MEMORANDUM

TO: Missouri Public Service Commission Official Case File,
Case No. GR-2003-0150, Atmos Energy Corporation

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/s/ David M. Sommerer 09/15/03	/s/ Thomas R. Schwarz 09/15/03
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff's Recommendation in Atmos Energy Corporation's 2001-2002
Actual Cost Adjustment Filing

DATE: September 15, 2003

The Procurement Analysis Department (Staff) has reviewed Atmos Energy Corporation's (Atmos or Company) 2001-2002 Actual Cost Adjustment (ACA) filing for the former territories of Greeley Gas (Area G), United Cities Gas (Areas P and U) and Associated Natural Gas (ANG) service territory (Areas B, K, and S). This filing was made on October 18, 2002, and was docketed as Case No. GR-2003-0150. The 2001-2002 ACA filing rates became effective on November 1, 2002.

Staff's review consisted of an audit and evaluation of the billed revenues and gas costs for the period of September 1, 2001 to August 31, 2002 for Areas B, K, and S and June 1, 2001 to May 31, 2002, for Areas G, P, and U. A comparison of billed revenue recovery with actual costs will yield either an over-recovery or under-recovery of the ACA, Refund and Transition Costs. Staff also performed an examination of Atmos' gas purchasing practices to determine the prudence of the Company's purchasing decisions. Staff conducted a reliability analysis including a review of estimated peak day requirements and the capacity levels needed to meet these requirements. Staff also conducted a hedging review to determine the reasonableness of the Company's hedging plans for this ACA.

Williams Gas Pipeline Central (WGPC) serves customers on Greeley's Southwest Missouri District (Area G). Greeley Gas serves approximately 530 customers in Rich-Hill and Hume Missouri.

United Cities Gas separates its gas operations into the Consolidated District (Area P and part of Area U) and the Neelyville District (the rest of area U). The Consolidated District is comprised of the former Districts of Hannibal/Canton, Bowling Green and Palmyra. Each of those former districts still had refund balances that applied specifically to customers in that former district during this ACA period. Therefore, the Company continued to keep separate refund balances for each of these

former districts. Once these separately held refunds have been distributed to the customers in each of these districts, future refunds will be applied to the Consolidated District. United Cities Gas serves approximately 14,600 customers in the Consolidated District and 570 customers in the Neelyville District.

Atmos separates its ANG gas operations into the following districts: SEMO (Area S), Kirksville (Area K), and Butler (Area B). The SEMO, Kirksville and Butler Districts serve approximately 37,000 customers, 6,200 customers and 4,000 customers, respectively. For purposes of the reliability review, Atmos separates its Missouri gas operations into the following service areas: Butler/Panhandle Eastern Pipe Line (PEPL), Kirksville/ANR, Jackson/Natural Gas Pipeline (NGPL), Piedmont/Mississippi River Transmission (MRT) and the Southeast Missouri Integrated system consisting of Texas Eastern Pipeline (TETC), Ozark Gas Transmission, and Arkansas Western Pipeline.

GREELEY GAS

REALLOCATION OF WILLIAMS STORAGE AND TRANSPORTATION DEMAND

Staff identified the proper demand-related costs associated with WNG transportation and WNG storage. The transportation and storage demand costs were then multiplied by the Missouri allocation factors developed by the Staff (for demand costs). For the period of June 2001 to October 2001, Staff used a demand allocation factor of 3.04% (carried forward from the 2000-2001 ACA) versus a Company filed allocation factor of 2.76% to Missouri. For the period of November 2001 to May 2002 Staff developed a demand allocation factor of 2.9% versus 2.67% filed allocation factor. The Staff proposes a net increase of $2,419 ($130 + $2,289) to the demand cost of storage and transportation.

STORAGE

Staff determined the cost of storage injections/withdrawals by using the weighted average cost of gas method. During this ACA period, Staff relied on Greeley's billed storage injection and withdrawal volumes. Those volumes were based on Greeley's planned storage injection and withdrawal volumes and storage inventory balances that were administered by its agent, Woodward Marketing. Staff will continue to monitor the planned injection and withdrawal volumes to actual volumes to test the reasonableness of the storage injections and withdrawals filed by the Company.

An adjustment was made to the Company's storage schedule. This adjustment is due to storage revisions made during August 2001, September 2001, December 2001 and May 2002 (February 13, 2003, e-mail response), post-period adjustments by the Company in June 2001, per Data Request (DR) 52, and Staff allocation changes. The Staff believes the cost of storage should be reduced by $14,885.

ACA BALANCE

The Staff made adjustments totaling ($41,188) during the 2000-2001 ACA review. This amount was agreed upon in the Unanimous Stipulation and Agreement in Case No. GR-2001-394. The Staff conducted a follow-up review on the status of these adjustments. During the 2001-2002 ACA filing, the Company included these adjustments twice: 1) In the ACA balance for the period of June 2000 to May 2001 ($136,585) that was carried forward to the 2001-2002 ACA; and 2) in the June 2001 to May 2002 cost of gas ($110,958). Staff believes that to correct this double-counting error, gas costs should be increased by $41,188.

CAPACITY RELEASE

Staff adjusted Greeley's capacity release credits on Williams pipeline during this ACA review. During the months of August 2001 to October 2001, the Company overstated its capacity release credits to Missouri. Staff revised the allocation factors during those months to reflect the proper capacity release credits. Staff believes the capacity release credits should be reduced by $1,251, thus, increasing the cost of gas by $1,251.

RELIABILITY ANALYSIS

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 the 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.

The Company submitted a peak day analysis for the market area, which includes customers in the Company's Missouri service area. Staff has the following comments and concerns regarding the Company's reliability analysis.

1. In the Company's peak day planning, it included a review of the average number of customers in past years. These averages are used to estimate the number of customers for future years. The Company does not explain the source of the average customer numbers. If this is an annual average, Staff is concerned that this may underestimate the number of customers in the winter months. Staff's review of past information from the Company shows that the customer numbers tend to be higher in the winter months. Thus, if these were annual averages, the Company would be underestimating the customer numbers for winter planning. Staff recommends that the Company more fully explain the source of these customer numbers and why the estimates are appropriate for peak day planning.

2. For the term of April 1, 2001 through March 31, 2002, the Company had a contract with Woodward Marketing as Blanket Agent on Greeley's transportation and storage contracts on Williams Natural Gas. The specific terms regarding the purchase of natural gas were to be detailed in Greeley's Summer and Winter Operational Plans. However, these plans are for

normal weather. Peak day requirements are not included in this documentation. Additionally, there is no specification in the contract of the maximum daily quantity (MDQ) of natural gas to be provided. Thus, Staff is concerned whether sufficient natural gas would have been provided for a peak cold day. Although the winter of 2001-2002 did not have any days near the Company's stated peak of 75 heating degree days (HDD), the Company did not know what the coldest day would be at the start of the winter.

The Company states that the Gas Supply Plan may be adjusted to assure ability to schedule storage sufficient for a late peak day, but no guidelines are given for minimum storage balances that should be targeted at the end of November, December, January and February to assure sufficient storage in subsequent months. The Company stated that it communicates with the agent to assure sufficient storage levels for later winter months. ** ___________
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_______ **. Staff is concerned that there is not sufficient language in the contract to assure that the inventory of natural gas in storage is properly managed to assure that sufficient gas is available for later winter months. This is also a concern because the Company's Trans-Storage Service (TSS) contract with Williams states that when a shipper requires deliveries at its maximum daily transportation quantity (MDTQ), at least one-third of, but no more than one-half of the total deliveries of gas shall be from flowing supply sources, and at least one-half of, but no more than two- thirds of the total deliveries of gas shall be from storage. Thus, the Company must manage its storage inventory so that adequate volumes of storage are available for each of the heating season months.

Staff recommends that for future gas supply plans, the Company consider what supply resources, including storage, will be utilized for a warm, normal and cold winter, and what supply resources will be utilized to meet peak day requirements.

HEDGING

Greeley Gas implemented a hedging plan within the guidelines of regulated utility operations risk management control. Based on normal requirements for Missouri during the winter 2001-2002, the Company combined futures contracts purchases and options to stabilize gas prices. These financial hedging instruments also included swaps and collars. The goal of the Company is to hedge up to 50% of its expected normalized purchased gas requirements. No physical hedges were transacted for Missouri during the winter 2001-2002. These financial instruments combined with storage

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utilization covered close to 70% of normal requirements during the winter months (November 2001 through March 2002), and it turned out that the financial instruments and storage combined to cover almost all deliveries in March. The financial hedging was provided by ONEOK Energy, Marketing, and Trading, and Woodward Marketing companies. The hedging activities occurred throughout the summer of 2001 up to early October 2001. The Company subscribes to several market publications as well as DTN, a satellite service that provides real-time NYMEX future quotes, weather and natural gas industry news. It seems that the execution of hedging was based largely on NYMEX price movements. The Company also conducted a customers survey study in November 2001 through The Research Partnership, Inc. regarding the customers' opinions about the hedging, and a sample of its customers participated in the study.

Given the Company's adoption of a hedging strategy that utilizes various financial instruments, it is recommended that the Company should carefully continue to monitor the market movements and look into the possibility of expanding its gas portfolio to include physical hedges in order to better ensure successful and prudent hedging.

For Staff's compliance adjustment ($35), see explanation in the "Hedging" section of Associated Natural Gas.

SUMMARY – GREELEY GAS

The Staff has addressed the following concerns regarding Case No. GR-2003-0150 for Greeley Gas' Southwest Missouri District and proposes the following:

1. That Greeley adopt the Staff-adjusted WNG storage, WNG transportation and gas demand charges, which will increase the cost of gas by $2,419 ($130 + $2,289).
2. That Greeley adopt Staff's revised storage inventory schedule that results in reduced gas costs of $14,885.
3. That Greeley increase gas costs by $41,188. The Company improperly included Staff's ($41,188) adjustment (from 2000-2001 ACA) twice in the 2001-2002 ACA filing.
4. That Greeley increase gas costs by $1,251 to reflect the proper allocation factors to capacity release credits.
5. Greeley implemented a hedging plan that includes financial hedging instruments such as swaps and collars, within the guideline of regulated utility operations risk management control. Staff also conducted a compliance review of the Company's hedging activities. Staff proposes that Greeley reduce gas costs by $35 for hedging activity.
6. Although there is no adjustment related to reliability or supply planning, Staff has concerns in these areas. These concerns are documented in the Reliability Analysis section of this recommendation.

RECOMMENDATION – GREELEY GAS

The Staff recommends the Commission issue an order requiring Atmos to:

1. Adjust the ACA account balances in its next ACA filing to reflect the following Staff adjustments and to reflect the <u>(over)/under</u> recovered ACA, Transition Cost and Refund balances in the third column of the table below:

(GREELEY) Area G **Description**	**Company Ending Balances per Filing**	**Staff Adjustments (2)**	**Staff Recommended Ending Balances**
(1) Ending 2000-01 ACA Balance	($136,585)	$0	($136,585)
Revenue Recovery	($122,456)	$0	($122,456)
Purchased Gas Cost	$110,958	$29,938	$140,896
DCCB	($ 170)	$0	($170)
Total (Over)/Under Recovery	($148,253)	$ 29,938	($118,315)
Refund	$ 7,734	$0	$7,734

1. Includes Staff's ($41,188) total adjustment from GR-2001-394
2. $2,419+($14,885)+$41,188+$1,251+($35)=$29,938

2. Take the following actions related to reliability analysis by January 12, 2004:

   a. Respond to Staff's concerns in the Reliability Analysis section regarding use of average number of customers for peak day planning. If the Company revises its estimate of the expected number of customers, submit updated estimates of peak day requirements for the 2002/2003 ACA period and two to three years beyond that, and submit updated estimates of the reserve margin for the 2002/2003 ACA period and for two to three years beyond that. Explain the Company's rationale for the reserve margin for each system for each of these years.

   b. Respond to Staff's concerns in the Reliability Analysis section concerning more complete natural gas supply plans for a warm, normal and cold winter, and supply resources that will be utilized to meet peak day requirements. Provide this information for the 2002/2003 ACA period. The natural gas supply plan should address Staff's concerns regarding availability of sufficient natural gas from storage for the later winter months of January, February and March.

3. File a written response to the recommendations included herein within 30 days.

UNITED CITIES GAS

BEGINNING BALANCES MAY 31, 2001

In its Order Approving Stipulation, Establishing ACA Balance, and Closing Case effective May 23, 2003, the Public Service Commission established the May 31, 2001, ending balances for United Cities Case No. GR-2001-397. The established balances agreed with Appendix "B" of the Unanimous Stipulation and Agreement that the parties filed on April 4, 2003. However, United Cities' support for the 2001-2002 ACA filing showed the beginning balances at May 31, 2001, to be different amounts. The reason is that the 2001-2002 Purchased Gas Adjustment/Actual Cost Adjustment (PGA/ACA) filing was made on October 17, 2002, while the prior year amounts were still in dispute until May 23, 2003. Therefore, Staff proposes adjustments to the May 31, 2001, ACA balances as shown in the table below:

	5/31/01 Beginning Balance per Filing for 2001-2002	**Staff Adjustments**	**Unanimous Stipulation & Agreement Ending Balances for 2000-2001**
Consolidated District: Demand ACA	($615,349)	($2,102)	($617,451)
Commodity ACA	$328,257	($194,894)	$ 133,363
Take-or-Pay	$ 10,655	$0	$ 10,655
Neelyville District: Demand ACA	($6,404)	$ 403	($6,001)
Commodity ACA	$ 46,193	($8,417)	$ 37,776
Take-or-Pay	($79)	$0	($79)
Refund	($387)	$ 124	($263)
Hannibal/Canton District: Refund	$ 13,268	($15,495)	($2,227)
Palmyra District: Refund	($2,943)	($11,292)	($14,235)
Bowling Green District: Refund	$ 812	($23)	$ 789

TAKE-OR-PAY BALANCES

Staff noted some misclassifications between United Cities' ACA and Take-Or-Pay (TOP) balance. However, there is no need for reclassifications between the accounts because they are to be combined. The United Cities tariff, Sheet No. 56.1, states, "After the permanent cessation of billing TOP settlement costs to United Cities by its supplier(s) or transporter(s), United Cities shall carry forward any remaining over or under recovery balance and include it in the calculation of the Annual PGA Filing." There were no new billings of TOP settlement costs during the 2001-2002 ACA

period, and the cessation appears to be permanent. Therefore, Staff proposes adjustments to close out the May 31, 2002, ending TOP balances of $1,213 under-recovered for the Consolidated District and ($70) over-recovered for the Neelyville District and combine those balances with the Commodity ACA balances for those respective districts.

REFUNDS

Staff's review of United Cities' refund activity for the Consolidated District indicated that the Company had over-refunded balances in their refund accounts at the end of the ACA period ending May 31, 2002. This means that the Company's refunds to customers exceeded the refund balance due the customers. On May 31, 2002, United Cities had balances collectible by the Company from customers in the amounts of $19,029 for the Hannibal/Canton District, $634 for Palmyra and $623 for Bowling Green. The Neelyville District, on the other hand, had a small under-refunded balance due to customers of $218.

The over-refunded balances, as computed by Staff, are smaller than the over-refunded balances reported by the Company in its ACA filing. The differences in the calculations are partly due to differences in the beginning balances carried forward from the prior year, as explained in the paragraph and table above, "Beginning Balances May 31, 2001." The rest of the differences are due to the Company's using different time periods for the computation of refunds passed through to, or collected from customers. For Hannibal/Canton and Palmyra Districts, United Cities used the period September 2001 through August 2002 in computing the amounts of refunds passed on to customers during the ACA period 2001-2002. For Bowling Green and Neelyville Districts, it used the period September 2000 through November 2001. Because United Cities' actual ACA period is from June 2001 through May 2002 and refund rates changed in all districts, the timing differences caused differences in reported refund activity.

Staff revised the refund balances, including interest, for all four districts. The Staff-adjusted refund balances are included in the table contained in the "Recommendations – United Cities" section of this ACA recommendation memo. Staff believes that the Company should adopt the refund balances proposed by Staff for the period ended May 31, 2002. The refund factors would become effective during the November 2003 Purchased Gas Adjustment (PGA) filing.

PROPANE

In the recommendation memo for the prior year ACA Case No. GR-2001-397 Staff proposed an adjustment to exclude the cost of propane used by one of United Cities' customers. That adjustment was included in the Order Approving Stipulation, Establishing ACA Balance, and Closing Case.

During the 2001-2002 ACA period, United Cities continued to buy propane for that customer. The Company then billed the customer a firm PGA to recover costs associated with the propane. In its 2001-2002 ACA filing, United Cities' reported gas costs included $999 for propane, and its reported PGA/ACA revenues included $565 related to customer charges for propane billings. There is no provision in the Company's tariffs for this type of propane service. The Staff believes that any costs

and revenues associated with this propane service should be excluded from the ACA filing. Therefore, the Staff proposes to adjust the Consolidated District's Commodity ACA balance by $434 to exclude the $999 propane costs, net of the $565 related revenue.

UNSUPPORTED INVOICE FOR GAS COSTS

United Cities' invoiced commodity cost for the Consolidated District included a Oneok invoice for which inadequate support was provided. The invoice, dated January 24, 2002, was a one-time invoice unlike any other charges for any other month. It showed no gas volume related to the $18,600 charge, and the Staff received no copy of the agreement that established the volume and rate for the charge. The cost was allocated based on volumes from another invoice. Of the $18,600 charge, $4,089 was allocated to Illinois and the remaining $14,511 to Missouri. In the absence of convincing evidence that this cost is properly includable in Missouri PGA costs, Staff proposes an adjustment to exclude the $14,511 Missouri portion from the recoverable Consolidated District Commodity ACA gas costs.

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% are 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 the 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.

In its 2001-2002 PGA/ACA filing the Company miscalculated the carrying costs applied to the DCCB in the Neelyville and Consolidated Districts. Therefore, the Staff proposes to increase the Consolidated District demand over-recovery by $728.16, decrease the Consolidated District commodity over-recovery by $1,685.60 and increase the Neelyville commodity over-recovery by $2.93.

RELIABILITY ANALYSIS

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 two United Cities Districts.

A. Consolidated District

1. The Company used a regression analysis to estimate usage for the industrial-firm customers. However, the adjusted coefficient of determination, R^2, is extremely low at 0.014, indicating that there is little relationship between estimated usage and heating degree days (HDD) for these customers.

   In the GR-2001-397 Staff Recommendation, Staff commented on the poor R^2 for the industrial-firm customers. Staff recommended that the Company reevaluate the Company's methodology for estimating industrial-firm customer usage and submit this by February 3, 2003. The Company response states that industrial firm load was analyzed using the same regression techniques as the other classes. The Company states that it had looked at other ways to evaluate this load, but determined the regression provided the most accurate results. These "other ways of evaluating load" were not provided. Staff fails to see how a model with a R^2 of 1.4% could provide a reasonable estimate of usage for industrial customers. Staff again recommends that the Company find a better estimator for industrial-firm customer usage.

2. The Company's selection of 77 HDD for the peak cold day does not seem appropriate. The Company review shows colder days of 80 HDD in the winter of 1989/1990 and 78 HDD in the winter of 1983/1984. Staff's review also shows colder days of 80.5 HDD on December 22, 1989 and 78 HDD on December 25, 1983. Staff recommends that the Company use 80 or 80.5 HDD for peak day planning.

3. The 2001/2002 reserve margin of 17.8% is high. Since the area experienced a colder day in 1989/1990, Staff looked at the reserve margin for a colder day and this reduces the reserve margin to 6.3%. Since one of the transportation contracts is only charged for the actual volumes used (no fixed charges), customers are not paying for this capacity unless it is used, and thus, the reserve margin is not a concern at this time.

4. Staff disagrees with the Company computation for peak day capacity from the propane-air plant. The Company's reserve margin calculation, in the Company Response to Case No. GR-2001-397 ACA Recommendation, shows the propane plant capacity as 3,300. The Company states that support for the propane capacity is provided in the Case No. GR-99-280, DR 56 and DR 60 responses. Although Staff does not agree with the Company rationale for 3,300, Staff can accept the Company comments regarding allowance for time for plant start-up and that the plant may be running at reduced efficiency. The Company provides no quantification for a reasonable reduced efficiency. Staff review shows the propane facility is capable of delivering 4,800 MMBtu/day natural gas equivalent. Staff's calculation of reduced deliverability uses the Company's estimate of a four-hour startup, and absent any estimation from the Company, Staff considered efficiency of 82%.

5. The Company's gas supply plan for the winter months shows that the Company considers normal requirements, but then adjusts the planned purchases based on a comparison to the prior winter. However, this review of prior winter purchases does not consider whether the prior winter monthly purchases were for warm, normal or cold weather. Staff believes that this comparison is not appropriate unless the Company considers weather normalization of prior year data.

B. Neelyville District

1. The 2001/2002 reserve margin of 31.9% is high. However since two of the transportation contracts are only charged for the actual volumes used (no fixed charges), and the reserve is less than the daily volume of these contracts, customers are not paying for this excess reserve margin, and thus, the high reserve margin is not a concern at this time.

2. For each of the two customer classes of residential and commercial-firm, the Company conducted a separate regression analysis of 25 months of customer counts and sales data for February 1999 – February 2001 by analyzing usage/customer versus HDD for this same time frame. HDD appears to be for the billing cycle of the 16th of one month through the 15th of the next month. The Company is not consistent in how it selects the HDD for each month. The Company uses HDD for January 16, 1999 - February 15, 1999, for February 1999, but then uses March 16, 1999 – April 15, 1999, HDD data for March 1999. The HDD data for February 16, 1999 – March 15, 1999, was skipped. The Company's HDD calculations for September 1999 and subsequent months return to using the HDD for the 16th of the prior month to the 15th of that month. Staff reran the regression analysis using the corrected HDD data (did not skip the HDD for February 16, 1999 - March 15, 1999). The output of this regression analysis shows a higher correlation, but the results do not make a large impact on the peak day estimate. Care should be taken in future Company analyses to assure that the appropriate usage and HDD data are being compared because there ould be a large difference in HDD from month to month.

3. The Company's response to Staff's request for a summary of the gas supply contracts for this ACA period was incomplete. The Company only included a summary for summer 2001 volumes for Energy USA and Anadarko, and volumes for Duke Energy for the winter of 2002-2003. No supply contracts were shown for the winter of 2001-2002. A review of the invoices showed winter purchased volumes for this ACA with Anadarko and PG&E. The combined supply contracts and storage contract could have provided only 46% of peak day requirements. Although it is possible that the Company had some swing contracts that could have been used if the weather had been cold, details of any such contracts were not provided. More complete information should be provided for the 2002-2003 ACA review.

4. The Company states that for Neelyville/NGPL the agent has been instructed to meet a peak day in the following manner: (1) baseload supply on the FT contract;

(2) storage supply to the maximum withdrawal capability on FT contract; (3) swing supply on any remaining FT capacity; and (4) swing supply on FTS-G (one part contract) for remaining demand. Staff questions that if storage is used to maximum withdrawal capability, how does the Company know that sufficient storage will be available if it is needed for a really cold day that occurs in January, February or March?

5. Storage was only filled to 44% at the end of October 2001. More storage was used in the winter months than was available; at the end of February 2002, the storage balance was –1%; at the end of March and April 2002, the storage balance was at -13%.

HEDGING

United Cities Gas implemented a hedging plan within the guidelines of regulated utility operations risk management control. Based on normal requirements for Missouri during the winter 2001-2002, the Company combined futures contracts purchases and options to stabilize gas prices. These financial hedging instruments also included swaps and collars. The goal of the Company is to hedge up to 50% of its expected normalized purchased gas requirements. No physical hedges were transacted for Missouri during the winter 2001-2002. These financial instruments combined with storage utilization covered close to 70% of normal requirements during the winter months (November 2001 through March 2002) and it turned out that the financial instruments and storage combined to cover more than 80% of actual deliveries for December through February. The financial hedging was provided by ONEOK Energy, Marketing, and Trading, and Woodward Marketing companies. The hedging activities occurred throughout the summer 2001 up to early October 2001. The Company subscribes to several market publications as well as DTN, a satellite service that provides real-time NYMEX future quotes, weather and natural gas industry news. It seems that the execution of hedging was based largely on NYMEX price movements.

Given the Company's adoption of a hedging strategy that utilizes various financial instruments, it is recommended that the Company should carefully continue to monitor the market movements and look into the possibility of expanding its gas portfolio to include physical hedges in order to better ensure successful and prudent hedging.

For Staff's compliance adjustment with United Cities ($3,110) and Neelyville ($75), see explanation in "Hedging" section of Associated Natural Gas.

SUMMARY – UNITED CITIES

The Staff has addressed the following concerns regarding Case No. GR-2003-0150 for United Cities Gas Company and proposes the following:

1. That United Cities adjust its beginning balances from May 31, 2001, to agree with the balances from the Unanimous Stipulation and Agreement that closed prior year Case

No. GR-2001-397. The related adjustments to the May 31, 2002, ending balances for ACA period 2001-2002 are the following:

a. Increase the Consolidated Demand ACA over-recovered balance by $2,102.
b. Increase the Consolidated Commodity ACA over-recovered balance by $194,894.
c. Increase the Neelyville Demand ACA under-recovered balance by $403.
d. Increase the Neelyville Commodity ACA over-recovered balance by $8,417.
e. Increase the Neelyville Refund over-refunded balance by $124.
f. Reduce the Hannibal/Canton Refund over-refunded balance by $15,495.
g. Reduce the Palmyra Refund over-refunded balance by $11,292.
h. Reduce the Bowling Green Refund over-refunded balance by $23.

2. That United Cities close out the May 31, 2002, ending Take-Or-Pay balances of $1,213 under recovered for the Consolidated District and $70 over-recovered for the Neelyville District and combine those balances with the Commodity ACA balances for those respective districts.

3. That United Cities adjust its refunds passed on to customers during the 2001-2002 ACA period to reflect the Staff's computations including interest as follows:
   a. Reduce the Neelyville 2001-2002 refunds to customers by $614 including interest, for a May 31, 2002, ending under-refunded balance of $218.
   b. Increase the Hannibal/Canton 2001-2002 refunds to customers by $9,722 including interest, for a May 31, 2002, ending over-refunded balance of $19,029.
   c. Increase the Palmyra 2001-2002 refunds to customers by $5,618 including interest, for a May 31, 2002, ending over-refunded balance of $634.
   d. Reduce the Bowling Green 2001-2002 refunds to customers by $484 including interest, for a May 31, 2002, ending over-refunded balance of $623.

4. That United Cities increase the over-collected Consolidated Commodity ACA balance by $434 to exclude costs of propane, net of PGA revenue claimed for propane sales.

5. That United Cities increase the over-collected Consolidated Commodity ACA balance by $14,511 to exclude gas costs for an inadequately documented and supported Oneok invoice dated January 24, 2002.

6. That United Cities adjust the interest on the DCCB to agree with the Staff's computation, as follows:
   a. Increase the Consolidated Demand ACA over-recovered balance by $728.
   b. Decrease the Consolidated Commodity ACA over-recovered balance by $1,686.
   c. Increase the Neelyville Commodity ACA over-recovered balance by $3.

7. Although there is no adjustment related to reliability or supply planning, Staff has concerns in these areas. These concerns are documented in the Reliability Analysis section of this recommendation.

8. United Cities implemented a hedging plan that includes financial hedging instruments such as swaps and collars, within the guideline of regulated utility operations risk management control. Staff also conducted a compliance review of Company's hedging activities. Staff proposes that United Cities reduce gas costs by $3,110 for hedging activity and Neelyville by $75.

RECOMMENDATION - UNITED CITIES

The Staff recommends the Commission issue an order requiring Atmos to:

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

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(UNITED CITIES) Areas P&U	**Ending Balances Due From Or (To) Customers per Filing**	**Notes Ref.**	**Staff Adjustments**	**Staff Recommended Balances Due From Or (To) Customers**
Consolidated District: Demand ACA	($801,690)	(A) (G)	($2,102) ($728)	($804,520)
Commodity ACA	($583,798)	(A) (B) (D) (E) (F) (G)	($194,894) $ 1,213 ($434) ($14,511) ($3,110) $1,686	($793,848)
Take-or-Pay	$ 1,213	(B)	($1,213)	$ 0
Neelyville District: Demand ACA	$ 170	(A)	$ 403	$ 573
Commodity ACA	($45,465)	(A) (B) (F) (G)	($8,417) ($70) ($75) ($3)	($54,030)
Take-or-Pay	($70)	(B)	$ 70	$ 0
Refund	$ 272	(A) (C)	$ 124 ($614)	($218)
Hannibal/Canton District: Refund	$ 24,802	(A) (C)	($15,495) $9,722	$19,029
Palmyra District: Refund	$ 6,308	(A) (C)	($11,292) $5,618	$634
Bowling Green District: Refund	$ 1,130	(A) (C)	($23) ($484)	$623

Notes to Staff Adjustments:

(A) Beginning balances May 31, 2001 adjusted to prior year ending balances

(B) Take-Or-Pay balances closed out and combined with commodity ACA balances

(C) Refunds adjustments for timing and interest

(D) Propane costs and revenues excluded from PGA/ACA balances
(E) Unsupported invoice for gas costs
(F) Hedging compliance adjustment
(G) DCCB interest adjustment

2. Take the following actions by January 12, 2004, related to United Cities reliability analysis:
   a. For the Consolidated District, re-evaluate the Company's methodology for estimating industrial-firm customer usage on cold days. Provide detailed justification explaining why the Company believes that this model is appropriate for estimating industrial-firm customer usage.

   b. For the Neelyville and Consolidated Districts, submit estimates of peak day needs for the 2002-2003 ACA period and two to three years beyond that. For the Consolidated District, use 80 or 80.5 HDD as the peak cold day for reliability planning. For the Neelyville District, address Staff's concerns in the Reliability Analysis section that the appropriate usage and HDD data are being analyzed.

   c. Provide details of the Company's quantification of efficiency for the propane-air plant for the Consolidated District.

   d. For the Neelyville and Consolidated Districts provide estimates of the reserve margin for the 2002-2003 ACA period and for two to three years beyond that. Explain the Company's rationale for the reserve margin for each system for each of these years.

   e. Respond to Staff's concerns in the Reliability Analysis section for the Neelyville District, items numbered 3 and 4, concerning more complete natural gas supply information and concerns regarding availability of sufficient natural gas from storage for the later winter months of January, February and March.

   f. Respond to Staff's concerns in the Reliability Analysis section for the Consolidated District, item number 5, concerning gas supply plans.

3. File a written response to the recommendations included herein within 30 days.

ASSOCIATED NATURAL GAS

ACA BALANCE

In the Unanimous Stipulation And Agreement approved on May 13, 2003, the Public Service Commission established the August 31, 2001, ending balances for Associated Natural Gas, Case No. GR-2001-396. However, the Company's support for the 2001-2002 ACA filing showed the

beginning balances at August 31, 2001, to be different amounts. The reason is that the 2001-2002 PGA/ACA filing was made on October 18, 2002, while the prior year, amounts were still in dispute until April 4, 2003 (Unanimous Stipulation and Agreement file date). Staff, therefore, proposes adjustments to the August 31, 2001, ACA balances as shown in the table below:

ANG Areas B, K, and S	8/31/01 Beginning Balance per Filing for 2001-02	Staff Adjustments	Unanimous Stipulation & Agreement Ending Balances for 2000-01
SEMO District: Firm ACA	($2,242,950)	($629,375)	($2,872,325)
Interruptible ACA	($208,399)	$23,450	($ 184,949)
Firm Refund	$13,313	$0	$13,313
Interruptible Refund	$1,896	$0	$1,896
Transition Cost	($26,764)	$0	($26,764)
Kirksville District: Firm ACA	($1,375,380)	($35,691)	($1,411,071)
Interruptible ACA	($227,304)	($102,496)	($329,800)
Firm Refund	$22,053	$0	$22,053
Interruptible Refund	$6,185	$0	$6,185
Transition Cost	($604)	$0	($604)
Butler District: Firm ACA	($653,081)	($16,155)	($669,236)
Interruptible ACA	($42,019)	($764)	($42,783)
Firm Refund	$ 1,956	$0	$ 1,956
Interruptible Refund	$1,051	$0	$1,051

LIQUIFIED NATURAL GAS

During the course of Staff's review of the 2001-2002 ACA, the Staff noted that the Company did not include $90,408 of commodity expenses for its Liquefied Natural Gas (LNG) deliveries in March 2002. Staff believes that these costs should have been recovered by Atmos as a cost of gas and recovered in the PGA, but were inadvertently omitted by the Company in its 2001-2002 ACA filing. Staff's adjustment increases gas costs for the SEMO firm customers by $83,139 ($90,407 x 91.96%) and SEMO interruptible customers by $7,268 ($90,407 x 8.04%).

During Staff's 1999-2000 and 2000-2001 ACA review, Staff disallowed certain expenses for LNG plant related to peaking services. The Staff conducted a follow-up review on the status of these adjustments. The adjustment pertaining to the 1999-2000 ACA was designed to reduce gas costs by $83,778 for the SEMO firm customer and $31,592 for the SEMO interruptible customer, for a total gas cost reduction of $115,370. During the 2001-2002 ACA filing, the Company included these adjustments twice: 1) In the ACA balances (firm and interruptible) for the period of September 2000 to August 2001 that were carried forward to the 2001-2002 ACA; and 2) in the September 2001 to August 2002 cost of gas (firm and interruptible). Staff believes that to correct this error, gas costs should be increased by $83,778 for SEMO firm customers and $31,592 for SEMO interruptible customers.

DCCB ADJUSTMENT

The Staff, as a result of its review of the Atmos 2001-2002 ACA filing, believes that the unit cost of gas derived by Atmos (for its DCCB calculation) was overstated for the SEMO, Kirksville and Butler Districts. The Staff believes that the purchase volumes used by the Company in calculating the unit cost of gas was understated and thus a higher unit cost of gas resulted. In addition, Atmos PGA tariffs specify that DCCB interest must be calculated on a month-ending cumulative basis for each month of the ACA period. As a result, when the cumulative balance exceeds an amount equal to ten percent of the average annual level of gas costs for the three most recent ACA periods, carrying costs are calculated. As a result of Staff's review, the 10% threshold (ten percent of the average annual level of gas costs) was only exceeded on the SEMO District interruptible class for the month of October 2001. Staff therefore proposes the following: 1) adjustment of ($803,898) to the SEMO District's firm customer ACA balance; 2) adjustment of ($12,533) to the SEMO District's interruptible customer ACA balance; 3) adjustment of($10,315) to the Butler District's firm customer ACA balance; 4) adjustment of ($1,288) to the Butler District's interruptible customer ACA balance; 5) adjustment of ($28,196) to the Kirksville District's firm customer ACA balance; and 6) adjustment of ($1,090) to the Kirksville District's interruptible customer ACA balance.

REFUNDS

Staff's review of the Company's refund activity for the SEMO and Kirksville Districts, as well as the Butler interruptible District, indicated that the Company had an over-collected balance in their refund account for the twelve months ended August 31, 2002. This means that the Company's collection of refunds exceeded the refund balance due the Company (an over-collection) therefore, a balance is due the customer. During the 2001-2002 ACA period, the Company did not carry forward the proper balance (positive or negative) in its refund accounts, which further increased the already existing over-collected balances in certain instances. Staff revised the refund balances for all three districts. The Staff adjusted refund balances are included in the table contained in the "Recommendations section" of this ACA recommendation. Staff's review also revealed that the sales volumes used to calculate the refund factor was the same for the SEMO and Kirksville Districts. Staff recommends that the Company use appropriate sales volumes in developing the refund factor for each district.

Staff believes that the Company should adopt the refund balances proposed by Staff for the period ended August 31, 2002. The refund factors would become effective during the November 2003 PGA filing.

AGENCY FEES

Atmos' contract agreement with Mississippi River Transmission (MRT) Energy Resources includes services provided under an agency agreement. As compensation for services provided, Atmos pays a monthly agency fee to MRT Energy Resources that is based on volumes delivered to Atmos.

The Company's tariffs do not allow for recovery of fees related to agency agreements. The Staff views agency fees as more closely related to consulting services that are typically reviewed in a general rate case. As a result, Staff proposes an adjustment to reduce the SEMO District gas costs by $4,660 ($4,083 firm and $577 interruptible).

INTEREST COSTS

From December 2001 to August 2002, Atmos was billed by TETC and NGPL for interest on past due balances. Staff does not believe that Atmos customers should be held responsible for interest expenses resulting from late payments made by the Company. As a result, Staff proposes to reduce gas costs for SEMO firm customers by $520 and interruptible customers by $55.

TRANSITION COSTS

On the SEMO District, Atmos had transition cost credits of $41,584, as of August 2002. Atmos indicated that they would write-off (eliminate) the transportation portion of the transition cost recovery of $17,252. Staff included the $17,252 credit in the Transportation Transition Cost recovery account (see table in Recommendation section). The balance of these transition costs, $24,332 ($41,584-$17,252) is transferred from the transition cost recovery account to the ACA account. The transition cost recovery account balance for sales customers is thereby eliminated for this ACA period. Staff believes the SEMO firm ACA account balance should be adjusted by ($21,557) and interruptible customers by ($2,775).

The same action occurred on the Kirksville District. Atmos had transition cost credits of $1,163 as of August 2002. The Company eliminated the transportation customers portion of the transition cost recovery of $707. Staff included the $707 credit in the Transportation Transition Cost recovery account (see table in Recommendation section). The balance of these transition costs, $456 ($1,163-$707) is transferred from the transition cost recovery account to the ACA account. Staff believes the Kirksville firm ACA account balance should be adjusted by ($363) and interruptible customers by ($93).

MRT ENERGY MARKETING COMPANY

Gas was purchased from MRT Energy Marketing Company (MRT Energy) during the 2001-2002 ACA period. During the months of November 2001 and December 2001, deliveries were made to the MRT west line delivery point that did not comply with the contract terms with MRT Energy. November 2001 deliveries were billed at the east line index price, not the west line index price. December 2001 deliveries were billed at the November 2001 west line index price, not the December 2001 west line index price. To adjust for these discrepancies, Staff believes the proper cost of gas for November 2001 deliveries is $23,170 ** ____________ **. The November 2001 invoiced cost is $31,920 ** _____________ **. This results in an $8,751 gas cost decrease for November ($23,170 - $31,920). Staff believes the proper cost of gas for December 2001 deliveries are $28,441 ** ________________ **. The December 2001 invoiced cost is $24,819 ** ______________ **. This results in a $3,622 gas cost increase for December ($28,441 - $24,819).

Adjustments for November and December combined for a $5,129 ($8,751-$3,622) gas cost reduction for SEMO customers, $3,459 ($6,644-$3,185) reduction for firm customers and $1,670 ($2,107-$437) reduction for interruptible customers.

OVER RUN GAS

Staff's review of the Company's storage and transportation activity on ANR pipeline (Kirksville District) indicate that over-run charges occurred during the period of November 2000 to April 2001 because the Company did not meet the requirements of ANR's tolerance level. The Staff believes that Atmos customers should not be responsible for excessive charges incurred by the Company's inability to take corrective action. Staff proposes that gas costs on the Kirksville District be reduced for the Company's firm customers by $11,216 and interruptible customers by $2,173, for a total reduction of $13,389.

Atmos also incurred unauthorized over-run charges on Natural Gas Pipeline System (NGPL) during the months of December 2001 and January 2002. As described above, the Staff believes that Atmos customers should not be responsible for excessive charges incurred by the Company's inability to take corrective action. Staff proposes that gas costs on the SEMO District be reduced for the Company's firm customers by $7,736 and interruptible customers by $1,014, for a total reduction of $8,750.

NP

STORAGE

Staff has reviewed the activity (injections and withdrawals) of Company's storage inventory with Texas Eastern Pipeline (TETC), Natural Gas Pipeline (NGPL) and MRT on the Company's SEMO District, Panhandle Eastern Pipeline (PEPL) on the Butler District, and with ANR on the Kirksville District. Based on its review, Staff adjusted the Company's storage inventory schedule for TETC and NGPL on the SEMO District and for ANR on the Kirksville District. Staff's adjustments were attributed to pricing and volume changes relate to prior period storage adjustments.

In summary, Staff proposes to reduce the overall cost of gas on the Kirksville District by $11,167. This impacts firm sales customers by $8,880 (79.52%), and interruptible sales customers by $2,287 (20.48%). For the SEMO District (TETC and NGPL), Staff proposes to increase the overall cost of gas by $57,997. This impacts firm sales customers by $51,710 (89.16%) and interruptible sales customers by $6,287 (10.84%). For the Butler District (PEPL), Staff proposes to reduce the overall cost of gas by $9,699. This impacts firm sales customers by $8,648 (89.16%) and interruptible sales customers by $1,051 (10.84%). If Staff's storage adjustments are accepted in this filing, Staff requests that its revised storage inventory schedules be adopted as well.

ENERGY USA RECONCILAIATION

Atmos prepared a reconciliation of buy-back gas from Energy USA for the period of November 2001 to April 2002. Energy USA purchased a certain amount of gas back from Atmos during this period and credited Atmos for this amount. Staff's review indicated, in this reconciliation, that Atmos misstated its payment made to Energy USA during the month of January 2002. Staff's review (of this reconciliation) indicated that the Company's record of payment to Energy USA in January 2002 was incorrectly stated at $178,018. Staff believes the proper credit for January 2002 purchases to Energy USA should be $225,353, a difference of $47,335. Staff therefore believes that a $47,335 gas cost reduction should be applied to the Company's filing for SEMO firm customers.

RELIABILITY ANALYSIS

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 five service areas.

A. All service areas

There is a large shift in expected peak day usage from the Case No. GR-2000-573 review to Case No. GR-2003-0150 review. Staff recommends that the Company continue to provide updates of usage analysis, with any revisions made to baseload and heatload factors, and

provide updates on Company decisions for required capacity.

B. Butler District

1. Staff continues to recommend that the Company use 80 HDD as the peak cold day for reliability planning.

2. The 2001-2002-reserve margin of 50.3% for a peak cold day of 80 HDD is extremely high. However, there are no fixed demand charges on the transportation capacity. Thus customers are not paying for this excess reserve margin.

3. From Staff's review of supply resources, Atmos has much more flowing supply than needed for a peak day. However, Staff's review shows no reservation charges for the supply contract. Thus, customers are only paying for the supply when it is used.

C. Kirksville District

1. The 2001-2002 reserve margin of 37.2% for a peak cold day of 80 HDD is high. These contracts were previously put in place by ANG when the demand estimate was much higher. The transportation contracts do not expire until October 31, 2008, and March 31, 2009.

   In the Case No. GR-2001-396 ACA Recommendation, Staff recommended that the Company provide by February 3, 2003, documentation of efforts and results to release excess capacity for this service area for the 2001-2002 ACA period. The Company's response was that historically, capacity release has not been successful due to a lack of market for the Company contractual path. The Company does not say when it last attempted to release capacity and provides no evidence that any attempts were made for the 2001-2002 ACA.

   Staff estimates the cost of this excess capacity as $82,413 to $119,793 for the 2001-2002 ACA. Since the peak day usage estimates provided in the reviews of Case Nos. GR-2000-573, GR-2001-396 and GR-2003-0150 show far more capacity than needed for a peak cold day, Staff recommends that the Company make a more thorough attempt to release its excess capacity. Since the Company has provided no justification for retaining the excess capacity, it could be released on a non-recallable basis for an entire winter season, and possibly for one year or longer. The Company may find that there is much more interest in capacity release that is not recallable for six to twelve months at a time than for recallable capacity releases. The Company should reevaluate every six months to a year the volumes to be released and the appropriate length of time for a non-recallable release.

2. From Staff's review of supply resources, Atmos has much more flowing supply than needed for a peak day. Review of the supply agreements shows no reservation charges. Thus, customers are not paying for the excess supply.

D. Jackson District

1. The 2001-2002-reserve margin of 29.1% for a peak cold day of 67 HDD is high. The Company information regarding the peak day capacity is inconsistent. The Company response to DR 27 in Case No. GR-2003-0150 includes an electronic file that shows no reduced capacity later in the heating season. The hard copy of the response to DR 27 and the Company response to the Staff Recommendation in Case No. GR-2001-396 (Recommendation 3h response for 2001-2002 only) shows reduced capacity of 10,419, but no support is provided.

   In the Staff ACA recommendation in Case No. GR-2001-396, Staff did not agree with the Company's rationale for reduced capacity. Staff therefore recommended that the Company respond by February 3, 2003, to Staff's concern regarding the Company's lack of support for the assumption for reduced capacity for the Jackson system. The Company's response simply stated that under maximum reduction of storage deliverability per pipeline tariffs, the Company would still have capacity to manage all firm requirements. No support was provided justifying the use of a lower capacity for peak day planning.

   As noted in the ACA recommendation in Case No. GR-2001-396, a review of the delivered storage contract shows a minimum and maximum monthly withdrawal as a percentage of the maximum storage volume (MSV), but it allows 100% of the maximum daily withdrawal quantity (MDWQ) for November 1 through February 15. Thus, Staff believes that no reduced capacity should be assumed. Further, Staff review of this delivered storage contract shows that reduced withdrawal is based on the inventory level at the start of the winter season; the Company must have at least 95% of MSQ in storage some time between October 15 and November 15. If the inventory is below 95%, but at least 90%, the MDQ at each delivery point is reduced to 75% of MDQ (reduced to 1,898), for the pur-poses of determining the withdrawal quantity. This reduction does not match the reduction that is being claimed by the Company in this case, Case No. GR-2003-0150. Additionally, since this constraint is known, Staff would expect the Company to ensure that the 95% requirement is met, and again, no reduction in capacity should be assumed.

2. The Company extended all of the capacity contracts for a term of December 1, 2001 through November 30, 2004. However, the peak day usage estimates for Case Nos. GR-2000-573, GR-2001-396 and GR-2003-0150 show much lower peak day demand than that shown by ANG in 1998-1999, and also show reserve margins of 10.2% to 29.1% for 2001-2002.

   Staff is concerned that the Company extended these contracts at the same volumes, knowing that this total capacity was not needed for a peak day. The Company provided no analysis justifying renewal of these contracts at the same volumes and provided no analyses regarding the costs to customers. Thus, Staff evaluated the costs to customers.

Given that the Company decisions on contract changes would have been made in November 2000, or earlier for this ACA period, the appropriate ACA review period for any adjustment is 2001-2002. Thus, Staff considered the cost of this excess capacity beginning in 2001-2002.

The peak day estimate and reserve margin for Case No. GR-2003-0150 considered usage data for February 1999 through February 2001. Thus, the results from this analysis were not available to the Company when decisions were made to extend contracts for capacity for this system. However, the results from the regression analyses provided in Case No. GR-2000-573 were available to the Company and this showed an excess reserve margin of 1,275 Dth/day if a peak day of 67 HDD is used and an excess of 1,003 if a peak cold day of 69 HDD is used. Staff's review of the contracts that were renewed indicates that any extension must be at least 3 years from the November 30, 2001, end date. Thus, Staff reviewed estimates of peak day usage for 2001-2002, 2002-2003 and 2003-2004. This review shows that capacity exceeds the 2003-2004 peak day demand estimate by 472 Dth/day. The Company provides no justification for any reserve margin. However, lacking any other estimate, Staff calculated a reasonable reserve margin of 3% over the coldest day requirements based on analysis of the regression results. (Staff considered the standard error of the y-estimate as a reasonable reserve for purposes of the calculation of any adjustment.)

Staff's estimate of the cost of this excess reserve is $17,199 for the 2001-2002 ACA. For the Jackson system this is $2.40 per customer. Staff recommends an adjustment of $17,199 for excess capacity for the Jackson system.

E. Piedmont District

The 2001-2002-reserve margin of 15.9% for a peak cold day of 67 HDD is high. Although the reserve margin is high, the Company is only charged for the quantity transported. Thus, customers are not paying for this excess reserve margin.

F. Southeast Missouri Integrated

1. In the Case No. GR-2003-0150 Company peak day summary and the comparison of actual to estimated use, the Company uses the baseload factor from the regression analysis of the February 1999 through February 2001 data, but then uses the heatload factor from the previous year, Case No. GR-2000-573 regression analysis. Staff cannot accept a heatload factor from one set of data and a baseload factor from another set of data. The heatload is calculated given the calculated baseload factor of that review, and thus, the heatload factor would change if the baseload factor were to change.

   In the ACA recommendation for Case No. GR-2001-396, Staff recommended that the Company respond to this concern about the Company selection of baseload factor

and heatload factor by February 3, 2003. The Company response was that it analyzed the data for the Southeast Missouri area using the Company's standard regression analysis, which provides the baseload and heatload factors from the available data, and only one analysis was used, not two different analyses. Staff reviewed the data and regression analysis submitted by the Company in Case No. GR-2003-0150. This review revealed that in estimating usage, the Company continues to use the baseload factor from the February 1999 – February 2001 regression analysis and uses the heatload factor from a prior review.

2. The 2001-2002-reserve margin of 31.7% for a peak cold day of 72 HDD is high. The Company had claimed in the review in Case No. GR-2001-396 that capacity was reduced from the maximum shown on the contracts. Staff did not agree with the Company assertion for reduced capacity and recommended that the Company submit by February 3, 2003, any support to justify using a reduced available capacity. The Company submitted no evidence to support lower deliverability for the LNG facility. Regarding the storage contract, the Company's response simply stated that under maximum reduction of storage deliverability per pipeline tariffs, the Company would still have capacity to manage all firm requirements. No support was provided justifying the use of a lower capacity for the peak day. Additionally, the Company's DR response in Case No. GR-2003-0150 shows no reduced capacity later in the heating season.

3. Staff is concerned that the Company extended the Ozark FTS contract at the same volume, knowing that capacity exceeds peak day requirements. The Company does state that this contract was terminated October 31, 2002. The Company provided no analysis justifying renewal of this contract at the same volumes for the 2001-2002 ACA and provided no analyses regarding the costs to customers. Thus, Staff evaluated the costs to customers.

   It is Staff's understanding that the Company decision on extension or modification of this contract would have been made in May 2001 for this ACA period. Thus, the 2001-2002 period is the appropriate ACA period to consider an adjustment. Staff's review of the contract that was renewed indicates that a one-year extension was considered. Thus, Staff only reviewed the estimate of peak day usage for 2001-2002.

   The peak day estimate and reserve margin for Case No. GR-2003-0150 considered usage data for February 1999 through February 2001. Thus, the Company could have used the results from this analysis when decisions were made to extend this contract. In Case No GR-2001-396, the Company expressed concerns that because of the cold winter of 2000-2001, usage patterns changed and the heatload was not truly representative of expected heatload. Staff can accept that the Company is concerned about the heatload factor not being representative, but using a baseload factor from one review and a heatload factor from another review is not appropriate as explained above.

Since a previous regression analysis from the review in Case No. GR-2000-573 was available to the Company, Staff reviewed the baseload factor and heatload factor from the review in Case No. GR-2000-573, and considered more recent information from the Company for expected customer numbers. This gives a larger estimate of usage than that from the baseload factor and heatload factor from the regression of the February 1999 through February 2001 data. This results in an excess reserve margin of 6,993 Dth/day for a peak cold day of 72 HDD.

The Company provides no justification for any reserve margin. However, lacking any other estimate, Staff calculated a reasonable reserve margin of 2.9% over the coldest day requirements based on analysis of the regression results (Staff considered the standard error of the y-estimate as a reasonable reserve for purposes of the calculation of any adjustment). Staff's estimate of the cost of this excess reserve is $228,896 for the 2001-2002 ACA. For the Southeast Missouri Integrated system this is $8.18 per customer. Staff recommends an adjustment of $228,896 for excess capacity for the Southeast Missouri Integrated system.

4. From Staff's review of supply resources, Atmos has more flowing supply than needed for a peak day. However, the cost of this excess supply is not substantial. Thus, no adjustment is recommended.

HEDGING

Associated Natural Gas implemented a hedging plan within the guidelines of regulated utility operations risk management control. Based on normal requirements for Missouri during the winter 2001-2002, the Company combined futures contracts purchases and options to stabilize gas prices. These financial hedging instruments also included swaps and collars. The goal is to obtain up to 50% of its expected normalized purchased gas requirements. No physical hedges were transacted for Missouri during the winter 2001-2002. These financial instruments combined with storage utilization covered close to 70% of normal requirements during the winter months (November 2001 through March 2002). The financial hedging was provided by ONEOK Energy, Marketing, and Trading, and Woodward Marketing companies. The hedging activities occurred throughout the summer of 2001 up to early October 2001. The Company subscribes to several market publications as well as DTN, a satellite service that provides real-time NYMEX future quotes, weather and natural gas industry news. It seems that the execution of hedging was based largely on NYMEX price movements.

Given the Company's adoption of a hedging strategy that utilizes various financial instruments, it is recommended that the Company should carefully continue to monitor the market movements and look into the possibility of expanding its gas portfolio to include physical hedges in order to better ensure successful and prudent hedging.

Staff also conducted a compliance review of the Company's hedging activity. From July 2001 to November 2001 Atmos entered into various hedging transactions (swaps) with ONEOK Energy Marketing, and Trading for deliveries in December 2001. The costs of the financial transactions were allocated between various jurisdictions that Atmos serves (Georgia, Iowa, Illinois, Missouri, Virginia and Louisiana). For the month of December 2001, Atmos allocated hedging costs of $8,980 (20,000 x $$0.449) to Missouri that should have been allocated to Illinois. This represents a gas cost decrease of $8,980 to Missouri. Since hedging activities (costs/benefits) are intended to include all Missouri service territories (Greeley, Kirksville, Butler, SEMO, Neelyville and United Cities), Staff believes that gas costs for all Missouri service territories should be reduced accordingly. After the proper allocation is applied, gas costs should be reduced as follows: Greeley $35; Kirksville $165 firm and $48 interruptible; Butler $481 firm and $48 interruptible; SEMO $4,412 firm and $606 interruptible; Neelyville $75 commodity ACA; and United Cities $3,110 commodity ACA. Staff's adjustments for Neelyville and United Cities are included in the "Recommendation" section (table) of each service territory.

SUMMARY – ASSOCIATED NATURAL GAS

1. Staff proposes the following gas cost adjustments:

    ACA Balance – SEMO ($629,375) firm sales and $23,450 interruptible sales.
    Kirksville ($35,691) firm sales and ($102,496) interruptible sales.
    Butler ($16,155) firm sales and ($764) interruptible sales.

    LNG commodity - SEMO $83,139 firm sales and $7,268 interruptible sales.
    LNG peaking service – SEMO $83,778 firm sales and $31,592 interruptible sales.

    DCCB Adjustment – SEMO ($803,898) firm sales and ($12,533) interruptible sales.
    Kirksville – ($28,196) firm sales and ($1,090) interruptible sales.
    Butler – ($10,315) firm sales and ($1,288) interruptible sales.

    Refunds - Adjustments included in the "Recommendation" section.

    Agency Fees – SEMO ($4,083) firm sales and ($577) interruptible sales.

    Interest Cost - SEMO ($520) firm sales and ($55) interruptible sales.

    Transition Cost – SEMO ($21,557) firm sales and ($2,775) interruptible sales.
    SEMO Transportation ($17,252).
    Kirksville ($363) firm sales and ($93) interruptible sales.
    Kirksville Transportation ($707).

    MRT Energy - SEMO ($3,459) firm sales and ($1,670) interruptible sales.

    Over-Run Gas – SEMO ($7,736) firm sales and ($1,014) interruptible sales.

Kirksville ($11,216) firm sales and ($2,173) interruptible sales.

Storage – SEMO $51,710 firm sales and $6,287 interruptible sales.
Kirksville ($8,880) firm sales and ($2,287) interruptible sales.
Butler ($8,648) firm sales and ($1,051) interruptible sales.

Energy USA reconciliation – SEMO ($47,335) firm sales.

Reliability – Staff recommends adjustments of ($17,199) for the Jackson system and ($228,896) for the Southeast Missouri Integrated system for excess capacity. For purposes of the PGA/ACA, Atmos includes the Jackson District, Piedmont District and Southeast Missouri Integrated District in the SEMO service area. The combined adjustment is ($246,095) and the impact is approximately $6.60 per customer.

Hedging - SEMO ($4,412) firm sales and ($606) interruptible sales.
Kirksville ($165) firm sales and ($48) interruptible sales.
Butler ($481) firm sales and ($48) interruptible sales.

2. ANG implemented a hedging plan that includes financial hedging instruments such as swaps and collars, within the guideline of regulated utility operations risk management control. Staff also conducted a compliance review of Company's hedging activities. Staff's adjustments for ANG are noted above.

3. Staff has concerns related to the Company's reliability analysis. These concerns are documented in the Reliability Analysis section of this recommendation.

RECOMMENDATION – ASSOCIATED NATURAL GAS

The Staff recommends the Commission issue an order requiring Atmos to:

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

(ANG) Areas B, K, and S	**8-31-02 ending Balances per Filing**	**Staff Adjustments**	**8-31-02 ending Balances Per Staff**
SEMO District (area S) Firm ACA	($832,920)	($920,468) ($629,375) (A)	($2,382,763)
Interruptible ACA	($407,628)	$25,917 $23,450 (A)	($358,261)
Firm Refund-Exh III	$ 15,101	($18,775)	($ 3,674)
Interruptible Refund-Exh III	$ 2,238	($3,164)	($ 926)
Transportation Transition cost	$0	($17,252)	($17,252)
Kirksville District (area K): Firm ACA	($ 267,360)	($48,820) ($35,691) (A)	($351,871)
Interruptible ACA	($ 54,200)	($5,691) ($102,496) (A)	($162,387)
Firm Refund-Exh III	$ 26,365	($38,442)	($ 12,077)
Interruptible Refund-Exh III	$ 7,354	($13,053)	($ 5,699)
Transportation Transition cost	$0	($707)	($707)
Butler District (area B): Firm ACA	$ 60,644	($19,444) ($16,155) (A)	$25,045
Interruptible ACA	$ 722	($2,387) (764) (A)	($2,429)
Firm Refund-Exh III	$2,330	$1,090	$3,420
Interruptible Refund-Exh III	$ 1,165	($12,397)	($11,232)

(A) Beginning balances August 31, 2001 adjusted to prior year ending balances (see ACA balance section).

2. Staff recommends that the Company take the following actions related to reliability analysis by January 12, 2004.

   a. Reevaluate the Company's baseload and heatload factors for each service area. Submit the details of this reevaluation and the impact on the peak day usage estimates. Do not use baseload factors from one regression analysis and heatload factors from another regression analysis as was done by the Company for the

Southeast Missouri Integrated system peak day planning in both Case Nos. GR-2001-396 and GR-2003-0150.

b. Submit estimates of peak day needs for the 2002-2003 ACA period and two to three years beyond that for each service area. For the Butler District, use 80 HDD as the peak cold day for reliability planning.

c. For each service area, provide estimates of the reserve margin for the 2002-2003 ACA period and for two to three years beyond that. Explain the Company's rationale for the reserve margin for each system for each of these years.

d. Respond to Staff's concerns in the reliability section concerning capacity release of excess capacity for the Kirksville District. Provide detailed documentation of efforts and results concerning release of excess capacity for the Kirksville service area for the 2002-2003 ACA period. Additionally, provide information showing that the Company has made efforts to release capacity and has considered non-recallable releases for at least six months to one year as a means of better marketing the capacity releases for the 2003-2004 winter and forward.

3. File a written response to the recommendations included herein within 30 days.