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JUN 01 2002

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy's Purchased Gas Adjustment tariff Revisions to be reviewed in its 2000 - 2001 Actual Cost Adjustment.	))))	Case No. GR-2001-382

STAFF RECOMMENDATION

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission") and respectfully states as follows:

1. On April 15, 2002 the Commission issued its Order Suspending Procedural Schedule and Directing Filing. In this Order, the Commission ordered Staff to file its Memorandum and Recommendation on or before May 31, 2002.

2. Missouri Gas Energy (MGE) provides natural gas service to some 508,000 customers in the Kansas City, Joplin and St. Joseph area.

3. Staff completed an analysis of billed revenues and actual gas costs for the period July 1, 2000 to June 30, 2001. Staff also reviewed MGE's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions. Staff also conducted a reliability analysis for MGE.

4. In the attached Memorandum (Appendix A), Staff recommends that the ACA case remain open pending an Order from the Commission in Case No. GR-98-167, Case No. GR-99-304, and Case No. GR-2000-425. Staff recommends that the Commission issue an order

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establishing the account balances as recommended by Staff. Staff further recommends that the Commission order MGE to provide the information in paragraph 3 of the Recommendation section of Appendix A by October 1, 2002. Staff also recommends that the Commission order MGE to respond to Staff Recommendations by July 12, 2002.

WHEREFORE, Staff recommends that the Commission issue its order in this case consistent with Staff's recommendations.

Respectfully submitted,

DANA K. JOYCE
General Counsel

/s/ Robert V. Franson

Robert V. Franson
Associate General Counsel
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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record this 31st day of May, 2002.

/s/ **Robert V. Franson**

Robert V. Franson

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MEMORANDUM

TO: Missouri Public Service Commission Official Case File, Case No. GR-2001-382, Missouri Gas Energy, a Division of Southern Union Company

FROM: Dave Sommerer, Manager- Procurement Analysis Department D.S.
Anne Allee, Regulatory Auditor -Procurement Analysis Department ama
Lesa Jenkins, P.E., Regulatory Engineer, Procurement Analysis Dept LAJ

Dave Sommerer 5/31/02 — Robert Franson 5/31/02

Dave Sommerer, Project Coordinator/Date — Robert Franson, General Counsel's Office/Date

SUBJECT: Staff's Recommendation in Missouri Gas Energy's 2000-2001 Actual Cost Adjustment Filing

DATE: May 31, 2002

The Staff has reviewed the Missouri Gas Energy (MGE or Company) 2000-2001 Actual Cost Adjustment (ACA) filing. The filing was made on October 18, 2001 and is docketed as Case No. GR-2001-382. The filing contains the Company's calculations of the ACA, Refund, Transition Costs, and Take-or-Pay account balances.

MGE serves approximately 508,000 customers in the Kansas City, Joplin and St. Joseph area. MGE transports its gas supply over Panhandle Eastern Pipe Line (PEPL), Williams Gas Pipeline (Williams), Mid-Kansas Partnership/Riverside Pipeline Company (MKP/RPC), and KN Interstate Pipeline (KNIP).

The Staff's review consisted of an analysis of the billed revenues and actual gas costs, for the period of July 1, 2000 to June 30, 2001. A comparison of billed revenue recovery with actual gas costs will yield either an over-recovery or under-recovery of the ACA, Refund, Take-or-Pay (TOP), and Transition Cost balances. The Staff also reviewed MGE's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions.

In addition, Staff conducted a reliability analysis for MGE including a review of estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, comparison of actual demand to estimated demand, and annual estimated demand.

REFUNDS

In the 1999/2000 ACA period, the Staff discovered a $339,470.56 error in the Residential and General Service Refund account balance. To correct this error, the Staff adjusted MGE's Residential and General Service Refund ending account balance by $339,470.56. The Company agrees with the Staff's adjustment and has subsequently corrected the ending refund balance.

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MKP/RPC PIPELINE ADJUSTMENT

The Staff believes that MGE incurred natural gas costs, with respect to its gas supply and transportation contract with MKP/RPC, that are substantially greater than comparable pipelines. Based upon this, the Staff has proposed the following adjustments to reduce MGE's gas costs in the prior four ACA cases:

Case Number	ACA Period	Adjustment
GR-96-450	1996/1997	$3,490,082.81
GR-98-167	1997/1998	$4,330,731.88
GR-99-304	1998/1999	$5,914,199.59
GR-2000-425	1999/2000	$5,886,058.13

Likewise, the Staff proposes to reduce MGE's gas costs by $5,341,127.63 for this ACA period. The Staff believes this adjustment is necessary for the same reasons as the Commission found in Case No. GR-93-140 that the heart of the problem with the initial 1991 contract was the excessive transportation charges when compared to Williams. The subsequent modifications to the contracts mitigated, but did not eliminate, the imprudence damage cited by the Commission in Case No. GR-93-140. These excessive transportation charges were simply continued in the 1995 contracts, with some mitigation that Staff fully credits in its proposed adjustments for the relevant periods. On March 12, 2002, the Commission issued a Report and Order in Case No. GR-96-450. The Staff is still evaluating the effect of that decision and recent Order denying rehearing, on ACA cases subsequent to Case No. GR-96-450.

CAPACITY RELEASE ON KANSAS PIPELINE COMPANY (KPC)

The Staff believes that MGE should have posted for release to other shippers its idle capacity on Kansas Pipeline Company (KPC) for the months of April through October (for this ACA period the release would relate to July-October 2000 and April-June 2001). Staff's concern is with MGE's administration of the Riverside I contract. Such a release could have been done on a non-recallable basis for the entire period (April through October), which would have maximized the released capacity's value in the market place. Non-recallable releases typically have higher market values since there are no provisions for the releasing shipper to call-back the capacity. Since no such posting took place, one option is to credit the full cost of the idle capacity back to MGE's customers. Another option would have been for MGE to post a non-recallable release of capacity on Williams Pipeline and source the replacement gas on KPC. If the release had resulted in a credit at 75% of Williams Pipeline Central maximum rates, the cost reduction would have resulted in a credit of $1,141,784 after consideration of fuel and variable pipeline rate differences.

PURCHASING PRACTICES

In its review of Company purchasing practices, the Staff reviewed the amount of gas MGE purchased during the ACA period and its corresponding price. The Staff found that even though

MGE had a small amount of fixed price contracts for December, January, and February, the Company relied on storage withdrawals and purchases of natural gas at first-of-month and daily index based prices. The Staff also found that MGE did not have a documented, formal plan to hedge the price it paid for natural gas during the winter of 2000/2001 to manage the risk from volatile prices faced by consumers.

The Staff believes that it was reasonable to expect MGE to hedge a minimum level of its natural gas purchases for the winter months of the ACA period. The Staff believes 30% of normal requirements as a minimum level of hedging for each month November 2000 through March 2001 is reasonable. Normal requirements are the amount of storage withdrawals and purchases MGE needs to make on a monthly basis in order to meet its demand based upon normal weather. The 30% of normal requirements minimum should not be viewed as an optimal level nor as precedent for future hedging levels, but only as a minimum level that was reasonable and attainable for the winter of 2000/2001.

The Staff compared MGE's monthly hedged volumes with the monthly 30% of normal requirements. The hedged volumes include storage and fixed price purchases. The Staff found that MGE did not meet this minimum level of hedging in January and March 2001. Based on its review of MGE's hedging practices, the Staff proposes a $614,365 reduction in gas costs for the 2000/2001 ACA period.

In addition, the Staff reviewed MGE's use of the hedged volumes from its storage resources during the winter of 2000/2001. Storage is an integral part of this Company's hedging efforts and must be considered when the hedging plan is developed and implemented. The Company's level of storage withdrawals are affected by the planned level of flowing supplies.

As noted in one of the major supply contracts, first-of-month (FOM) nominations for flowing supplies must be made six business days before the first of the month. Flowing supply simply means gas that is purchased for current consumption and not taken from storage. So Staff reviewed the information known to the Company on 10/24/00, 11/22/00, 12/21/00, 1/24/01, and 2/21/01. Nomination means ordering gas for some date in the future. The gas market has a daily market and first-of-month market. Typically, in order to attain a FOM price, gas must be nominated prior to the beginning of the month that the gas will flow. Given the information known to the Company when decisions were made regarding planned flowing volumes and storage withdrawals for November through March, Staff believes that MGE should have ordered a higher level of flowing supplies in November and December 2000. The higher levels of flowing supplies in November would have preserved storage for the normally colder months of December and January and to assure that the Company had sufficient storage withdrawal capabilities to cover a possible late winter cold snap (e.g. a week long cold period at the end of January or in February). By reviewing the storage inventory level at the end of November, as well as the storage needed to meet December 2000 and January and February 2001 requirements, higher levels of flowing supplies were also indicated in December. Also the Company decided to order less first-of-the-month gas than needed to meet a normal December because it believed prices would drop in December. The Company provided no support for this belief.

MGE storage inventories were at 68% of maximum storage quantity as of November 30, 2001 and at 30% of maximum storage quantity as of December 31, 2001. MGE's heavy use of storage gas and lower levels of flowing supplies ordered for November and December led to less storage gas available for the remainder of the winter season. Because of extended cold weather, little other fixed pricing besides storage, and MGE's plan to use storage early, consumers became exposed to high market prices. Staff found that MGE's storage withdrawals were less than expected in January, February, and March and this resulted in MGE meeting its requirements through gas purchased at the then higher index prices. Staff believes that MGE could have reasonably avoided its exposure to the higher prices by (1) following a reasonable approach for planned flowing gas and storage withdrawals; and (2) not speculating on price decreases in December 2000 without adequate analysis and documentation to support such a course of action. MGE's plans for flowing gas and storage withdrawals had an economic impact on purchased gas costs of $8,051,049. Therefore, the Staff proposes to reduce gas costs by $8,665,414 ($614,365 for failure to hedge a minimum of 30% for January and March, 2001; and $8,051,049 for its decisions regarding use of flowing supplies and storage).

RELIABILITY ANALYSIS

The Company submitted a 2000/2001 Reliability Report that shows peak day estimates for the 11 years of 2000/2001 – 2010/2011. The previous Reliability Report was for 1998/1999. The peak firm usage is estimated for the entire Missouri system – no separate analysis is done for the 3 major service areas of Kansas City, Joplin, and St. Joseph. Staff has the following concerns regarding MGE's reliability analysis:

1. The Company states that a series of regression analyses are performed on the historic daily firm sales to determine the baseload and weather sensitive heatload factors. However, the Company states that this analysis was undertaken in 1994 and cannot be found. The Company states that the baseload and heatload factors are updated annually but the heatload factors appear to be based on a review of usage for only one cold day each year, not a series of regression analyses. Staff does not believe that the review of one cold day in each year is sufficient to establish the heatload factors.

2. Support for the Company's monthly usage for the base case, low case, and high case scenarios were not submitted. It is unclear whether these analyses were also based on the 1994 data that cannot be found.

3. On May 14, 2002 the Company provided additional information pertaining to its estimates of baseload and heatload factors and indicated that comments would be appreciated for consideration on a going forward basis. Staff forwarded comments to the Company on May 28, 2002.

4. The coldest heating degree day (HDD) experienced during this and the previous ACA period was 64 HDD, which is not close to the Company's peak design day of 85 HDD. Staff recommends that comparisons of actual usage to usage estimated by the model continue to be provided, especially as occurrences with higher HDD are experienced, so that the reasonableness of the peak day estimate can be better evaluated.

5. In the 2000/2001 Reliability Report, the Company states that additional capacity is needed prior to 2003/2004, however, Staff's review of peak day estimates and capacity shows that additional capacity is not needed until 2005/2006.

SUMMARY

The Staff has addressed the following concerns regarding Case No. GR-2001-382 for Missouri Gas Energy:

1. The Staff (pending a final Commission Order in Case No. GR-96-450, Case No. GR-98-167, Case No. GR-99-304 and GR-2000-425) will propose for this ACA case, Case No. GR-2001-382 an adjustment to reduce MGE's gas costs by $5,341,127.63. The Staff believes this adjustment is necessary for the same reasons as the Commission found in Case No. GR-93-140 that the heart of the problem with the initial 1991 contract was the excessive transportation charges when compared to the Williams alternative. Staff expressed similar concerns in its direct, rebuttal and surrebuttal testimony filed in Case No. GR-96-450 and in its recommendations in Case No. GR-98-167, Case No. GR-99-304 and GR-2000-425. In June of 1998, the contract itself changed from the contract that was the subject in Case No. GR-96-450. The replacement contract is "transportation" only rather than the bundled supply and transportation service litigated in the 1996-1997 ACA case. The Staff believes the operation of the contract in subsequent ACA periods after June 1998 only serves to strengthen Staff's argument that the rates paid are excessive.

2. In addition to the Riverside prudence adjustment described above, the Staff is recommending an operational disallowance based upon MGE's failure to post for release its idle capacity on the KPC system or post a non-recallable release on the Williams system and replace such a release with KPC capacity. For the 2000/2001 period, that adjustment is quantified as $1,141,784.

3. Staff believes that the Company purchasing practices did not adequately manage price protection for its customers to reduce the volatility of gas prices during the 2000/2001 heating season. Therefore, the Staff proposes a $8,665,414 reduction in gas costs.

4. To adequately review MGE's estimated peak day requirements and the rationale for the reserve margins, Staff recommends that additional information be submitted.

RECOMMENDATIONS

1. The Staff recommends that this ACA case remain open pending an Order from the Commission in Case No. GR-98-167, Case No. GR-99-304, and Case GR-2000-425.

2. Establish the account balances shown in the table below in it next ACA filing to reflect the (over)/under recovery of ACA, Refund, Transition Costs and Take-or-Pay balances to be (refunded)/collected from the ratepayers as of June 30, 2001.

Account	Balance per MGE Filing	Staff Adjustments Current ACA Period	Staff Adjustments Prior ACA Periods	Ending Balances
ACA	$ 17,652,581	$ (15,148,326)	$ (19,621,072)	$ (17,116,817)
Residential & Small General Service Refund	$ 2,215,780	$0	$ (339,471)	$ 1,876,309
Large Volume Refund	$ (584,202)	$0	$0	$ (584,202)
Transition Cost	$0	$0	$0	$0
Take-or-Pay	$0	$0	$0	$0

3. To assure sufficient capacity, but not excess capacity, is available to meet firm customer peak day capacity and natural gas supply requirements, Staff recommends that the Commission issue an order requiring MGE to submit the following information by October 1, 2002:

   a. A current analysis of the usage data to support the Company's baseload and heatload factor for estimating peak day demand for 2001/2002 and three years beyond that. Provide the detailed worksheets supporting the Company's baseload and heatload factors.

   b. A current analysis of the monthly usage for the base case, low case, and high case scenarios considered by the Company for 2001/2002 along with the input and output sheets showing the details of the Company's analysis.

   c. A current analysis for the planned monthly storage withdrawals for 2001/2002.

   d. A summary of actual usage, actual HDD, and HDD adjusted for wind speed for five, or more, non-weekend and non-holiday, cold days in the winter of 2000/2001 or 2001/2002. Compare the actual usage on these cold days to the usage estimated by the Company's forecasting model for those days. Include a calculation of the percent over (under) estimation by the forecasting model. List firm and interruptible volumes separately or show how the model treats these. Provide an explanation when the modeled usage does not reasonably agree with the actual usage encountered. If the model is re-evaluated based on these findings, please explain.

4. The Staff recommends that the Commission order the Company to respond to recommendations 1-3 herein by July 12, 2002.

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Case No. GR-2001-382
Revised: May 31, 2002 (SW)

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