MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2008-0379, Southern Missouri Natural Gas

FROM: David M. Sommerer, Manager - Procurement Analysis Department
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David M. Sommerer 04/07/09	Robert S. Berlin 04/07/09
Project Coordinator/Date	Office of General Counsel/Date

SUBJECT: Staff's Recommendation for Southern Missouri Natural Gas's 2007/2008 Actual Cost Adjustment Filing

DATE: April 7, 2009

The Procurement Analysis Department (Staff) has reviewed Southern Missouri Natural Gas' (SMNG or Company) 2007/2008 Actual Cost Adjustment (ACA) filing. This filing was made on September 19, 2008 and docketed as Case No. GR-2008-0379. The 2007/2008 ACA filing rates became effective on October 1, 2008. During the 2007/2008 ACA, SMNG provided natural gas to an average of 7,582 sales customers in the southern portion of the state including communities in Greene, Webster, Wright, Howell, Douglas and Texas counties. SMNG is currently undergoing expansions to Lebanon, Branson/Hollister and Houston, Missouri. 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.

Effective October 2007, SMNG added the following schools as School Aggregation customers: Ava Schools, Mansfield Schools, Mountain Grove Schools, Rogersville Schools, West Plains Schools and Willow Springs 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, 2007, to August 31, 2008. 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

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 2007 and January 2008. After applying interest using the proper 2007/2008 prime rates, Staff found no material differences so no adjustment was made.

MISSOURI SCHOOL PILOT PROGRAM

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 $1,711. These revenues should be included as part of the Company's total revenue recovery thereby increasing total revenues by $1,711.

The customer charge assessed to the schools was not included in the school aggregation contract agreement. After further discussion with SMNG, the Company agrees to include the customer charge provision upon renewal of its contract in October 2009.

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

TRANSPORTATION IMBALANCES

Currently SMNG receives a monthly nomination report from School Aggregation and Transportation customers during mid-month. An imbalance schedule is also developed on a monthly basis. This schedule has an impact in determining the following month nominations by SMNG's transportation customers and by SMNG for its sales customers. Imbalances are monitored by SMNG on a monthly basis. SMNG indicated that they do not have the resources to monitor imbalances on a daily basis (although at least five transportation customers have daily metering). In addition, SMNG does not charge the transporter for monthly imbalance gas that is owed to them (negative imbalance). Instead, imbalances are reduced by a volumetric adjustment in the nomination process during the following month. While the imbalances for the 12-month period ended August 2008 were relatively small, monthly imbalances had a tendency to be much larger. SMNG is encouraged to more closely monitor transportation imbalances in order to minimize monthly imbalances and review its tariff to provide greater incentive to stay in balance. Because SMNG does not have its own storage to balance on, they may be required to purchase additional quantities of gas (beyond planned purchases) to make up for an imbalance shortfall created by a transportation customer. This scenario could have adverse economic results.

HEDGING

SMNG hedged with fixed price purchases (contracts) from a gas supplier BP for the winter heating season (November 2007 through March 2008). SMNG's target for its 2007-2008 winter hedging 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, 2007, respectively. This hedging target was implemented pursuant to the Commission's Order as a result of the Unanimous Stipulation and Agreement between the Office of the Public Council, the Staff, and SMNG in Case GC-2006-0180. SMNG hedged, with fixed price purchases, as required under the Stipulation and Agreement that resulted in a 59% total hedge by the end of September 2007 for its normal heating season (November 2007 through March 2008).

Although the Company's hedging practice using fixed price purchases was pursuant to the Commission's Order, Staff recommends the Company continue to maintain a current hedging plan, to evaluate the possibility of further diversifying its gas supply portfolios, including a gas supply planning horizon of multiple years, evaluating storage availability especially as the SMNG system expands, and keep abreast of market developments in order to make prudent gas procurement decisions.

RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

The Company is responsible for conducting reasonable long range supply planning to meet its customers' needs and is responsible for the decisions resulting from 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 reviews 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:

1. Methodology Concerns for Peak Day Estimates and Monthly Estimates

    a. Peak Day for Residential and General Service Customers

        SMNG's peak day evaluation is acceptable to Staff, except SMNG's analysis should consider Staff's comments in the 2006/2007 ACA, GR-2007-0484.

(SMNG's analysis should consider whether any of the data should be excluded and the reasonableness of the results.) Because of the nature of the ACA reviews, SMNG could not incorporate the 2006/2007 ACA comments into its planning for the 2007/2008 ACA. The 2006/2007 ACA recommendation was filed in August 2008 and the methodology was previously discussed in a conference call with SMNG in February 2008. The 2007/2008 ACA began in September 2007. Thus, SMNG's peak day methodology could consider these comments beginning with the 2008/2009 ACA.

b. Peak Day Estimates for Large Sales Customers

SMNG revised its peak day methodology for the large sales (LGS and LV) customers. Because of the changes in operation for some of the large customers and limited daily data (only available for some LGS and LV customers), Staff recommends that SMNG continue to evaluate its peak day estimation methodology for these customers.

c. Monthly Estimates of Natural Gas Supply Requirements.

There are large differences in SMNG's normal estimates for the months of January, February, March, May, June, July and August (DR Nos. 1 and 87).

SMNG Monthly Evaluation	Estimated Normal		DR87 vs DR1, % Difference
	DR1	DR87	
Sep-07	25,688	24,167	-5.9%
Oct-07	39,696	45,333	14.2%
Nov-07	76,422	75,500	-1.2%
Dec-07	115,498	126,667	9.7%
Jan-08	128,823	148,667	**15.4%**
Feb-08	101,650	122,500	**20.5%**
Mar-08	79,883	95,000	**18.9%**
Apr-08	47,979	43,833	-8.6%
May-08	25,723	30,167	**17.3%**
Jun-08	15,903	25,833	**62.4%**
Jul-08	15,469	20,667	**33.6%**
Aug-08	15,325	25,833	**68.6%**
Total	688,059	784,167	14.0%
Winter Total	502,276	568,334	13.2%

Staff recommends that SMNG evaluate whether its use of the same base load and heatload factors each month (DR No. 1) is reasonable for estimating the requirements for each month. SMNG may find that for the estimates of normal, separate monthly factors or seasonal factors will provide improved estimates. SMNG should also review its 6-year averages (DR Nos. 87 and 20) to determine why it is using these, instead of the normal estimates. The 6-year averages can under or overstate monthly usage when the weather is not normal. For example, the normal heating degree day (HDD) for January is 1,032, but for SMNG's 6-year review of 2001-2006 data, there is an average of 940 HDD, which is 91% of normal.

The cold weather estimate in DR87 is simply the six-year average times 1.3. 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.

Staff continues to recommend that SMNG evaluate its planning for normal, warm and cold weather. Similar comments were made in the 2006/2007 ACA. SMNG stated in its 8/21/08 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 the 2006/2007 ACA comments into its planning for the 2007/2008 ACA. The 2006/2007 ACA recommendation was filed in August 2008 and the methodology was previously discussed in a conference call with SMNG in February 2008. The 2007/2008 ACA began in September 2007. Thus, SMNG's monthly planning methodology could consider these comments beginning with the 2008/2009 ACA.

2. School Aggregation

Six schools moved from large general to transport (school aggregation) customers during this ACA period.

Schools are not included in 2007/2008 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. Because the capacity release provisions for school aggregations (Tariff Sheet 18.5) states the release will be made on a recallable basis, but the Company agrees not to recall capacity unless requested to do so by Customer, capacity release to schools must be considered in the available capacity (unavailable capacity) for peak day planning and the associated reserve margin. Available capacity will become a greater issue as the SMNG system expands into Lebanon and the capacity is more fully utilized for non-transportation customers.

The capacity release provisions of the contracts with the Pool Operator, the entity responsible to contract for and cause delivery of adequate natural gas supplies to meet the forecasted daily supply requirements, and with each of the schools in the School Aggregation Pool do not specify the firm pipeline capacity to be released each month. Each school agreement contains an estimated annual requirement and specifies a rate up to 50 MMBtu per day. Thus for the six schools this would be up to

300 MMBtu/day. However the agreement states that the customer and SMNG may agree at any time to a change in the maximum daily rate. In essence, the natural gas sales customers are being asked to carry and pay for additional capacity for the schools in case the weather is cold and the schools might need it, at which time the schools would pay for it for some period of time, possibly only one month. Per the daily delivery statements provided for the school transportation customers, Staff found that the 50 MMBtu per day was exceeded by each school for at least one month. Generally when capacity is released, the volume of the capacity release is negotiated up front and the release shippers pays for that capacity for each day of the term of the contract, not a varying maximum daily quantity (MDQ) for each month, unless the contract defines up front the capacity to be released (such as a specified MDQ for the winter months and another MDQ for the summer months). In contracting for capacity, the peak needs for the year or season are generally considered. In this ACA, the schools only paid for the actual volume of capacity that was delivered to them each month. In the March 3, 2009 conference call, SMNG stated that they will review the school aggregation agreements prior to the new program year which begins in October 2009.

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 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 8/31/07	$147,317 (A)	$0	$147,317 (A)
Cost of Gas	$5,634,220	$0	$5,634,220
Cost of Transportation	$1,349,932	$0	$1,349,932
Revenues	($6,722,288)	($1,711)	($6,723,999)
ACA Approach for Interest Calculation	$3,157	$0	$3,157
Total ACA Balance 8/31/08	$412,338	($1,711)	$410,627

(A) Includes settlement adjustment of ($75,000) in Case GR-2006-0352.

2. Include customer charge language in the school aggregation contract agreements upon renewal of its contract in October 2009.

3. To closely monitor transportation imbalances in order to minimize monthly imbalances and to review its tariffs to provide greater incentive to stay in balance.

4. Maintain a current hedging plan and continue to evaluate the possibility of further diversifying its gas supply portfolios including a gas supply planning horizon of multiple years and evaluation of firm storage opportunities, and keep abreast of the market developments to help its gas procurement decision-making. The current hedging plan must include detailed plans to provide proper documentation of gas purchasing decisions at the time that such decisions are made.

5. Respond within 30 days to the concerns expressed by Staff in the Reliability Analyses and Gas Supply Planning section related to (1) methodology concerns for peak day estimates and monthly estimates and (2) school aggregation

6. 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. d/b/a Southern Missouri Natural Gas' Purchased Gas Adjustment Factors to be Reviewed in its 2007-2008 Actual Cost Adjustment	))))	Case No. GR-2008-0379

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:	Billed Revenues and Actual Gas Costs
Lesa A. Jenkins:	Reliability Analysis and Gas Supply Planning
Kwang Y. Choe:	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 17th day of April, 2009.

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

Notary Public