MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2008-0136, Missouri Gas Utility, Inc.

FROM: David M. Sommerer, Manager – Procurement Analysis Department
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/s/ David M. Sommerer 07/14/08	/s/ Lera L. Shemwell 07/14/08
Project Coordinator, Date	General Counsel's Office, Date

SUBJECT: Staff's Recommendation for the 2006-2007 Actual Cost Adjustment Filing of Missouri Gas Utility, Inc.

DATE: July 14, 2008

The Procurement Analysis Department, with assistance from the Auditing Department (Staff), has reviewed Missouri Gas Utility, Inc.'s (MGU or Company) 2006-2007 Actual Cost Adjustment (ACA) filing. This filing was made on November 9, 2007, for rates to become effective November 20, 2007, and was docketed as Case No. GR-2008-0136.

Missouri Gas Utility, Inc. (MGU), a Colorado Corporation, is a subsidiary of Summit Utilities, Inc. Summit Utilities' principal office is located in Littleton, Colorado. MGU was formed in November 2004 to provide natural gas service to both residential and commercial customers in the Missouri communities of Coffey, Jameson, Gallatin and Hamilton in the counties of Harrison, Daviess and Caldwell. On December 14, 2004, the Commission issued MGU a certificate of convenience and necessity (CCN) for the provision of natural gas service to these communities. The CCN was granted in the Commission's December 8, 2004 Order adopting Staff's Non-unanimous Stipulation and Agreement. On July 6, 2007 and November 6, 2007, the Commission issued Orders granting a CCN for MGU to expand its service area in the counties of Davies and Harrison. ANR Pipeline Company serves MGU which, during the 2006/2007 ACA period, provided natural gas to 913 gas sales customers and one transportation customer in the northern-central portion of the state.

Staff's review consisted of an analysis and evaluation of the billed revenues and actual gas costs for the period of September 1, 2006, through August 31, 2007, included in the Company's computation of the ACA rate. A comparison of billed revenue recovery with actual gas costs yields either an over-recovery or under-recovery of the ACA balance. In addition to this comparison, Staff conducted a hedging review to determine the reasonableness of the Company's hedging practices for this ACA period. Staff also conducted a reliability analysis including a review of estimated peak day requirements and the capacity levels needed to meet these requirements. Finally, Staff reviewed MGU's gas purchasing practices to determine the prudence of the Company's purchasing decisions.

BEGINNING ACA BALANCE AUGUST 31, 2006

MGU's ACA filing contained an incorrect beginning ACA balance. The beginning ACA balance should have been the ($78,153) over-recovery established by the Commission Order in Case No. GR-2008-0060. Therefore, the Staff proposes an adjustment of $12,803, which will increase MGU's beginning ACA balance to the correct amount established by the Commission in Case No. GR-2008-0060.

GAS COST AND BILLED REVENUE ERRORS

During its evaluation, Staff discovered several formula errors in the Company's ACA workpapers for the current ACA review. The overall impact of these formula errors resulted in a Staff adjustment of $899 to increase the Total Cost of MGU Gas Delivered to the City Gate. Because of an additional Company error, $77 related to the Cost Recovery from Premium Standard Farms Sales for the month of August 2007 was omitted.

INTEREST ON STORAGE BALANCE

The Company's ACA computation included an allowance for interest paid to Cache Bank to fund the purchase of gas delivered to the City Gate. Staff found no provision in the Company's tariff to allow gas costs to include interest on the storage balance. Therefore, Staff proposes an adjustment of $17,185 to exclude this interest from the ACA gas costs.

RECORD RETENTION AND DOCUMENTATION

The Company did not provide complete documentation in support of its responses to data requests. Although the majority of documentation and workpapers could be provided to Staff via electronic mail, phone conversation, and additional data requests, Staff expects that for the 2007/2008 ACA period and beyond, invoices for transportation, storage, and natural gas supply purchases be submitted in their entirety, to include the actual costs the Company incurred and daily volumes flowed. For natural gas purchases, the transaction confirmations sheets from either the Supplier or Company detailing the terms of gas deliverability for the agreement. (i.e. pricing, volumes, dates, etc.) need to be provided.

TRANSPORTATION SERVICE TARIFFS

MGU's tariff sets out how transportation customers' imbalances are to be eliminated on its system. An imbalance is the difference between the amount of gas a transportation customer delivers versus the gas it uses. The term for eliminating imbalances is a "cash-out." The cash-out mechanism allows transporters to eliminate imbalances by either making or receiving cash payments.

Staff is concerned MGU's current transportation tariff could possibly allow a transport customer to impact the Company financially or operationally through the mismanagement of imbalances. Therefore, Staff recommends MGU file an update to its transportation service tariff. Staff recommends the updated tariff include cash-out provisions for imbalances and a standardized Transportation Service Agreement for transport customers.

HEDGING

MGU's winter hedging plan, which starts in April, calls for it to set target prices and amounts of gas to be purchased for each month from May through September. MGU purchases and injects gas into storage according to this plan. The Company's plan is to fill storage by October 1. Thus, storage injection is the Company's only plan for hedging. For this winter ACA period (November 2006 – March 2007), MGU started purchasing gas in April and continued in May, and June 2006, which resulted in filling 92% of maximum storage quantity by October 1, 2006. This also represents 68% of normal weather requirements. By comparison, storage, when filled to maximum, covers 74% of normal weather requirements. Deliveries to MGU's city-gate were 9,104 MMBtu in November 2006, and 13,136 MMBtu in December 2006, and 19,778 MMBtu in January 2007, and 19,072 MMBtu in February 2007, and 7,751 MMBtu in March 2007. The November, December, and January deliveries were made completely from storage withdrawals while February and March deliveries were made primarily from flowing gas purchased for each delivery month.

Although MGU's overall hedging practice for this winter ACA period utilizing storage was adequate, Staff has the following comments:

1. MGU's hedging plan for this winter's ACA contains contradictory information. The objective in Missouri Gas Utility, Inc. Heating Season Hedging Plan says, "Missouri Gas Utility, Inc. hedges its winter gas supply by purchasing natural gas during the off-peak months of April – October and storing this gas in the storage associated with the Seasonal Transportation Service (STS) Contract between MGU and ANR Pipeline. This storage has a maximum capacity of 55,000 Dth." However, in the same plan document, MGU also states "Each year, on or about April 5, the MGU gas purchasing committee, made up of 4 company officers and 2 outside consultants, sets a target purchase price and quantity of gas to be purchased for each month from May through September, in order to fill storage by October 1." Thus, it is not entirely clear whether MGU plans to hedge winter supply through filling storage by November 1 or October 1.

2. Although MGU utilized storage withdrawals for the deliveries in November and December of 2006, and January of 2007, it depended primarily on flowing gas for the deliveries in February and March 2007. Its storage inventory was only 5% full at the end of January, thus, MGU subjected its customers to potential late winter price spikes during the last two months of the winter heating season, though such extremes did not occur.

For example, MGU could have purchased gas during January 2007 when the prices became relatively moderate compared to the previous months, thus providing more storage gas in order to avoid potential late winter price spikes. Certainly Staff acknowledges that there is no guarantee for the price drops during the winter months and MGU should not rely on this practice. However, MGU's storage level was quite low at the beginning of February 2007 due to its complete reliance on storage withdrawals for the deliveries in November and December of 2006, and January of 2007.

3. The Company needs to evaluate the amount of <u>each month's requirements</u> that are protected under normal, warmer than normal, and colder than normal weather scenarios. MGU must maintain reasonable price protection for each winter month. The Company should not be overly reliant on a "price view" that may prove wrong and ultimately expose the customers to catastrophic price increases.

Therefore, Staff recommends, for the 2008/2009 ACA period and beyond, that the Company:

(a) establish and maintain a current and consistent hedging policy based on month-specific normal weather requirements (with impacts of warmer and colder than normal scenarios);

(b) continue to start placing hedges early enough to hedge, for example, against potential hurricane-related price spikes during summer months;

(c) appropriately balance between storage withdrawals and flowing gas supply for the deliveries during the winter months;

(d) carefully evaluate hedging instruments;

(e) document the reasoning for executing any hedging transactions or decisions, whether by means of storage, fixed price contracting or other financial hedging instruments and the rationale for not executing any hedging transactions and decisions as planned;

(f) make the hedging documents available to the Staff for its reviews of subsequent ACA periods; and

(g) provide the hedging plan for 2008-2009 no later than August 30, 2008.

Finally, the company needs to consider multi-year hedging, especially as it supplements its use of storage with other hedging practices. Given the risks of high natural gas prices due to hot summers, hurricane activity or other events, a hedging approach that relies too heavily on the May through September time period, just prior to the winter being hedged, may not offer an adequate opportunity to diversify the pricing of the hedges. In addition, since the company's hedging plan is so reliant on the timing of storage injections, the company should carefully consider the risks of low storage fills.

RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

As a local distribution company providing an essential service to captive customers, the Company is responsible for conducting reasonable long range supply planning and making reasonable decisions based on 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 reviewed 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.

Transportation volumes

For this ACA review, transportation volumes were estimated on a daily basis. Even though monthly volumes were matched up on a monthly basis, this still allows for transportation customers to "balance" on MGU's storage on a daily basis. Another concern is that daily gas telemetry was not available for determination of the volumes of the transportation customers for this ACA period. In prior ACA Reviews, via phone conversation on February 11, 2006, Staff had conversations with MGU about daily metering. In that conversation, MGU stated to Staff, beginning in May of 2006, telemetry was being installed on all Premium Standard Farms (PSF) meters that will record daily data. Thus, daily imbalances will be known. In Staff's conversation with the Company on Friday, February 15, 2008, MGU stated that telemetry metering was not actually installed until the first week of December 2007. Thus daily metering will not be realized until the Company is doing its planning for the 2008/2009 ACA. The first few days of metering will still be estimated for PSF for the regression analysis for the 2008/2009 period.

Reserve Margins

MGU states its reserve margin for the 2006/2007 was 1.5%. This is based on a peak day estimate of 1,084 MMBtu/day and capacity of storage withdrawal at 1,100 MMBtu/day. However, the STS contract allows for maximum daily quantity (MDQ) at 2,000 MMBtu/day. Therefore, Staff has calculated the reserve margin as shown in the following table:

Reserve Margin 2006/2007 ACA	
Capacity	2,000
Peak Day Estimate (MMBtu)	1,084
Reserve	916
Reserve Margin %	84.5%

MGU's reserve margin calculation needs to be based on transportation capability (flowing gas and storage withdrawal rights), namely the maximum daily quantity (MDQ) allowed by the contract(s). The 84.5% reserve margin seems high, however, due to the STS Rate structure for this capacity, customers are only charged for the capacity that is used. Thus, the high reserve margin is not an issue in this review.

MGU did not provide reserve margins beyond this ACA period. With the growth this system is encountering, Staff recommends MGU provide estimated reserve margins for the next 3-5 ACA periods, beginning with its reporting for the 2007/2008 ACA period.

Storage

The storage plan (provided in the PGA filing) details injections during the months of November and December, yet the Company states that all planned purchases are to occur during the off season months (DR69, hedging plan), so the storage plan and the hedging plans are contradictory. MGU purchased no natural gas supplies for September of 2006 through January of 2007. The Company relied entirely on withdrawals of natural gas from storage. Staff has concern because:

1. MGU's storage plans and hedging plans are contradictory.

2. Storage balances were allowed to go into a negative balance before additional gas was procured during the month of February of 2007. Storage, if filled to 100% of maximum storage quantity, could provide up to 74% of a normal winter season. If weather is normal or colder than normal, then additional flowing natural gas supply will have to be procured for delivery during the winter. Waiting until storage balances are extremely low or negative before acting upon this decision to buy additional natural gas can expose ratepayers to the volatility of the natural gas supply market.

Staff recommends that MGU evaluate its various storage plans for consistency and monitor storage balances more closely when making decisions on when to purchase additional flowing supply.

Planning for Colder/Warmer Weather and Extreme Weather

MGU provides warmer and colder weather volumes via DR65, however, fails to show how supply or storage is going to fulfill those requirements. Staff recommends MGU's planning be expanded to explain how it will meet the extreme weather requirements.

RECOMMENDATIONS

The Staff recommends the Commission issue an order requiring MGU to:

1. Establish the following ACA account balance in its next ACA filing to reflect the August 31, 2007 (over)/under-recovered ACA balance shown in the "Staff Recommended" column of the table on the following page. An over-recovery reflects an amount owed to the customer by the Company, while an under-recovery is an amount owed to the Company by the customers.

	Company's ACA Balance per Response to Staff DR49	Staff Adjustments	Staff Recommended ACA Balance
Beginning ACA Balance @ 9/1/2006 – (Over-recovered)/Under-recovered	$ (65,350)	$ (12,803)	$ (78,153)
Total Cost MGU Gas Delivered to City Gate	$ 647,328	$ 899	$ 648,227
Total Cost Recovery	$ (644,482)	$ (77)	$ (644,559)
Interest Paid to Cache Bank to Fund Gas Purchases (i.e., interest on storage balance)	$ -	$ (17,185)	$ (17,185)
Ending ACA Balance @ 8/31/2007- (Over-recovered)/Under-recovered	$ (62,504)	$ (29,166)	$ (91,670)

2. Respond to those items beneath the Reliability Analysis and Gas Supply Planning Section and respond within 30 days with any additional actions being taken by MGU to address Staff's recommendations related to reserve margin projections for 3 to 5 years, evaluation of its various storage plans for consistency, monitoring storage balances more closely when making decisions on when to purchase additional flowing supply, and expanding its planning to explain how it will provide natural gas for extreme weather requirements.

3. Respond to Staff's comments 1 – 4 and recommendations (a) – (g) in the Hedging Section.

4. Respond to Staff's proposed adjustments and recommendations within the Record Retention and Documentation and Transportation Service Tariffs sections.

5. Respond to the recommendations herein within 30 days.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

PGA Tariff and Supporting documentation. In the Matter of Missouri Gas Utility, Inc.'s Purchased Gas Adjustment (PGA) Factors to be Audited in its 2006-2007 Actual Cost Adjustment	))))	Case No. GR-2008-0136

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 Department of the Utility Services Division, he has participated in the preparation of the foregoing report, consisting of 7 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,

Anne M. Allee:	Billed Revenues and Actual Gas Costs
Kwang Y. Choe:	Hedging
Derick Miles:	Reliability Analysis and Gas Supply Planning
Lesa A. Jenkins:	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

David M. Sommerer

Subscribed and sworn to before me this 14th day of July 2008.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn

Notary Public