MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2003-0323, Fidelity Natural Gas, Inc.

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/s/ David Sommerer 02/25/04	/s/ Thomas R. Schwarz, Jr. 02/25/04
David M. Sommerer, Utility Services Division/Date	Thomas R. Schwarz, Jr. General Counsel's Office/Date

SUBJECT: Staff Recommendation for Fidelity Natural Gas, Inc.'s 2002-2003 Actual Cost Adjustment Filing

DATE: February 25, 2004

The Procurement Analysis Department (Staff) has reviewed Fidelity Natural Gas, Inc.'s (FNG or Company) 2002-2003 Actual Cost Adjustment (ACA) filing. This filing was made on October 15, 2003, for rates to become effective November 1, 2003, and was docketed as Case No. GR-2003-0323. During the ACA period, FNG provided natural gas to approximately 1,260 sales customers in the counties of Franklin and Crawford, which include the City of Sullivan, Oak Grove Village and the unincorporated areas of Crawford County.

Staff's review consisted of an audit and evaluation of the billed revenues and actual gas costs for the period of September 1, 2002, to August 31, 2003, included in the Company's computation of the ACA rate. A comparison of billed revenue recovery with actual gas costs will result in an over-recovery or under-recovery. The ACA ending balance in the Company's 2002-2003 ACA filing is $127,995 under-recovery.

In addition, Staff conducted a reliability analysis for FNG including a review of information required to be submitted in response to the reliability recommendations in the 2001-2002 Staff ACA recommendation, Case No. GR-2003-0148, estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, a comparison of actual demand to estimated demand and natural gas supply plans.

Staff also conducted a hedging review to determine the reasonableness of the Company's hedging plans for this ACA period.

COMPANY'S ADJUSTMENTS TO ACA BALANCE

On October 15, 2003, the Company reported that the ending ACA balance at August 31, 2003, was an under-recovery of $127,994.69, per the ACA Worksheet that accompanied the Purchased Gas Adjustment (PGA) / ACA filing. On December 12, 2003, in response to the Staff's Data Request (DR) No. 0001, the Company provided a revised ACA Worksheet that showed the ending ACA under-recovery to be $128,242.75. The difference is $248.06.

The Company explained the difference in their hard copy response to DR No. 0001, "Please note the following changes to the ACA: Total PGA Billed for August 2003 on the ACA Worksheet has been corrected to reflect the actual PGA Billed; The Cost of Gas-Commodity for April 2003 was revised to reflect the actual billed amount; The DCCB worksheet has been revised to reflect the actual cost of gas. Due to these corrections the ACA under recovery has changed… to $128,242.75."

The Company's changes to the reported ACA balance included:

PGA Billed: Increase	$ (64.34)
Cost of Gas – Commodity: Decrease	$ (.01)
*DCCB: Increase	$ 312.41
Net change in 8/31/03 reported ACA balance	$ 248.06

*DCCB is the Deferred Carrying Cost Balance

The Staff's testing has confirmed the correctness of the Company's December 12, 2003, revisions to the August 31, 2003, ACA balance. Therefore, Staff concurs with the Company's adjustments to increase PGA/ACA Revenues by $64 and increase the DCCB interest by $312.

HEDGING

The Company delivered a total of 176,349 million British thermal units (MMBtu's) of gas to its customers during the winter months of November 2002 – March 2003. The Company procured the delivered gas through a contract with its affiliate, Fidelity Energy.

The gas procurement methods for the ACA period included purchasing full requirements at the lower price of a price cap or Fidelity Energy's actual cost (combined average monthly cost from all sources, including futures contracts, index pricing and any other hedging instruments). The price cap covered each winter month, and it appeared to reflect the company's "corporate guarantee" of the price, though it is not clear as to what hedging instrument(s) the price cap was based on.

For the months of November 2002 – January 2003, the delivered gas was purchased at index, since this price was lower than the ** ________ **, at an average weighted cost of $4.25 per MMBtu. The February and March gas was purchased at the ** ________________ ** per MMBtu.

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The Company needs to continue to evaluate the price movements as the gas market continues to develop. Also, the methods of diversifying the gas portfolio need to be examined further by the Company. For example, it is necessary to examine whether the fixed price mechanism should all be based on the futures contracts or in combination with other tools such as fixed forward contracts.

RELIABILITY STUDY

To assure that sufficient capacity, but not excess capacity, is available to meet firm customer peak day capacity and natural gas supply requirements, Staff conducts a reliability analysis. The objective is to assure that a company has adequate capacity to provide natural gas to its firm customers on even the coldest days, without maintaining excess capacity that would cost consumers money without any related benefit. Staff has the following comments and concerns regarding the Company's reliability analysis and reserve margins for the 2002-2003 ACA period.

1. Customer Growth

   The Company reviewed monthly customer counts for January 1997 through August 2003 for the customer classes of Residential, Business, Large Volume and Commercial Flex. The actual customer counts for part of 2002 and all of 2003 would not have been known when the Company was planning for the 2002-2003 ACA period.

   The Company states that it estimates residential growth of 1%. However, a review of the Company workpapers shows that the Company uses actual residential customer counts for 2002; actual residential customer counts for January through August 2003; then uses a 1.5% growth for September through December 2003; the growth rate for January through August 2004 varies from 1.3% to 4.8%; and then the Company uses a 1% growth rate for September 2004 through December 2006. Thus, there is an inconsistency of the Company's application of its stated growth rate.

   Staff recommends that the Company check its calculation for residential customer numbers in the planning for natural gas requirements. Also, when estimating usage for an ACA period, the Company should plan in advance of that ACA, and thus the usage estimates would consider customer numbers known prior to the ACA, not actual customer counts from after the ACA period has begun.

2. Regression Analysis for Customer Usage

   As in the 2001-2002 ACA, the Company is using regression analysis to estimate customer usage. The Company's regression analysis considers actual daily usage per customer (total for all customer classes) and actual heating degree days (HDD) for the period of January 1, 2000, to March 31, 2003. The usage and HDD data for part of 2002 and all of 2003 would not have been known when the Company was planning for the 2002-2003 ACA period. A review of data for this timeframe would be more appropriate when planning for the 2003-2004 ACA and forward.

Staff evaluated information that the Company would have known prior to the 2002-2003 ACA period. Staff's regression analysis considers Company data for actual daily usage per customer (total for all customer classes) and the Company's stated actual HDD for the period of January 1, 2000, to March 31, 2002. Staff findings show a slightly higher base load and a slightly lower heat load. The difference in the peak day estimate is minimal.

It is recommended that the Company continue to update usage estimates routinely, adding newer usage data and deleting older usage data.

3. Reserve Margin

As in the 2001-2002 ACA review, Staff is concerned about the negative reserve margin for capacity on both of these pipelines for 2002-2003 (negative reserve margins of 8.9% for Missouri Pipeline Company (MPC) and 13.9% for ** ______ **-transported on Panhandle). ** ____ ____ ____________________________ **, which is not sufficient should a historic peak cold day of 74 HDD recur. However, the Company has provided information showing that it has increased capacity beginning with the 2003-2004 ACA period, which addresses Staff's concerns about the reserve margin.

4. Coldest Month Analysis

The Company provided estimates of usage for normal weather and coldest month weather. The Company reviews HDD for 1948 to 2003 to obtain normal HDD. The 2003 HDD data and some of the 2002 HDD data would not have been known when the Company was making plans for this ACA period.

The Company estimates coldest month HDD for each of the winter months as 135% of normal HDD; support for this methodology is not provided. Staff reviewed HDD for a 30-year period of 1971 to 2000, and this revealed that the coldest month HDD was 139% to 149% of normal month HDD. For the months of December and January, the months with the greatest number of HDD, the coldest December HDD was 145% of normal and the coldest January HDD was 142% of normal. Staff has concerns about the Company's methodology for estimating coldest month HDD and the impact on the usage estimates. Using actual coldest month HDD information, Staff obtains estimates for coldest month usage that are 4.3% to 5.0% higher than the Company's estimates for the coldest months of December and January.

Staff recommends that the Company more closely evaluate its requirements for coldest month usage.

SUMMARY

The Staff has addressed the following concerns regarding Case No. GR-2003-0323 for Fidelity Natural Gas, Inc. and proposes the following:

1. Staff concurs with the Company's adjustments to increase PGA/ACA Revenues by $64 and increase the DCCB interest by $312.
2. Staff is proposing no dollar adjustments related to reliability, but Staff has concerns regarding the Company's reliability analysis and recommends that additional documentation regarding the reliability information be submitted by November 1, 2005.
3. Staff is proposing no dollar adjustments related to hedging, but Staff recommends that the Company needs to continue to evaluate the price movements as the gas market continues to develop, and the methods of diversifying the gas portfolio need to be examined further by the Company.

RECOMMENDATIONS

The Staff recommends that the Commission issue an order requiring Fidelity Natural Gas to:

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

Description	Balance Due From (To) Customers Per 10/15/03 Filing	Company Adjustments in Support for Filing 12/12/03	Balance Per Company's Support for Filing 12/12/03	Staff Adjustments	Balance Due From Or (To) Customers per Staff
ACA Balance 8/31/02	$(61,662)		$(61,662)	$ 0	$(61,662)
Cost of Gas - Commodity	$1,113,968		$1,113,968	$ 0	$1,113,968
Cost of Gas – Transport	$440,213		$440,213	$ 0	$440,213
PGA Billed	$(1,366,753)	$(64)	$(1,366,817)	$ 0	$(1,366,817)
DCCB Interest	$2,229	$ 312	$2,541	$ 0	$2,541
ACA Balance 8/31/03	$127,995	$ 248	$128,243	$ 0	$128,243

2. Take the following actions related to the Company's reliability analysis by November 1, 2005:

   a. Review, revise, and submit to Staff the Company's peak day and annual demand study to address the concerns expressed by Staff in the Reliability Analysis Summary section. Show the estimated demand for the 2004-2005 ACA period and for three years beyond that.

   b. Submit to Staff the reserve margin estimate for the 2004-2005 ACA period and for three years beyond that. Explain the rationale for the reserve margin for each of these years. For any negative reserve margin shown, provide the following:

      i. an explanation of the firm capacity that will be used to meet demand requirements beyond the firm contract maximum daily quantities;

      ii. details about the actions the Company will take for firm residential, commercial, large volume, and commercial flex customers whose demand will not be met should a peak day recur; and

      iii. an updated economic analysis comparing the cost of additional firm capacity on both pipelines (Missouri Pipeline Company and Panhandle Eastern Pipe Line) to the cost of the penalties for exceeding the contract maximum daily quantities by the amount of the negative reserve quantity.

3. File a written response to the above recommendations by April 1, 2004.