BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company	)	
d/b/a Ameren Missouri's 2010-2011	)	Case No. GR-2012-0077
ACA Audit.	)	

RESPONSE TO STAFF RECOMMENDATION

COMES NOW Union Electric Company d/b/a Ameren Missouri (Ameren Missouri or Company) and for its *Response to Staff Recommendation*, states as follows:

1. On December 21, 2012, the Staff (Staff) of the Missouri Public Service Commission (Commission) filed a *Staff Recommendation* in this case. The Commission ordered Ameren Missouri to respond no later than February 11, 2013.

2. The *Staff Recommendation* asks the Commission to hold open this case so that Staff can monitor Ameren Missouri's pursuit of refunds from MoGas Pipeline LLC (MoGas). At this point, the Commission has held open multiple Actual Cost Adjustment (ACA) audit cases in order to "monitor" the Company's actions. The Company does not believe that it is necessary to hold this case open since none of the gas costs being reviewed include any overcharges from MoGas and since closing this case will not affect Staff's ability to monitor Ameren Missouri's pursuit of collection of the judgment. In the Company's view, this case and future ACA cases should be closed when they are completed.

ACA BALANCE ADJUSTMENT

3. The *Staff Recommendation* proposed an adjustment to the Company's filed ACA balances and Ameren Missouri does not object to such an adjustment. In fact, this adjustment has already been made back in August of 2012.

RELIABILITY ANALYSIS

4. The *Memorandum* attached to the *Staff Recommendation* (*Memo*) recommended that the Company update its capacity planning for the Columbia/Panhandle Eastern Pipe Line Company system. Ameren Missouri updates its demand studies every three years, but agrees with Staff that for 2013 and 2014, updating the peak day capacity planning portion of its demand study on an annual basis makes sense under the current circumstances and the Company will provide this information to Staff as it is completed each year.

5. The *Memo* also recommends the Company provide an estimate of peak design days (for years one through five) for its Rolla area customers served by MoGas. The Company does not object to this request and will provide this information to Staff as it is completed.

HEDGING BACKGROUND

6. The *Staff Recommendation* sets forth several concerns, comments and/or recommendations regarding the Company's hedging policies. The Company will respond to each of the identified issues below. Prior to that response, however, an overview of Ameren Missouri's local distribution company (LDC) hedging strategy is required.

7. Ameren Missouri has a long history of hedging the natural gas supply for its local distribution company. The Company's hedging strategy is reviewed annually and approved by the Company's Risk Management Steering Committee (RMSC). This policy has been provided to Staff in numerous ACA audit cases (which occur annually) as well as in Ameren Missouri rate cases filed in recent years, whether natural gas or electric. Finally, Ameren Missouri meets with Staff twice a year in the spring and fall, to discuss its LDC's Natural Gas Strategy for the upcoming winter, which includes the hedging strategy and its LDC hedging positions. In these presentations, the LDC has provided an overview of the market conditions and the timing each

hedge was completed for the summer and winter. The Company makes an effort to be very responsive to questions during these meetings and to any follow-up questions or additional data requests it receives following the presentations.

8. It is important to understand what the Company's hedging strategy is designed to do and what it is not designed to do. The goal is NOT to time the market in an effort to obtain the lowest prices (in other words, to speculate), but rather to provide price stability for the Company's customers. This means the policy shaves off the high market price peaks that customers would otherwise experience, but it also means that customers may not fully realize the lowest bottoms of the market.

9. This policy is designed for the benefit of the Company's customers. In fact, it should be noted that Ameren Missouri shareholders do not benefit from the Company's LDC hedging strategy. In fact, it does not reduce the Company's risk at all. If the Company is imprudent in the execution of its hedging, then it bears the risk of a disallowance of costs.

10. At a high level, the Company's LDC hedging strategy is to layer on hedges over time so that the price it pays for gas supplies in any year is determined by dollar cost averaging. This layering produces price stability and achieves Ameren Missouri's hedging goals. The timing of each hedge layer is not predetermined and the Company attempts to execute those hedges when it finds favorable market prices. Other general market conditions also impact the exact timing of each hedge. Again, the strategy is not to beat the market or to otherwise speculate on natural gas prices. The current planning horizon is thirteen seasons or just over six years. This relatively long time horizon also works to dampen volatility.

STAFF CONCERNS

11. On page 7 of the *Memo*, Staff indicates concern over "the continued negative financial impacts from the hedging transactions in this ACA period." This statement comes from a different viewpoint on hedging. It is Ameren Missouri's contention that its hedging strategy should be judged by how well it dampens volatility or, put another way, how stable the policy has kept natural gas prices for its customers. Staff's concern over "negative financial impacts" can only stem from a comparison between Ameren Missouri's hedged price and a 'hindsight' comparison to spot prices. This is in direct contradiction with the next sentence of the *Memo* which says that Ameren Missouri should not attempt to beat the market. Ameren Missouri does not attempt to beat the market. Ameren Missouri attempts to provide natural gas to its customers while mitigating price volatility. This goal is consistent with the Commission's own rules regarding hedging. Chapter 40 of the Commission's regulations is applicable only to natural gas utilities. The language used within this rule is instructive. The Purpose section of the rule reads:

> This rule represents a statement of commission policy that natural gas local distribution companies should undertake diversified natural gas purchasing activities as part of a prudent effort to *mitigate upward natural gas price volatility* and secure adequate natural gas supplies for their customers. (Emphasis added).

4 CSR 240-40.018(1)(A):

> As part of a prudent planning effort to secure adequate natural gas supplies for their customers, natural gas utilities should structure their portfolios of contracts with various supply and pricing provisions in an effort to *mitigate upward natural gas price spikes*, and provide a level of stability of delivered natural gas. (Emphasis added).

4 CSR 240-40.018(1)(C):

> Part of a natural gas utility's balanced portfolio may be higher than spot market price and ties, and this is recognized as a possible result of prudent efforts to *dampen upward volatility*. (Emphasis added).

There are two important observations about these regulations which should be made. First, neither the purpose clause nor the two sections cited above (and in fact, no part of this rule) mentions a goal of obtaining the lowest possible price for customers. Second, the rule only mentions protecting customers against *upward natural gas price spikes* and *dampening upward volatility*. Clearly, the concern of the Commission at the time it issued this rule (because it is the only pricing concern to be articulated within the rule) was to protect customers from upward price swings. Ameren Missouri's hedging policy has a superior track record of providing that protection. During times of high natural gas spot market prices, Ameren Missouri's customers were protected from the volatile upward price spikes.

12. The *Memo* also states that Ameren Missouri's hedging policy should be flexible enough to incorporate changing market conditions (Page 7). Ameren Missouri's policy does exactly that. When prices go below a certain level, the policy requires that Ameren Missouri increase the amount of future supply that is hedged. Ameren Missouri has complied with this requirement. The Company continues to believe that layering gas hedges over time is the most appropriate strategy--even under the current market conditions. Staff characterizes the current market as "less volatile," yet that could change tomorrow if Congress or the natural gas producing states decide to restrict natural gas fracking, as an example. No one knows what future prices will be or, with any certainty, whether they will decline or rise. The Company's current strategy is built upon staggered, long term hedges, which remove volatility (upwards or downwards) of the natural gas market. The Commission's own price volatility mitigation rules,

found at 4 CSR 240-40.018, recognize that the purpose of hedging is to prevent upward price spikes more than it is to capture downward price events. If the Staff believes the Company should adopt a completely different approach, they should provide a specific recommendation along with support for that recommendation. In the absence of such an alternative recommendation, the Company believes its current practices accomplish this stated goal. Of course, we will continue to review our hedging strategy and refine it where possible to improve its performance for customers. But we do not believe radical changes in the Company's strategy are warranted.

13. Ameren Missouri recognizes that there is a natural inclination to more closely examine its hedging policies when it has a PGA level that is higher than market prices. However, the Company hopes that a better understanding of Ameren Missouri's hedging policy and the reasons for the policy will provide a better background upon which to judge the Company's hedging performance.

14. The Staff *Memo* lists some specific concerns with Ameren Missouri's hedging policy (Page 7). Specifically, the *Memo* warns against the Company's "extensive reliance on swaps" and the limitations the Company's hedging strategy places upon out-of-the-money calls as a possible hedge tool.[1] Ameren Missouri has used more call options, as a reaction to the lower price environment in which the Company operates today.[2] However, it must be recognized that call options, like all hedging instruments have a cost associated with them.

[1] Swaps are derivatives in which counterparties exchange payments based on changes in the price of a commodity or a market index, while fixing the price they effectively pay for the physical commodity.
[2] Call options are options that give the buyer the right, but not the obligation, to buy a futures/forward contract for a specified strike price within a specified period of time in exchange for a one-time premium payment.

STORAGE

15. The *Memo* also warns of risks associated with a possible reduction in the level of storage maintained by Ameren Missouri, and recommends that the Company analyze the costs and benefits of storage over other hedging options prior to turning any storage back (Page 8). Of course, that is exactly what Ameren Missouri would do prior to making any decision to release or turn back storage. If Staff has certain specific analyses that it is requesting be done, then Ameren Missouri requests that Staff be more specific in this recommendation. Otherwise, Ameren Missouri has no objection to this recommendation.

16. The *Memo* discusses the importance of the Company regularly examining the balance between storage and financial hedging instruments, and further recommends Ameren Missouri continue to document its hedging decisions and provide such documentation to Staff (Page 8). As the *Memo* indicates, Ameren Missouri already does this and will continue to do so in the future. Ameren Missouri does not read this section to request any additional information from the Company or to require anything be provided outside of the ACA process. If Staff intended this condition to require new information, Ameren Missouri requests Staff be more specific in this recommendation. For example, one sections talks about the "benefits/costs based on outcomes from the hedging strategy." If this means that Ameren Missouri must demonstrate that its hedged PGA rate is lower than spot market, then it is an inappropriate standard by which to judge Ameren Missouri's hedging and should be rejected by the Commission.

WHEREFORE, Ameren Missouri respectfully submits this response to the Staff Recommendation filed on December 21, 2012.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing *Response to Staff Recommendation* was served on the following parties via electronic mail (e-mail) on this 11th day of February, 2013.

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