MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GR-2011-0161, Atmos Energy Corporation

FROM: David M. Sommerer, Manager - Procurement Analysis
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Kwang Choe, Ph.D., Regulatory Economist - Procurement Analysis
Derick Miles, P.E., Regulatory Engineer - Procurement Analysis
Lesa Jenkins, P.E., Regulatory Engineer - Procurement Analysis

/s/ David M. Sommerer, 12/21/12	s/Bob Berlin, 12/21/12
Project Coordinator, Date	General Counsel's Office, Date

SUBJECT: Staff's Recommendation in Atmos Energy Corporation's
2010-2011 Actual Cost Adjustment Filing

DATE: December 21, 2012

Procurement Analysis (Staff) has reviewed Atmos Energy Corporation's (Atmos or Company) 2010-2011 Actual Cost Adjustment (ACA) filing. This filing was made on October 17, 2011, for rates to become effective on November 1, 2011, in all areas served in Missouri. This filing was docketed as Case No. GR-2011-0161.

On March 14, 2012, Case No. GM-2012-0037, the Missouri Public Service Commission (Commission) issued its Order Approving Unanimous Stipulation and Agreement authorizing Liberty Energy (Midstates) Corporation (Liberty-Midstates or Liberty Utilities) to purchase the assets of Atmos' Missouri service areas, including the issuance of new certificates of convenience and necessity.

Section 15, paragraph f. of the Unanimous Stipulation and Agreement requires that "Atmos shall transfer to Liberty-Midstates copies of all records and documents related to PGA/ACA cases."

Liberty-Midstates, now known as Liberty Utilities (or Liberty), is the successor in interest to Atmos' previously filed PGA/ACA cases. However, for the purposes of this Memorandum, Staff will refer to Atmos because Atmos made the decisions for the current ACA and for most of the subsequent 2011/2012 ACA. Liberty has adopted Atmos' tariffs and is now administering Atmos' ACA filings.

This memorandum is organized into three sections. Each section begins with detailed explanations of Staff's concerns and recommendations. The three sections are:

1. Atmos Energy Corporation - General;
2. Southeast area
3. West area

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** **Denotes Highly Confidential Information** **

Staff's analysis consisted of:

1. A review and evaluation of the Company's billed revenues and its natural gas costs for the period of September 1, 2010, to August 31, 2011. A comparison of billed revenue recovery with actual costs will yield either an over-recovery or under-recovery of the ACA costs.

2. An examination of Atmos' gas purchasing practices to determine the prudence of the Company's purchasing decisions.

3. A hedging review to determine the reasonableness of the Company's hedging plans for this ACA period.

4. A reliability analysis of the Company's estimated peak day requirements and capacity levels to meet those requirements.

Atmos' (Liberty's) Missouri service territory

Atmos serves the following areas: West, Kirksville, Northeast and Southeast. A more detailed description, with the associated interstate pipelines serving these areas, follows.

The West area includes Butler which is served by Panhandle Eastern Pipe Line Co., LP (PEPL) and the former Rich-Hill/Hume service area which is served by Southern Star Central Gas Pipeline, Inc. (SSCGP). The West area is served by an average of nearly 4,000 firm sales customers.

The Kirksville area, served by ANR Pipeline Co. (ANR), has an average of 5,666 firm sales customers.

The Northeast area, served by Panhandle Eastern Pipe Line Co., LP (PEPL), serves an average of 13,291 firm sales customers in Hannibal-Canton, Bowling Green and Palmyra.

The Southeast area (SEMO) includes Jackson, served by Natural Gas Pipeline Co. of America (NGPL), Piedmont, served by Mississippi River Transmission Corp. (MRT), and the Southeast Missouri Integrated system, served by Texas Eastern Transmission, LP (TETCO) and Ozark Gas Transmission, LLC. The Southeast area also includes the former Neelyville service area which is served by Natural Gas Pipeline Co. of America (NGPL) and TETCO. Together they served an average of nearly 33,000 firm sales customers.

On August 1, 2011, Atmos Energy and Liberty Energy (Midstates) filed a joint application for authority to sell its regulated natural gas utility assets in Missouri, Illinois and Iowa to Liberty Energy (Midstates) Corporation. (Joint Application of Atmos Energy Corporation and Liberty

Energy (Midstates) Corporation – File No. GM-2012-0037). The sale of the properties was contingent upon approval from the three regulatory commissions in Missouri, Illinois and Iowa. That sale closed on or about August 1, 2012.

Summary of Recommendations

The Staff recommends that the Commission issue an order requiring Liberty to:

1. Respond to the issues in the Reliability Analysis and Gas Supply Planning section of this memorandum. (There is no financial adjustment related to Reliability or Supply Planning for this ACA review period.)
2. Respond to Staff's comments in the Hedging section. (There were no financial adjustments related to Hedging).
3. Respond to the Cash-out section for school transportation customers outlined in Section 1.
4. Respond to the Southeast and West areas as outlined in Sections 2 and 3.

STAFF TECHNICAL REPORT AND ANALYSIS

SECTION 1. ATMOS ENERGY CORPORATION - GENERAL

Reliability Analysis and Gas Supply Plan Review

As a gas corporation providing natural gas service to Missouri customers, Atmos was responsible for conducting reasonable long-range supply planning to meet its customer needs. Atmos was required to make prudent decisions based on that planning. One purpose of the ACA process is to examine the reliability of the Local Distribution Company's (LDC) gas supply, transportation, and storage capabilities. For this analysis, Staff reviews the LDCs' plans and decisions regarding estimated peak-day requirements and the LDC's pipeline capacity levels to meet those requirements, the peak day reserve margin, and the rationale for this reserve margin, and the natural gas supply plans for various weather conditions.

Staff has the following comments and concerns regarding the reliability analysis:

Reserve Margin for Southeast Missouri (SEMO) area

The SEMO area is served by the Texas Eastern Transmission Company Pipeline (TETCO) and Ozark Gas Transmission Pipeline Company (OGT). The SEMO area previously had a reserve margin of 12.5% for the 2009/2010 ACA Period. This reserve margin was reduced when the OGT contract expired and was replaced by another contract. The new contract term is 11/1/2010 through 10/31/2013. The reduction in the contract brings the reserve margin for the 2010/2011 ACA period to 8.2%. The Company currently projects no growth for the SEMO area. When

Staff questioned why the Company didn't further reduce the [reserve] margin, the Company responded:

The explanation for the 8.2% reserve margin was explained in Case No. GR-2011-0161, DR-86 as follows:

> "*SEMO – The reserve margin for ACA 10-11 was 8.21%. Incorporating the first ratchet level on the Texas Eastern SS1 storage contract, which occurs once the storage inventory drops below 211,434 DTH, the MDWQ is reduced from 11,303 DTH to 9,637 DTH. The reduction in MDWQ effectively reduces the reserve margin to 2.77% which the Company deems reasonable.*"

The Company does have ratchets on its storage, meaning that as the storage inventory balance declines, the maximum daily withdrawal quantity (MDWQ) declines. However, the Company's planned storage balance, at the end of February, for the Texas Eastern SS1 storage contract is 238,410 dth, and at this balance, the reduced MDWQ ratchets have not yet kicked in. The Company still has the MDWQ available, not a reduced quantity. Staff also reviewed the Company's peak day model and the Company has determined that a peak day would most likely occur in January. Because the Company is concerned about the lower storage MDWQ in March, Staff recommends the Company also consider in its capacity and supply planning for a late winter peak day and the storage availability at that time. Staff encourages the Company to re-evaluate capacity requirements for the SEMO area prior to the expiration and future renewals of the Ozark and TETCO contracts.

Hedging

Atmos implemented a hedging plan using the Company's Regulated Utility Operations Risk Management Control Guidelines. The Risk Management activities may include both physical transactions and financial transactions. The Company's hedging plan, based on expected requirements for Missouri for the 2010-2011 winter, included storage and financial hedging instruments. For financial hedging, the Company used swap agreements, over-the-counter instruments that allow the Company to fix a price in exchange of cash flows. This method, combined with the use of storage, was consistent with the Company's hedging purpose to stabilize the volatility of natural gas prices. It is noted that hedging may not necessarily achieve the lowest possible cost.

The Company's goal is to obtain 25% to 50% of expected normalized purchased gas requirements through financial instruments. These financial hedging instruments, combined with storage, were expected to cover 72% of normal requirements during the winter months (November 2010 through March 2011). It turned out that the financial hedging instruments and storage combined to cover 75% of the volumes actually delivered to customers for November 2010 through March 2011. This is equivalent of hedging 72% of normal winter requirements with storage and the financial instruments. The financial hedging purchases for November 2010 through March 2011 were ratably made between early April 2009 and late October 2010. The Company's hedging term is for two winter seasons (November through March) and its implementation period, or hedge placement period, is from April through October.

While Staff is concerned with the negative financial impacts from Atmos' financial hedging had in this ACA period, Staff reviews the prudence of a Company's decision-making based on what the Company knew at the time it made its hedging decisions. Nevertheless, the Company's hedging planning should be flexible enough to incorporate changing market circumstances, though Staff is not suggesting that the Company should or could design its hedging strategy in order to beat the market.

The Company should evaluate its hedging strategy in response to changing market dynamics to balance the cost of hedging against the goal of price stabilization, and thus to achieve a cost effective hedging outcome. For example, the Company should evaluate whether the swaps and the volumes associated with them are appropriate under the current market where the market prices have become less volatile. The Staff notes the Company's recent evaluation of call options as a possible hedging tool to diversify certain hedge risk. Staff recommends the Company be aware of any fundamental shifts in the market dynamics while being cautious on the market views.

Staff also recommends the Company continue to assess and document the effectiveness of its hedges for the 2011-2012 ACA and beyond. The analysis should include, but not be limited to, whether the hedging implementation was consistent with the hedging plan, identifying the benefits/costs based on the outcomes from the hedging strategy, and thus evaluate any potential improvements on the future hedging plan and its implementation. The Staff further recommends the Company continue to document its hedging decisions and provide the documentation to the Staff during each ACA review. This documentation should include an overall hedging plan that addresses hedging goals, objectives, and strategies for each month of each ACA review and the circumstances under which certain hedging transactions occurred. The hedging plan should be updated, documented and completed well in advance of each approaching winter season. The Staff notes that Atmos has traditionally compared its actual hedged portfolio to a market benchmark to help assess hedge performance against an un-hedged portfolio, which is helpful.

Atmos should also carefully consider longer term horizons in its hedging strategy. Consideration should be given to dollar cost averaging concepts when hedging. Additionally Staff recommends the Company evaluate whether the hedging plan for each of the four systems has operational implications for warm and cold weather conditions. Additionally, Staff recommends the Company continue to monitor the market movements diligently, employ disciplined as well as discretionary approaches in its hedging practices, and look into the possibility of expanding its gas portfolio to include physical as well as financial hedge, in addition to storage, that more closely track physical price risk. There should be a strong relationship between the physical price risk and the hedges used to mitigate that price risk.

	Hedged % of Normal
Kirksville	80%
Butler	75%
SEMO	69%
Consolidated	75%
(Note: Difference generally is attributable to storage availability)	

Cash-outs - Missouri School Transportation Service

Atmos tracks its transportation customers' monthly imbalances for gas the customer nominated versus the gas it actually used. For school transportation customers, Atmos currently applies an average pipeline index rate to the monthly imbalance for calculating cash out charges. According to the Company's tariff sheet No. 63-3b for the Missouri School Transportation Service, "The cash-out rate charge or credit will be calculated by multiplying the monthly imbalance by the pipeline's applicable cash-out rate as published at the end of each month." Because the tariffs were not followed for the transactions mentioned above, there were some differences in Staff's cash-out calculations. In total, the differences were small so Staff did not propose any cash out adjustments in this ACA. Going forward, Staff recommends that the Company apply the applicable cash-out rate as published at the end of each month.

RECOMMENDATION – ATMOS ENERGY CORPORATION, GENERAL

The Staff recommends that the Commission issue an order requiring Liberty to:

1. Respond to the issues in the Reliability Analysis and Gas Supply Planning section of this memorandum. (There is no financial adjustment related to Reliability or Supply Planning for this ACA review period.)
2. Respond to Staff's comments in the Hedging section.
3. Respond to the Cash-out section for school transportation customers in this memorandum.

SECTION 2 –SOUTHEAST AREA

Transportation Service

Errors were found in the calculation of pipeline fuel charges for MRT transportation customers from November 2010 to August 2011. These charges, in addition to the cost of gas and transportation charges, are used to establish the cash-out price for monthly imbalance volumes (Tariff sheet 52-C1). Staff found the fuel percent to be 1.61% (1.03% + .58%) compared to 6% used by the Company. T here were some differences to the cash-out calculations for three customers due to the fuel charges applied; however the differences were small so Staff did not propose any cash- out adjustments in this ACA. Staff recommends that the Company make the proper corrections to the fuel charges for these three customers going forward.

SECTION 3 – WEST AREA

Rich-Hill/Hume contract changes and bid offers

In anticipation of its sale of Missouri properties to Liberty Energy, Atmos negotiated with Southern Star to separate the pipeline capacity serving its' customers in Missouri. This culminated into a newly formed transportation contract with Southern Star, effective April 2011, to serve Rich-Hill/Hume customers in Missouri. Prior to the separation of pipeline contracts between Kansas and Missouri, savings on gas purchases were achieved when purchases were made for the combined Kansas and Missouri (Rich-Hill/Hume) systems, including thousands of customers in Kansas. Currently gas supply contracts are negotiated for the Rich-Hill/Hume system with less than 500 customers. Conforming bids for the Rich-Hill/Hume system decreased from ** ________ ** prior to the contract change to ** ____________ ** in the current ACA (June 2011 to March 2012). This raises concerns on the availability of gas supply bids for these customers. For the contract period of April 2012 t o March 2013, the number of conforming bids increased to ** __**. While this is an improvement from the prior contract period, Staff believes that the Company should continue to review its plans to increase vendor participation in response to the small number of bid responses to RFP's.

Butler Storage (PEPL)

As addressed in Case GR-2009-0417, Staff found inconsistencies in the Company's calculation of PEPL storage injection costs. PEPL Trans Market Access commodity costs were used prior to December 2010 whereas PEPL Trans Field commodity costs were used from December 2010 to August 2011. S taff recommends that the Company re-evaluate the PEPL commodity components used in its calculation of PEPL storage injection costs for Butler customers.

RECOMMENDATION – ATMOS ENERGY CORPORATION

The Staff recommends that the Commission issue an order requiring Liberty 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 balances in the "Staff Balances" column of the following table:

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TABLE 1 (SECTIONS 1-3)

ALL AREAS	**Filed Balances for 2010-2011 (Ending 8-31-11)**	**Staff Adjustments (A)**	**Staff Balances for 2010-2011 (Ending 8-31-11)**
Southeast Area: Demand ACA	$11,520	$0	$11,520
Commodity ACA	($602,559)	$0	($602,559)
Kirksville Area: Demand ACA	($64,079)	$0	($64,079)
Commodity ACA	($159,199)	$0	($159,199)
West Area: Demand ACA	$18,821	$0	$18,821
Commodity ACA	$3,736	$0	$3,736
Northeast Area: Demand ACA	$173,225	$0	$173,225
Commodity ACA	($226,888)	$0	($226,888)

A) All prior period adjustments have been adopted by the Company.

2. Respond to the Reliability analysis/Gas supply plan review, hedging and cash-out areas as outlined in Section 1.
3. Respond to the Southeast and West areas as outlined in Sections 2 and 3.
4. File a written response to the recommendations included herein within 30 days.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Purchased Gas Adjustment Tariff Filing	))	Case No. GR-2011-0161

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 8 pages to be presented in the above case; that he has verified that the following Staff Memorandum was prepared by himself and Staff of the Commission that have knowledge of the matters set forth as described below; that he has verified with each of the Staff members listed below that the matters set forth in the Staff Memorandum are true and correct to the best of his knowledge and belief,

Phil Lock, Utility Regulatory Auditor III:	Billed Revenues & Actual Gas Costs
Derick Miles, PE, Utility Regulatory Engineer I:	Reliability Analysis & Gas Supply Planning
Kwang Choe, PhD, Regulatory Economist II:	Hedging
Lesa A. Jenkins, P.E., Regulatory Engineer:	Reliability Analysis and Gas Supply Planning

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, 2012.

SARA SEAVER
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: August 23, 2015
Commission Number: 11231209

Sara Seaver
Notary Public