

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Union Electric Company)
d/b/a Ameren Missouri's 2011-2012) Case No. GR-2013-0100
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 October 30, 2013, 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 December 2, 2013.

2. The *Staff Recommendation* identified an accounting adjustment to the Company's ACA balances, recommended that the Commission hold this case open until such time as Ameren Missouri provides documents demonstrating that it has received a settlement payment from MOGas Pipeline, LLC (MOGas) and that it has returned that settlement payment to customers via refunds to customers through its PGA/ACA mechanism, and set forth comments regarding the Company's hedging practices. Each of these issues is addressed below.

I. ACA Balance Adjustment

3. The *Staff Recommendation* proposed an adjustment to the Company's filed ACA balances and Ameren Missouri does not object to that adjustment.

II. MOGas Refunds

4. The *Staff Recommendation* proposed that the Commission hold open this case until such time as the Company provides documents demonstrating that MOGas has made the payment required by a settlement agreement between the companies and that the Company has returned that payment to its customers through the PGA/ACA mechanism.

5. Ameren Missouri believes this recommendation to be unnecessary. The Company has already notified the Commission (and Staff) that MOGas made the required payments to it via wire transfers. A statement of this fact was filed on October 3, 2013 in File Nos. GR-2008-0107, GR-2008-0366, GR-2009-0337, GR-2010-0180 and GR-2012-0077. Ameren Missouri presumes these multiple notifications to be sufficient to fulfill this aspect of the *Staff Recommendation*, but if not, asks the Commission to consider this pleading as notice of the same. Additionally, in File No. GR-2014-0061, Ameren Missouri requested a variance from a portion of its PGA tariffs in order to allow it to return the refund to its customers. On October 24, 2013, the Staff filed a response to the request which recommended the Commission grant the variance request. The Commission issued an order approving that request on October 30, 2013. Accordingly, the MOGas settlement payment is already being refunded to Ameren Missouri customers through the Company's PGA rates. Ameren Missouri presumes this action is sufficient to fulfill this aspect of the *Staff Recommendation*. As a result, Ameren Missouri sees no reason to hold open this docket for these issues.

III. Reliability Analysis/Hedging Comments

A. Propane Changes

6. The *Staff Recommendation* points out that Ameren Missouri is retiring its propane plant and that will require review in a future rate case. Ameren Missouri does not disagree that the Commission may review its decision to retire the propane plant in a future rate case, but notes that no action is required by the Commission on this topic at this time.

B. Storage

7. The *Staff Recommendation* suggests that Ameren Missouri review its Natural Gas Strategy so that its plans incorporate the actual operational storage plans that the Company

intends to follow. Ameren Missouri will incorporate its most current storage plans into future Natural Gas Strategy documentation.

C. Hedging

8. 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.

9. 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, both natural gas and electric. Finally, Ameren Missouri meets with Staff twice a year, in the spring and in the 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 Company 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 requests for information it receives following the presentations.

10. 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.

11. 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.

12. 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 price volatility. Staff's specific comments, addressed below, seem to be based upon a belief that volatility has been removed from the natural gas market. Trusting that belief would mean one would adopt a completely different hedging strategy, but Ameren Missouri does not believe it prudent to assume natural gas prices will never increase or fluctuate in the manner they have historically. Restrictions on natural gas hydraulic fracturing, natural disasters or other uncontrollable factors can and will still impact the cost of natural gas. Unless the Commission is comfortable with forgoing the protection of hedging, Ameren Missouri believes its general hedging strategy is appropriate, that it provides the best protection for its customers and that it should be continued.

D. Staff Concerns

13. On page 6 of the *Memo* attached to the *Staff Recommendation*, Staff indicates its concern over “the continued negative financial impacts from the hedging transactions in this ACA period.” This statement appears to stem from a different viewpoint on the purpose of 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 hindsight comparison between Ameren Missouri’s hedged price and spot prices. This concern implies that Ameren Missouri should attempt to beat the market with its hedging strategy. Ameren Missouri does not attempt to beat the market and does not believe that an appropriate hedging strategy should attempt to beat the market. Ameren Missouri attempts to provide natural gas to its customers in a way that mitigates price volatility. This goal is consistent with the Commission’s own rule regarding hedging. For example, the Purpose section of 4 CSR 240-40.018 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) adds:

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).

Further, 4 CSR 240-40.018(1)(C) states:

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 was to protect customers from upward price swings. Ameren Missouri's hedging policy has a proven 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.

14. The *Memo* (page 6) also states that Ameren Missouri's hedging policy should be flexible enough to incorporate changing market conditions. Ameren Missouri's policy does exactly that. When prices drop below a certain level, the policy requires that Ameren Missouri increase the amount of future supply that is hedged. Currently, the policy also allows the Company to hedge more or less, depending on circumstances, as long as the amount hedged falls within a certain range. As explained above, the Company continues to believe that layering gas hedges over time is the most appropriate strategy--even under the current market conditions.

15. 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 this explanation of its hedging policy and the reasons for the policy will provide a better background upon which to judge the Company's hedging performance.

16. The Staff *Memo* (page 6) continues to recommend that the Company evaluate its current strategy of financially hedging summer storage injections. The reason behind that recommendation is the statement that market prices have become less volatile. Ameren Missouri does not hedge all of its summer storage injections, but rather, it only hedges approximately 50%.

17. The Staff *Memo* (page 6) acknowledges that the Company used more call options¹ to hedge its summer prices, which allow for participation in downward price movements. This statement is true. However, it must be recognized that call options, like all hedging instruments, have a cost associated with them.

18. Staff also warns that using a delta-adjusted evaluation of hedges² may limit consideration of out-of-the-money calls. Ameren Missouri recognizes that could happen, but does not believe that this evaluation method has been overly limiting. That said, as the Company reevaluates its hedging strategy, as it does on a regular basis, this is an area that the Company will consider modifying. This, like all aspects of hedging, is somewhat of a balancing act and the Company strives to maintain an appropriate balance.

19. Finally, Staff's *Memo* (page 6) repeats a recommendation, a recommendation that it has made in previous cases, that the Company continue to assess and document the effectiveness of its hedges for the upcoming ACA periods. As the *Memo* indicates, the Company already documents its hedging decisions and provides that documentation to Staff. Ameren Missouri does not read this recommendation to request any additional information from the

¹ 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.

² The Staff *Memo* refers to this type of hedge as a "delta hedge." A delta hedge is a unique strategy for managing positions that can include selling. This is not Ameren Missouri's hedging strategy, thus it is more appropriately referred to as delta-adjusted hedging.

Company or to require anything to be provided outside of the ACA process. Ameren Missouri will continue to document its hedging decisions in future ACA cases.

WHEREFORE, Ameren Missouri respectfully submits this response to the *Staff Recommendation* filed on October 30, 2013.

Respectfully Submitted,

/s/ Wendy K. Tatro

Wendy K. Tatro, #60261

Corporate Counsel

1901 Chouteau Avenue, MC 1310

P.O. Box 66149

St. Louis, MO 63166-6149

(314) 554-3484 (phone)

(314) 554-4014 (facsimile)

amerenmoservice@ameren.com

**ATTORNEYS FOR UNION ELECTRIC
COMPANY d/b/a AMEREN MISSOURI**

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 2nd day of December, 2013.

General Counsel Office
Missouri Public Service Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
staffcounsel@psc.mo.gov

Robert Berlin
Missouri Public Service Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
Bob.berlin@psc.mo.gov

Lewis Mills
Office Of Public Counsel
200 Madison Street, Suite 650
P.O. Box 2230
Jefferson City, MO 65102
opc@ded.mo.gov

/s/ Wendy K. Tatro

Wendy K. Tatro