jenkins PE, 12/18/14
Utility Regulatory Engineer II/ Date

SUBJECT: Staff's Recommendation in Case GR-2014-0060, Liberty Energy (Midstates) Corporation 2012-2013 Actual Cost Adjustment Filing (formerly Atmos Energy Corporation)

DATE: December 18, 2014

Procurement Analysis Staff has reviewed Liberty Energy (Midstates) Corporation 2012-2013 Actual Cost Adjustment (ACA) filing. This filing was made on October 28, 2013, for rates to become effective on November 14, 2013, in all areas served in Missouri. This filing was docketed as Case No. GR-2014-0060.

On August 1, 2011, Atmos Energy and Liberty Energy (Midstates) Corporation filed a joint application for authority to sell its regulated natural gas utility assets in Missouri, Illinois and Iowa to Liberty Energy (Midstates) Corporation. (*Joint Application of Atmos Energy Corporation and Liberty Energy (Midstates) Corporation* – File No. GM-2012-0037). The sale of the properties was contingent upon approval from the regulatory commissions in Missouri, Illinois and Iowa.

On March 14, 2012, Case No. GM-2012-0037, the Missouri Public Service Commission issued its *Order Approving Unanimous Stipulation and Agreement* authorizing Liberty Energy (Midstates) Corporation to purchase the assets of Atmos' Missouri service areas, including the issuance of new certificates of convenience and necessity.

Section 15, paragraph f. of the Unanimous Stipulation and Agreement requires that "Atmos shall transfer to Liberty-Midstates copies of all records and documents related to PGA/ACA cases."

Liberty-Midstates, now known as Liberty Utilities ("Liberty" or "Company"), is the successor in interest to Atmos' previously filed PGA/ACA cases. However, for the purposes of this Memorandum, Staff will refer to Atmos Energy ("Atmos") because Atmos acted as agent for

Liberty for much of the current ACA. Liberty has adopted Atmos' tariffs and is now administering Atmos' ACA filings.

This memorandum is organized into four sections. Each section contains detailed explanations of Staff's concerns and recommendations. The four sections are:

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

Staff's analysis consisted of:

1. A review and evaluation of the Company's billed revenues and its natural gas costs for the period of September 1, 2012, to August 31, 2013. A comparison of billed revenue recovery with actual costs will yield either an over-recovery or under-recovery of the ACA costs. The Company's over-recovery is shown as a negative ACA balance that must be returned to customers; under-recovery is shown as a positive ACA balance that must be recovered from customers.
2. A reliability analysis of the Company's estimated peak day requirements and capacity levels to meet those requirements.
3. An examination of the Company's gas purchasing practices to determine the prudence of the Company's purchasing decisions.
4. A hedging review to determine the reasonableness of the Company's hedging plans for this ACA period.

Atmos'/Liberty's Missouri service territory

The Liberty systems in Missouri are grouped into three geographic areas: Northeast, Southeast and West. For gas cost recovery there are four PGA/ACA rate divisions, three of which are made up of the three geographic divisions. A fourth PGA division, Kirksville, is separate from the Northeast area. A more detailed description, with the associated interstate pipelines serving these areas, follows:

The West area (WEMO) includes Butler which is served by Panhandle Eastern Pipe Line Co., LP (PEPL) and Stateline (also known as Rich-Hill/Hume) service area which is served by Southern Star Central Gas Pipeline, Inc. (SSCGP). The West area is served by an average of 3,915 firm sales customers.

The Northeast area (NEMO) includes (1) Kirksville served by ANR Pipeline Co. (ANR); and (2) Hannibal-Canton, Bowling Green and Palmyra served by Panhandle Eastern Pipe Line Co., LP (PEPL). Kirksville serves an average of 5,451 firm sales customers and the rest of the NEMO area serves an average of 13,210 firm sales customers.

The Southeast area (SEMO) includes Jackson, served by Natural Gas Pipeline Co. of America (NGPL), Piedmont, served by Mississippi River Transmission Corp. (MRT), and the Southeast Missouri Integrated system, served by Texas Eastern Transmission, LP (TETCO) and Ozark Gas Transmission, LLC. The Southeast area also includes the former Neelyville/Quilin service area. Together they served an average of 32,179 firm sales customers.

The total customer count for all divisions is an average of 54,755 firm sales customers.

Based on its review, Staff recommends the following adjustments to the Company's filed ACA balances: A positive ACA balance indicates an under-collection that must be recovered from customers. A negative ACA balance indicates an over-recovery that must be returned to customers.

ALL AREAS	**Filed Balances for 2012-2013 (Ending 8-31-13)**	**Staff Adjustments**	**Staff Balances for 2012-2013 (Ending 8-31-13)**
SEMO Area: Demand ACA	($176,315)	$1,494	($174,821)
Commodity ACA	($2,271,787)	$159,168	($2,112,619)
Kirksville Area: Demand ACA	$117,571	$16,867	$134,438
Commodity ACA	($272,612)	$23,618	($248,994)
WEMO Area: Demand ACA	($11,205)	$0	($11,205)
Commodity ACA	($67,470)	$22,618	($44,852)
NEMO Area: Demand ACA	($154,448)	$0	($154,448)
Commodity ACA	$97,183	$67,945	$165,128

Summary of Recommendations

The Staff recommends that the Commission issue an order requiring Liberty to:

1. Respond to Staff's recommendations in Section I – Billed Revenue and Actual Gas Costs.
2. Respond to the issues in Section II - Reliability Analysis and Gas Supply Planning. (There is no financial adjustment related to Reliability or Supply Planning for this ACA review period.)
3. Respond to Staff's comments in Section III - Hedging. (There is no financial adjustment related to Hedging).

STAFF TECHNICAL REPORT AND ANALYSIS

I. BILLED REVENUE AND ACTUAL GAS COSTS

Compliance Adjustments

During Staff's ACA review, there were several compliance adjustments proposed by Staff as a result of misstated or missing entries in the Company's filing. These adjustments affect the SEMO, NEMO and Kirksville service areas.

Kirksville Service Area

On the Kirksville service area there are two adjustments:

1. All ANR transportation and storage reservation costs were misstated during the month of November 2012. ** ________________ **
2. ** ________________ **

In summary, the commodity cost of gas should be reduced by $1,020 ($1,055 - $35) and the demand cost of gas should be increased by $16,867 for Kirksville firm sales customers.

SEMO Service Area

On the SEMO service area there are two adjustments:

1. ** ________________ ** This increases the demand cost of gas by $1,494 for SEMO firm sales customers.
2. ** ________________ ** The commodity cost of gas should be reduced by $14,238 for SEMO firm sales customers.

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In summary, the commodity cost of gas should be reduced by $14,238 and the demand cost of gas should be increased by $1,494 for SEMO firm sales customers.

NEMO Service Area

** ________ ** The commodity cost of gas should be reduced by $2,166 for NEMO firm sales customers.

<u>Hedging</u>

There were four discrepancies in the way Liberty calculated the hedging costs in the 2012-2013 ACA filing.

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2. ** ________ **
3. ** ________ **
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<u>Monthly Cash-out Provisions</u>

A. Transportation Customers

"Cash-outs" are a way of encouraging shippers that buy gas from suppliers other than the Company to keep reasonably balanced between the gas they have delivered into the Company's distribution system versus the gas that the shippers actually use. When a customer delivers too little gas to the Company (in which case the Company must supply that customer with additional gas), a typical cash-out provision would require the customer to reimburse the Company for the extra system gas consumed. The following is taken from Tariff Sheet 52 (c) of the Company's tariffs– Cash out of Monthly Imbalances:

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> If the volume of gas delivered to the Customer's point of delivery is greater than the volume of gas received by the Company from the Connecting Pipeline Company for the Customer's account (negative imbalance), the Company will sell the difference in gas volumes to the Customer based on the highest index price for the respective Connecting Pipeline Company for any week beginning in the calendar month as published in Natural Gas Week plus applicable pipeline fuel and transportation charges. If the volume of gas delivered to the Customer's point of delivery is less than the volume of gas received by the Company from the Connecting Pipeline Company for the Customer's account (positive imbalance), the Company will buy the difference in gas volumes from the Customer based on a price equal to the lowest index price for the respective Connecting Pipeline Company for any week beginning in the calendar month as published in Natural Gas Week, plus applicable pipeline fuel and transportation charges. In the absence of such published Natural Gas Week index, the Company will determine, subject to Commission's review in Company's actual Cost Adjustment (ACA) filing, a suitable replacement source for such weekly market price information.

In this period, the Staff believes Liberty was applying the cash-out provisions in a different manner from its predecessor, Atmos. It is common for tariffed cash-out provisions to reference a specific pricing point or "index" to cash-out over- or under-deliveries of end-user gas supplies. Atmos' practice was to use a weekly price, while Liberty's practice generally used a daily transactional reference.

The Staff will first describe Atmos' pricing methodology for cash outs of monthly imbalances. It is Staff's opinion that Atmos' practice was consistent with the cash-out tariff provisions.

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Below is a hypothetical weekly example of a *Natural Gas Week* published index price.

MIDCONTINENT

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Staff summary recommendation-Transportation Customers

As indicated in Commission Case GR-2014-0152, Staff believes that the existing tariff language is clear enough to describe the price indices to be used. However, in an attempt to help clarify the matter, Staff has offered to modify the existing tariff language to include the following tariff language in Sheet 52(c): “For purposes of this paragraph, “index price” shall mean the price from the “$ / MMbtu” column in the Natural Gas Week Spot Prices table reported in Natural Gas Week.”

There were differences in the pricing of cash-out transactions using the pricing methodologies described, but the total differences were small so Staff is not recommending an adjustment for this

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issue in this ACA. With the adoption of the language in the previous paragraph, Staff will re-examine the materiality of any necessary ACA adjustments as part of its 2013-2014 ACA review.

B. Missouri School Transportation Service

Tariff sheet 63(3b) states the following: “The cash-out rate will be calculated by applying the applicable pipeline’s maximum firm transportation commodity rate and fuel charges to the pipeline’s applicable cash-out rate as published at the end of each month.” ** ______________

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Company Supporting Documentation for ACA filing

Staff notes several areas of concern about the clarity and completeness of the underlying documentation that supports this ACA filing. For hedging documentation, as previously noted, there were several different misapplications of how the hedges were recorded. Staff did not initially receive full documentation related to the various hedges.

In addition, sourcing and support for the underlying accounting spreadsheets for physical and asset management storage was not transparent, and not fully provided, though the Company did supplement the filing with further documentation and explanatory meetings. The Company should continue the comparison and tracking of physical storage balances versus the “billable” storage in the context of its asset management agreements.

Also, as previously mentioned, the Company did not have a process in place for testing consistency with Atmos’ previous application of the cash-out provisions.

Staff recommends that the Company provide supporting ACA documentation in a more complete and detailed fashion in subsequent review periods. In addition, the Company should ensure that the entries related to its hedges are accurate and fully supported.

II. RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

As a regulated gas corporation providing natural gas service to Missouri customers, a Local Distribution Company (LDC) is responsible for: 1) conducting reasonable long-range supply planning, and 2) the decisions resulting from that planning. One purpose of the ACA process is to review the Company’s planning for gas supply, transportation, and storage to meet its customers’ needs. 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 no proposed financial adjustments for the 2012-2013 ACA period related to Reliability Analysis and Gas Supply Planning section.

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Staff's review produced the following comments and recommendations:

Natural Gas Supply- Asset Management Agreements

The Company plans for gas supply include Asset Management Agreements (AMAs), also known as Asset Management Arrangements, for some service areas. Under these AMAs, Liberty contracts with third-party "asset managers" to provide natural gas supplies to the LDC and allows the asset manager to use and manage the LDC transportation assets, including storage.[1] In theory, the AMA allows the "asset manager" to optimize the LDC's natural gas transportation and storage contracts in a way to maximize the underlying value of the gas contract(s), while still maintaining reliability of natural gas deliveries to the LDC through the provisions of the AMA or contract. A key distinction between more traditional gas transportation, storage and supply contracts and an AMA is the concept that reliability of volumes delivered to the LDC's city-gate is governed by the AMA contract. The AMA provisions and related AMA transactions themselves can be quite complex. The complexity can arise from the notion that the LDC is nominating and paying for its supplies by a process that is separate and distinct from the actual physical receipts and deliveries. The following sections describe Staff's concerns about the Liberty AMA transactions.

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[1] FERC Order No. 712, Final Rule issued June 19, 2008 defines an Asset Management Arrangements as "any pre-arranged release that contains a condition that the releasing shipper may, on any day during a minimum period of five months out of each twelve-month period of the release, call upon the replacement shipper to deliver to the releasing shipper a volume of gas up to one-hundred percent of the daily contract demand of the released transportation capacity. If the capacity release is for a period of less than one year, the asset manager's delivery obligation described in the previous sentence must apply for the lesser of five months or the term of the release. If the capacity release is a release of storage capacity, the asset manager's delivery obligation need only be one-hundred percent of the daily contract demand under the release for storage withdrawals," and notes that "The annual five month minimum would apply to AMAs with terms of one year or longer. The delivery obligation for any AMA between five months and a year would be for five months of the release. The delivery obligation would apply to the entire term for any AMA of less than five months."

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4. ** [redacted] **

Lost and Unaccounted for Natural Gas

Nationally, there is growing regulatory concern and attention being paid to the issue of lost and unaccounted (L&U) natural gas[4]. In 2013 the National Regulatory Research Institute (NRRI)

[4] "More study needed on lost and unaccounted for gas: think tank", Washington, Platts April 5, 2013. http://www.platts.com/latest-news/natural-gas/washington/more-study-needed-on-lost-and-unaccounted-for-7689865.

conducted a survey of state utility commissions to determine current regulatory practices regarding L&U gas[5]. This study summarized the regulatory concerns, including higher purchased gas costs for customers and safety. The NRRI grouped the response of surveys results received from 41 state commissions into the following categories:

- Commissions devoting little effort to reviewing L&U allowing cost recovery with minimal oversight;
- Commissions placing caps on allowed cost recovery or applying an explicit incentive mechanism; and
- Commissions that routinely scrutinize levels of L&U gas to determine cost recovery or identify potential safety or other problems. These Commissions tend to act when levels of L&U are abnormal or deviate far from historical averages.

The NRRI study cautioned against comparing L&U percentages across utilities at a given point in time for determining cost recovery and utility prudence, as it could lead to inappropriate action. The study said the best benchmark arguably comes from tracking an individual utility's L&U percentage over time.

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Liberty states at the present time the L&U is analyzed at a state level as it works to hone the process of daily purchased volumes versus sold volumes using cycle billing. Liberty Utilities has not defined a percentage that would trigger an investigation.[9]

Because the Liberty service areas are not interconnected and are served by different pipelines, Staff recommends that at a minimum the Company monitor L&U natural gas (also known as UFG) for each of the four PGA areas, West, Northeast, Kirksville, and Southeast. If modeling or pressure problems exist, additional points should be monitored for L&U natural gas. Staff

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[5] Lost-and-Unaccounted-for Gas: State Utility Commission Practices, Ken Costello, NRRI, November 17, 2013. http://www.narucmeetings.org/Presentations/Presentation-on-LAUF-Gas%20-NARUC-Gas-Subcommittee-November-17-2013-Costello.pdf

[6] ** ______________ **

[7] ** ______________________________________ **

[8] ** ____ **

[9] GR-2014-0060, DR 34.1

recommends Liberty review its processes and procedures to define L&U levels that would trigger an investigation.

III. HEDGING

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IV. RECOMMENDATIONS

The Staff recommends that the Commission issue an order requiring Liberty to:

1. Adjust the ACA account balances in its next ACA filing to reflect the following Staff adjustments and to reflect the (over)/under-recovered ACA balances in the "Staff Balances" column of the following table:

continued on next page

TABLE 1

ALL AREAS **(+) Under-recovery** **(-) Over-recovery**	**Filed Balances for 2012-2013 (Ending 8-31-13)**	**Staff Adjustments**	**Staff Balances for 2012-2013 (Ending 8-31-13)**
SEMO Area: Demand ACA	($176,315)	$1,494 (B)	($174,821)
Commodity ACA	($2,271,787)	($14,238) (B) $131,219 (D) $42,187 (E)	($2,112,619)
Kirksville Area: Demand ACA	$117,571	$16,867 (A)	$134,438
Commodity ACA	($272,612)	($1,020) (A) $18,350 (D) $6,288 (E)	($248,994)
WEMO Area: Demand ACA	($11,205)	$0	($11,205)
Commodity ACA	($67,470)	$18,065 (D) $4,553 (E)	($44,852)
NEMO Area: Demand ACA	($154,448)	$0	($154,448)
Commodity ACA	$97,183	($2,166) (C) $54,492 (D) $15,619 (E)	$165,128

(A) ANR transportation & storage
(B) MRT reservation cost $1,494 & NGPL cash-out credit ($14,238)
(C) PEPL capacity release credit
(D) Hedging – Call Options
(E) Hedging - Swaps

2. Respond to Staff’s recommendations in Section I – Billed Revenue and Actual Gas Costs.

3. Respond to Staff’s recommendations in Section II – Reliability Analysis and Gas Supply Planning.

4. Respond to Staff’s recommendations in Section III – Hedging.

5. Respond to recommendations included herein within 45 days.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of In the Matter of Liberty Energy (Midstates) Corp. d/b/a Liberty Utilities' Purchased Gas Adjustment Tariff Filing.	)))	Case No. GR-2014-0060

AFFIDAVIT OF PHIL S. LOCK

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Phil S. Lock, being of lawful age, on his oath states: that as a Utility Regulatory Auditor III in the Procurement Analysis Unit of the Utility Services Department, in the Regulatory Review Division, he has participated in the preparation of the foregoing memorandum consisting of 18 pages to be presented in the above case; that he has knowledge of the matters set forth in the Memorandum pertaining to *Billed Revenue and Actual Gas Costs*; and that such matters are true and correct to the best of his knowledge and belief,

Phil S. Lock

Phil S. Lock

Subscribed and sworn to before me this 18th day of December, 2014.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of In the Matter of Liberty Energy (Midstates) Corp. d/b/a Liberty Utilities' Purchased Gas Adjustment Tariff Filing.	)))	Case No. GR-2014-0060

AFFIDAVIT OF KWANG Y. CHOE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Kwang Y. Choe, PhD. being of lawful age, on his oath states: that as a Regulatory Economist II in the Procurement Analysis Unit of the Utility Services Department in the Regulatory Review Division, he has participated in the preparation of the foregoing memorandum consisting of 18 pages to be presented in the above case; that he has knowledge of the matters set forth in the Memorandum pertaining to *Hedging*; and that such matters are true and correct to the best of his knowledge and belief.

Kwang Y. Choe

Kwang Y. Choe

Subscribed and sworn to before me this 18th day of December, 2014.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of In the Matter of Liberty Energy (Midstates) Corp. d/b/a Liberty Utilities' Purchased Gas Adjustment Tariff Filing.	)))	Case No. GR-2014-0060

AFFIDAVIT OF LESA JENKINS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Lesa Jenkins, PE, being of lawful age, on her oath states: that as a Utility Regulatory Engineer II in the Procurement Analysis Unit of the Utility Services Department in the Regulatory Review Division, she has participated in the preparation of the foregoing memorandum consisting of 18 pages to be presented in the above case; that she has knowledge of the matters set forth in the Memorandum pertaining to *Reliability Analysis and Gas Supply Planning*; and that such matters are true and correct to the best of her knowledge and belief.

Lesa A. Jenkins
Lesa Jenkins

Subscribed and sworn to before me this 18th day of December, 2014.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public