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STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS
Public Hearing
July 10, 2003
Jefferson City, Missouri
Volume 1

In the Matter of Proposed Rulemaking)
Concerning Mitigation of Natural Gas) Case No. GX-2002-478
Price Volatility)

MORRIS L. WOODRUFF, Presiding,
SENIOR REGULATORY LAW JUDGE.

REPORTED BY:
KELLENE K. FEDDERSEN, CSR, RPR, CCR
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1 P R O C E E D I N G S

2 JUDGE WOODRUFF: I've got now three minutes
3 after ten, so let's go ahead and get started. We're already
4 on the internet. We're here for a rulemaking hearing, a
5 comment hearing. This is Case GX-2002-478, and it concerns
6 the rulemaking -- a proposed rulemaking that's been filed by
7 the Commission, 4 CSR 240-40.018, which concerns natural gas
8 price volatility.

9 And I see we have quite a few people here
10 today. Let's begin by taking entries of appearance,
11 beginning with Staff.

12 MR. BERLIN: Yes, your Honor. Robert S.
13 Berlin, attorney for Staff of the Missouri Public Service
14 Commission, Post Office Box 360, Jefferson City, Missouri
15 65102.

16 JUDGE WOODRUFF: Thank you. For Public
17 Counsel?

18 MR. MICHEEL: Douglas E. Micheel, appearing on
19 behalf of the Office of the Public Counsel and the public,
20 and I have one witness here today, your Honor, Jim Busch.

21 JUDGE WOODRUFF: Okay. Who else wants to go
22 next?

23 MR. PENDERGAST: Michael C. Pendergast,
24 appearing on behalf of Laclede Gas Company. Would you
25 prefer that we give our business addresses, Judge?

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1 JUDGE WOODRUFF: Go ahead.

2 MR. PENDERGAST: 720 Olive Street, St. Louis,
3 Missouri 63101.

4 JUDGE WOODRUFF: And --

5 MR. HACK: Robert Hack for Missouri Gas Energy
6 Company. I've provided my address to the reporter.

7 JUDGE WOODRUFF: Okay.

8 MR. COOPER: Dean L. Cooper from the law firm
9 of Brydon, Swearingen & England, P.C, P.O. Box 456,
10 Jefferson City, Missouri 65102, appearing on behalf of
11 Aquila, Inc., doing business as Aquila Networks-MPS and
12 Aquila Networks-L&P.

13 MR. FISCHER: James M. Fischer, 101 Madison
14 Street, Suite 400, Jefferson City, Missouri 65101, and I'm
15 appearing today on behalf of Union Electric, doing business
16 as AmerenUE, and I'd also like to enter an appearance for
17 Southern Missouri Gas Company LP and Atmos Energy
18 Corporation. I also have one witness today, Scott Glaeser.

19 JUDGE WOODRUFF: Is there anyone else?

20 (No response.)

21 JUDGE WOODRUFF: All right. Looks like we've
22 got everybody then. I'm sorry. Go ahead.

23 MS. RANDOLPH: Anita Randolph, 1659 East Elm
24 Street, Jefferson City, Missouri on behalf of the Missouri
25 Department of Natural Resources Energy Center.

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1 JUDGE WOODRUFF: And Mr. Fischer and
2 Mr. Micheel indicated that they had witnesses. I assume
3 Staff will have witnesses as well.

4 Does anyone else have a witness?

5 MR. COOPER: Yes, your Honor. Aquila will
6 have a witness, Sean Gillespie.

7 JUDGE WOODRUFF: Let's go ahead and get
8 started, then. I believe what I'll do is save Staff's
9 witness for last so that they can respond to the other
10 witnesses. So let's begin with the Public Counsel witness.

11 MR. MICHEEL: Okay. We'd call Jim Busch.

12 JUDGE WOODRUFF: All right. Mr. Busch.

13 (Witness sworn.)

14 JUDGE WOODRUFF: You may be seated.

15 And, Mr. Micheel, if you want to come up to
16 the podium and you can ask questions if you like.

17 JIM BUSCH testified as follows:

18 DIRECT EXAMINATION BY MR. MICHEEL:

19 Q. would you state your name and address and how
20 you're employed?

21 A. My name is James A. Busch. I work with the
22 Office of the Public Counsel as an economist, and my address
23 is P.O. Box 7800, Jefferson City, Missouri 65102.

24 Q. Do you have any comments you'd like to provide
25 to the Commission with respect to this rule?

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1 A. Yes, I do. We have submitted written
2 comments, and then we have just a brief statement that we
3 would like to make today as well.

4 Q. Please make that statement.

5 A. First of all, Public Counsel would like to
6 thank the Commission for the opportunity to not only provide
7 written comments on this proposed rule, but to also have the
8 chance to come here today and talk to you briefly about the
9 proposed natural gas price volatility mitigation rule.

10 The Public Counsel supports the proposed rule
11 that is before us today. The Public Counsel believes that
12 this rule should help natural gas utilities in their efforts
13 to provide a more balanced natural gas supply to the
14 consumers and the citizens of the State of Missouri.

15 Hopefully this rule will be the nudge that is
16 needed to get all the utilities in the State of Missouri to
17 investigate and utilize the various techniques and
18 instruments that are available in the market to curb upward
19 price volatility.

20 There are some utilities that have been very
21 active in hedging, and that has provided substantial
22 benefits to those consumers. However, it is necessary that
23 all LDCs in the state get out there and be proactive and
24 utilize the tools that are available to protect the
25 consumers.

1 we'd also like to point out and reiterate that
2 this rule is not a blanket preapproval of all hedging
3 instruments and all uses of hedging. The LDCs, the gas
4 supply personnel at the LDCs make decisions to purchase
5 natural gas supplies, and part of that decision-making
6 process should involve the use of hedging instruments, but
7 this rule does not give them a blanket whatever they use is
8 okay. They still have to make prudent decisions on the use
9 of natural gas hedging instruments and hedging tools as a
10 part of their portfolio.

11 And some of the comments that we've read kind
12 of indicate that this could be a more blanket preapproval,
13 and we want to make sure that everybody knows that it's not
14 a blanket preapproval. It's saying that, yes, we agree that
15 it is something that needs to be looked at, that it is --
16 hedging is something that is necessary in a well-balanced
17 portfolio, but it's prudent hedging, just like it's prudent
18 natural gas supply decision-making, as it has always been.
19 And we just want to make sure that that is clear.

20 Finally, we want to make sure that -- there
21 were a couple of comments by the -- some of the industry
22 personnel about some changes that they would like to see to
23 the rule, and we would like to address those changes that
24 they proposed briefly.

25 The first one that I'd like to talk about is

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1 that they want to change the word "upward." They want to
2 remove the word "upward price volatility" from the rule, and
3 we disagree with that.

4 We think that this proposed rule is supposed
5 to prevent upward price volatility. We recognize that when
6 you prevent upward price volatility, that you are locking in
7 a price or you are capping a price. That limits your
8 abilities for the prices to go down, to be involved with
9 those down and to participate in those downward movements as
10 a consumer. That is an economic cost of hedging.

11 We are not trying to prevent downward price
12 volatility. If there is a market that is moving downward,
13 we would hope that that would affect the decisions made by
14 the gas supply personnel in their mix of hedging techniques
15 and instruments that they use to hopefully participate more
16 in a downward moving market. We recognize, like we said,
17 that you're not going to get the lowest price, and we
18 understand that. That's not the issue. But we want you to
19 balance, and balance we recognize is going to not -- not
20 catch the dips.

21 And that's okay, but upward price volatility
22 is what we're afraid of. We do not know how high that price
23 can go, and that's what we're trying to protect. If upward
24 price -- excuse me. If downward volatility was the only
25 reason why we were here, we wouldn't be here today. We do

1 not care about downward price volatility.

2 Secondly, there were some comments that they
3 wanted to add index pricing as a part of this rule. We do
4 not agree with adding index pricing because this is a rule
5 for price volatility mitigation, and price volatility
6 mitigation leads itself to hedging techniques. Index
7 pricing is what the industry norm has been since -- probably
8 since the beginning of time, as far as I know, as far as the
9 natural gas. They used index pricing because of the
10 volatility in the index pricing and what the person with
11 index prices can move to. That's why we need to utilize
12 hedging techniques as well. So . . .

13 JUDGE WOODRUFF: Could you explain to me what
14 index pricing is?

15 THE WITNESS: Index pricing is generally when
16 a company -- they get a contract to provide natural gas
17 supplies. They're going to provide it on November 1st or
18 for the whole month of November. The price that they pay
19 will be based upon a published index price of natural gas,
20 say, from, like, an inside FERC on a given pipeline, and
21 that will say the price for November will be \$4 an MMBtu,
22 and that will be the price for each MMBtu that is purchased
23 for that month for that contract.

24 December may have a price of \$5. It may have
25 a price of \$2.50, depending upon market conditions. It is a

1 constantly changing price as the months roll forward, versus
2 a futures contract where you say, I want to lock in today,
3 July 10th, for a price December 1st at \$4, and that's the
4 price I will pay when December 1st rolls around. Index
5 pricing is a price that moves monthly and it is what the --
6 it's what the actual supplies of natural gas that the LDCs
7 purchase are.

8 JUDGE WOODRUFF: Okay. You indicated that's
9 how they've been doing it?

10 THE WITNESS: And that's how they've been
11 doing it.

12 JUDGE WOODRUFF: Are you saying they shouldn't
13 do that anymore?

14 THE WITNESS: No. No. No. No. We're not
15 saying they shouldn't do that anymore. In fact, that is a
16 very important part of a well-balanced portfolio, because we
17 do not know what the price will be in the future. And so
18 you have to have some index pricing because if the prices go
19 down, we can then participate when those prices go down.

20 Furthermore, you have to have probably some
21 index pricing because you cannot hedge 100 percent of your
22 volumes, because you do not know -- an LDC does not know how
23 many volumes they're going to sell in a given month or given
24 year because of weather. And so if they try to assume, you
25 know, a coldest weather possible, well, that's not going to

1 happen very often. So they would hedge a lot more volumes
2 than they're actually going to need. So they hedge a
3 certain amount to catch any swings in volumes that they're
4 going to need to purchase due to weather.

5 So yeah, we are -- it is definitely -- we're
6 definitely for index pricing for a portion of their
7 portfolio. This rule is a price volatility mitigation rule,
8 to come up with other techniques to prevent the upward price
9 spikes that occur in the index market from being a problem
10 for consumers. So, yeah, we are not at all saying do not
11 index price. This rule -- we don't need to add that into
12 this rule.

13 JUDGE WOODRUFF: Okay. I want to ask you a
14 little bit about the comment that was filed recently by
15 Department of Natural Resources about including energy
16 efficiency programs in the options to mitigate volatility.
17 Do you agree with that suggestion?

18 THE WITNESS: Well, we agree wholeheartedly
19 with the comments that were made by the Department of
20 Natural Resources. We are very active, a very active
21 proponent for weatherization within the State of Missouri,
22 and we think that it's a vital tool for consumers in
23 Missouri to help curb usage.

24 However, this rule -- we don't think that this
25 is the proper place for that. This is a supply side rule.

1 That is more of a demand side concern. And we would be
2 happy to sit down with DNR staff and the industry to come up
3 with good solid weatherization throughout the state;
4 however, this rule just is not -- we don't think this rule
5 is where it belongs

6 JUDGE WOODRUFF: That brings me into another
7 comment that was filed by one of the gas utilities
8 suggesting that there should be a change to make it explicit
9 that this is a demand side rule, because I believe there was
10 a clause in there, an and/or clause. Are you familiar with
11 what I'm talking about?

12 THE WITNESS: Yeah. I think it's --

13 JUDGE WOODRUFF: And do you agree with them?

14 THE WITNESS: I think what they're referring
15 to was Section 2G of the rule. That part of the rule
16 states, other tools utilized in the market for cost
17 effective management of price and/or usage volatility, and I
18 believe they want to get rid of that usage part.

19 I don't agree with that because, aside from
20 the weatherization part of it, there are other tools that
21 are available in the market, like a weather derivative that
22 protects weather. If weather is colder or hotter than
23 normal, that will help offset the volumes that are utilized
24 or have to be paid for by the consumers.

25 And also there could be some fixed bills

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1 programs that could be set up where a consumer pays a
2 certain amount no matter what their usages, and those would
3 kind of be a usage volatility and could be -- kind of work
4 together with a price mitigation tool and that usage tool.

5 So I think it's important to leave that
6 language in there to make sure that we catch any of those
7 types of programs that are available today or may be
8 available in the future.

9 JUDGE WOODRUFF: So you want to encourage them
10 to be a little creative?

11 THE WITNESS: Yes, if they can be creative,
12 they can. We think the weatherization rule is something
13 that is very important, and we should look at that and
14 develop that, but just not within this rule. This rule --
15 the way I kind of look at it, this rule affects the gas
16 supply personnel who are making the decisions throughout the
17 year of their gas supply portfolios that they have to
18 prepare for the upcoming winter heating season, and that's
19 why I think that piece should be left in.

20 JUDGE WOODRUFF: Okay.

21 THE WITNESS: And I also have one more
22 comment with the -- they wanted to add NYMEX, the New York
23 Mercantile Exchange futures contracts. In fact, it's
24 Section 2 -- 2F, they want to add NYMEX futures contract,
25 and we disagree with that proposal because we don't want to

1 tie them to only using NYMEX futures contracts. We think
2 that they should utilize any futures contracts that are
3 available to them that can provide the same level of hedging
4 that NYMEX futures contract can.

5 There are other places where they can go.
6 There may be others in the future. So futures contracts
7 covers NYMEX and any others. So adding NYMEX, I think,
8 limits, and we don't want to limit the LDCs and what they
9 can do for their customers.

10 JUDGE WOODRUFF: Okay. Thank you. Any other
11 attorneys have any clarifying questions they want to ask
12 this witness? All right. Then you can step down.

13 THE WITNESS: Thank you.

14 JUDGE WOODRUFF: Thank you. And does Public
15 Counsel have anything else?

16 MR. MICHEEL: Not at this time, your Honor.

17 JUDGE WOODRUFF: Okay. I don't remember who
18 else had witnesses, so who wants to go next?

19 MR. FISCHER: Ameren will go next, if that's
20 all right.

21 JUDGE WOODRUFF: That's fine.

22 MR. FISCHER: Ameren would call Scott Glaeser.

23 (Witness sworn.)

24 JUDGE WOODRUFF: You may be seated. Could you
25 spell your last name?

1 THE WITNESS: My name is Scott Glaeser,
2 G-l-a-e-s-e-r.

3 JUDGE WOODRUFF: Thank you. Mr. Fischer, go
4 ahead.

5 SCOTT GLAESER testified as follows:

6 DIRECT EXAMINATION BY MR. FISCHER:

7 Q. Please state your name and business address
8 for the record.

9 A. My name is Scott Glaeser. I'm manager of
10 natural gas supply and transportation for Ameren Energy
11 Fuels and Services Company.

12 Q. And that's located in St. Louis?

13 A. Yes.

14 Q. Mr. Glaeser, are you familiar with the current
15 rule that's the subject of this proceeding?

16 A. Yes, I am.

17 Q. Do you have some comments you'd like to make
18 regarding that rule?

19 A. Yes, we do.

20 Q. Please go forward.

21 A. First of all, Ameren appreciates the
22 opportunity to give these comments, what we feel is a very
23 important rulemaking. The company did participate in the
24 Commodity Price Task Force that was established in 2001 by
25 the Commission, which kind of was the genesis of this

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1 rulemaking. And we also played a role in helping craft the
2 initial drafts of this rule.

3 We do believe that the rule is very important
4 for the gas industry in Missouri to give guidance and
5 direction to all the gas utilities in the state, to
6 establish that the Commission and the Staff recognizes the
7 importance of hedging gas supply commodity price risk and
8 enables them to have the tools at their disposal to
9 basically perform those hedging without the fear of being
10 secondguessed or the cost of the hedging tools being
11 disallowed in the future.

12 Ameren has been utilizing hedging techniques
13 dating back to 1995, which it had an experimental program
14 with the Missouri Public Service Commission on the use of
15 call options to cap price risks during winter periods. From
16 that, we've learned a lot about the hedging strategies and
17 the various financial markets and have applied that
18 continuously year by year since then to improve our hedging
19 strategies and to reduce price risk for our customers.

20 We do have some comments that we believe would
21 help clarify the rule and enhance the rule, and I'd like to
22 go through those.

23 JUDGE WOODRUFF: Please do.

24 THE WITNESS: One issue that we'd like to
25 discuss or bring forward is the issue of the rate recovery

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1 through the PGA mechanism of the cost of hedging
2 instruments. Various hedging instruments, such as call
3 options, put options, even financial swap product, NYMEX
4 contracts had associated cash flows with them, both positive
5 and negative on these various instruments. It's still not
6 clear if those cash flows are eligible to flow through the
7 PGA. We have had those flow through the PGA in the past two
8 cases of AmerenUE and the Staff didn't challenge those, but
9 we would like the rule to maybe address the rate recovery of
10 the PGA of these financial products.

11 In regards to a comment made by OPC,
12 Mr. Busch, we actually are the ones that asked that NYMEX be
13 put into the futures contract. One reason for that is to
14 clarify that that is the primary futures market for natural
15 gas trading in the United States and in Canada.

16 We would also like to, as a supplement to
17 that, add references to what we call the over-the-counter
18 markets, OTC markets, which is all the other financial
19 institutions that offer natural gas price hedging
20 instruments.

21 Many of the major banks in this country,
22 people like Morgan Stanley, Bank of America, Goldman Sachs,
23 are now in the natural gas financial products business,
24 selling financial swap options, collars and floors, and we
25 feel that the rule would be enhanced by clarifying that that

1 is another market and important choice for the LDCs to
2 examine and utilize in their hedging.

3 JUDGE WOODRUFF: You don't want to limit it to
4 those, you just want to --

5 THE WITNESS: We want to add it.

6 JUDGE WOODRUFF: -- add those as an example?

7 THE WITNESS: Correct. Our goal is to enhance
8 the definitions of the NYMEX futures contract and to add the
9 over-the-counter financial markets as well, so it's clear to
10 everyone by reading the rule that you can use the banks, you
11 can use the NYMEX futures market to price hedge with.

12 JUDGE WOODRUFF: All right.

13 THE WITNESS: We also believe that we need to
14 add index contracts. I respect the opinion of Mr. Busch,
15 but we also would like to add that index contracts play an
16 important role in hedging gas supply price risk.

17 They perform two functions. One is that index
18 contracts reflect the value of gas at the market, whether it
19 be a monthly base load contract, index -- insider FERC
20 publication or a daily gas supply index to a gas daily
21 publication that provides part of your portfolio to be
22 priced at market, which is important because any balanced
23 portfolio, you want exposure, certain level of exposure to
24 the market because markets can and do go down. So you want
25 some portion of the portfolio to be exposed to downward

1 movement.

2 The second rule which the index contracts play
3 is that your NYMEX contracts and your financial instruments
4 have to be mated up, basically, or paired with physical gas
5 supply and index to create a fixed price for that gas
6 supply. So the index of a physical gas supply contract,
7 when compared with a financial swap from a bank or NYMEX
8 contract yields fixed price for gas supply, even though the
9 physical gas supply itself is indexed.

10 So the indexing actually plays an important
11 role in coupling with financial products to create fixed
12 prices to reduce price volatility. We feel it's necessary
13 to add that to the rulemaking to clarify that point.

14 I believe that's all of our key issues that
15 we'd like to bring forward at this time.

16 JUDGE WOODRUFF: I have a question, same
17 question I asked Mr. Busch, about Department of Natural
18 Resources' suggestions about putting energy efficiency
19 programs as an option to mitigate volatility. Do you have a
20 position on that?

21 THE WITNESS: Yes, we do. Basically, we agree
22 with Mr. Busch that it is important, but it is a demand side
23 component, and this rulemaking is based on supply side price
24 mitigation. So although demand side management is
25 important, this is not the proper venue to bring that into

1 the rulemaking.

2 JUDGE WOODRUFF: would you support a separate
3 rulemaking on that issue?

4 THE WITNESS: Yes, a separate rulemaking.

5 JUDGE WOODRUFF: That's all the questions I
6 have. was there anything else you wanted to add?

7 THE WITNESS: Not at this time.

8 JUDGE WOODRUFF: Any other attorneys out there
9 want to ask any clarifying questions?

10 (No response.)

11 JUDGE WOODRUFF: All right. Then you can step
12 down. Thank you.

13 MR. FISCHER: Thank you, your Honor.

14 JUDGE WOODRUFF: Mr. Cooper, I believe you had
15 a witness.

16 MR. COOPER: Yes, your Honor.

17 (Witness sworn.)

18 JUDGE WOODRUFF: You may be seated.

19 SEAN GILLESPIE testified as follows:

20 DIRECT EXAMINATION BY MR. COOPER:

21 Q. Please state your name.

22 A. Sean Gilispie.

23 Q. would you spell your last name?

24 A. G-i-l-l-e-s-p-i-e.

25 Q. what's your business address?

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1 A. It is 1815 Capital Avenue, Omaha, Nebraska
2 68102.

3 Q. By whom are you employed and in what capacity?

4 A. I'm employed with Aquila, Inc. and my title is
5 director of gas supply planning and operations for our south
6 region.

7 Q. Are you familiar with the rulemaking that's
8 the subject of this hearing?

9 A. Yes.

10 Q. Do you have any comments you would like to
11 make on behalf of Aquila?

12 A. Yes, I do.

13 Q. Please proceed.

14 A. Thank you.

15 First of all, I'd like to thank you for the
16 opportunity to come in and make comments regarding this
17 rulemaking. At Aquila, we are supportive of the proposed
18 rulemaking at this time. We believe that it provides a
19 clear understanding of natural gas utilities, that it's
20 appropriate to have a diversified and in-balance portfolio,
21 and it takes out a lot of the uncertainty as far as that is
22 concerned, as far as from the utilities' perspective.

23 We also -- Aquila also appreciates the fact in
24 the rulemaking that it recognizes the fact that a
25 diversified portfolio will not -- that it may not and most

1 likely will not result in the lowest possible price. Aquila
2 has over the last several years been utilizing a diversified
3 portfolio, and we believe that it has worked very well.

4 Granted, we have not had the lowest prices in
5 the state, but we believe by having this balanced portfolio
6 approach, it has met two goals for our customers; one is to
7 mitigate price volatility, and two is to provide some price
8 stability.

9 Now, in a portfolio approach, though, there is
10 index purchases or being subject to market prices, but as
11 Mr. Glaeser indicated, a balanced portfolio needs to have
12 the opportunity to be able to participate in the falling
13 market, but it also needs to contain other products that can
14 cap prices but also allow you to participate in the market
15 as well.

16 And in the last three years, Aquila has come
17 in and sat down with Staff before going into the next winter
18 and gone over our approach, also with the OPC, and have
19 talked about what our plans are and how we would like to
20 proceed. And I believe it's been well received over the
21 last three years, and we appreciate the opportunity to sit
22 down with them and receive feedback from all of the parties.

23 Also, I'd like to add that Aquila does support
24 all of the comments that were provided by the other
25 utilities, especially with what Ameren has added, that we do

1 believe that having NYMEX and the OTC, as a clarification,
2 is necessary because there are a lot of tools available.
3 And I agree with OPC, we don't want to limit it. We need to
4 have the flexibility as much as possible with the tools we
5 can be utilized, but we also need to have further
6 clarification to take out the ambiguity in the matter.

7 And at this -- that's pretty much about all
8 the comments that I had at this point in time.

9 JUDGE WOODRUFF: Thank you. I'll ask you also
10 about the Natural Resources comment. Did you have any
11 position on that?

12 THE WITNESS: I would have the same position
13 as what Ameren's was at that point in time. What this deals
14 with is the supply side and not the demand side, but we
15 would be in support of a separate rulemaking.

16 JUDGE WOODRUFF: Do you agree that supply side
17 adjustments can affect volatility?

18 THE WITNESS: Yes.

19 JUDGE WOODRUFF: And I assume there are ways
20 of doing that?

21 THE WITNESS: Yes. As indicated before, I
22 believe that there are -- in Section 2G where it talked
23 about any usage volatility, there are tools out there that
24 can utilize, such as weather hedges and other type of
25 products that can be utilized to help -- to help on the

1 usage side. And I think, yeah, that there's -- that that is
2 good to have.

3 JUDGE WOODRUFF: Can you tell me more about
4 weather hedges? That's a new term to me.

5 THE WITNESS: What a weather hedge is, is that
6 you go out and you purchase a product, and based on a range
7 of heating degree days, let's say from normal to 20 percent
8 on either side, there are parties out there that are willing
9 to provide a hedge for you, so if the weather is colder than
10 normal or warmer than normal, they will compensate you for
11 that difference. And what that does is it helps mitigate
12 the cost in that fashion.

13 JUDGE WOODRUFF: Actually it's an insurance
14 policy?

15 THE WITNESS: That's just another tool we can
16 use to ensure, yes.

17 JUDGE WOODRUFF: Has a premium attached to it,
18 I'm sure?

19 THE WITNESS: Absolutely. And -- it can be,
20 but they can pay you or the other way around. We actually
21 had one last year in the state of Iowa, and the party
22 actually paid us to have the weather hedge.

23 And it's -- it doesn't necessarily mean that
24 it's going to be a savings to the customer, because if it
25 would have been normal, then most likely they wouldn't have

1 paid off. But they typically don't pay off until you get
2 those parameters, either colder than normal or much warmer
3 than normal. That's what you're trying to hedge against, a
4 colder than normal in most cases.

5 JUDGE WOODRUFF: I believe Mr. Busch indicated
6 that he thought that type of instrument could be used under
7 the existing rule as proposed. Do you agree?

8 THE WITNESS: As long as it has the usage
9 volatility in there, I would agree with that. The one thing
10 I would like to add, though, is to see that added as another
11 tool to be used, though, weather hedges, so it once again
12 takes out the ambiguity.

13 JUDGE WOODRUFF: So it is explicit that you
14 can do that?

15 THE WITNESS: Yes.

16 JUDGE WOODRUFF: Okay. Any clarifying
17 questions?

18 (No response.)

19 JUDGE WOODRUFF: Anything else for you,
20 Mr. Cooper?

21 MR. COOPER: No, your Honor.

22 JUDGE WOODRUFF: You may step down. Other
23 than Staff, were there any other witnesses?

24 MR. HACK: I would just say, your Honor, that
25 if you have questions for Missouri Gas Energy, I'd be happy

1 to attempt to answer them, if that would be your desire.

2 JUDGE WOODRUFF: Well, let me just ask you for
3 the comments that have already come in today, do you have
4 anything that you wanted to clarify for MGE?

5 MR. HACK: The only thing I would offer to
6 clarify is that my understanding and our company's
7 understanding of weather derivatives is that those are
8 really designed to protect the margin revenue side of
9 things, the -- not the PGA, not the gas cost. It's designed
10 to protect revenue, not bills for customers. We don't see
11 that as a real viable alternative to help the price
12 volatility for customers.

13 JUDGE WOODRUFF: Okay. Mr. Pendergast?

14 MR. PENDERGAST: On behalf of Laclede Gas
15 Company, I'd just -- in regard to Mr. Hack's comments, it
16 does seem to me that in introducing weather derivatives,
17 that's not to suggest that there aren't certain alternative
18 weather derivative-based programs that you can potentially
19 offer customers and that type of thing, and, you know, the
20 Commission's had round tables to go ahead and discuss those.

21 And those do seem to us to be sort of separate
22 programs, but when it comes to what you do with respect to
23 trying to affect upward price volatility or price volatility
24 in general, whether you want to call it upward or just price
25 volatility, that is primarily used or done through

1 instruments that are available on the NYMEX market. It's
2 primarily done through over-the-counter instruments.

3 And it just seems to me that if you're going
4 to go ahead and introduce weather derivatives into the
5 process, that -- which are primarily used for margin rather
6 than for going out and trying to protect customers from
7 unusual cold weather, that that ought to be the subject of a
8 separate proceeding as well.

9 Because it's a big subject, and I don't think
10 it's been adequately addressed by simply putting the term
11 "usage" in without a further, you know, examination of
12 exactly what you mean by weather derivatives, how you would
13 intend to go ahead and use those, what kind of products
14 would be appropriate. So I think we would still be in favor
15 of eliminating that from the proposed rule.

16 JUDGE WOODRUFF: Thank you. Anything else
17 before we go to Staff?

18 (No response.)

19 MS. RANDOLPH: Judge?

20 JUDGE WOODRUFF: Do you wish to testify?

21 MS. RANDOLPH: Yes, I do.

22 (Witness sworn.)

23 JUDGE WOODRUFF: You may be seated.

24 ANITA RANDOLPH testified as follows:

25 THE WITNESS: I am Anita Randolph, director of

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1 the energy center, which is a component of the Missouri
2 Department of Natural Resources located at 1659 East Elm
3 Street in Jefferson City, 65101.

4 I think the development of this rule is
5 extremely timely. We are all well aware that we face, once
6 again, a very tight supply situation regarding natural gas,
7 the continuing prospect of high or even higher prices of
8 natural gas as we move through the summer and into the
9 winter.

10 We do believe the rule would benefit from the
11 inclusion of energy efficiency programs for natural gas
12 utility customers as one component or one choice that the
13 utility companies can use to help mitigate the impact of
14 higher prices on customers and mitigate price volatility.

15 After the winter of 2000-2001, the Public
16 Service Commission did establish a Natural Gas Commodity
17 Price Task Force which dealt with a number of these issues,
18 and among the discussion in the task force was an
19 explanation about the role of energy efficiency in helping
20 control price volatility.

21 We believe that it is essential to include
22 both demand side and supply side options. We need both in
23 order to help ensure adequate and affordable supplies of
24 natural gas to Missouri citizens, to Missouri business and
25 industry. We do urge inclusion of energy efficiency

1 programs in this rule as one of the options for helping
2 accomplish the mitigation of volatility and ensure adequate
3 and affordable supplies.

4 The comments that I'm making also were
5 affirmed by the Governor's Energy Policy Task Force
6 appointed by Governor Holden, and which delivered its report
7 to the Governor in October of 2001. The Governor's task
8 force also supported the implementation of the PSC task
9 force finding, including support for the role of energy
10 efficiency programs to customers as a way to mitigate price
11 volatility.

12 So in closing, we do -- we do support and
13 would advocate the inclusion of both supply side and demand
14 side components in this rule. Thank you.

15 JUDGE WOODRUFF: Let me ask this. Would
16 demand side components be handled -- more appropriately
17 handled in a separate rule as some of the other witnesses
18 have indicated or should it be included in this rule?

19 THE WITNESS: We believe it should be included
20 in this rule. At the same time, we would welcome the
21 opportunity to participate in a proceeding that might
22 discuss the energy efficiency possibilities in a broader and
23 more complete sense.

24 JUDGE WOODRUFF: Well, thank you very much.
25 Does anyone else wish to ask any clarifying questions?

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1 (No response.)
2 JUDGE WOODRUFF: You may step down then.
3 Was there anyone else wishing to testify?
4 (No response.)
5 JUDGE WOODRUFF: Then we'll go to Staff.
6 MR. BERLIN: Yes, your Honor. Staff calls
7 Warren Wood.
8 JUDGE WOODRUFF: Thank you.
9 (Witness sworn.)
10 JUDGE WOODRUFF: You may be seated. You may
11 inquire.
12 WARREN WOOD testified as follows:
13 DIRECT EXAMINATION BY MR. BERLIN:
14 Q. Mr. Wood, for the record, would you please
15 state your name, your position and place of employment.
16 A. Warren C. Wood, energy department manager,
17 Missouri Public Service Commission Staff.
18 Q. Mr. Wood, did you make a prepared statement
19 entitled Proposed Rule Comments and Missouri Public Service
20 Commission Staff Responses?
21 A. Yes, I did.
22 MR. BERLIN: Your Honor, Staff wishes to enter
23 into the record as Staff Exhibit No. 1 the prepared
24 statement of Mr. Wood.
25 JUDGE WOODRUFF: It's already in the case

1 record. If you wish to make it part of the hearing record,
2 that's fine. Exhibit 1. I assume this is what has
3 previously been filed, is it, or is it something new?

4 THE WITNESS: No, this is new.

5 JUDGE WOODRUFF: This is new. Okay. I'm
6 sorry.

7 MR. HACK: May I interrupt? Do we have
8 copies?

9 JUDGE WOODRUFF: Go ahead and hand those out.

10 (EXHIBIT NO. 1 WAS MARKED FOR IDENTIFICATION
11 BY THE REPORTER.)

12 BY MR. BERLIN:

13 Q. Mr. Wood, do you have comments that you wish
14 to make in this proceeding?

15 JUDGE WOODRUFF: Let me deal with Exhibit 1
16 first here. It appears to be Staff's written response to
17 various comments that were filed with the other comments
18 that came in; is that correct?

19 THE WITNESS: Yes.

20 JUDGE WOODRUFF: All right. It's been marked
21 as Exhibit 1 and it will be admitted into the record of this
22 proceeding.

23 (EXHIBIT NO. 1 WAS RECEIVED INTO EVIDENCE.)

24 MR. BERLIN: Thank you, your Honor.

25 JUDGE WOODRUFF: Go ahead.

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1 BY MR. BERLIN:

2 Q. Mr. Wood, do you have comments you wish to
3 make in this proceeding?

4 A. Yes, I do.

5 Q. Please proceed.

6 A. I would like to briefly address the origins of
7 this rule and how the language in this proposed rule was
8 developed with interested stakeholders.

9 The Commission created the Natural Gas
10 Commodity Price Task Force following the dramatic natural
11 gas price fights that occurred during the winter of
12 2000-2001. A number of the recommendations from this task
13 force pointed to the development of the Commission policy
14 statement regarding gas volatility that states that
15 Missouri's natural gas utilities should consider a number of
16 different purchasing strategies to mitigate natural gas
17 upward price volatility.

18 This proposed rule addresses the following
19 recommendations from the Natural Gas Commodity Price Task
20 Force recommendation 3A, referring to fixed price contracts,
21 call options and collars, recommendation 3C, referring to
22 natural gas storage, recommendation 3D, referring to
23 outsourcing agency agreements, and the policy statement of
24 the Natural Gas Commodity Price Task Force.

25 Associated with the generic purchased gas

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1 adjustment docket, Case GO-2002-452, Staff, the Office of
2 Public Counsel, and the regulated natural gas utilities
3 discussed the format of this proposed rule. Staff was
4 satisfied that all concerns with this rule had been
5 addressed before it was presented to the Commission for
6 approval to submit it to the Secretary of State.

7 During the last meeting of the generic PGA
8 working group, no additional changes were recommended to
9 this rule. In response to the request for public comment
10 that was issued when this proposed rule was published,
11 additional comments were provided by some of the
12 stakeholders that previously participated in the development
13 of this rule. All comments the Staff received and Staff's
14 responses to each of these comments are provided in Exhibit
15 No. 1.

16 In response to these comments, the Staff is
17 supportive of three changes to the rule that are outlined on
18 pages 9 and 10 of Staff's exhibit. If I may, briefly, I'll
19 go through those.

20 The first one would be an addition to a new
21 sentence or the addition of a sentence at the end of Section
22 1B of the proposed rule that reads as follows: Financial
23 gains or losses associated with price volatility mitigation
24 efforts can be flowed through the purchased gas adjustment
25 mechanism, subject to applicable provisions of natural gas

1 utilities tariff and applicable prudence review procedures.

2 The second addition would be changing 2G,
3 which currently reads, other -- starts with "other tools,"
4 and making that -- changing 2G to now say "financial swaps
5 and options from over-the-counter markets," and then the
6 current G would change to H.

7 The next recommended change is under 1C, the
8 end of that sentence, between upward and volatility, Staff
9 would insert the word "price," and those are the changes
10 that we're recommending at this time. And that concludes my
11 comments.

12 JUDGE WOODRUFF: I have some questions.

13 These were given to me by Commissioner Murray,
14 and Commissioner Forbis also expressed some of these
15 concerns, and I think you've answered some of them.

16 You indicated that about the flowing these
17 things, these costs through the PGA/ACA process, and you
18 made that change. There was also a suggestion that the
19 words "upward volatility" be removed and that it just be
20 price volatility upward or downward. Do you agree with that
21 suggestion?

22 THE WITNESS: I cannot. The reason being that
23 the policy statement of the Natural Gas Commodity Price Task
24 Force specifically included upward price volatility being
25 the issue of primary concern. I wouldn't want to be

1 construed or misunderstood in any way that Staff doesn't
2 understand that price volatility mitigation in total, both
3 upward and downward, is likely an outcome of a number of
4 the -- or a symptom of a number of different mechanisms that
5 are recommended in this rule.

6 Just a recognition that where opportunities
7 present themselves to participate in downward market and
8 primarily attack the issue of an upward price volatility, we
9 don't want to water down or confuse that issue. We want the
10 upward volatility the focus of the effort.

11 JUDGE WOODRUFF: But you recognize that
12 downward volatility is also going to be affected?

13 THE WITNESS: Very possibly.

14 JUDGE WOODRUFF: Okay. There's also the
15 question about including index-based contracts in the rule.
16 Do you agree with that?

17 THE WITNESS: I can't agree with the addition
18 of index contracts, and I wouldn't want Staff's exclusion of
19 index contracts from the list in the rule under Section 2 to
20 be read to imply that index contracts are imprudent or
21 inappropriate in a well-structured purchasing portfolio,
22 just that Staff does not consider them a purchasing
23 mechanism for attempting to address upward price volatility.

24 JUDGE WOODRUFF: So you're saying go ahead and
25 use them, but it's not a --

1 THE WITNESS: It's recognized as a very, very
2 possible element and likely an element of purchasing
3 portfolios. This rule isn't structured -- it wasn't
4 originally structured to be a rule describing all
5 appropriate things to be considered in development of a
6 purchasing portfolio for an LDC service.

7 Now, we didn't get into how you address peak
8 days, we didn't get into what percentage of margin you
9 should have or how you address growth in customers and all
10 of those issues. This was a rule focused on addressing
11 upward price volatility mitigation.

12 If we wanted to add index contracts and try to
13 make this rule address, you know, all issues that should be
14 considered by a utility in acquiring supplies for their
15 community, we would add many more things to this rule.

16 JUDGE WOODRUFF: Okay. Do you agree -- I
17 believe this was a comment filed by the Missouri Gas
18 Utilities Group -- that none of the measures are useful or
19 capable of mitigating usage volatility of the customers?
20 Was that the focus of this rule?

21 THE WITNESS: Where -- where Missouri Gas
22 Utilities referred to usage volatility, I would agree to
23 some of the comments of Aquila's witness. Usage volatility
24 as placed in the rule, and my intent, was that that would
25 provide opportunities where you see a contract that may be

1 keyed off of heating degree days and see some sort of a
2 hedging mechanism that provides for additional flow of gas
3 in response to abnormally cold weather.

4 Perhaps at a designated price or not, but it
5 gives a mechanism to attempt to address volatility, since in
6 the usage, which is quite often when the weather results
7 in -- brings up usage, it often brings up price, we're
8 currently addressing the price side of it, but on the gas
9 supply planning side of the utility, where there are
10 opportunities to hedge usage in a way that is somehow useful
11 to the utility in balancing risk and market prices, we
12 wouldn't want to see that removed from the rule as something
13 that's specifically recognized.

14 JUDGE WOODRUFF: That brings up a question of
15 weather derivatives that was mentioned I believe by a couple
16 of previous witnesses.

17 What is Staff's position on use of weather
18 derivatives?

19 THE WITNESS: It was primarily a margin issue.
20 I think it kind of falls on the fringes of this rule. The
21 usage volatility that we were thinking about in the rule was
22 more along the lines of, I would say, hedging mechanisms
23 keyed off heating degree days above normal or below normal
24 that somehow can have an effect on a PGA calculation.
25 Whereas, weather derivatives that are tied to margin may not

1 really be the intent of this rule.

2 JUDGE WOODRUFF: Let me ask you then about
3 Natural Resources' comments. What is Staff's position with
4 regard to those comments?

5 THE WITNESS: Mirroring the comments of a
6 number of the witnesses, I would say we're very supportive
7 of weatherization programs. We have been supportive of low
8 income programs. There's a number of different experiments
9 taking place in the state at this time. We've issued a
10 large number of public notices regarding conservation and we
11 often bring flyers to public hearings of natural gas price
12 public hearings of one kind or another.

13 I do, however, believe this rule is really
14 focused at and I want -- the people I want reading this and
15 focusing on it are the gas supply planners of the natural
16 gas utilities. Another rule may be an appropriate place to
17 place that type of information regarding conservation, but
18 this is really a supply side focused rule.

19 JUDGE WOODRUFF: All right. That's all the
20 questions I have for you. Anyone want to ask any clarifying
21 questions?

22 Yes, Mr. Pendergast.

23 MR. PENDERGAST: Thank you. Good morning.

24 JUDGE WOODRUFF: Why don't you come up here to
25 the podium?

1 CROSS-EXAMINATION BY MR. PENDERGAST:

2 Q. Just have a couple questions. On page 12 of
3 the handout that you provided to us and I think is marked as
4 Exhibit 1, you have some language at the bottom of there
5 that I think you're proposing be incorporated into the rule;
6 is that correct?

7 A. Yes, it should be exactly the same language as
8 was provided on page 9.

9 Q. Great. And my only question there was, when
10 you say financial gains or losses associated with price
11 volatility mitigation efforts, are you looking upon that in
12 a broad enough way where that includes the cost to go ahead
13 and acquire those instruments?

14 A. Premiums associated with call options for
15 instance?

16 Q. Right.

17 A. Yes.

18 Q. So it's not just a gain or loss, but the
19 transaction costs and that type of thing?

20 A. Yes.

21 Q. Okay. And on the usage, I would take it from
22 the rule that -- that this is a clear statement of
23 Commission policy, that when it looks at gas supply
24 portfolios in the future, you know, it would anticipate
25 seeing some level of hedging, some level of instruments

1 being used in a diversified portfolio.

2 And I guess my question would be, given our
3 discussion on what usage means and weather derivatives, are
4 you suggesting that with this policy statement, it would be
5 a statement that you would expect to see weather derivatives
6 as part of an LDC's gas supply portfolio?

7 A. Not an expectation. Just a recognition in the
8 rule that if you see and then, as you can read in the rule,
9 if you got into a situation where you were looking at some
10 way to structure a hedge where your review of -- or your
11 effort to balance market price risk benefits and price
12 stability point to that sort of a mechanism, you would have
13 the opportunity to pursue it under this rule.

14 Q. Okay. But you wouldn't feel the same way
15 about a portfolio that did not have weather derivatives as
16 you would about a portfolio that had no financial
17 instruments or hedging of any kind?

18 A. Could you repeat the question?

19 Q. Yeah. I guess what I'm asking is, in looking
20 at what a diversified portfolio is, given this policy
21 statement, you would expect to see in that portfolio at
22 least some use of instruments that can be used to mitigate
23 price volatility; is that correct?

24 A. If the utility's review or their expectations
25 regarding natural gas price volatility usage, the price

1 range that they potentially see for their customers and a
2 balancing of those risks versus the cost of participating in
3 these programs showed that they should be getting into these
4 sort of hedging mechanisms, then I would expect to see them.

5 If -- you know, this isn't a preapproval that
6 you have to have 30 or 50 percent of hedging. It's a
7 recognition that in the gas supply planning process we want
8 to see an effort to balance market price risk benefits and
9 price stability.

10 Q. I guess what I was asking, given that and
11 given the emphasis on having a diversified portfolio, would
12 you expect yourself to see under this kind of policy
13 statement that there would be some level of those
14 instruments being used?

15 A. Given the current, some of the utilities are
16 aggressively hedging their findings when they look at --
17 when they balance these different factors for their gas
18 purchasing portfolio, I would anticipate seeing some level
19 of diversification in their supplies.

20 Q. Okay. And I guess, just to put a final cap on
21 this, that's not necessarily true as far as the weather
22 derivatives, though, you wouldn't necessarily expect to see
23 weather derivatives as part of that portfolio?

24 A. No.

25 Q. Okay. And finally on the index contract, your

1 basic position on that is that we really start from a
2 foundation where index contracts are used. Staff
3 anticipates that to some degree they will continue to be
4 used, and you just don't believe it's necessary to go ahead
5 and put it into the rule because the rule is designed to
6 look at alternative mechanisms of mitigating those market
7 price changes?

8 A. I'll attempt to answer your question by giving
9 a little bit of explanation.

10 Q. Sure.

11 A. If this doesn't answer, I'm sure you will come
12 back to ask it again, and that's fine.

13 In 1B of the rule, it points to the item
14 described in 2A through G, which is now 2A through H,
15 balance market price risk, benefits and price stability.
16 When I look at the term "balance market price risk," market
17 price risk in that is -- you could almost substitute index
18 priced contracts in there.

19 Q. Okay.

20 A. Okay. We're trying to balance some of the
21 risk brought into the market with the mechanisms described
22 in the list. Okay. It's not meant to exclude index
23 contracts from purchasing portfolios, just a recognition
24 that 2A through H, the types of tools that we would expect
25 as a starting list of things to be evaluated in balancing

1 that risk in their portfolio that will likely include some
2 index-based contracts.

3 Q. Okay. So you would say, at least by
4 implication, it already assumes that when you're balancing
5 something what you're balancing against is index-priced
6 contracts?

7 A. Market-based pricing, yeah.

8 Q. And you would expect any diversified portfolio
9 would probably have some element of that in it?

10 A. Unless some great deal comes along where they
11 can fix all their gas costs and they don't have to
12 participate in index contracts, in general I expect to see
13 some index-based contracts.

14 MR. PENDERGAST: Great. Thank you.

15 JUDGE WOODRUFF: Anyone else wish to ask any
16 clarifying questions of this witness?

17 (No response.)

18 JUDGE WOODRUFF: All right. You may step down
19 then.

20 Staff have anything else?

21 MR. BERLIN: No, your Honor.

22 JUDGE WOODRUFF: All right. Give one final
23 chance for any other comments anyone wants to make.

24 (No response.)

25 JUDGE WOODRUFF: All right. With that, then,

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1 this rulemaking hearing is adjourned.

2 Thank you all very much.

3 WHEREUPON, the public hearing was concluded.

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EXHIBITS INDEX

MARKED RECEIVED

Exhibit No. 1

Proposed Rule Comments & Missouri
Public Service Commission Staff
Responses

30

30