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Metro

FEBRUARY 20, 2014

TO: BOARD OF DIRECTORS

THROUGH: ARTHUR T. LEAHY
CHIEF EXECUTIVE OFFICER

FROM: NALINI AHUJA
EXECUTIVE DIRECTOR, FINANCE AND BUDGET

SUBJECT: NATURAL GAS HEDGING PROGRAM

ISSUE

The Natural Gas Hedging Program (the "Hedging Program") requires that we report compliance with the Hedging Program Guidelines and program performance to the Board on a quarterly basis.

DISCUSSION

The purpose of this report is to present the status of compliance and performance for the hedged portion of our compressed natural gas ("CNG") budget. Operations related variances are presented in order to provide an overall perspective for CNG costs.

The objective of the Hedging Program is to improve budget certainty for fuel costs and to help establish the CNG budget for the upcoming year by capping the cost in advance or otherwise reducing the effects of price increases on the budget. Budget certainty was improved through FY11 by utilizing a hedging instrument known as a commodity swap to hedge most of the planned volume for each fiscal year. In January 2011, the Board approved the updated CNG Hedging Program, adding commodity options and the use of cost stabilization reserves in addition to the continued use of commodity swaps. The addition of commodity options and cost stabilization reserves enhances the mix of tools we can use to hedge under various market conditions to reduce the potential for budget variances.

Beginning with FY12 we began using a "costless collar" strategy to facilitate better participation when rates are lower. With a costless collar there is no upfront cash outlay. Under the collar strategy a "ceiling" or upper limit and "floor" or the lower limit are measured against an Index price. If the Index price stays within the collar no payments are made by us or the hedge counterparty. If the index rises above the ceiling, the hedge counterparty pays us and if the index drops below the floor, we pay the hedge counterparty. The Index, based on the wholesale price to Southern

California Gas Company, is closely correlated to the monthly cost Metro pays before transportation and distribution fees of approximately $0.11 per therm.

As of December 31, 2013, we had one hedge transaction outstanding for the remainder of FY14. The current hedge offers price protection on approximately 12% of projected consumption for the remainder of the fiscal year. The table below provides a summary of the outstanding hedge transaction. Positive/(negative) market value indicates the amount we would receive/(pay) on an early termination at the specified valuation date. The Contract Rates, Ceiling and Floor, reported in the table below do not include the transportation and delivery fees Metro pays.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of December 31, 2013

Period Hedged	Provider	Credit Ratings (S&P, Moody's, Fitch)	Index Rate per Therm	Remaining Therms	Current Market Value*
FY 14	Bank of America	A-/Baa2/A	Ceiling / Floor $0.450/ $0.298	2,896,000	$36,000

*Monthly LIBOR rate used.

Compliance

As of the date of this report the Hedging Program is in compliance with all the specified limitations and requirements. The individual compliance items are listed on Attachment A.

Performance

For the quarter, CNG costs were approximately $447,300 under budget as the actual average gas price of $0.491 per therm was slightly lower than the $0.50 per therm budget price, and the actual usage was lower than budget.

For the quarter, 1.47 million therms were hedged compared to 11.85 million therms actually consumed, for a realized hedge ratio of 12.4%. During the second quarter of fiscal 2014, no payments were made by either the counterparty or us as the Index was within the collar. See Attachment B.

At this time we are not recommending additional hedges as current forecasts of natural gas prices are above budget price. We are updating the Hedging Program to incorporate changes mandated by the Dodd-Frank Act for all swap and hedging participants and will request Board approval of those changes in calendar 2014.

NEXT STEPS

- Review current program with hedge consultant.
- Request Board approval for an updated Hedge Program.
- Execute additional hedges as determined in consultation with OMB and Operations.

ATTACHMENTS

A. Program Compliance
B. Quarterly Summary of CNG Costs and Variances

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Attachment A

Program Compliance

Maximum Trade Maturity – The guidelines specify that hedges will settle or expire not more than 30 months from the date they are acquired. – All trade maturities are in compliance.

Maximum Trade Amount – Number of therms in CNG forecast times the Hedge Ratio divided by value for Frequency of Trades. At the time of each trade total therms hedged for the year may not exceed the Hedge Ratio. All trade amounts have been in compliance with the Hedging Program Guidelines.

Hedge Ratio - Limited to 100% of planned volume when based solely on the volume, but may be increased by up to an additional 10 percentage points as determined by staff, not to exceed 110% of planned volume - All trade amounts have been in compliance with the Hedging Program Guidelines.

Frequency of Trades: From 2 to 6 per year. – No trades have been executed during FY14.

Timing of Trades: Trades will generally be executed in advance of the budget year and have at least 28 days separation between trades.

Counterparty Credit Ratings – No changes in ratings this quarter.

Summary of Credit Ratings-December 31, 2013

Provider	Credit Ratings (S&P/ Moody's / Fitch)
Bank of America	A-/Baa2/A

Collateral Requirements – Requirements to post collateral are based on credit ratings of the counterparties. The threshold is $25 million for counterparties rated "A-/A3" or better. The current market value of our existing trade is significantly below the $25 million threshold, so no collateral is required.

Re-Confirm Assumptions – Assumptions have been reconfirmed for factors that would affect the Gas Company's cost of gas and reduce the correlation between the Gas Company's cost and the pricing index the hedges are tied to. Before entering into new hedges we will confirm assumptions with our hedging consultant.

Re-Confirmation of Therms - The amount of therms was reconfirmed with the Operations staff prior to entering into any hedge for FY14 and will be reconfirmed prior to entering into additional hedges.

All information is as of the report date for the end of the quarter, unless otherwise specified.

ATTACHMENT B

Quarterly Summary of CNG Costs and Variances
FY 2014 Q2

Performance vs. Budget	Price per Therm	Volume in Therms	Total Cost
Budget	$ 0.50	12,522,615	$6,261,308
Therms hedged and net payments for hedge (a)		1,472,000	$0.00
Actual therms consumed	$ 0.491	11,851,018	$5,813,976
Total cost of gas including hedge	**$ 0.491**		**$5,813,976**
% of therms hedged		12.42%	
Actual volume vs budget variance fav (unfav)		671,597	$335,799
Actual price vs budget variance fav (unfav)	$ 0.01		$111,533
Total variance to budget fav (unfav)			$447,332
Actual cost as a percentage of budget			92.86%

(a) Index rates were within the hedge collar hence no gain or loss on the hedge.

Collar (Ceiling $0.450/Floor $0.298)	Actual Index
Oct-13	$0.370
Nov-13	$0.387
Dec-13	$0.395