

**Exhibit No.:**  
**Issue(s):**  
**Witness/Type of Exhibit:**  
**Sponsoring Party:**  
**Case No.:**

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Hedging Expenses  
Riley/Surrebuttal  
Public Counsel  
ER-2016-0156

**SURREBUTTAL TESTIMONY**

**OF**

**JOHN S. RILEY**

Submitted on Behalf of the Office of the Public Counsel

**KCP&L GREATER MISSOURI OPERATIONS COMPANY**

CASE NO. ER-2016-0156

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**Denotes Highly Confidential Information that has been Redacted**

September 2, 2016

**NP**

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

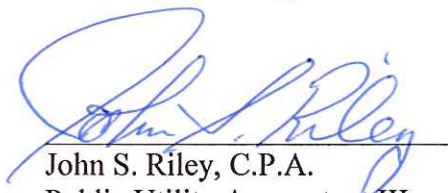
In the Matter of KCP&L Greater )  
Missouri Operations Company's )  
Request for Authority to Implement ) File No. ER-2016-0156  
a General Rate Increase for )  
Electric Service )

**AFFIDAVIT OF JOHN S. RILEY**

STATE OF MISSOURI )  
 ) ss  
COUNTY OF COLE )

John S. Riley, of lawful age and being first duly sworn, deposes and states:


1. My name is John S. Riley. I am a Public Utility Accountant III for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

  
John S. Riley, C.P.A.  
Public Utility Accountant III

Subscribed and sworn to me this 2<sup>nd</sup> day of September 2016.



JERENE A. BUCKMAN  
My Commission Expires  
August 23, 2017  
Cole County  
Commission #13754037

  
Jerene A. Buckman  
Notary Public

My Commission expires August 23, 2017.

**SURREBUTTAL TESTIMONY**  
**OF**  
**JOHN S. RILEY**  
**KCP&L GREATER MISSOURI OPERATIONS COMPANY**  
**CASE NO. ER-2016-0156**

1 **Q. Please state your name and business address.**

2 A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102

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

4 A. I am employed by the Missouri Office of the Public Counsel (“OPC”) as a Public Utility  
5 Accountant.

6 **Q. Are you the same John S. Riley who filed direct and rebuttal testimony in this matter**  
7 **on behalf of OPC?**

8 A. Yes.

9 **Q. What is the purpose of your surrebuttal testimony?**

10 A. To respond to the rebuttal testimony of KCP&L Greater Missouri Operations Company  
11 (“GMO” or “Company”) witness Wm. Edward Blunk and Missouri Public Service  
12 Commission Staff (“Staff”) witness Dana Eaves concerning GMO’s purchased power cross  
13 hedging and natural gas hedging policies and procedures.

14 **Q. Could you summarize the OPC’s surrebuttal position concerning the Company’s**  
15 **hedging practices?**

16 A. It is OPC’s position that it is not prudent for the Company’s to continue its current hedging  
17 activity due to the low price and low volatility reflected in the purchased power and natural  
18 gas market over the past several years. OPC also has concerns with the Company’s  
19 inflexible hedging policies that have magnified these loss amounts.

1 OPC's position is consistent with the Staff's recommendation that the Company cease its  
2 hedging practices at this time and that purchased power cross hedging costs be removed  
3 from GMO's fuel adjustment clause ("FAC"). However, OPC's position regarding cost  
4 recovery of hedging if GMO decides to resume hedging is different from Staff's position.

5 **Q. What is OPC's position regarding cost recovery of hedging should GMO decide to**  
6 **hedge again?**

7 A. Recognition of natural gas hedging activity should not be through GMO's FAC but rather  
8 through a general rate case proceeding. The Company's financial gains or losses from their  
9 natural gas hedging activities should be recorded in the appropriate regulatory asset or  
10 liability account<sup>1</sup> and should seek rate recovery in the Company's next rate case.

11 **Q. Mr. Blunk points out in his rebuttal testimony<sup>2</sup> that you never addressed the Missouri**  
12 **Public Service Commission's ("Commission's") prudence standard. What is the**  
13 **Commission's prudence standard that OPC relies upon as the basis of its position?**

14 A. OPC witness Lena Mantle included the standard at page 27 of her direct testimony as  
15 follows:

16 [A] utility's costs are presumed to be prudently incurred....  
17 However, the presumption does not survive "a showing of  
18 inefficiency or improvidence.... [W]here some other participant in  
19 the proceeding creates a serious doubt as to the prudence of  
20 expenditures, then the applicant has the burden of dispelling these  
21 doubts and proving the questioned expenditure to have been  
22 prudent.

23  
24 In the same case, the PSC noted that this test of prudence should  
25 not be based upon hindsight, but upon a reasonableness standard:  
26 [T]he company's conduct t should be judged by asking whether  
27 the conduct was reasonable at the time, under all the circumstance,  
28 considering that the company had to solve its problem

<sup>1</sup> Gains in FERC account 186 or losses in FERC account 182.3

<sup>2</sup> Blunk rebuttal, page 4, beginning line 14

1 prospectively rather than in reliance on hindsight. In effect, our  
2 responsibility is to determine how reasonable people would have  
3 performed the tasks that confronted the company.<sup>3</sup>  
4

5 **Q. Based on this standard, do you believe the Commission should judge GMO’s hedging**  
6 **transactions based on reasonableness?**

7 A. Yes. I believe the Commission should apply the “reasonableness” standard described above.  
8 The reasonableness standard with respect to hedging activities should be viewed from the  
9 perspective of activities that would be taken by competitive businesses given the same facts  
10 and circumstances as faced by GMO as it relates to its hedging activities.

11 **Q. Why should competitiveness be a factor in how the Commission applies the**  
12 **reasonableness standard to GMO’s hedging activities?**

13 A. Because of the monopolistic environment of electric utility service, one of the necessary  
14 functions of the Commission is to act as a replacement for competition. The Commission  
15 sets rates that are “fair” and “reasonable” and allow the utility an opportunity to earn a fair  
16 rate of return. In a competitive market competition sets prices. For a monopoly that has no  
17 competition such as GMO, the Commission is vested with that responsibility. The  
18 Commission must set utility prices due to the absence of competition. One of the ways the  
19 Commission should look at reasonableness is by asking the question – how would a  
20 reasonable and prudent manager of a competitive company engage in hedging activities  
21 given the changes in the purchased power and natural gas market over the past several  
22 years? Would a reasonable and prudent manager of a competitive company continue to  
23 accrue millions of dollars of hedging losses if it had to absorb such losses, year after year, as

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<sup>3</sup> 954 S.W.2d 520, 528-29 (Mo. App. W.D.,1997) (citations omitted)

1 GMO has done? Given that these \*\* \*\* since 2008<sup>4</sup>, the answer  
2 the Commission should reach is no. A competitive company would not accept such losses.

3 **Q. Clarify a competitive environment.**

4 A. A reasonable person in a competitive business environment has to justify and be accountable  
5 for his or her decisions. GMO has continues to engage in hedging purchases day-after-day  
6 with no apparent concerns with the multi-millions of dollars in hedging losses that are  
7 embedded in the price for utility services charged to its to customers. GMO pays the cost of  
8 hedging 67% of its projected natural gas and purchase power requirements and is comforted  
9 with the knowledge, that no matter how imprudent the decision,, its shareholders will face  
10 minimal consequences of these decisions and its management will not be held accountable  
11 for these decisions because 95% of the losses above what is included in base rates are passed  
12 through to GMO's customers through the FAC. Removing cost recovery of hedging losses  
13 from GMO revenue requirement places the burden of determining the prudence of hedging  
14 on GMO. Removing hedging costs from the FAC moves the risk of hedging to GMO. If  
15 GMO's management determines it is prudent to hedge, then it accepts the risk of losses and  
16 enjoys the benefits of gains just as a competitive company would.

17 **Q. Working within the context of the prudence standard above, was the Company's**  
18 **conduct reasonable at the time, under all the circumstances, considering that the**  
19 **Company had to solve its problem prospectively rather than in reliance on hindsight?**

20 A. No. Given the actual natural gas market and the projections of future natural gas prices  
21 which showed little or no increases and little or no price volatility, GMO should have  
22 considered the magnitude of its hedging losses over the past several years and realized that  
23 these losses would continue to be incurred.

24 **Q. How does OPC judge this problem prospectively?**

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<sup>4</sup> Staff (highly confidential)direct, p. 190

1 A. We are currently experiencing a low price, low volatility natural gas market and it has been  
2 this way for some time. In my direct testimony, I point out that GMO has a variety of  
3 forecasting sources that estimate natural gas prices from \*\* \*\* to \*\* \*\* through at  
4 least 2017.<sup>5</sup> The EIA predicts gas in 2017 will be \$2.96<sup>6</sup>. These forecasts are based, in part  
5 on the record amount of gas in storage<sup>7</sup>. This isn't a question of hindsight. The natural gas  
6 market has been oversupplied for a while. This is basic economics; supply exceeding  
7 demand puts downward pressure on prices as well as volatility.

8 **Q. What is the magnitude of GMO's past hedging losses?**

9 A. Staff has listed GMO's hedging losses at \*\* \*\*<sup>8</sup> over the last five years

10 **Q. Would it have been prudent for GMO to reevaluate and make changes to its hedging**  
11 **practices given the magnitude of its hedging losses?**

12 A. Yes.

13 **Q. To your knowledge has GMO re-evaluated and made changes to its hedging practices**  
14 **given the magnitude of its hedging losses?**

15 A. No.

16 **Q. Please sum up this imprudence scenario.**

17 A. A reasonable person, that has to answer for their decisions, would have looked at their past  
18 losses, reviewed natural gas forecasts and, knowing that the same hedging policy would  
19 continue to result in losses, should have decided that the possible benefit would not have  
20 been great enough to risk the losses.

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<sup>5</sup> Riley Direct, page 5 Lines 9-11

<sup>6</sup> Riley Direct, JSR Schedule D-1

<sup>7</sup> Riley Direct, JSR Schedule D-1, bottom p.2 and top of page 3

<sup>8</sup> Staff witness Dana Eaves direct testimony, page 190

1 **Q. In Mr. Blunk's rebuttal testimony, he argues that the majority of the hedging**  
2 **contracts that comprise your \*\* \*\* were actually placed prior to the test year**  
3 **and prior to SPP's integrated marketplace ("IM") platform implementation<sup>9</sup>. Please**  
4 **comment.**

5 A. If we accept Mr. Blunk's argument the correction would be even larger. OPC's adjustment  
6 of \*\* \*\* was through the test year ending in June 2015. If the dollar amount of  
7 hedging losses was updated as proposed by Mr. Blunk, the losses would be  
8 \*\* \*\*<sup>10</sup>.

9 **Q. Has the Commission provided a guideline on what constitutes price volatility?**

10 A. Yes, the Commission has stated: "[M]arkets in which prices are volatile tend to go up and  
11 down in an unpredictable manner."<sup>11</sup>

12 **Q. Mr. Blunk asserts that the formation of the SPP IM has actually increased power price**  
13 **volatility<sup>12</sup>. Has the SPP market experienced volatility as the Commission defines it?**

14 A. No. SPP purchased power prices have not gone up and down in an unpredictable manner.  
15 Below is an exhibit, that lists monthly SPP pricing for on-peak demand and in the far right  
16 column is the monthly Henry Hub natural gas price. The SPP's on-peak purchased power  
17 prices reflected in the chart below show a general downward trend over this period reflective  
18 of current economic and market conditions. These purchased power prices do not appear to  
19 be swinging up and down and acting in an unpredictable manner. We should not confuse  
20 the expected rise and fall of natural gas and purchase power prices with a loosely adapted  
21 meaning of volatility.

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<sup>9</sup> Blunk rebuttal, p.8

<sup>10</sup> Company ledger account 547 through Dec 2015

<sup>11</sup> Report and Order, Ameren Missouri, ER-2007-0002, p.23 line 4,5

<sup>12</sup> Blunk rebuttal, P.8&9



Month	Year	ATC (\$/MWh)	Off-Peak (\$/MWh)	On-Peak (\$/MWh)	Henry Hub Gas Prices (\$/mmBtu)
Jan	2015	\$ 24.62	\$ 21.09	\$ 28.46	\$ 2.99
Feb	2015	\$ 24.34	\$ 20.95	\$ 28.06	\$ 2.83
Mar	2015	\$ 22.83	\$ 19.57	\$ 26.06	\$ 2.79
Apr	2015	\$ 23.40	\$ 22.39	\$ 24.43	\$ 2.58
May	2015	\$ 21.83	\$ 20.07	\$ 24.12	\$ 2.83
Jun	2015	\$ 22.28	\$ 19.04	\$ 25.56	\$ 2.75
Jul	2015	\$ 25.95	\$ 21.79	\$ 30.18	\$ 2.82
Aug	2015	\$ 22.62	\$ 19.95	\$ 25.83	\$ 2.76
Sep	2015	\$ 21.77	\$ 17.88	\$ 26.03	\$ 2.65
Oct	2015	\$ 18.95	\$ 15.68	\$ 22.39	\$ 2.33
Nov	2015	\$ 18.71	\$ 16.11	\$ 21.73	\$ 2.07
Dec	2015	\$ 17.19	\$ 14.77	\$ 20.04	\$ 1.86
Jan	2016	\$ 19.33	\$ 17.45	\$ 21.83	\$ 2.27
Feb	2016	\$ 16.97	\$ 15.87	\$ 18.09	\$ 1.97
Mar	2016	\$ 16.67	\$ 14.14	\$ 18.93	\$ 1.69
Apr	2016	\$ 18.49	\$ 15.55	\$ 21.54	\$ 1.90
May	2016	\$ 17.17	\$ 15.00	\$ 19.65	\$ 1.89

**Note: SPP prices at GMO load hub**

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On peak demand was most expensive in July as you would expect when demand for electricity is highest for the SPP footprint and then drifted lower in the non-summer months due to a reduction in the demand for electricity in the non-summer months.

**Q. Would you summarize the OPC’s position?**

A. GMO’s hedging costs have not been prudently incurred and should not be included in GMO’s cost of service in this rate case. GMO hedging policy is rigid and ineffective in the current and near-foreseeable natural gas and purchased power price environment. In

1            addition, GMO's continued accrual of millions of dollars of hedging losses is not justified  
2            by the market in which GMO acquires purchased power and natural gas.

3            OPC requests the Commission to remove all hedging results from the test year books and  
4            records for this case and not allow future hedging activity to be included in the Company's  
5            FAC.

6            Q.     **Does this conclude your surrebuttal testimony?**

7            A.     Yes it does.