BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company/Fidelity Natural Gas, Inc.'s Purchase Gas Adjustment for 2005-2006	)))	Case No. GR-2007-0179

STAFF'S RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") and files its Recommendation in this case.

The Staff recommends adjustments as set forth in the attached memorandum and requests that the Commission order Laclede to respond within 30 days.

Respectfully submitted**,**

/s/ Steven C. Reed____________________

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 31st day of December, 2007.

/s/ Steven C. Reed____________________
Steven C. Reed

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MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2007-0179, Laclede Gas Company/Fidelity Natural Gas, Inc.

FROM: David M. Sommerer, Manager - Procurement Analysis Department
Phil S. 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

/s/ David Sommerer 12/20/07	/s/ Steven Reed 12/20/07
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff Recommendation for Laclede Gas/Fidelity Natural Gas, Inc.'s
2005-2006 Actual Cost Adjustment Filing

DATE: December 20, 2007

The Procurement Analysis Department (Staff) has reviewed Laclede Gas Company/Fidelity Natural Gas, Inc.'s (Company, Laclede, Fidelity) 2005-2006 Actual Cost Adjustment (ACA) filing. This filing was made on November 3, 2006, for rates to become effective November 20, 2006, and was docketed as Case No. GR-2007-0179. Laclede /Fidelity provided natural gas to an average of ** _____ ** sales customers in the counties of Franklin and Crawford, which include the City of Sullivan, Oak Grove Village and the unincorporated areas of Crawford County. Staff's proposed adjustments are included in the tables of the Recommendations section of this memorandum.

The Missouri Public Service Commission (Commission) issued an order on February 21, 2006 in Case GM-2006-0183, with an effective date of February 28, 2006, in which the Laclede Gas Company (Laclede) was granted a certificate of convenience and necessity to provide natural gas service as a gas corporation and public utility, subject to the jurisdiction of the Commission, in the service areas previously served by Fidelity. The Commission approved Laclede's ownership of Fidelity effective February 24, 2006. Thus, any recommendations in this 2005-2006 ACA case, GR-2007-0179, applicable to Fidelity may also impact Laclede.

The review consisted of an analysis of the billed revenues and actual gas costs for the period of September 1, 2005, to August 31, 2006, included in the Company's computation of the ACA rate. A comparison of billed revenue recovery with actual gas costs will yield either an over-recovery or under-recovery of the ACA balance. The ACA ending balance in the Company's 2005-2006 ACA filing is $85,588 over-recovery.

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 the Company's gas purchasing practices for this ACA period.

REVENUE RECOVERY

Staff believes a discrepancy occurred in the Company's revenue recovery for the months of February 2006 and March 2006. During this period, Fidelity's Base versus Use report and Laclede's 5281 Revenue report combined did not reconcile with the revenue recovery per the Company's filing. This occurred during the transition period from Fidelity to Laclede that included revenue recovery from both Fidelity and Laclede. The filing included estimated revenue recovery of $703,497 for the months of February 2006 and March 2006, but the actual billed revenues was $693,623. Staff recommends a $9,874 decrease in revenue ($693,623 - $703,497) to reflect actual revenue recovery that occurred during those months. Laclede indicated in its response to Data Request No. 98 that it will make an adjustment for this difference in its 2006-2007 ACA filing.

GAS PURCHASING COSTS

In its contract with ** ________ **, Fidelity contracted for gas supply for the period of November 1, 2005 to October 31, 2006. According to the contract, ** __________________ ____ ________________________ ** A credit is then issued to Fidelity. ** ___________________ ____ ____ _________________ **. In January 2006, a credit was issued to Fidelity ** ___________ **. In this credit, Fidelity was not compensated for Panhandle fuel losses. Staff believes the fuel losses on the ** _______ ** volumes should be $3,167 (** _______________________ _______ **). Fuel losses increase the credit issued to Fidelity, therefore Staff recommends a gas cost reduction of $3,167 to reflect Panhandle fuel losses.

During February 2006, Panhandle transportation costs of $14,284 were included in cost recovery twice, once as a cost of gas and once as a cost of transportation. The total cost of gas supply plus transportation is $352,092 per filing and $337,808 per invoice (see data request Nos. 2A, 30 and 33). Staff recommends that the cost of gas should be reduced by $14,284 to reflect the invoiced cost of gas.

In summary of the adjustments above, Staff recommends that the cost of gas should be reduced by $17,451 ($3,167 + $14,284).

HEDGING

Fidelity procured the delivered gas to its customers through a contract with its affiliate, Fidelity Energy for the 2005-2006 ACA period. The November, January, and March deliveries were made, respectively, only at the prevailing market prices, while portions of December and

February deliveries came also from the fixed price purchases (** ______________________ ____ **). The fact that Fidelity hedged its gas purchases late during the winter months and only for two of the five winter months shows the Company's inadequate hedging practice for this ACA period.

Fidelity states that it relied on its Gas Procurement Plan (Plan) dated September 30, 2003 for its planning for the 2005/2006 ACA period. It states that the Plan was not updated due to the pending sale to Laclede. (DR71) Historically, Fidelity's gas procurement methods included purchasing full requirements at the lower of ** _________ ** or Fidelity Energy's actual cost (combined average monthly cost from all sources, including fixed price contracts, index pricing and any other hedging instruments). ** ________________________ _______ ** However, the hedging method (under Fidelity's plan) utilizing ** __________ ** was removed for the winter months of November 2005 through March 2006. Despite the removal of the ** _______ **, Fidelity did not place any fixed price hedges until November 2005 and January 2006 for volumes in December 2005 and February 2006, respectively.

Staff has the following concerns with the Fidelity's hedging practices for the 2005-2006 winter months:

1. Fidelity stated that it removed a price cap provision because they incurred a ** ____ ** during which the price cap was in place and because of Fidelity's own view that they no longer needed to give some type of incentives to its customers to ** ____________________ **. This action removed an important safeguard that was in place for the past 7 years. Fidelity's lack of fixed price purchases in the absence of the price caps prior to the winter months of November 2005 through March 2006 exposed its customers to high market prices for the winter months.

2. As part of a prudent planning effort to secure adequate natural gas supplies for its customers, Fidelity should have structured its portfolio of contracts with various supply and pricing provisions in an effort to mitigate upward natural gas price spikes, and provide a level of stability for delivered natural gas prices. In particular, the fact that Fidelity abandoned ** __________ ** provision for the 2005-2006 winter months made it all the more critical for Fidelity to put in place other alternative hedging mechanisms.

3. Historical practice by Fidelity has shown that hedging for the winter has not generally started until the late summer and fall prior to the upcoming winter. However, the increased summer price volatility could easily subject the Company to market risk during the summer. This is precisely what happened

> during the summer of 2005. The market price rose substantially throughout the summer and fall of 2005 amid one of the country's most devastating Gulf coast hurricane seasons. Fidelity could have reasonably avoided the higher market prices during the summer and fall of 2005 by following their traditional hedging practice of purchasing full requirements at the lower of a ** ________ ** or Fidelity Energy's actual cost (combined average monthly cost from all sources, including fixed price contracts, index pricing or other hedging instruments). Furthermore, Fidelity could have avoided the higher market prices by placing hedges early in the spring or summer of 2005 for the winter months of November 2005 through March 2006.

The Staff compared Fidelity's actual gas costs with gas costs based on four other approaches which Fidelity could reasonably have taken for the winter months of November 2005 through March 2006.

- Scenario I considers the costs to customers for hedges at the lower cost of (A) a price cap level that could have been determined on September 1, 2005 or (B) Fidelity Energy's actual cost (combined average monthly cost from all sources, including fixed price contracts, index pricing and any other hedging instruments) combined with the late hedges the Company placed. I chose September 1 as a midpoint to reflect corporate price cap placements in the past three ACA periods.

- Scenario II considers the costs to customers for hedges placed ratably in June, July, and August, which combined with the late hedges the Company placed, represents 50% of the normal winter volumes.

- Scenario III considers the costs to customers for fixed price hedges placed on August 10, 2005, which combined with the late hedges the Company placed, represents 50% of the normal winter volumes. August 10 was the earliest date prior to winter on which the Company purchased fixed price contracts in the past three ACA periods.

- Scenario IV considers the costs to customers for hedges ratably placed in June, July, August, and September, which combined with the late hedges the Company placed, represents 50% of the normal winter volumes.

A summary of the cost to customers of these scenarios compared to the actual costs is summarized below:

	Cost to Customers	Damages	Annual Cost Per Customer (A)
Actual	$1,692,260		
Scenario I	$1,598,726	$93,534	$70.11
Scenario II	$1,600,575	$91,685	$68.73
Scenario III	$1,633,776	$58,484	$43.84
Scenario IV	$1,670,619	$21,641	$16.22

(A) Based on an average of ** _____ ** customers during the 2005-2006 ACA.

Although Staff is concerned with the late hedges incorporated in these hedge scenarios for the 2005-2006 ACA period, Staff is not disregarding the late hedges placed by Fidelity. Staff believes that any of these four scenarios represent a reasonable level of hedging for Fidelity to have undertaken for the 2005-2006 ACA period. Staff, therefore, recommends an adjustment to reduce gas costs by $21,641 to $93,534 for this ACA period.

RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

The Company is responsible for conducting reasonable long range supply planning and 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 reliability analysis and gas supply planning for Fidelity.

1. Model Development for Peak Day Estimate and Monthly Estimates

   The Company's regression analysis considers actual daily usage per customer and actual HDD for the period of January 1, 2002 to August 31, 2005, including summer data. The usage and HDD data for part of 2005 would not have been known when the Company was planning and making decisions for the 2005/2006 ACA period that began September 2005. Thus, the Company's analysis was completed after decisions were made for the ACA period. For example, an agreement ** _____________________ _________________ ** is dated July 15, 2005, but the Company analyses considered data through August 31, 2005.

   The Company must provide the data and analyses that it considered when making its capacity and supply decisions, not an after-the-fact analyses.

2. Capacity Requirements for Peak Day

Although there is a negative reserve margin of 2.7% for 2005/2006 for the Missouri Pipeline Company capacity, this only represents an additional 79 MMBtu/day. Fidelity's expected growth in peak day requirements for 2006/2007 and 2007/2008 support the need for ** ______________________ **.

The gas supply transaction confirmations with a marketer do not specify a maximum daily quantity for the upstream capacity on Panhandle Eastern Pipe Line (PEPL). Although the agreements are for full requirements, the nature of the capacity on the PEPL contract is not known. The LDC must have sufficient verification with the marketer that the upstream capacity is firm, not interruptible, and is not at a lower reliability than primary firm capacity, so that the capacity can be counted on when needed.

Laclede took over this service area in March 2006 and will need to incorporate this service area into its planning for sufficient firm capacity.

3. Gas Supply Plans

a. Nomination Process

Conflicting information was provided about the nomination process documentation. The Company's Plan states that its entire nomination process is handled by the Company's gas marketer and by Missouri Pipeline Company, both as agents of the Company and that the pipeline sends the Company a monthly summary of each day's nominations and gas delivered (pp. 6-7 of Plan, DR71). However, another response states that all nominations are done by the marketer and therefore, Fidelity does not have any documentation pertaining to nominations (DR53).

Documentation must be maintained to support nominations. This is also critical because the marketer's charge per MMBtu varies when the delivered volumes of natural gas is different from the contract volumes.

b. Gas Supply for ACA Period

Fidelity's agreement with a marketer for natural gas delivered to Fidelity–Sullivan includes various transportation charges and is priced at the monthly ** ____________ ____________ ** rather than at the mid-continent price. In addition to the gas costs, the agreement covers various transportation charges. A Local Distribution Company (LDC) that buys gas from the mid-continent at Panhandle Eastern Pipe Line would expect to pay a gas cost that is less than NYMEX. NYMEX is a gulf coast based price but is a common price reference. Therefore, when negotiating with a supplier, the LDC would seek a "discount" or basis differential from NYMEX to represent a mid-continent based price.

Volumes above or below the contracted monthly volumes are priced differently in the agreement. As a full requirements supply contract, with a monthly contracted volume, the contract provides operational flexibility. There is no stated daily minimum or maximum quantity and thus the contract allows daily swings at the stated pricing provisions as long as the contracted monthly volumes are achieved. There will be deviations from the specified monthly contract volumes because of weather variations and other usage variations. The supply agreement contains provisions for gas in excess or less than the estimated contract quantity.

In order to assure that the pricing provisions of the bundled gas supply agreement are reasonable, Fidelity should have done a cost/benefit analysis to estimate the gas costs for normal, warm, and cold winter scenarios. There is no evidence to support that Fidelity did such an analysis. Fidelity simply compared the agreement to a prior year's agreement and did not evaluate the contract under current market conditions. Staff's concern is for the stated pricing provisions for gas taken in excess of the monthly volumes for a cold winter. Because this ACA period had a warm winter, this issue is not material for this ACA period.

SUMMARY

The Staff has addressed the following concerns regarding Case No. GR 2007-0179 for Laclede Gas/Fidelity Natural Gas, Inc:

1. Staff reviewed the billed revenues of the period of September 1, 2005, to August 31, 2006, and believes a $9,874 decrease in revenue recovery is necessary to reflect actual revenues during the period of February and March 2006.

2. Staff has reviewed and evaluated the actual gas costs for the period of September 1, 2005, to August 31, 2006, and proposes two adjustments. First, Staff believes a decrease of $3,167 is necessary to compensate Fidelity for fuel losses associated with their ** _____________ ** from ** _________ **. Secondly, Staff recommends that the cost of gas be reduced by $14,284 to reflect the invoiced cost of gas for the month of February 2006.

3. Staff believes Fidelity's lack of an effective hedging tool with no safeguard prior to the beginning of the 2005-2006 winter season did not adequately protect customers from market price risks. Staff, therefore, recommends an adjustment to reduce gas costs by $21,641 to $93,534 for this ACA period

4. Staff is proposing no dollar adjustment related to reliability and gas supply planning.

RECOMMENDATIONS

1. The Staff recommends that Laclede Gas/Fidelity Natural Gas, Inc., adjust the ACA account balance in its next ACA filing to reflect the following Staff adjustments and to reflect the (over)/under-recovered ACA balance in the "Ending ACA Balance Per Staff" column of the following tables. Staff also recommends that the proposed adjustments apply to the former Fidelity Natural Gas customers only.

Using High End of Staff's Recommended Adjustment for Hedging			
Description	**Ending ACA Balance Per Filing**	**Staff Adjustments**	**Ending ACA Balance Per Staff**
2004-2005 ACA Ending Balance	($24,646)	$0	($24,646)
Cost of Gas/Transportation	$2,455,326	($17,451) (A) ($93,534) (B)	$2,344,341
Revenues	($2,519,147)	$9,874	($2,509,273)
ACA Approach for Interest Calculation	$2,879	$0	$2,879
Total (Over)/Under Recovery 2005-2006	($85,588)	($101,111)	($186,699)

Using Low End of Staff's Recommended Adjustment for Hedging			
Description	**Ending ACA Balance Per Filing**	**Staff Adjustments**	**Ending ACA Balance Per Staff**
2004-2005 ACA Ending Balance	($24,646)	$0	($24,646)
Cost of Gas/Transportation	$2,455,326	($17,451) (A) ($21,641) (B)	$2,416,234
Revenues	($2,519,147)	$9,874	($2,509,273)
ACA Approach for Interest Calculation	$2,879	$0	$2,879
Total (Over)/Under Recovery 2005-2006	($85,588)	($29,218)	($114,806)

(A) ($3,167) + ($14,284)
(B) Hedging

2. Respond to the comments/concerns in the Reliability Analysis and Gas Supply Planning section of this memorandum within 30 days.

3. 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 Laclede Gas Company's)
Purchased Gas Adjustment Tariff Filing.) Case No. GR-2007-0179

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 9 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 S. Lock:	Billed Revenues and Actual Gas Costs
Lesa 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

David M. Sommerer

Subscribed and sworn to before me this 20th day of December 2007.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

D Suzie Mankin
Notary Public