

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the PGA filing of)	
Southern Missouri Gas Company, L.P.,)	
d/b/a Southern Missouri Natural Gas')	
Purchased Gas Adjustment (PGA) Factors)	Case No. GR-2009-0287
to be Reviewed in its 2008-2009 Actual)	
Cost Adjustment.)	

STAFF'S RECOMMENDATIONS FOR SMNG's

2008/2009 ACTUAL COST ADJUSTMENT

COMES NOW the Staff of the Missouri Public Service Commission (Staff), and respectfully files its Recommendation with the Missouri Public Service Commission (Commission) and respectfully suggests the Commission issue an order requiring SMNG to file a written response within thirty (30) days of this Recommendation addressing the Staff's *Memorandum*, as well as responding to the specific questions indicated below:

1. On September 15, 2009, Southern Missouri Natural Gas Company, L.P., d/b/a Southern Missouri Natural Gas (SMNG or Company) filed its 2008/2009 Actual Cost Adjustment (ACA) with the rates contained in tariff sheet P.S.C. MO No. 1, 26th Revised Sheet No. 27, effective October 1, 2009. The filing reflected an ending ACA balance as of August 31, 2009, of \$312,789.

Review and Analysis

2. For the period of September 1, 2008, through August 31, 2009, the Staff has reviewed and evaluated SMNG's billed revenues, actual gas costs, natural gas purchasing practices and hedging plans. The Staff also conducted a reliability analysis of: the Company's

peak requirements and the capacity levels needed to meet those requirements; reserve margins; and the requirements necessary based on differing weather conditions.

3. The Staff's *Memorandum* in this matter is attached as Appendix A. The Staff has several concerns regarding the Company's calculation of interest, crediting of the monthly aggregation and balancing charges collected, hedging practices, and the methodology used for calculating peak day and monthly estimates.

4. For example, SMNG collects aggregation and balancing charges from the transporter to offset the costs incurred by the Company due to any imbalances between the forecasted daily supply requirement and the actual consumption. While SMNG billed these charges, the charges were not credited to the ACA account. Therefore, Staff made an adjustment to increase total revenues by the amount of the imbalance charges..

5. Regarding hedging, SMNG hedged with fixed price purchases during the 2008-2009 winter heating season as a result of the *Unanimous Stipulation and Agreement* filed in Case No. GC-2006-0180. The Staff recommends that the Company continue to keep abreast of the market developments in order to make prudent gas procurement decisions; employ both disciplined and market based approaches in implementing a reasonable hedging strategy; continue to maintain a current hedging plan to evaluate the need of further diversifying its gas supply portfolios to include a gas supply planning horizon of multiple years considering the Company's planned growth.

6. Regarding the methodology used for calculating peak day and monthly estimates, the Staff reminded SMNG during the 2007/2008 ACA to: include only the data that is known for the review period; include complete data; consider whether the Company should exclude any of the data; and consider the reasonableness of the results. SMNG could improve its reliability and

supply planning information by plotting the data and including a regression trend line. Had it done so in this case, the Company could have identified suspect data.

Recommendation

7. The Staff recommends that the Commission issue an order requiring SMNG to file a written response within thirty (30) days of this Recommendation addressing the Staff's *Memorandum*, as well as indicating:

- a. Whether the Company intends to reflect the ACA account balance in its next ACA filing to include the (over)/under-recovered ACA balance of \$ 2,620 for a total ACA balance as of 8/31/09 of \$310,169, as shown in the "Staff Recommended" column of the following table:

Description (+) Under-recovery (-) Over-recovery	Company Ending Balances Per Filing	Staff Adjustments	Staff Recommended Ending Balances
Prior ACA Balance 8/31/08	\$410,627	\$0	\$410,627
Cost of Gas	\$4,481,334	\$0	\$4,481,334
Cost of Transportation	\$1,525,949	\$0	\$1,525,949
Revenues	(\$6,108,325)	(\$2,159)	(\$6,110,484)
ACA Approach for Interest Calculation	\$3,204	(\$461)	\$2,743
Total ACA Balance 8/31/09	\$312,789	(\$2,620)	\$310,169

- b. How the Company will respond to the Staff's concerns in the "Hedging" section of the attached *Memorandum*; and
- c. How the Company will respond to the concerns expressed by the Staff in the "Reliability Analyses and Gas Supply Planning" section of the attached *Memorandum* related to methodology concerns for peak day estimates and monthly estimates for normal, cold, and warm weather.

WHEREFORE, the Staff submits this Recommendation and attached *Memorandum* for the Commission's information and consideration and requests that the Commission issue an order requiring SMNG to file a written response within thirty (30) days of this Recommendation addressing the Staff's *Memorandum* and paragraph eight (8) above.

Respectfully submitted,

/s/ Jennifer Hernandez
Jennifer Hernandez
Staff Legal Counsel
Missouri Bar No. 59814

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Certificate of Service

I hereby certify that correct copies of the foregoing have been emailed, mailed, hand-delivered, or transmitted by facsimile to all parties/counsel of record this 27th day of May, 2010.

/s/ Jennifer Hernandez

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2009-0287, Southern Missouri Natural Gas

FROM: David M. Sommerer, Manager - Procurement Analysis Department
Phil Lock, Regulatory Auditor - Procurement Analysis Department
Lesa A. Jenkins, P.E., Regulatory Engineer - Procurement Analysis Department
Kwang Choe, Ph.D., Regulatory Economist - Procurement Analysis Department

David M. Sommerer 05/05/2010 Jennifer Hernandez 05/05/2010
Project Coordinator/Date Office of General Counsel/Date

SUBJECT: Staff's Recommendation for Southern Missouri Natural Gas's 2008/2009
Actual Cost Adjustment Filing

DATE: May 5, 2010

The Procurement Analysis Department (Staff) has reviewed Southern Missouri Natural Gas' (SMNG or Company) 2008/2009 Actual Cost Adjustment (ACA) filing. This filing was made on September 15, 2009 and docketed as Case No. GR-2009-0287. The 2008/2009 ACA filing rates became effective on October 1, 2009. During the 2008/2009 ACA, SMNG provided natural gas to an average of 7,678 sales customers in the southern portion of the state including communities in Greene, Webster, Wright, Howell, Texas and Douglas counties. SMNG is currently undergoing expansions to the Lebanon, Branson/Hollister and Houston, Missouri areas. SMNG anticipates annual sales volumes to increase from the current sales volumes of approximately 700,000/Mcf to over 1,000,000/Mcf upon completion of these projects.

During the 2008/2009 ACA, SMNG's customer base included the following schools as School Aggregation customers: Ava R-I Schools, Cabool R-IV Schools, Fordland R-III Schools, Mansfield R-IV Schools, Mountain Grove R-III Schools, Norwood R-1 Schools, Logan-Rogersville R-VII Schools, West Plains R-VII Schools and Willow Springs R-IV Schools. Schools comprise less than 1% of SMNG's total delivered volume. Further discussion is outlined in this memorandum.

Staff reviewed and evaluated SMNG's billed revenues and actual gas costs for the period of September 1, 2008, to August 31, 2009. The Staff also reviewed SMNG'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, warm and cold weather requirements. Staff also reviewed SMNG's hedging for the period to determine the reasonableness of the Company's hedging plans.

ACA APPROACH TO INTEREST CALCULATION

As indicated in the 2007/2008 ACA, interest should be calculated based on the Prime lending rate, as published in the Wall Street Journal on the first day of the following month, minus two percentage points. SMNG calculated interest based on the Prime lending rate, as published in the Wall Street Journal on the first day of the current month, minus two percentage points. This resulted in changes during the months of October and December 2008. After applying interest using the proper 2008 Prime lending rates, Staff found differences that decrease the filed under-recovered cost by \$461 (\$142 + \$319), a reduction to the cost of gas.

MISSOURI SCHOOL PILOT PROGRAM, TRANSPORTATION SERVICE

The Company is responsible for any imbalances between the forecasted daily gas supply requirement and the actual consumption. An aggregation and balancing charge of \$0.04 per MMBtu on all through put is collected from the transporter to offset the costs incurred by the Company to provide this service. Furthermore, balancing charges will be collected and credited to the monthly cost of the Purchased Gas Adjustment (PGA) Clause. While SMNG billed the transporters for these charges, these charges were not credited to the monthly PGA. Multiplying the sales volumes associated with school aggregation customers by the \$0.04 aggregation and balancing charge results in a total collection of \$2,159. These revenues should be included as part of the Company's total revenue recovery thereby increasing total revenues by \$2,159.

Further comments related to the school aggregation program are included with the section on Reliability and Gas Supply Planning.

HEDGING

SMNG hedged with fixed price purchases (contracts) from gas suppliers such as Conoco Phillips, and BP for the winter heating season (November 2008 through March 2009). SMNG's target for the winter (November 2008 through March 2009) hedge was to secure a minimum of 20, 40, and 55% of normal winter heating-season gas supply by no later than April 30, July 15, and October 1, 2008, respectively. This hedging target was implemented, with a modification, pursuant to the Commission order as a result of the Unanimous Stipulation and Agreement (Agreement) between the Office of the Public Counsel, the Staff, and SMNG in Case No. GC-2006-0180. On April 15, 2008, SMNG contacted Staff to request a variation of the April hedge target from the overall guidelines of the Agreement. The rationale for SMNG to vary the April target was to respond to the rising market condition at that time, thus to spread the April hedge requirement into May / June. Staff reviewed the SMNG's request and subsequently agreed to the variation, (which, if there is good cause shown, is contemplated by the Agreement), to the extent that SMNG put in about 10% of the April hedges by April 30, but requiring the full 20% by end of May. SMNG hedged, with the

variation to the April hedge requirement, as required by Agreement, which resulted in a 60% total hedge by mid-August 2008.

Although the Company's hedging practice using fixed price purchases was pursuant to the Commission's Order, it is recommended that the Company continue to keep abreast of the market developments in order to make prudent gas procurement decisions. The Company should also employ both disciplined and market based approaches in implementing a reasonable hedging strategy. Additionally, the Company should continue to maintain a current hedging plan, considering the growth in the Lebanon area and planned growth in the Branson area, to evaluate the possibility of further diversifying its gas supply portfolios to include a gas supply planning horizon of multiple years, beyond the minimum guideline in April of each year.

RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

As a regulated gas corporation and a Local Distribution Company (LDC) providing natural gas service to Missouri customers, assuring reliability of supply is an essential company function. The Company is responsible for conducting reasonable long-range supply planning and for the decisions resulting from that planning. One purpose of the ACA process is to examine the Company's analysis and decisions to assure reliability of its gas supply, transportation, and storage capabilities. For this analysis, Staff reviews: the LDC's plans, methods of calculating, and decisions regarding its estimated peak day requirements and the capacity levels to meet those requirements, the LDC's peak day reserve margin and its rationale for this reserve margin, and the Company's 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:

1. Methodology Concerns for Peak Day Estimates and Monthly Estimates
 - a. Peak Day for Residential and General Service Customers.

In the 2007/2008 ACA, GR-2008-0379, Staff reminded SMNG that it should consider Staff's comments in the 2006/2007 ACA, GR-2007-0484, which included: SMNG's analysis should only include the data that is known for the review period; it should consider whether any of the data should be excluded; it should include complete data; and it should consider the reasonableness of the results.

Plotting the data and the regression trend line would assist SMNG in considering the reasonableness of the data or the resulting line estimate. SMNG does not plot the data in its review (DR2). Had it done so, it should have seen the usage on 12/09/2006 was much lower than other cold days.

Further investigation reveals SMNG had recorded an incorrect heating degree day (HDD) for 12/09/2006; it recorded 62 HDD for the day, instead of the actual 27 HDD. SMNG explained the 12/09/2006 HDD value was a typo and has been corrected in its files on a moving forward basis.

Inclusion of the trend line in the plot of the data, or use of the Excel Regression function, would give SMNG information about the R-squared. The R-squared value is an indication of the interdependence between the factor(s) considered and the estimated result (requirements or usage in this case). A value of zero would indicate no relationship between the factor(s) and estimated usage. A value of one would indicate a perfect relationship between the factor(s) and estimated usage. If a low R-squared is obtained, it would indicate to the Company that more scrutiny of the data and the Company's methodology is required to develop a better model for estimating peak day requirements. The Excel Regression function output also provides other useful information such as the standard error, the factors used to estimate a peak day, and a confidence interval (such as 95% confidence interval). More thorough SMNG analysis will become more critical to assure SMNG has adequate capacity for a peak cold day as the number of customers continue to increase.

Staff recommends: (1) SMNG plot the data to assist in determining whether some of the data is suspect; and (2) SMNG include either the standard error or the 95% confidence interval factors to assure SMNG has adequately estimated its potential requirements for a peak cold day.

b. Reserve Margin for Future Periods.

SMNG provides information showing another potential capacity increase of 5,000 per day beginning in November 2010. SMNG does not provide any justification for this increasing capacity. Staff will review the Company's rationale and its decision for this increase in capacity in the 2010/2011 ACA.

c. Monthly Normal Weather Estimates of Natural Gas Requirements.

SMNG provides four estimates for monthly normal requirements for the 2008/2009 ACA.

Estimate 1: SMNG uses the same base load and heat-load factors from its evaluation for peak day. The monthly estimate (DR1 & 2) is based on normal HDD and base load and heat-load factors per customer for each customer type (RS, OG, GS, and LGS & LV) multiplied by the estimated number of customers. The base load and heat-load factors do not vary by month.

As in the 2007/2008 ACA, Staff recommends SMNG evaluate whether it is reasonable to calculate the normal month usage using the same base load and heat-load factors for every month, and provide its decision and rationale to the Staff. SMNG may obtain more reasonable estimates by considering each month separately or considering winter months separately from summer months.

Estimate 2-4: SMNG provides a monthly estimate in DR58 (hedging DR for volumes exposed to price risk) based on averages of market allocations for each month of the 7 1/2-year period of January 2001 through August 2008.

The estimate in its Gas Supply Plan Update (received via email 6/02/2008) has normal winter month estimates similar to those in the DR58 response (after reductions for total lost). The estimates in the Weekly Activity Reports (DR24), noted as “7-Year Average Throughput”, are comparable to those of DR58 (before reductions for total lost).

An average of prior years’ data is not an adequate predictor of normal usage for the following reasons: (1) The weather is not necessarily normal over a 7 ½ year period; and (2) SMNG is expanding and usage will be much different because of the change in customer numbers.

d. Monthly Cold and Warm Weather Estimates of Natural Gas Requirements.

The SMNG cold weather estimate is simply the 7 1/2-year average times 1.3. It did not provide justification for its 30% colder scenario. No estimate of warm-weather requirements is provided for this ACA period. SMNG should justify the rationale for its 30% colder scenario and provide its warm winter scenario, in the next ACA review, the 2009/2010 ACA.

Staff’s prior review of 30+ years of HDD shows the winters vary from 23% colder than normal to 19% warmer than normal. This same review revealed for the coldest months of December through February, (1) the HDD can be as much as 44% to 51% colder than normal; and (2) the normal plus 2 standard deviations are 36% to 39% colder than normal. A review of 30+ years of HDD data shows the warmest HDD for the months of November through March can be as much as 27% to 49% warmer than normal.

Staff continues to recommend SMNG evaluate its monthly planning for warm and cold weather. Similar comments were made in the 2006/2007 ACA and 2007/2008 ACA.

SMNG stated in its 8/21/2008 response to Staff's 2006/2007 ACA recommendation that it will re-evaluate its planning for normal, warm and cold weather and maintain documentation to support its estimates. Because of the nature of the ACA reviews, SMNG could not incorporate Staff's comments into its planning for the 2007/2008 ACA (2006/2007 ACA recommendation made in 8/14/2008 and comments made in conference call to Company in February 2008. The 2007/2008 ACA began in September 2007.) Thus, Staff expected to see changes in SMNG's monthly planning methodology beginning with this 2008/2009 ACA, but concerns are still noted.

2. School Aggregation

Staff has similar concerns to those expressed in the 2007/2008 ACA, GR-2008-0379, with capacity plans for schools in the school aggregation program. Schools are not included in the 2008/2009 estimate of peak day because they are transport customers, and obtain their own capacity and supply of natural gas. However, SMNG releases capacity to the schools. Tariff Sheet 18.5, contains the capacity release provisions for school aggregations, and states the release will be made on a recallable basis. However, the Company agrees not to recall capacity unless requested to do so by Customer, and as such, capacity release to schools must be considered in the available capacity for peak day planning and the associated reserve margin. This will become a greater issue as the SMNG continues to expand into Lebanon, Branson, and Houston and the capacity is more fully utilized for non-transportation customers.

The comments regarding capacity release provisions of the contracts with the Pool Operator and with each of the schools in the School Aggregation Program are the same as those in GR-2008-0379.

In the 3/03/2009 conference call between Staff and SMNG, SMNG stated that it would review the school aggregation agreements prior to the new program year which began in October 2009. Thus, Staff will review changes in the 2009/2010 ACA review.

RECOMMENDATIONS

The Staff recommends that Southern Missouri Natural Gas:

1. Reflect the ACA account balance in its next ACA filing to include the (over)/under-recovered ACA balance of \$ 2,620 for a total ACA balance as of 8/31/2009 of \$310,169, as shown in the "Staff Recommended" column of the following table:

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Total ACA Balance 8/31/09	\$312,789	(\$2,620)	\$310,169

2. Respond within 30 days to the comments expressed by Staff in the Hedging section.
3. Respond within 30 days to the concerns expressed by Staff in the Reliability Analyses and Gas Supply Planning section related to methodology concerns for peak day estimates and monthly estimates for normal, cold, and warm weather.
4. File a written response to the above recommendations within 30 days.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Southern Missouri Gas Company, L.P.'s)
d/b/a Southern Missouri Natural Gas Purchased Gas)
Adjustment (PGA) Factors to be Reviewed in its 2008-)
2009 Actual Cost Adjustment)

Case No. GR-2009-0287

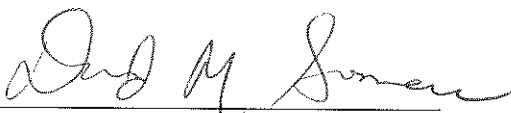
AFFIDAVIT OF DAVID M. SOMMERER

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,

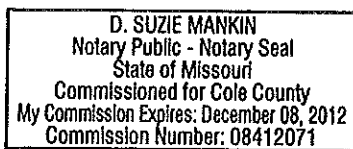
Phil Lock, Regulatory Auditor - Billed Revenues and Actual Gas Costs
Lesa A. Jenkins, P.E., Regulatory Engineer - Reliability Analysis and Gas Supply Planning
Kwang Choe, Ph.D., Regulatory Economist - Hedging

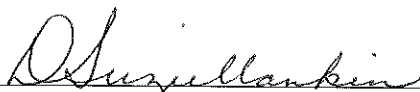
that he has knowledge of the matters set forth in such report and that such matters are true to the best of his knowledge and belief.



David M. Sommerer

Subscribed and sworn to before me this 5th day of May, 2010.





Notary Public