BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy Purchased Gas Adjustment Change	))	Case No. GR-2005-0169

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

David M. Sommerer, of lawful age, on his oath states: that he has participated in the preparation of the following Staff Memorandum; that the information is given by him; that he has knowledge of the matters set forth; and that such matters are true and correct to the best of his knowledge and belief.

David M. Sommerer

David M. Sommerer

Subscribed and sworn to before me this 29th day of December 2006

Toni M. Charlton

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

MEMORANDUM

TO: Missouri Public Service Commission Official Case File, Case No. GR-2005-0169, Missouri Gas Energy, a Division of Southern Union Company

FROM: David M. Sommerer, Manager - Procurement Analysis Department
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/s/ David M. Sommerer 12/29/06	/s/ Robert Franson 12/29/06
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff's Recommendation in Missouri Gas Energy's 2004-2005 Actual Cost Adjustment Filing

DATE: December 29, 2006

I. BACKGROUND

The Procurement Analysis Department (Staff) has reviewed the Missouri Gas Energy (MGE or Company) 2004-2005 Actual Cost Adjustment (ACA) filing. This filing was made on October 18, 2005, and was docketed as Case No. GR-2005-0169. The filing contains the Company's calculations of the ACA and Refund account balances. The 2004-2005 ACA filing rates became effective on November 1, 2005.

MGE served as many as 520,000 customers in the Kansas City, Joplin and St. Joseph areas during the 2004-2005 ACA (MGE data request 64). MGE transports its gas supply over Panhandle Eastern Pipe Line (PEPL), Southern Star Central Gas Pipeline, Mid-Kansas Partnership/Riverside Pipeline Company (MKP/RPC) now called Enbridge Pipeline (most recently known as Kansas Pipeline Company) (KPC), and Kinder Morgan Interstate Gas Transmission (KM).

Staff reviewed and evaluated MGE's billed revenues and actual gas costs for the period of July 1, 2004, to June 30, 2005. The Staff also reviewed MGE's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions. Staff conducted a reliability analysis of estimated peak day requirements and the capacity levels needed to meet those requirements; peak day reserve margin and the reasons for this reserve margin; and a review of normal and cold weather requirements. Staff also reviewed MGE's hedging for the period to determine the reasonableness of the Company's hedging plans.

Staff proposes two adjustments to MGE's gas costs and makes three recommendations to improve MGE's gas supply planning. The adjustments are a reduction in gas costs of $1,965,531 for imprudently incurred transportation costs under MGE's contract with Kansas Pipeline Company (KPC), and a reduction of $2,357,827 in gas costs for excess transportation capacity. Adequate Planning for reliable gas delivery to its customers is one of the most basic functions of an LDC. Staff recommends the Company make planning improvements to its calculation of peak day gas supply estimates, storage planning and hedging practices.

II. TRANSPORTATION ISSUES

CASH-OUT PROVISIONS

MGE reconciles differences between deliveries and nominations (gas that is ordered) on a monthly basis. If customers under-nominate the amount of gas they actually use in a month, as long as the customer is within a 10% monthly tolerance level, the customer may repay the Company at index price. If a customer over-nominates within a 10% tolerance level, the Company will pay back the customer at index price. If the customer under-nominates, Staff is concerned that a sophisticated customer could take advantage of two situations: 1) a high price in the current month, and 2) a cheaper price to pay back those volumes in the subsequent month. Staff's concern may be addressed by certain tariff changes that have been proposed in the current MGE rate case, GR-2006-0422, regarding imbalances. Staff will monitor the impact of this practice on both the Company and on customers in subsequent ACA periods.

TAXATION ON DAILY BALANCES

MGE assessed taxes for daily balancing customers. MGE indicated in its response to DR 108.1 that the majority of transportation accounts are not "sale for resale" customers (a sale of natural gas to a customer who in turn sells that gas to someone else); therefore, MGE must assess taxes on those customers. Total net taxes of ($6,496) (franchise, city, county and sales taxes) were inadvertently included in PGA recovery for the July 2004 to June 2005 period. The Company indicated that the entry to book the taxes was changed to the appropriate tax account effective with the 2006 ACA period. Staff does not propose an adjustment in this case due to the immateriality of this issue but believes that MGE provide Staff the entries to the proposed tax-related accounts designed to correct this in the future.

III. ADJUSTMENTS

A. MID-KANSAS PARTNERSHIP (MKP)/RIVERSIDE PIPELINE COMPANY (RPC) PIPELINE ADJUSTMENT

MGE incurred natural gas costs under its transportation contract with Kansas Pipeline Company (KPC) that are substantially greater than comparable pipelines. For this reason, the Staff has proposed the following adjustments to reduce MGE's gas costs in this case and its prior seven ACA cases:

Case Number	ACA Period	Adjustment
GR-98-167	1997-1998	$4,330,732
GR-99-304	1998-1999	$5,914,200
GR-2000-425	1999-2000	$5,886,058
GR-2001-382	2000-2001	$5,341,128
GR-2002-0348	2001-2002	$6,099,369
GR-2003-0330	2002-2003	$3,570,936
GR-2005-0104	2003-2004	$2,233,540

In this case Staff proposes to reduce MGE's gas costs by $1,965,531. This adjustment is necessary for the same reasons that the Commission made an adjustment in Case No. GR-93-140 that the initial 1991 contract resulted in imprudent excessive transportation charges from the KPC contract. Subsequent modifications to the contracts mitigated, but did not completely eliminate, effects of MGE entering into an imprudent KPC contract as discussed by the Commission in Case No. GR-93-140. Transportation charges in excess of charges available on credits in its proposed adjustments for each relevant period. During 1998, the "bundled" sales/transportation service with KPC was replaced with a "transportation only" service. Although litigated in Case No. GR-96-450 (1996-1997 ACA case) certain aspects of the transaction changed subsequent to the 1996-1997 ACA including elimination of the supply aspect of the agreement, the admission by MGE that the supply is one of the most expensive on MGE's system, and the low utilization rate of the pipeline. In addition, the Staff notes that, given the previous disallowance in Case No. GR-93-140 and the recognition of regulatory authority in the contract, MGE could have taken the opportunity to lower the KPC contract rates to the rates of other pipeline suppliers.

The Federal Energy Regulatory Commission (FERC) has significantly reduced KPC's transportation rates and ordered refunds for service during several of the ACA periods discussed above. On December 13, 2004, Enbridge Pipeline (formerly KPC) filed tariff sheets and a refund plan covering the period of December 2, 1997, through November 8, 2002. The following is a summary of refund obligations to MGE:

- FERC approved principal and interest through December 31, 2004, totaling $13,523,203;
- Incremental interest from January 1, 2005, through payment date of January 28, 2005, totaling $49,276;
- Total payment to MGE of $13,572,479.

The total refund payment of $13,572,479 was included in MGE's 2004-2005 ACA filing (MGE Attachment 1, page 6). The principal portion of these refunds, $10,288,060, would in effect, reduce the disallowances summarized in the table above because the Enbridge (KPC) charges in previous years were effectively reduced. In addition to the refund, the Enbridge reservation charge has been reduced as a result of a FERC order, and that has reduced Staff's adjustment from previous years. In essence, the Staff has used the FERC refund as a direct offset to the original disallowance since that original disallowance calculation had been based upon the higher KPC rates that were ultimately adjusted downward through the FERC decision.

B. EXCESS TRANSPORTATION CAPACITY

The Company is responsible for operating its system to supply its captive customers in a safe and adequate manner. This objective requires the Company to conduct long-range planning in a reasonable manner and make prudent decisions using the information generated from this planning activity. A component of the ACA audit process is to examine the reliability of the LDC's gas supply, transportation, and storage capabilities. For this analysis, Staff reviews the LDC's plans and decisions regarding estimated peak-day requirements, the capacity levels needed to meet those requirements, peak-day reserve margin and the underlying rationale for the resultant reserve margin, and natural gas supply plans for various weather conditions.

The primary service areas to which MGE distributes natural gas are Kansas City, St. Joseph and Joplin. MGE has approximately ** _______ ** firm customers in the Kansas City area, ** ______ ** in St. Joseph, and ** ______ ** in Joplin, for a total of ** _______ ** firm customers (MGE Demand/Capacity Analysis, October 2004). To assure that each area has sufficient transportation capacity, MGE must consider the capacity available for each area. In its most recent peak day analysis, the Draft March 2004 Demand/Capacity Analysis and the October 2004 Demand/Capacity Analysis, MGE did plan its capacity by service area. Prior to that, MGE's peak day analyses in its 2001/2002 Reliability Report and 2002/2003 Reliability Report did not consider capacity planning by service area.

Staff has documented concerns with the Company's peak day planning/ reliability analysis in the previous five cases, the 2003/2004 ACA, GR-2005-0104; the 2002/2003 ACA, GR-2003-0330; the 2001/2002 ACA, GR-2002-0348; the 2000/2001 ACA, GR-2001-382; and the 1999/2000 ACA, GR-2000-425. Staff continues to have concerns with the Company's peak day planning in this current case.

MGE could have done a better job evaluating the amount of transportation capacity it needed to meet its customers' natural gas requirements on a peak (coldest) day. As a result of its analysis, MGE purchased more capacity than it needed to meet peak day requirements in two of its service areas.

Transportation contracts were revised and extended beginning with the 2001/2002 ACA and continuing through the 2005/2006 ACA. The decision regarding capacity results in an excess reserve margin for the Kansas City and St. Joseph areas and impacts costs to customers beginning with the 2001/2002 ACA and continuing through the 2005/2006 ACA.

Staff recommended a disallowance in the prior three cases related to excess capacity in the Kansas City and St. Joseph areas. No disallowance was previously proposed for the Joplin area. Staff continues to have the same concern regarding excess capacity for the Kansas City and St. Joseph areas. Staff's quantification of the excess reserve margin is as follows:

ACA Period	Case No.	Adjustment
2001/2002	GR-2002-0348	$ 2,041,931
2002/2003	GR-2003-0330	$ 2,015,661
	Subtotal	$ 4,057,592
2003/2004	GR-2005-0104	$ 2,044,795
	Subtotal	$ 6,102,387
2004/2005	GR-2005-0169	$2,357,827
	Total	$ 8,460,214

The Staff recommended adjustments for the 2001/2002 through 2003/2004 ACA periods are provided for reference only. The 2001/2002 ACA, Case No. GR-2002-0348; and the 2002/2003 ACA, Case No. GR-2003-0330 were consolidated and the hearing was held in August 2006. The cost of the disallowance is different for each ACA because the reservation costs are different for each ACA.

The prior Staff analysis of the Joplin service area revealed that the Company had inadequate capacity beginning with the 2004/2005 winter. MGE updated its analysis for the 2004/2005 ACA and it recognized that additional market area capacity was required for the Joplin area. Although Staff does not agree with MGE's methodology for calculating its peak day, for this ACA period the Staff does not oppose the additional capacity of ** ______ ** Dth/day for the Joplin area.[A]

If the Commission accepts the Staff adjustment in the consolidated cases, GR-2002-0348 and GR-2003-0330, Staff's adjustment for excess capacity for the Kansas City and St. Joseph areas for the 2004/2005 ACA is $2,357,827, which is approximately $4.80 per customer.

IV. PLANNING IMPROVEMENT RECOMMENDATIONS

A. PEAK DAY PLANNING/ RELIABILITY ANALYSIS

Staff has documented concerns with the Company's peak day planning/ reliability analysis in the previous five cases, the 2003/2004 ACA, GR-2005-0104; the 2002/2003 ACA, GR-2003-0330; the 2001/2002 ACA, GR-2002-0348; the 2000/2001 ACA, GR-2001-382; and the 1999/2000 ACA, GR-2000-425. Staff continues to have concerns with the Company's peak day planning in this case. Please see the discussion in the Adjustments, Excess Transportation Capacity section of this memorandum for a summary of these concerns.

[A] MGE's peak day planning methodology for Joplin for this ACA period is similar to that used by MGE's consultant, John Reed, in the consolidated cases, GR-2002-348 and GR-2003-0330, which went to hearing in August 2006. Staff's comments and concerns regarding this methodology are documented in testimony in the consolidated cases.

B. STORAGE PLANNING

Staff continues to have concerns regarding the Company's planned normal storage withdrawals. MGE's plan for normal weather is to have the largest planned withdrawal in November, the heating season month with the fewest number of heating degree days (November and March have nearly the same HDD; 670 HDD in November and 674 in March). Similar concerns were documented in the following ACA Cases:

2003/2004 ACA, GR-2005-0104,
2002/2003 ACA, GR-2003-0330,
2001/2002 ACA, GR-2002-0348
2000/2001 ACA, GR-2001-382

C. HEDGING

In its review of MGE's purchasing practices, the Staff reviewed the Company's hedging transactions. The Staff also reviewed the Company's natural gas hedging policy, natural gas trading procedures, and 2004 hedging strategy. Staff's conclusion is that MGE did a reasonable job of hedging for this ACA period.

Based upon information the Staff has reviewed, the Company assessed which direction prices were going to move in the market. MGE combined storage and financial instruments to hedge the volumes needed for the winter heating season November 2004 through March 2005. In particular, the Company started placing the financial hedges toward the end of April 2004 and continued purchasing them through the middle of January 2005.

Overall, the winter hedge covered about 71% of gas actually delivered for the winter heating season from November 2004 through March 2005.

Although the Company used a diversified portfolio approach to hedge against market risks for the winter heating season November 2004 through March 2005, Staff recommends that the Company analyze its hedging risk for each winter month under normal conditions and cold weather conditions, including cold weather that may occur late in the winter season. This analysis should include a review of the volumes hedged and the associated cost. In addition, MGE should analyze each month where price exposure exists, to evaluate the costs and risks of not covering, or minimally covering, the unhedged price volatility for that particular month. The Staff further recommends that the Company continue to update and document its hedging decisions and provide the documentation to the Staff during each ACA review. This documentation should include an overall hedging plan that addresses hedging goals, objectives, and strategies for each month of each ACA review. The hedging plan should be documented and completed well in advance of each approaching winter season. The Company should also evaluate longer term time horizons for placing hedges. Historical Company practice has shown that hedging for the winter is generally not started until the spring prior to the winter that is hedged. In essence, most of the hedging would be done from the time period between spring and fall just prior to the winter under consideration. However, the increased summer price volatility could easily subject the Company to the market risk during the summer. Finally, the Company should test, as much in detail, for hedge effectiveness for any financial instruments that attempt to hedge the physical price risk exposure.

V. RECOMMENDATIONS

The Staff recommends that this ACA case remain open pending an Order from the Commission in Case Nos. GR-98-167, GR-99-304, GR-2000-425, GR-2001-382, GR-2002-0348, GR-2003-0330 and GR-2005-0104. The Staff recommends that the Riverside issue be held in abeyance pending a final decision from the courts regarding the appeal of the Commission's decision in MGE Case No. GR-96-450.

Additionally, it is Staff's opinion that the Company should do the following:

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

Account	6-30-05 Ending Balances per MGE Filing	Staff Adjustments Current ACA Period	Staff Adjustments Prior ACA Periods	6-30-05 Staff Recommended Ending Balances
2004-2005 ACA Adjustments:				
MKP/RPC Pipeline		($1,965,531)		
Excess Transportation Capacity		($2,357,827)		
Enbridge (KPC) Refund		10,288,060		
Total ACA Balance	**($21,006,973)**	**$5,964,702**	**($43,391,042)[(A)]**	**($58,433,313)**
Residential, Small General Service & Large General Service Refund	$0[(B)]	$0	$0	$0[(B)]
Large Volume Refund	($633,543)	$0	$0	($633,543)

Notes to Staff Adjustments and balances:

(A) ACA beginning balance 6-30-04 adjustment to agree with current status of prior year issues in Case No. GR-2005-0104.

(B) Sheet 18 of MGE's PGA clause indicates that "All refund balances from prior periods and any outstanding refunds will be rolled into the August 2004 monthly ACA balance. Such refunds shall be credited to the ACA account in the month received and shall be a part of the overall ACA interest calculation."

2. Consolidate the issue of an adjustment for excess transportation capacity in this case, Case No. GR-2005-0169, with the same issue in Case No. GR-2005-0104, and hold the issue in abeyance pending a decision for the same issue in the consolidated cases for Case No. GR-2002-0348 and GR-2003-0330. If the Commission accepts the Staff adjustment for excess capacity in the consolidated cases, GR-2002-0348 and GR-2003-0330, then adjust the MGE ACA account balance as summarized below:

ACA Period	Case No.	Adjustment
2001/2002	GR-2002-0348	$ 2,041,931
2002/2003	GR-2003-0330	$ 2,015,661
	Subtotal	$ 4,057,592
2003/2004	GR-2005-0104	$ 2,044,795
	Subtotal	$ 6,102,387
2004/2005	GR-2005-0169	$2,357,827
	Total	$ 8,460,214

3. Improve its peak day planning/ reliability analysis.

4. Analyze its hedging risk for each winter month under normal conditions and cold weather conditions, including cold weather that may occur late in the winter season. This analysis should include a review of the volumes hedged and the associated cost. MGE should analyze each month where price exposure exists, to evaluate the costs and risks of not covering, or minimally covering, the unhedged price volatility for that particular month. The Staff further recommends that the Company continue to update and document its hedging decisions, and provide the documentation to the Staff during each ACA review. This documentation should include an overall hedging plan that addresses hedging goals, objectives, and strategies for each month of each ACA review. The hedging plan should be documented and completed well in advance of each approaching winter season. The Company should also evaluate longer term time horizons for placing hedges. Historical Company practice has shown that hedging for the winter is generally not started until the spring prior to the winter that is hedged. In essence, most of the hedging would be done from the time period between spring and fall just prior to the winter under consideration. However, the increased summer price volatility could easily subject the Company to the market risk during the summer. Finally, the Company should, as much in detail, test for hedge effectiveness for any financial instruments that attempt to hedge the physical price risk exposure.

Staff recommends that MGE's hedging information for the 2005-2006 ACA and 2006-2007 ACA be submitted no later than May 1, 2007. If MGE does not have such an analysis for the 2005-2006 ACA or 2006-2007 ACA, Staff recommends that MGE provide, no later than May 1, 2007, a more detailed analysis prior to the 2007-2008 ACA period.