MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2009-0161, Missouri Gas Utility, Inc.

FROM: David M. Sommerer, Manager – Procurement Analysis Department
Anne Allee, Regulatory Auditor – Procurement Analysis Department
Kwang Choe, Ph.D., Regulatory Economist – Procurement Analysis Department
Derick Miles, Utility Engineering Specialist – Procurement Analysis Department
Lesa A. Jenkins, P.E., Regulatory Engineer – Procurement Analysis Department

/s/ David M. Sommerer 05/01/09	/s/ Lera L. Shemwell 05/01/09
Project Coordinator, Date	General Counsel's Office, Date

SUBJECT: Staff's Recommendation for the 2007-2008 Actual Cost Adjustment Filing of Missouri Gas Utility, Inc.

DATE: May 1, 2009

The Procurement Analysis Department has reviewed Missouri Gas Utility, Inc.'s (MGU or Company) 2007/2008 Actual Cost Adjustment (ACA) filing. This filing was made on October 29, 2008, for rates to become effective November 12, 2008, and was docketed as Case No. GR-2009-0161.

Missouri Gas Utility, Inc., a Colorado Corporation, is a subsidiary of Summit Utilities, Inc. Summit Utilities' principal office is located in Littleton, Colorado. MGU provides natural gas service to both residential and commercial customers in the Missouri communities of Coffey, Jameson, Gallatin, Hamilton, Jamesport, Ridgeway, and Pattonsburg in the counties of Harrison, Daviess, and Caldwell. ANR Pipeline Company serves MGU which, during the 2007/2008 ACA period, provided natural gas to 945 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, 2007, through August 31, 2008, 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.

During this ACA, MGU utilized KTM Energy Consulting Services, Inc. (KTM, Inc. or KTM) of Boulder, Colorado for management of its gas supply. This agreement included management of storage, transportation, and the purchasing activities (including hedging) of natural gas. Most data request responses for this ACA period were responded by KTM.

HEDGING

MGU's winter hedging plan calls for, in April, setting 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. Furthermore, the hedging plan is to fill storage by October 1st. Thus, storage injection is the company's primary means of hedging, providing up to 68% of the requirements for a normal winter. For this winter ACA period (November 2007 – March 2008), MGU started purchasing gas in April and continued through June 23, 2007, which resulted in filling storage to 96% of capacity. In addition, MGU purchased fixed price volumes toward the end of June 2007 for December 2007, January 2008 and February 2008. These volumes, combined with the storage, represent 98% of normal winter weather requirements. Deliveries to MGU's city-gate were 10,568 MMBtu in November 2007, and 20,932 MMBtu in December 2007, and 25,516 MMBtu in January 2008, and 23,066 MMBtu in February 2008, and 15,232 MMBtu in March 2008. The November city-gate deliveries were storage withdrawals while the December, January, and February deliveries were storage withdrawals and fixed price purchases. However, the March delivery was solely flowing gas purchased for the delivery month.

Although MGU's overall hedging practice for this winter ACA period utilizing storage and fixed price purchases was adequate, Staff has the following comments about the company's hedging practice for this winter ACA period:

1. Although MGU utilized storage withdrawals for the deliveries in November, December 2007, January, and February 2008 it depended solely on flowing gas for the delivery in March 2008. Thus, MGU was subjected to late winter price spikes during the last month of the winter heating season. The Staff believes it is important to evaluate the amount of each month's requirements that are reasonably protected under warmer than normal, normal, and colder than normal weather scenarios. For example, if storage is not sufficient to maintain reasonable price protection for each winter month, fixed priced gas supply contracts should be considered for the months that are not reasonably protected by storage withdrawal. The Company should not be overly reliant on a "price view" that may prove wrong and ultimately expose the customers to catastrophic price increases.

2. MGU's hedging practice essentially calls for purchasing gas whenever it is less expensive than storage WACOG. However, this approach can lead to a situation where MGU indefinitely waits for the price to be viewed less expensive. For example, MGU could have purchased gas during January and early February 2008, thus providing more storage gas in order to avoid potential late winter price spikes. MGU's storage level was quite low at the beginning of February 2008 due to its substantial usage of storage withdrawals for the deliveries in November, December 2007, and January 2008.

3. MGU utilized a basis differential to fix only the discount off of the NYMEX futures prices for the winter months December 2007, January and February 2008. Although MGU fixed the natural gas price by triggering the discount soon after, thus early enough before the winter season started, the Company should use caution when only utilizing the basis differential without locking in the entire price. Since it is possible that the Company

may indefinitely delay triggering the discount until the NYMEX futures prices become more favorable, the price is partially exposed to upward price movement. There is no guarantee that the NYMEX futures prices always move in the Company's favor.

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) maintain planned storage withdrawals and flowing gas supply for the deliveries during the winter months,
(d) carefully evaluate the option of diversifying its gas supply portfolio (i.e., evaluate the interplay between storage capacity / purchase fixed price contracts),
(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
(f) make the hedging documents available to the Staff for its reviews of subsequent ACA periods.

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 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.

Staff has the following comments and concerns regarding the reliability analysis:

Storage Balances and Monthly Load Estimations

MGU does not have a storage plan that integrates how it could serve normal, colder, and warmer monthly loads. Although the Company provided a seasonal load estimate in its regression analysis, MGU did not consider how storage withdrawals would be integrated into its plans to serve its system on a monthly basis. Staff recommends MGU expand its planning for future ACA periods to include normal, warmer, and cooler monthly and seasonal usage and estimated monthly storage withdrawals.

Storage Reliability

MGU let its storage level get remarkably low for this ACA period. At the end of February 2008, the storage was 964 dekatherms (dth) or 1.8% full. There were numerous reasons for this low level. One reason was weather. Weather for November 2007 through February 2008 was 13% colder (4,354 heating degree days (HDD) versus a normal HDD of 3,870). Another reason was the imbalance of gas sales to MGU's sole Transportation customer. From December to January, MGU sold 7,948 dth of gas because this customer under-nominated its gas usage. Absent these gas sales, MGU's storage balance at the end of February would have been a more reasonable 16.2%. Lastly, one other factor is MGU's philosophy of buying gas only when the price is below the storage weighted average cost of gas (WACOG) price. Storage WACOG stayed constant from September through the end of month February at approximately $7.60/MMBtu. The WACOG remained constant because there was only one month, October 2007, during which MGU injected gas. When injection fuel and transportation fees were considered, this monthly purchase did not change the storage WACOG. Staff recommends that the Company establish a storage plan that considers normal, colder, and warmer weather.

Meter Error and Transportation Imbalances

During the 2007/2008 ACA, MGU Accounting Staff noted a discrepancy in the gas sold and the gas brought onto the [LDC] system. This discrepancy was a result of the transportation customers' meter being retrofitted with telemetry in December of 2007. The meter was corrected in July 2008 and the customer was re-billed for the correct delivered volumes of gas for December 2007 through June of 2008. MGU reports it has implemented procedures to prevent and detect meter errors in the future. The meter error was one reason the transport customer had significant monthly gas supply imbalances (as much as 44% in February). For the majority of this ACA period, MGU's tariff did not require Transportation customers to stay within a required percentage of its gas supply nomination. Since transportation customers' nominated quantities of gas may affect system reliability, MGU updated its tariff to incorporate a penalty to transportation customers if their imbalance is negative by more than 15%, effective April 15, 2008.

ACA BALANCE

The ACA factor is changed once a year at the same time the Company makes its required Winter PGA filing. In addition to its Winter PGA filing, MGU is permitted to make up to three (3) additional PGA filings each year. MGU's beginning 2007/2008 ACA balance was $83,170 over-recovery. MGU's ending balance was a $145,923 under-recovery which resulted in an ACA rate of $.0789 per hundred cubic feet (Ccf). In this period, MGU's ACA factor was approaching an upper range of reasonableness. Therefore, the Staff recommends the Company monitor its ACA balance throughout the year and make adjustments to its PGA rate to prevent its ACA balance from reaching an unreasonable level.

Tariff Modification – Billing Adjustment

During its review, the Staff identified an area it recommends MGU clarify in its tariff. Generally, the Rules and Regulations portion of an LDC's tariff sets out the procedures to be applied in the event of a billing error to residential and non-residential customers. The rules for a residential customer billing error can also be found in 4 CSR 240-13.025 Billing Adjustments. However, MGU's tariff does not address the specific procedures it applies to billing errors. Therefore, the Staff recommends MGU incorporate within its tariff the specific procedures to be used when billing errors occur.

There are no Staff - recommended financial adjustments for this ACA period.

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, 2008 (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	**Staff Adjustments**	**Staff Recommended ACA Balance**
Beginning ACA Balance @ 9/1/2007 – (Over-recovered)/Under-recovered	$ (83,170)	$ 0	$ (83,170)
Total Cost MGU Gas Delivered to City Gate	$ 1,296,472	$ 0	$ 1,296,472
Total Cost Recovery	$ (1,067,379)	$ 0	$ (1,067,379)
Ending ACA Balance @ 8/31/2008- (Over-recovered)/Under-recovered	$ 145,923	$ 0	$ 145,923

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 monthly planning for normal, warmer, and colder weather and establishment of a storage injection and withdrawal plan that considers normal, warmer, and colder weather.

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

4. Respond to the recommendations herein within 30 days.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Utility, Inc.'s Purchased Gas Adjustment (PGA) Factors to be audited in its 2007-2008 Actual Cost Adjustment.	))))	Case No. GR-2009-0161

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 5 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 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

Subscribed and sworn to before me this 1st day of May, 2009.

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