MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2003-0148, Fidelity Natural Gas, Inc.

FROM: David M. Sommerer, Manager - Procurement Analysis Department
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/s/ David M. Sommerer 03/25/03	/s/ Thomas R. Schwarz 03/25/03
David M. Sommerer,	Thomas R. Schwarz,
Utility Services Division/Date	General Counsel's Office/Date

SUBJECT: Staff Recommendation for Fidelity Natural Gas, Inc.'s 2001-2002 Actual Cost Adjustment Filing

DATE: March 25, 2003

The Procurement Analysis Department (Staff) has reviewed Fidelity Natural Gas, Inc.'s (FNG or Company) 2001-2002 Actual Cost Adjustment (ACA) filing. This filing was made on October 15, 2002 for rates to become effective November 1, 2002, and was docketed as Case No. GR-2003-0148. The audit consisted of an analysis of the billed revenues and actual gas costs for the period of September 1, 2001 to August 31, 2002, included in the Company's computation of the ACA rate. FNG provided natural gas to a maximum of 1,249 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. The ACA ending balance in the Company's 2001-2002 ACA filing is $61,077 over-recovery.

In addition, Staff conducted a reliability analysis for FNG including a review of information required to be submitted in response to the reliability recommendations in the 2000-2001 Staff ACA recommendation, Case No. GR-2001-495, 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 natural gas supply plans.

DEFERRED CARRYING COST BALANCE

The Deferred Carrying Cost Balance (DCCB) is the cumulative under- or over-recovery of gas costs at the end of each month for each annual ACA period. Each month, carrying costs at a simple interest rate equal to the prime rate minus 1% is credited to customers for any over-recovery of gas costs, or credited to the Company for any under-recovery of gas costs when the DCCB exceeds an amount equal to 10% of Company's average annual level of gas costs for the three most recent ACA periods. Any DCCB amount existing at the end of the Company's ACA period, including interest, is included in the determination of the new ACA factor to be effective in the scheduled winter PGA filing.

During the 2001-2002 ACA period, FNG had cumulative over-recovered gas costs that exceeded the 10% threshold in all six months from March through August 2002. Staff believes that carrying costs of $585 should be deducted from the Company's recoverable cost of gas.

PURCHASING PRACTICES

The PSC Staff sent several Data Requests for FNG's plans, policies and procedures related to gas procurement. The Company responded that FNG has no written Strategic Plan or any formal policies or procedures related to gas purchasing.

As a result, knowledge of the Company's gas procurement plans and activities may remain with those who directly perform the tasks. Without documentation, protective procedures may erode over time. Staff is concerned that FNG may be vulnerable to changes in many areas (i.e. staff turnover at decision-making level, interruption of supply, market volatility, regulatory changes.)

A planning document need not be burdensome to prepare, even for a small Company. Such a document can assist the Company in ensuring that its purchasing practices are performed consistently, can be useful in the event of turnover in gas procurement positions and can serve as further communication to auditors and regulatory bodies regarding the Company's gas supply practices. Staff recommends that FNG document the Company's gas procurement plans, strategies, policies, procedures and practices in a document or manual, to include at a minimum the following information:

1. The Company's gas procurement goals (including hedging);
2. The Company's strategies to meet the goals;
3. Potential situations that might prevent the Company from meeting its goals and the Company's contingency plans to deal with those situations;
4. A list of those responsible for gas procurement plans, policies and procedures and a list of those authorized to make gas procurement contracts and transactions;
5. Responsibilities of personnel in gas procurement positions;
6. The Company's evaluation of gas supply requirements for warmest weather and coldest weather scenarios and types of contracts (base load, swing, etc.) necessary to provide for these variations in usage;
7. Vendor selection criteria for potential supplies of natural gas, including verification of financial solvency and performance in delivering contracted supplies;
8. The Company's process of soliciting and evaluating bids, the criteria for accepting and/or rejecting certain suppliers, and the documentation of the bid process and bid awards (including documentation of verbal offers);
9. The Company's process of entering into gas supply contracts, and the documentation of the contracting process;
10. The Company's nomination process, both for first-of-month determining and ordering required natural gas and for daily changes to the nomination. The nomination process includes, but may not be limited to the interaction between short-term weather forecasts, pricing information, nomination deadlines, demand forecasts, end-user analysis, existing

gas supply contracts and constraints and first-of-the-month flowing gas prices versus daily gas market prices; and

11. The Company's process of verifying and approving gas supply invoices before paying them.

RELIABILITY STUDY

To assure that sufficient capacity, but not excess capacity, is available to meet firm customer peak day capacity and natural gas supply requirements, Staff conducts a reliability analysis. The objective is to assure that a company has adequate capacity to provide natural gas to its firm customers on even the coldest days, without maintaining excess capacity that would cost consumers money without any related benefit. Staff has the following comments and concerns regarding the Company's reliability analysis and reserve margins for the 2001-2002 ACA period.

1. Staff accepted the Company's growth estimates, but because of the downward trend in residential growth, Staff recommends that the Company continue to monitor growth and provide growth estimates.

2. The Company has changed its methodology for estimating customer usage and the methodology is much improved over that used in the 2000-2001 ACA review. Even so, Staff has comments regarding the usage estimate.

   a. Because the usage data is not split out by customer type, the contribution by each type of customer cannot be evaluated in this analysis. The number of customers has changed since 1997 and not necessarily by the same percentages in each customer class. Since the Company's analysis isn't set up to distinguish between types of customers, it is recommended that the Company continue to update usage estimates annually, adding newer usage data and deleting older usage data.

   b. Staff requested information regarding the Company's planning for a warmer-than-normal winter and a colder-than-normal winter. The company responded that it only calculates usage for a normal winter. ** HC _____ _____ _____ ** However, Staff believes that the Company should calculate requirements for a colder-than-normal winter. A review of historic temperature data will show that the coldest month is 35-45% colder than a normal heating season month. Thus the usage requirements would be much different.

3. A comparison of actual usage on recent cold days to that estimated by the model has been provided by the Company. Because none of these cold days are near the peak cold day of 74 heating degree days (HDD), Staff recommends that these comparisons continue to be provided.

4. The Company notes that it has a reserve margin of negative 13.5% for the capacity contracted on Missouri Pipeline Company. Additionally, the reserve margin is negative 20.9% for the capacity contracted with ** HC ** on the Panhandle Eastern Pipe Line. Staff continues to be concerned about the negative reserve margins for capacity on both of these pipelines. These concerns were also noted in the Staff Recommendation for the 2000-2001 ACA, Case No. GR-2001-495, and the 1999-2000 ACA, Case No. GR-2001-250. Staff is concerned that additional firm capacity will not be available should a peak day of 74 HDD (-9° Fahrenheit) recur. Staff concerns are as follows:

   a. ** HC **

   b. ** HC **

   c. ** HC **

      HC **

   d. The Company states that since the peak cold day of 74 HDD has not been recorded since 1989, and recent cold days have not been near this historical peak, that the reserve margin is acceptable at this time. The Company's statement that it is looking at the HDD for recent years causes Staff to be concerned. Just because a few recent past years have had no single day near the historic peak, does not mean that future years will not have HDD at this level. This rationale for a negative reserve margin does not seem prudent. However, if Staff were to

calculate the reserve margin for the second highest peak day of 70 HDD, the reserve margin would still be negative.

The Company did acknowledge that additional firm capacity is not guaranteed so Fidelity will reevaluate the maximum daily quantity on an ongoing basis for the upcoming heating season and beyond to assure that additional firm capacity will be available should a peak cold day of 74 HDD recur.

5. The Company provided a cost analysis showing that the lower MDQ on Missouri Pipeline saves $993 per month, but when considering the average number of customers in the 2001-2002 ACA period, this is only a savings of $0.82 per month. The Company did not provide an analysis showing savings for the MDQ on Panhandle Eastern Pipe Line. It is recommended that the Company provide such an analysis so that the Company can consider the total additional cost to customers when considering an appropriate reserve margin for this service area.

SUMMARY

The Staff has addressed the following concerns regarding Case No. GR-2003-0148 for Fidelity Natural Gas, Inc.:

1. Staff proposes to reduce the cost of gas by $585 to reflect the carrying cost of the DCCB.

Description	ACA Balance Per Filing	Staff Adjustments	ACA Balance Per Staff
2000-2001 ACA Balance	$31,997	$0	$31,997
Cost of Gas	$634,621	$0	$634,621
Cost of Transportation	$297,003	$0	$297,003
Revenues	$(1,024,698)	$0	$(1,024,698)
DCCB	$0	$(585)	$(585)
Total (Over)/Under Recovery	$(61,077)	$(585)	$(61,662)

2. Staff recommends that FNG document and provide by September 30, 2003, the Company's gas procurement plans, strategies, policies, procedures and practices.

3. Staff is proposing no dollar adjustments related to reliability, but Staff has concerns regarding insufficient volumes for a peak cold day and recommends that additional documentation regarding the reliability information be submitted by November 1, 2003.

RECOMMENDATIONS

The Staff recommends that the Commission issue an order requiring Fidelity Natural Gas to:

1. Adjust the firm sales ACA balance by $585 increasing the filed over-recovery balance of $61,077 to the Staff adjusted over-recovery balance of $61,662, to include the carrying cost of the DCCB.

2. Document and submit by September 30, 2003, a copy of the Company's gas procurement plans, strategies, policies, procedures and practices, including at a minimum, the information from the "Purchasing Practices" section above.

3. Take the following actions related to the Company's reliability analysis by November 1, 2003:

    a. Review, revise, and submit to Staff the Company's peak day and annual demand study to address the concerns raised by Staff in the Reliability section. Show the estimated demand for the 2002-2003 ACA period and for three years beyond that.

    b. Submit to Staff the reserve margin estimate for the 2002-2003 ACA period and for three years beyond that. Explain the rationale for the reserve margin for each of these years. For any negative reserve margin shown, provide an explanation of the firm capacity that will be used to meet demand requirements beyond the firm contract maximum daily quantities. For any shortfall of capacity, provide details about the actions the Company will take for firm residential, commercial, large volume and commercial flex customers whose demand will not be met should a peak day recur. Submit an updated economic analysis comparing the cost of additional firm capacity on both pipelines (Missouri Pipeline Company and Panhandle Eastern Pipe Line) to the cost of the penalties for exceeding the contract maximum daily quantities by the amount of the negative reserve quantity.

    c. Submit to Staff an updated summary of actual usage, actual heating degree days and customer counts for five or more recent cold days from the 2001-2002 or 2002-2003 ACA period. Compare the usage on these actual cold days to the usage estimated by the Company's peak day 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. If the model is re-evaluated based on these findings, please provide details of the re-evaluation.

4. File a written response to the above three recommendations by April 30, 2003.