BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

AG PROCESSING INC A COOPERATIVE, Complainant,	)	
	)	
vc.	)	**HC-2010-0235**
	)	
KCP&L GREATER MISSOURI OPERATIONS COMPANY, Respondent.	)	

AG PROCESSING INC A COOPERATIVE SUPPLEMENTAL INITIAL BRIEF ON REMAND

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ATTORNEYS FOR AG PROCESSING INC A COOPERATIVE

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I. SUMMARY

A. Introduction

We are before the Commission on a remand from the Western District of the Missouri Court of Appeals in case No. WD74601.[1/] The court decided that the Commission had employed a standard that placed the burden of proof on the utility when that burden should have remained on customers. The case continues to concern imprudence on the part of Aquila (now GMO)[2/] in implementing a hedging program for its steam system in St. Joseph, Missouri.

When the matter was originally submitted, the parties disagreed regarding the burden of proof. In ordinary rate cases, the utility has the burden of proof on all issues.[3/] In a typical complaint case the burden of proof shifts to the complainant.

[1/] Ag Processing Inc a Cooperative ("AGP") did and does not agree with the Court of Appeals' decision. We believe the Court became misdirected by the titling of the proceeding as a "complaint" when it fact is was review of GMO's prudence in implementing and effectuating a steam hedging program. Moreover, the Court's decision would adversely impact other parties seeking to challenge prudence of a utility's purchasing decisions, including Commission Staff. The decision exalts form over the substance of the proceeding, but that has been litigated and the matter remanded to the Commission. The Commission decision was remanded for reconsideration in light of a different standard of proof. Other points raised by GMO in its appeal were not addressed. AGP will argue herein that the ultimate result should not change in that the standard of proof was sustained.

[2/] We will endeavor to use the terms "Aquila" and "GMO" in a manner that is consistent with the relevant time frame.

[3/] Section 393.130.1 RSMo 2000. All statutory citations are to the Revised Statutes of Missouri, 2000.

The Commission, however, believed that this case differed from a typical "complaint" in the form of a complaint case and is substantively a prudence challenge. As such, under the rule in *Associated Natural*[4/] and *State ex rel. Nixon v. PSC*,[5/] the putative complainant, here Ag Processing Inc a Cooperative ("AGP"), raised a serious doubt about the prudence of the utility.

In the initial case, a unanimous Commission found that AGP had demonstrated Aquila's imprudence.[6/] However, the court has now ruled that the Commission had used an incorrect standard of proof. As will be shown herein, AGP, one of GMO's steam customers, has more than met this newly-imposed burden of showing Aquila's imprudence by a preponderance of the evidence of record. Accordingly, a change in result is not indicated, but rather, all that is needed is issuance of a new Report and Order that finds that imprudence has been shown by a preponderance of the evidence of record. That conclusion will be upheld should there be a subsequent appeal because it will be supported by competent and substantial evidence on the whole record.

[4/] *State of Missouri ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 528 (Mo. App. 1997).

[5/] *State ex rel. Nixon v. PSC,* 274 S.W.3d 569 (Mo. App. 2009).

[6/] This matter has now been before three different Regulatory Law Judges. The first, Nancy Dippell, presided at the hearing but left the Commission's employ for other opportunities before a final Report and Order was issued. The second, Morris Woodruff, took over the task of finalizing a Report and Order. Now the matter appears to have been assigned to Harold Stearley.

Given that none of the current Commissioners were on the bench when the original steam rate case was presented in 2005, a brief background may be helpful.[7/]

B. The Quarterly Cost Adjustment ("QCA")

The settlement in steam Case No. HR-2005-0450 created a Quarterly Cost Adjustment (QCA) mechanism. The QCA was a unique structure at the time. There was no analog on the electric side; SB 179 did not exist.[8/] There was no Rate Adjustment Mechanism either by statute or rule. But there are similarities. The QCA accumulated fuel costs that varied up or down from an agreed base level, then at the end of the quarter, began to be collected from (or flowed back to) customers over a following 12-month period. The QCA results in a "smoothing" of the steam price volatility caused by underlying fuel cost volatility.[9/]

The QCA included a coal performance standard. Because coal was a base load fuel for the steam system, the Coal Performance Standard helped to assure that less expensive coal fuel would continue to be used as a base and the coal boilers main-

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[7/] The Report and Order approving the settlement stipulation in Case No. HR-2005-0450 was entered on February 28, 2006.

[8/] The current QCA is clearly a creature of the settlement in HR-2005-0450. There remains a question, not necessary to address here, whether a steam utility may have an FAC under SB 179 and the resulting Commission rules.

[9/] Tr., p. 162, ll. 14-16:

> [I]t has the ability to take the costs that we have accumulated . . . and spread that over 12 months.

tained, while natural gas, the "swing" fuel, could not, for QCA cost tracking, be used to offset coal usage as the base load fuel. Thus, the steam customers could not become insurers of the availability of Aquila's coal fired steam operations. The QCA did this by imputing an agreed amount of coal fired generation in the event that an agreed availability standard was not met.

Despite Mr. Clemens' later acknowledgement at the hearing, in its design of the hedging program Aquila did not acknowledge that the QCA structure provided a smoothing or mitigating effect on the impact of natural gas price volatility on steam rates. On Aquila's electric side, Aquila enjoyed an Interim Energy Charge (IEC) from a prior case and had instituted a hedging program for its natural gas purchases, an approach that it shorthanded as a "1/3, 1/3, 1/3 strategy." Aquila then sought to apply this same electric "strategy" to natural gas for its steam system.

However, Aquila did not perform any analysis of the "base" and "swing" fuels on volumes needed for the steam system, or whether it was even realistically possible to hedge natural gas for the steam system, particularly given the uncertain swing fuel requirements. Aquila also did not consider the smoothing effects on the retail steam price volatility that the QCA brought into play.

C. Aquila Was Imprudent in Over-Hedging Its Natural Gas Usage For Its Steam System

Aquila's forecast was grossly wrong and resulted in Aquila substantially over-hedging its natural gas purchases. When gas prices tumbled, Aquila was left with a large overhang of hedges (without corresponding physical usage) that it had to settle at large losses that were passed to the customers under the QCA's 80/20 sharing mechanism.

Aquila performed its own forecast of volumes to hedge, then directed the purchases. No GMO witness accepted responsibility for the design of the program. No GMO witness accepted responsibility for Aquila's flawed forecast of natural gas usage.

D. All Steam Customers Were Damaged By Aquila's Imprudence

The record will show by a preponderance of unrefuted proof that Aquila's actions were imprudent and resulted in charges through the QCA to ***all*** steam customers, not just AGP. Imprudent costs should not be passed to customers. Pursuant to the stipulation and the resulting tariff, these amounts were collected subject to refund. The collection of the amounts subject to refund was not questioned by Aquila. And, pursuant to the Commission's earlier Order, that refund has now been made through the mechanism of the QCA.

Indeed, it is not entirely clear that a change in outcome by the Commission could cause amounts that were collected under an obligation of refund and, in fact, refunded, to be

recovered. The costs were incurred some time ago. As this, by Aquila's contention, is a complaint case, the Commission is without authorization to order charges to customers for services and costs that were provided or incurred in prior periods. GMO did not seek a stay of the Commission's earlier order nor did it provide a suspending bond under Section 386.520 and thus any rights that GMO/Aquila might have had have been vitiated by its own arguments that this is a complaint case.

II. STATEMENT OF FACTS

A summary of the facts of this case begins with Aquila's steam rate increase filing in Case No. HR-2005-0450.

On May 27, 2005, Aquila, Inc., submitted proposed tariff sheets (YH-2005-1066) intended to implement a general rate increase for steam service provided to retail customers in its L&P operating division in Missouri. On June 1, the Commission suspended the Company's proposed tariff sheets until April 24, 2006. On February 17, 2006, Aquila, Inc., the Staff of the Missouri Public Service Commission, AGP, and the City of St. Joseph filed a nonunanimous stipulation and agreement. ("Stipulation and Agreement").[10/]

The steam rate increase case was a companion to Case No. ER-2005-0436. Fuel and purchased power electric issues were addressed in the ER electric case; issues relevant to the steam

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[10/] The Stipulation and Agreement, after approval by the Commission on February 28, 2006, was embodied in a compliance tariff promptly filed by Aquila. References to either are generally intended to be references to both.

service were raised in the HR case. Aquila's electric and steam cases proceeded in parallel but with different customer intervenor groups involved. Although several St. Joseph electric customers[11/] were represented through industrial groups and Public Counsel, only AGP was involved in the steam rate case.[12/]

At the time of Aquila's filings, there was no fuel adjustment authorizing legislation from the General Assembly. Aquila had an Interim Energy Charge (IEC) from an earlier settlement.[13/] An IEC differs from the current fuel adjustment clause in several significant ways that will be addressed later in this brief.

The Stipulation and Agreement in HR-2005-0450 resolved all disputes between the parties regarding the proposed steam rate increase. Staff filed suggestions in support of the stipulation and agreement on February 24. On February 27 the Commission held an on-the-record presentation regarding the proposed stipulation and agreement. At that proceeding, the Commission questioned the signatory parties, as well as parties that did not sign but did not object to the stipulation and agreement.

On February 28, 2006 the Commission approved the Stipulation and Agreement, effective March 6, 2006, directed the parties to comply with the terms of the settlement, and authorized Aquila to file the *pro-forma* tariffs that had been

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[11/] Of which AGP is one.

[12/] Ex. 108, pp. 96-97.

[13/] ER-2004-0034.

attached to the Stipulation and Agreement. On March 2, 2006 the Commission approved Aquila's compliance tariffs.

Aquila began to submit quarterly adjustment factors pursuant to the Commission's Order. In due course, Aquila-submitted QCA rate adjustments for the 2006 and 2007 adjustment periods were proposed and completed in Case Nos. HR-2007-0028 and HR-2007-0399. A series of negotiation sessions ensued involving Aquila, AGP and Commission Staff, ultimately proving unsuccessful. Meanwhile, Aquila was acquired by Great Plains Energy and renamed KCP&L Greater Missouri Operations Company or "GMO". During this period, negotiations were put on hold, and unsuccessfully resumed after the acquisition was completed. Pursuant to the Stipulation and Agreement, AGP challenged Aquila's prudence in the two QCA matters (HR-2007-0028 and HR-2007-399), which the Commission then transferred to this case.

A hearing was held on November 18 and 19, 2010 at the Commission offices in Jefferson City, Missouri.

On September 28, 2011 the Commission issued its Report and Order in this case, directing that Aquila (now GMO) refund the amounts that were imprudently collected by Aquila under an obligation of refund, pursuant to the QCA rate schedule. In its new name of GMO, Aquila appealed using the newly established procedure of direct appeal (Section 386.510) but did not seek a stay or seek to provide an appeal bond. Accordingly, the earlier Commission decision is conclusive as to the refunded amounts. Section 386.550. The amounts that were originally found by the

Commission to have been imprudently incurred and collected from the Aquila's steam customers under an obligation of refund have now been fully refunded to the steam customers through the mechanism of the QCA.

III. ARGUMENT

A. Aquila/GMO Was Imprudent (1) In Adopting a Steam Hedging Program Design Without Analyzing The Nature Of Its Natural Gas Usage and (2) Quantifying The Amount of Natural Gas Fuel That Should Have Been Subject to Any Steam Hedging Program

1. Aquila Was Imprudent In Not Analyzing The Nature of Its Natural Gas Usage for Steam Generation

The function of natural gas as a swing fuel in the Lake Road steam generation system has been well documented and implicitly acknowledged by GMO.[14/] Indeed, it could not have been otherwise because of the coal performance standard that was part of the QCA. GMO witness Blunk acknowledged: "Aquila was obviously aware that natural gas was the marginal fuel at Lake Road . . . ."[15/]

After examination of the documents produced by Aquila pursuant to production requests, Mr. Johnstone noted that Aquila had provided no documentation that they had analyzed the usage of

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[14/] Johnstone Direct, Exhibit 1, p. 19, ll. 9-10; Johnstone Rebuttal, Exhibit 2, p. 12, ll. 6-7; Tr. 115, l. 7-p. 116, l. 10; Tr. 110, l. 7 - p. 111, l. 10; Blunk Direct, p. 17, ll. 17-18.

[15/] Blunk Direct, Ex. 105, p. 17, ll. 17-18.

the steam system for purposes of entering into a hedge arrangement.[16/]

GMO witness Blunk testified that a hedging program should begin with the identification of the objectives of such a program.

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Where would you start with designing a hedging program generally?
A. Generally you'd start with what are the ***objectives***? ***What are you trying to accomplish? What is the risk that you're exposed to? Why do you want a hedging program?***[17/]

The hedging instruments used would vary, per Mr. Blunk, depending on the risk to be hedged against.

Q. And Mr. Blunk, were you asked: Well, how would you go about selecting which instrument or combination of instruments to use?
And did you answer: ***We would look at the objective of our program, the risk we were facing and the character or the characteristics of the instruments and based on that, we would select a set?***
A. ***Yes.***
Q. So I take it from that that there could be flexibility in designing a hedging program and what particular instruments you chose to use?
A. Generally, yes.
Q. It's not -- not just a cookie cutter type approach. Right?
A. Well, there may be limits on what your universe of instruments are available, but inside of that, depending what you're trying to achieve, your portfolio might look different.
Q. ***And that's driven by what you're trying***

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to achieve and the objectives of the program. Are we -- are we communicating?
A. Yes.[18/]

It is beyond question that use of natural gas as a swing fuel for the raising of steam is relevant. Witness Blunk

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[16/] Johnstone Rebuttal, Exhibit 2, p. 13, ll. 7-17.

[17/] Tr. 326 (emphasis added).

[18/] Tr. 327-28 (emphasis added).

was not there at the time of the transactions in question. The best that he could offer, is that use of natural gas as a "swing fuel" for the Lake Road station was so "obvious" that it must have been considered by Aquila. But there are no facts or documentation that supports the claim of Aquila consideration. AGP proved that Aquila was imprudent by a preponderance of the evidence that Aquila was imprudent in its failure to properly consider, analyze or evaluate the need for and amount of natural gas hedging that it should do. Through the hearing and testimony process, Aquila had a full opportunity to present facts showing such actual consideration, analysis and evaluation but did not. The facts speak loudly: there was no consideration of what GMO now admits should have been obvious.

2. Aquila Was Imprudent In The Design Of Its Hedging Program In That, Among Other Things, It Did Not Analyze The Smoothing Effect Of The QCA

The Quarterly Cost Adjustment or "QCA" is also a critical part of this case. Indeed, Aquila included it as an exhibit to Mr. Clemens' testimony and AGP attached it as an exhibit to its original pleading. It was and is a rate schedule with the approved tariff of GMO and references to the QCA should also be taken to be the then effective sheets of the Aquila tariff.

The QCA as designed had several features including: (1) an 80%/20% cost sharing mechanism[19] combined with a tracking mechanism;[20] (2) a quarterly accumulation period coupled with a 12-month extended recovery period; and (3) a coal performance standard;[21] and (4) a 10% benchmark intended to limit prudence review[22] to those cases where a large amount of imprudence was involved.[23]

GMO witness Clemens agreed that the QCA mechanism mitigated the effect of fuel cost variations and price spikes on steam rates,[24] and also agreed that "it has the ability to take the costs that we have accumulated . . . and spread that over 12 months."[25]

It is proved beyond question that Aquila did not analyze the nature of its natural gas usage for steam generation before simply implementing its cookie cutter approach to the hedge program. GMO witness Blunk, who claims expertise in designing hedging programs, agreed on the need for the initial analysis. In 2006 this initial step was bypassed by Aquila and

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[19] Johnstone Direct, Exhibit 1, p. 7.

[20] *Id.* This provision in the QCA was an effort to establish enough "skin in the game" that Aquila's prudence would be self-enforcing.

[21] Johnstone Direct, Exhibit 1, pp. 8-9.

[22] Johnstone Rebuttal, Ex. 2, p. 10, ll. 7-10.

[23] Ex. 10.

[24] Tr., Page 176, ll. 7-12.

[25] Tr., p. 162, ll. 14-16.

this lead to costs that were imprudently incurred. On its own the QCA mechanism would have smoothed gas pricing perturbations and this should have been taken into account in the design of the hedging program. Despite its years of operating the steam delivery system, in its eagerness to engage in a hedging program, Aquila failed to consider that natural gas for steam generation at the Lake Road station is now acknowledged even by Aquila to be a "swing" fuel that is subject to wildly unpredictable volume requirements. This unpredictability is a simple reality that should have been accommodated in the design of any hedging program. It was not.

Aquila provided no evidence that the nature of the steam generation natural gas load had been subject to any analysis to determine what objectives Aquila was trying to achieve. GMO witness Blunk noted that Aquila was "obviously aware that natural gas was the marginal fuel at Lake Road . . . ,"[26/] In fact, based on the testimony of Mr. Gottsch (who implemented the hedges), Mr. Gottsch simply followed orders from Mr. Korte (who was not on the witness list) and those numbers apparently were derived by and came to Mr. Gottsch from Mr. Nelson (who also did not appear or testify), after Mr. Nelson massaged the steam usage numbers that had been provided to him by Mr. Fangman.

Exhibit 109 demonstrates that Aquila did not even follow its own "strategy" and established hedge positions, not on 2/3 of what was the actual burn volumes, rather Aquila initially

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[26/] Blunk Direct, Ex. 105, p. 18, ll. 17-18.

over hedged its positions in excess of the actual natural gas usage.

A natural gas hedging program must identify the quantity of natural gas to be hedged, the hedging strategy and include an accurate forecast.[27] GMO witness Blunk testified:

> Q. And Mr. Blunk, were you asked: Well, how would you go about selecting which instrument or combination of instruments to use?
> And did you answer: ***We would look at the objective of our program, the risk we were facing and the character or the characteristics of the instruments and based on that, we would select a set?***
> ***A. Yes.***[28]

Facts, however, demonstrate that Aquila failed to analyze any of these considerations or consider any of these factors. Mr. Blunk, GMO's subject matter witness, lays out what ***should*** have been done, but he was not an Aquila employee and could not testify as to what ***was*** done. The record is lacking in evidence of what was in fact done in terms of defining the problem to be addressed. Instead, the record shows that Aquila simply adopted a "model" for contract structure that it had used in its electric business. This was referred to as the "1/3, 1/3, 1/3 strategy." Summarized, the intent was to cover 1/3 with futures, 1/3 with options leaving 1/3 uncovered.[29]

As revealed by the facts, the Stipulation and Agreement authorizing and approving the QCA mechanism was not approved by

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[27] Johnstone Direct, Ex. 1, p. 12, ll. 9-12.

[28] Tr. 327 (emphasis added).

[29] Johnstone Direct, Ex. 1, p. 13, ll. 5-14.

the Commission until February 28, 2006 effective March 6, 2006.[30] On February 15, 2006, at 9:46 a.m., ***two full days ahead of the filing of the Stipulation and Agreement***, Mr. Gottsch queried his managers as follows:

> I have received from Tim Nelson a budget for steam usage volumes for St. Joe due to new and expanding existing customers. I have a breakdown by month for Nat Gas consumption for this purpose which amounts to around 1.5 BCF for '06, and around 2.4 BCF for '07 & '08 each. The discussion in the past is that we may want to incorporate these volumes into our Missouri Electric gas hedge plan. 1) Is that still the case? 2) If so, when can I begin to implement? 3) Do we want to keep these volumes seperated [[sic] or just fold them into the existing Missouri Electric Hedge plan? 4) Is the 1/3, 1/3, 1/3 approach still acceptable?[31]

In its presentation of how Aquila implemented its particular hedge program, GMO ignored the need for the basic analysis that was identified by Mr. Johnstone and corroborated by Mr. Blunk. There is simply silence. Aquila offered no facts to show that it performed the analysis that its witness stated should have been done. There was no analysis of the risk, no identification of objectives to be achieved, and no quantification of the amount of the natural gas that should be considered as "base" fuel and "swing" fuel.[32] The intention

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[30] *Order Approving Stipulation and Agreement*, Case No. HR-2005-0450.

[31] Ex. 4.

[32] At the time the Stipulation was presented to the Commission, coal represented roughly 2.1 mmBtus, the rest gas. Ex. 108, p. 104, l. 22 - p. 105, l. 2.

stated at 9:45 am on Feb. 15, 2006 clearly was to "incorporate" or "fold in" the gas requirements for the steam system with the electric mechanisms.

Then, almost appearing to answer himself, and only 21 minutes after his first e-mail, Mr. Gottsch sent a second e-mail:

> I will draft a procedure for the Risk Management committee review. ***At this point we would envision a procedure similar to the plan already in place for Missouri Electric designed for budgeted volumes, using the 1/3, 1/3, 1/3 strategy.*** We are ***assuming*** that the procedure would be deemed prudent with respect to the rate stipulation's risk sharing design.[33/]

Mr. Gottsch may have received direction from an unnamed source. But, there was no analysis of the nature of the steam load and the fuel mix needed to meet it (either base or swing), and no reference to the smoothing effects of the QCA. Moreover, there was an "assumption" that the procedure would be deemed prudent, not as a result of a documented analysis of the risk of the load, rather as a result of the "risk sharing design" embodied in the Stipulation and Agreement. Ironically the twenty percent "skin in the game" was intended to encourage a prudent result, not as a foil to allow sloppy management practices without proper analysis. But Aquila, instead of seeing an encouragement to careful analysis, imprudently interpreted the provision as a license to act arbitrarily and unilaterally.

[33/] Ex. .

Finally, the word came from Mr. Williams, only 31 minutes after Mr. Gottsch's ***original*** query and ***just 10 minutes after his second e-mail***:

> The sharing mechanism in the steam case provides for the flow through of hedge costs into the fuel sharing mechanism. Therefore, I believe that hedging of the anticipated gas volumes necessary to serve the steam load is prudent and that a policy similar to the one for electric volumes (1/3, 1/3, 1/3) ***if stated in advance in writing would be deemed prudent.***
>
> Just one note of clarification. The steam settlement has not been filed with the Commission yet pending some last minute Staff review. ***However, I do not think that impacts the prudence of our decision to hedge the gas volumes.*** We should follow whatever procedure we would normally take whether or not there is [[a] sharing mechanism.

Aquila's decision to hedge was made two days ahead of even the filing of the Stipulation and Agreement and it was unambiguously based on the electric model. However, there was no analysis of the nature of the risk to be hedged, and certainly no analysis of the impact of QCA volatility mitigation attributes on the need, if any, for the hedge program. These e-mails are silent as regards these critical factors. Moreover, we are not familiar with any principle of Commission jurisprudence that results in a hedging policy being "deemed" prudent because it is "stated in writing."

In cross-examination, Mr. Clemens identified the real "decision-maker" as Mr. Empson.[34/] However Mr. Empson's name

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[34/] Tr. 165, ll. 2-6.

does not appear in this e-mail exchange.[35/] Thus, either he was not the decision maker or the Commission has not been provided with complete information from GMO. Given that this e-mail thread would appear to be complete (GMO Id. # 523), this exchange exposes the entirety of Aquila's decision to implement a hedging program for steam. As Mr. Clemens testified, these e-mails told Mr. Gottsch to "go do it."[36/]

3. Aquila Was Imprudent In Setting Quantities of Natural Gas to Hedge

Aquila's 1/3 strategy was represented to the Commission was supposed to provide protection in an up market and participation in a down market. Because of Aquila's imprudence customers were exposed to unnecessary costs.

Had Aquila not been inept and imprudent in its implementation of this strategy, it could have worked. The "1/3 Hedge Program" was described to the Commission on the 2006 record as a program that would always be 2/3 "right" with respect to the market. Because of Aquila's ineptness and imprudent mismanagement that it was not.

One-third was to be "unhedged," that is, 1/3 of the required natural gas volumes were to be simply bought at market

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[35/] Tr. 172, ll. 15-19.

[36/]

11 Q. So without regard to the 20/80 or the
12 80/20 depending on which way you want to look at it,
13 he's saying go do it?
14 A. Yes.

Tr. 172.

price. This did not happen because of the wildly wrong Aquila forecasts that were not properly monitored, corrected, and updated consistent with Aquila's representations. One-third was to be "hedged" with futures contracts. This did not happen either because of the wildly wrong Aquila forecast that was not properly monitored and corrected. The final one-third was to be "hedged" with call options. But this did not happen either for two reasons: *First*, because of the wildly wrong Aquila forecast that was not properly monitored and corrected. *Second,* because Aquila did not simply buy call options, as Aquila explained to the Commission in 2006, that would have expired without further effect in a down market. Instead, Aquila sold puts for profit providing protection to those who purchased the puts, but ultimately at great cost to Aquila customers when market prices fell.

What should have been clear (and would have been clear if there had been a proper analysis up front) was that Aquila's natural gas requirements were susceptible to large variations because natural gas was a swing fuel and requiring continual monitoring and close scrutiny. Instead of additional scrutiny and care in monitoring, Aquila had less frequent monitoring of volumes.

Incorrect volumes were extremely costly for these reasons: *First,* too much gas was hedged - at costly prices. *Second,* the sale of puts for the protection of third parties instead of the promised protection for its own gas costs. *Third,* the 1/3 that should have floated down with the market was mostly

absent. The cost was high and quite extraordinary, running into the millions for a utility where total fuel costs were only five to six million dollars per year.

Fuel procurement is not an exact science. Among other justifications, that is why the QCA mechanism recognized that a cost would need to rise over 10% of the total before a prudence claim would be pursued. Aquila, however, significantly overran even this generous tolerance and its actions were simply egregious. Instead of the purported gas cost volatility mitigation function, Aquila ventured into a program that bet that the market would continue to rise "for the foreseeable future."[37/] Instead the market price declined, requiring Aquila to incur losses to settle its imprudent hedge positions that bet on a rising market.

One of the larger problems was the error in forecasting which resulted in a massive over-projection demonstrated on Exhibit 109 and the identified errors shown on Exhibit 9. And, it should be noted: There had been an error that was "significant" in the forecast for 200**5** and this should have alerted Aquila to the problem. Instead, however, Aquila purchased all the 2006 hedges in one batch[38/] and did essentially the same

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[37/]

Q. Now that we've been through that, Mr. Gottsch, were you asked: Well, over what period of time rising?
And did you answer: For the foreseeable future?
A. Yes.

Tr. 214, 216.

[38/] Ex. 108, p. 57.

thing for 2007. As their own documentation demonstrated, "[b]y the time it was apparent that actual steam load was significantly less than budgeted volumes ***it was too late*** to affect Aquila's natural gas hedge program for the steam system. The hedges [had] already been placed."[39/] This clearly was not what Aquila represented as an equivalent programs, at least as Mr. Clemens represented as the ***electric*** program.

> A. Other than they're going to purchase hedges one month at a time for the next -- over the 28-month period, just as it says.[40/]

4. Aquila's Belated Futile Attempts To Shift Responsibility For Its Imprudence To The Steam Customers Are Misplaced And Disingenuous

In response, Aquila sought to put the blame for its failures on its customers, but Aquila steam customers were not even told that Aquila was going to start hedging natural gas for their steam usage.

There are six steam customers, all with facilities in near proximity to the Lake Road station. None were queried regarding the steam hedging program. Of Aquila witnesses, only Gary Clemens, Joe Fangman and Gary Gottsch were Aquila employees during the relevant time period and none refuted the overwhelming evidence of imprudence nor does their testimony support Aquila's contentions of customer blame. Steam usage is not natural gas

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[39/] Ex. 8 (emphasis added).

[40/] Tr. 155; Clemens Direct, Ex. 101, Schedule GLC-2, p. 2.

usage. This conversion required knowledge not available to steam customers.

a. GMO Witness Fangman

Joe Fangman was the St. Joseph-located customer service representative. His testimony is filled with descriptions of numerous contacts with the several steam customers[41/] and he certainly had input into the forecast usage of the steam customers.[42/] However, on the critical issue of whether the customers even had input to a natural gas hedging program for steam or were advised that their estimates were going to be used as one of the inputs for that purpose, he disclaimed knowledge of the hedging program entirely.

> Q. Now, this whole complaint has to do -- you probably picked up that it has to do with the hedging.
> A. Yes.
> Q. Do you see -- do you have anything to do with hedging?
> A. No, I did not.
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> Q. Did you ever have occasion to talk about the customers in the context of the hedging program for steam?
> A. I have not. Other than a discussion that -- with Gary Chestnut in which he mentioned his concern about the hedging program.[43/]

Not only did Mr. Fangman not inform the customers about the hedging program, he found out about the program from a discussion, not with his employer, but with AGP's management:

[41/] Tr. 267, ll. 18-24.

[42/] Tr. 268, l. 19 - Tr. 289, l. 16.

[43/] Tr. 282-283.

Q. So we can just cover it all by just saying didn't have any discussion about the hedging program with any of the customers other than what you mentioned with Mr. Chestnut?
A. Yes.
Q. In fact, that's how you found out about the hedging program, wasn't it?
A. I believe so.
Q. With that contact with Mr. Chestnut?
A. Yes.
Q. Before that, you didn't even know that there was a hedging program going on; is that fair?
A. I didn't know we were using hedging in the steam program.[44/]

b. GMO Witness Blunk

Mr. Blunk never worked for Aquila.[45/] He disclaimed connection with the steam hedging program and also disclaimed knowledge of the program.

Q. Mr. Blunk, [I'll] try to shortcut this in view of the time. Would you agree with me that you had nothing to do with the development of the Aquila steam hedging program?
A. If you're referring to this program, the one-third strategy, that is true.
Q. At the time that that was either conceived or whatever term you want put on it, you were working for Kansas City Power & Light. Am I correct?
A. Yes.[46/]

[44/] Tr. 284 (emphasis added).

[45/]
Q. And, in fact, based on your indications in the deposition that we took some weeks ago, your entire career has been with Kansas City Power & Light; is that right?
A. Mostly. I worked with John Deere Company for a short period before that.

Tr. 317.

[46/] Tr. 317.

c. GMO Witness Gottsch

Mr. Gottsch implemented the hedge purchases, but did not testify that he had customer contact. An objection to purported testimony about information from customers was stricken as hearsay.[47]

Mr. Gottsch purchased the hedges. He took orders and did what he was told. He did not calculate or establish the amounts of natural gas he was directed to hedge. He exercised no initiative whatever during his work on this matter with Aquila. He did not design the program.

Q. Mr. Gottsch, we had an opportunity to have a deposition together, didn't we?
A. Yes, sir.
Q. And one of the things we talked about in that was how you started the hedge program. ***What's the very first step you have to do when you start up a hedge program?***
A. ***Get authorization to begin a program***.
Q. And how would you go about doing that?
A. In my particular position, ^F***I waited for my manager to instruct me to do so.***
Q. Okay. You just waited for him. This would have been Mr. Korte (ph.)?
A. At the time, correct.
Q. Have you ever had any instances in which you kind of said, well, I think there's a need for a hedge program here and I want to go talk to my manager?

A. No.
Q. So the only experience you have is just doing what somebody tells you to do?
A. With Aquila, yes.
Q. No -- no initiative at all?
A. Correct.[48]

And further (although it took some work):

Q. So is it -- is it fair -- and I don't mean this as a put-down because I'm not -- not in that

[47] Tr. 208, l. 8 - 209, l. 3.

[48] Tr. 211-12 (emphasis added).

00217

mode, but is it -- ***is it fair to say that you took instructions from somebody else, in this case, Andrew Korte, and then executed those instructions?***

A. Correct.

Q. So if I was -- if I were to ask you if you had done any kind of an analysis of what might be consistent -- considered a consistent flow of natural gas or steam, you would say you didn't do that, somebody else had done that above you and you just did what they told you to do?

A. Regarding the flow of natural gas?

Q. Well, I'm sorry. That was a complicated question. I'll -- I'll back up.

Did you do any analysis of what might be considered a consistent flow for natural gas or steam?

A. No, I did not.

Q. And your role in the company, at least with respect to this hedge operation, somebody above you, let's call it Andrew Korte, gave you the budgeted volumes. Right?

A. I did not receive them from Andy, no.

Q. Who did you get them from?

A. I received them from the Resource Planning Group.

Q. But somebody above you in that group or

00218

somebody at a different level or different group gave you --

A. Somebody from --

Q. -- those numbers?

A. -- a different group, correct.

Q. That's a yes then?

A. Yes.[49/]

d. GMO Witness Rush

Mr. Rush was a St. Joseph Light & Power employee for numerous years, was familiar with that company's steam distribution system, but only worked for Aquila for roughly a month after the St. Joseph utility was acquired by Aquila.[50/] He had no evidence regarding customer notice or information given to customers.

Q. Yeah. Okay. 2001 through 2008 you

00302

really didn't have any involvement with -- with the -- with the Aquila entity that was operating the steam

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[49/] Tr. 216-18 (emphasis added).

[50/] Tr. 301, ll. 1-21.

> system up there; is that right?
> A. I did not have any direct involvement, that's correct.[51/]

Mr. Rush testified later that customer-provided information was often in error.[52/]

e. GMO Witness Clemens

Mr. Clemens was the only GMO witness who appeared to argue that customers were given information about the hedging program ahead of time. *First* he pointed to electric hedging, but that can have no relevance. However, he also points to the February 27, 2006 hearing where the customers and the Commission were given at best, ambiguous, and at worst, misleading information.

In truth, the program described by Mr. Clemens did not comport with the reality of the program involved in this proceeding.[53/] However, besides painting an incorrect picture of the program, there was no reason for either AGP or the Commission to expect up front that Aquila would design and implement a program imprudently. The one thing that would have made a difference would have been a revelation of its then and pending imprudent hedge activity. Customers were instead told about a program that

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[51/] Tr. 301-02.

[52/] Tr. 311.

[53/] He explained a program that would limit risk by providing participation of the 2/3 of the volumes in a down market and protection for 2/3 of the volumes in an up market. The program did not come close to what was described for the down market - at a huge cost.

did not exist. In the final analysis none of this is compelling unless Aquila substantiated that it told its customers that they were going to hedge in an imprudent manner and gave them the opportunity to prevent that. They obviously did not as the imprudence came to a halt only at the request of AGP in 2007 upon review of the disastrous results.[54/]

Exhibit 13 was claimed to describe the steam hedging program. Among other things, it states: "[F]orecasts are prepared based on sales history, which includes results through April." There was no evidence that this was done and there was no evidence that Aquila used 200***5*** actual usage information for its hedge purchases in 2006 or information from 2006 for hedge purchases in 2007.

Exhibit 13 also states that "An integral component of the sales forecasts is feedback on the projections for large industrial loads, which may not reflect history." Exhibit 13 was a response provided in April of 2008 and supposedly pertained to the steam operations and budgeted sales figures. However, given that there are only six steam customers, and they are all "large industrial loads," it is apparent that Exhibit 13 referenced the electric program and ***not*** the steam hedging program. The exhibit also states: "Review is made of the prior calendar year's monthly actual billings (sales) and fuel inputs." The response then attached "[m]onthly annual data for 2006-2007 . . . ." This attachment demonstrated that 200***5*** actual data showed that actual

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[54/] Exhibit 5; Exhibit 6.

usage was below the fuel purchase budget by 211,903 mmbtus or just over 10%.

B. Aquila Was Imprudent In Purchasing The 2006 Positions All At One Time

Nevertheless, these inputs were used to purchase hedges for 2006. These hedges were ***not*** purchased in accordance with the supposed "strategy" on the "sales history" as stated on Exhibit 13 or on a monthly basis as described in Exhibit 14. To the contrary, as disclosed in Exhibit 14: "***2006 purchases were all made in February 2006 and 2007 purchases were spread out from February 2006-October 2006.***" This, even though Exhibit 11 states:

> Revisions provided to Gary Gottsch, either as part of a forecast revision or the next annual budget, may adjust the planned hedge volumes. Increases are reflected as ratable increases in purchases for the balance of the buying cycle. ***Decreases are implemented by unwinding existing positions or by ratable decreases in purchases for the balance of the buying cycle.***[55/]

Aquila's own imprudent actions locked it into positions from which it could not escape without incurring costs that would be passed to customers. Exhibit 9 shows that actual usage by the customers (the six steam customers -- all within walking distance

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[55/] Ex. 11, GMO # 408.

of the Lake Road Plant) was well below Aquila's 2006 budget by 752,653 mmbtus (roughly a 26% difference).[56/] But,

> [b]y the time it was apparent that actual steam load was significantly less than budgeted volumes it was too late to affect Aquila's natural gas hedge program for the steam system. The hedges would have ***already been purchased***.[57/]

These facts, from Aquila's own records, show Aquila's imprudence. It was too late only because Aquila was not paying attention to the steam hedging program.

C. Aquila Was Imprudent In Failing To Adjust Its Natural Gas Usage Forecast And Its Hedging Program In Response To Actual Consumption Data

Aquila's own Exhibit 109 reinforces its imprudence. According to this Exhibit, confronted with actual "burn" of slightly under 1,500,000 mmBtus, under its "philosophy," Aquila hedged slightly over 2,000,000 mmBtus. This action was not even consistent with the stated 1/3, 1/3. 1/3 philosophy or strategy. According to Aquila, under this strategy, only 2/3 would be hedged; the remaining 1/3 would be purchased on the spot market at market prices. Had Aquila been consistent, total hedges would have been nearer 1,000,000 mmBtus with the remainder bought at market as needed.

[56/] Ex. 9, GMO # 402.

[57/] Ex. 8, GMO # 407 (emphasis added).

1. Mr. Clemens' Schedules Demonstrate That Aquila Failed to Follow It's Own Program

For additional evidence that the electric program that Aquila implemented was not what the steam customers got, we need only look to Mr. Clemens' own Schedules.

Although Mr. Clemens took great pains to try to confuse the two programs to attempt to blur the distinction with what was in place, the two programs are different and the differences ended up in a deleterious impact for the steam program.

First, the electric program was designed around an IEC.[58/] An IEC creates a "band" which is detrimental to the utility only if fuel costs rise above the cap or amount stated in the approved tariffs. If fuel costs come in lower than that, either the utility simply refunds down to the actual level of cost, or (if the cost goes below the threshold level) refunds only down to that level.[59/]

This creates a substantial incentive for the utility to hedge to limit rising costs, but little incentive (or indeed a perverse incentive) for reducing costs. The former can result in substantial losses for the utility. The latter results either in no losses or potential gains for the utility. Accordingly the bias of an IEC-designed hedging program is to mitigate upside risk while being less concerned about downside risk where it perceives its chance of profit to be small. Moreover, should an

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[58/] Clemens Direct, Ex. 101, Schedule GLC-2, p. 2.

[59/] *Id*.

unanticipated downside occur, the utility would not incur a loss. An unanticipated upside fuel cost presents substantial potential for loss.

Mr. Clemens' Schedule 2 makes clear that Aquila's electric program was designed for an IEC.[60/] During cross-examination, Mr. Clemens seemed to blank out on those details. The QCA is not an IEC-type mechanism.[61/]

Second, the electric hedging program identifies as a "key element" the amount of price volatility the utility needs to mitigate.[62/] The steam program made no such statement and, indeed, no evidence that an analysis of the steam need was performed was submitted by GMO.

[60/] Clemens Direct, Ex. 101, Schedule GLC-2, p. 2, provides in part:

> The Missouri Public Service Commission ("MPSC") issued an April 2004 order accepting the Stipulated Settlement (the "Stipulation Agreement") between interveners and Aquila, Inc. d/b/a Aquila Networks - Missouri ("Aquila") regarding Aquila's rate disposition for the period April 22, 2004 through April 21, 2006. Appendix A of the Stipulation Agreement details the Interim Energy Charge ("IEC") by which Aquila is allowed to recover, subject to the specified predetermined energy charge limitation, the production fuel and purchase power costs incurred to meet combined Missouri Public Service and St. Joseph Light & Power Company customer requirements during that period. In the event the cumulative two years of energy charges under the IEC are determined to be less than the! predetermined charge Aquila will be obligated to refund any over collection thereof to its constituent ratepayers.

[61/] Ex. 108, p. 52, ll. 21-24.

[62/] Clemens Direct, Exhibit 101, Schedule GLC-2, p. 2.

Third, the electric hedging program states that it is to be executed by a series of monthly purchases over a 28 month period.[63/] Instead, Aquila purchased all the monthly hedges for 2006 in one batch[64/] and did not analyze or spread its purchases as specified in the electric program. (Risk was therefore concentrated around prices at a single peak point instead of being spread over more than two years. This made worse every other problem in the Aquila hedge program.)

Fourth, the electric hedging program detailed in Schedule GLC-2 in Mr. Clemens' direct testimony (Exhibit 101) quite openly deals with purchased power and the conversion of on-peak purchase power to meet Aquila's net system requirements.

Fifth, the electric program specified a mechanism to adjust the hedges when the forecast changed that was supposed to be no less frequently than three months.[65/] The steam hedging

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[63/] Again, Schedule GLC-2, p. 3, attached to Mr. Clemens' Direct (Exhibit 101) states:

> The hedging plan is executed by purchasing one-third of the monthly forecast quantity, for each month over a 28 month period, proportionally procured in fixed price financial contracts. An additional one-third of the monthly forecast quantity is proportionately procured using options (primarily participatory collar) form . . . .

[64/] Ex. 14.

[65/] Clemens Direct, Ex. 101, Schedule GLC-2, p. 3 states:

> If there are significant changes in key inputs to the volumetric forecast for natural gas and on-peak purchased power such as the

(continued...)

program ignored this provision and was stated to be reviewed only annually. Given natural gas volumetric uncertainty as a swing fuel this was a change in exactly the wrong direction.

Sixth, according to the electric program, Aquila's Energy Resources and Commodity Risk Management group was to meet monthly in a documented process to discuss issues relevant to the hedging process.[66/] Neither Mr. Clemens nor GMO produced documentation of any such meetings regarding the steam hedging program.

Seventh, monthly option positions are to be closed mechanically and proportionally according to the electric pro-

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[65/](...continued)
cost of natural gas, the cost of on-peak purchase power, scheduled unit availability or whenever directed by Commodity Risk Management, Energy Resources will rerun the fuel budget model. These re-runs of the model will be done no less frequently than three months of the prior (re)run. The resulting new forecasted natural gas and on-peak purchase power natural gas equivalent quantities will then become the new-targeted procurement quantities. Energy Resources will then adjust its purchasing to meet the new target quantities.

[66/] Clemens Direct, Ex. 101, Schedule GLC-2, p. 3 states:

Energy Resources and Commodity Risk Management will meet no less than once a month to discuss all issues relevant to this hedging process. Energy Resources will record and otherwise document and all transactions including a summary of and current valuation of the hedge accounts.

gram.[67] There is no evidence of any mechanical (or otherwise) closing of unneeded hedge positions in the steam program. Doubtless a manifestation of the lack of monitoring.

There is enough dissimilarity between the two programs so simply conclude that they are not the same. Given that the electric program was the program that Aquila purportedly "told" all the steam customers about, even if steam customers could have somehow mystically divined that Aquila's descriptions of electric hedging were intended to apply to an undisclosed steam hedge program, the parameters of the program that was actually used to hedge natural gas supplies for the steam system were simply not communicated.

It should be apparent that the program, strategy or whatever Mr. Clemens chooses to call it was not implemented for the steam system in accord with what even Aquila contends it told the six steam customers. Moreover, it is not the fact alone that Aquila hedged that caused the problem here, rather it is the imprudent manner in which Aquila hedged that created huge costs.

Aquila clearly failed to adjust or react to changes from its forecast natural gas requirements. The 2006 forecast was made in June, 2005,[68] and information about the variance in the 2005 forecast, while not quantified on an annual basis, of course, was known to Aquila monthly and should have been the basis for action.

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[67] Clemens Direct, Ex. 101, Schedule GLC-2.

[68] Tr. 270, ll. 12-18.

Based on the 200***5*** 10+% variance between forecast and actual use, it would certainly have been prudent to make an adjustment in the amount hedged. But such was not to be because Aquila purchased all the 2006 hedges in one batch.[69/] This should not have been and was not in accord with Aquila's stated hedging philosophy. And, given the roughly 25% variation between forecast and actual steam usage for 2006, it would have been prudent to make some adjustment for 2007. But no adjustment was made.

Commissioner Kenney put his finger on this very problem, first with GMO Witness Clemens:

> QUESTIONS BY COMMISSIONER KENNEY:
> Q. What was the feedback you got from Staff? And I know you said it was just applicable to the electric side, not the steam side.
> A. The electric side of -- of the programs beginning in -- probably in 2006 and '7, they had some concerns with the program just I think in a -- Gary Gottsch could talk about more the details of that program. But the philosophy of being one-third, one-third wasn't an issue. It was just some -- more the detail inside it.
> Q. You said the one-third, one-third, one-third was not the problem --
>
> 00193
> A. No.
> Q. -- or was?
> A. My understanding it was just how some of the steps were implemented. But I didn't do the hedge program so it would be better to ask Mr. Gottsch for that.
> Q. And just so I'm clear, the particular date that we're talking about is prior to February 2006. Right? There was -- that was the date prior to which there was no hedging for the steam --
> A. That's correct.[70/]

and then with GMO Witness Gottsch:

[69/] Ex. 8, GMO #407.

[70/] Tr. 192-93.

QUESTIONS BY COMMISSIONER KENNEY:
Q. I'm sorry. You said that there was -- the concerns that Cary Featherstone expressed were with respect to inflexibility of the purchasing?
A. Right. His -- his opinion at the time was you were making purchases each month ***regardless of where the price of the market was.*** In particular, during the run-up in prices after the Hurricane Katrina, the program continues to make purchases each month regardless of price. And his concerns at the time were that you were making purchases in September, October, November, December during that time frame.
Q. And when did -- when were those concerns expressed?
A. Again, I -- I know I was in a meeting with him and I can't recollect the exact time.
Q. Just the month and the year.
A. I thought it was in the winter of '06,

00245

'07. Probably the spring of '07 I believe is when we had meetings with them.
Q. So the hedging program for the steam production had begun, but you weren't having discussions specifically with respect to the hedging program?
A. I was not personally.
Q. Did -- who was?
A. I believe it was Andy Korte, Gary Clemens.
Q. Mr. Clemens who just testified?
A. Correct.
Q. Well, he said he wasn't having conversations; that you would be the one that would be having conversations with Staff about hedging.
A. Past -- past implementation of the program.
Q. Okay. All right. And then the hedging program for steam production ceased in '07?
A. Correct. October of '07.
Q. Okay. Now, the programs are similar. Right? So would Mr. Featherstone's critiques or criticisms with respect to the electric side have been applicable to the steam side?
A. I believe that's correct.

00246

Q. Even though -- even though he wasn't speaking specifically to the steam production side, the critique would have been equally as applicable?
A. I believe so.[71/]

Compare GMO's own Exhibit No. 109. According to this Exhibit, confronted with actual "burn" of slightly under 1,500,000 mmBtus, under its "philosophy," Aquila hedged slightly over 2,000,000 mmBtus. This action was not even consistent with the stated 1/3, 1/3. 1/3 philosophy or strategy. According to

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[71/] Tr. 244-46.

Aquila, under this strategy, only 2/3 would be hedged; the remaining 1/3 would be purchased on the spot market at market prices. Had Aquila been consistent, total hedges would have been nearer 1,000,000 mmBtus with the remainder bought at market as needed.

2. Aquila Failed to Monitor And Adjust For Actual Burns As Against Its Forecast Volumes

Mr. Rush was queried by the bench regarding his experience in forecasting accuracy. He testified:

> QUESTIONS BY JUDGE DIPPELL:
> Q. And I'm not sure if you're the right person to ask about this or not, Mr. Rush. On page 11 of your testimonies, on line 3 you say: The company has a robust planning process that it has utilized for years.
> Do you know have the forecasts for this particular process ever been off like they were in this or appear to have been in this particular process in past years?
> A. ***Yes, they have been.***[72/]

Mr. Rush went on to describe instances of inaccuracies in customer provided forecasts of their steam purchases that simply validate that such forecasts are understandably inaccurate. To the extent that customer usage is one of the important considerations, this corroborates the critical need for careful analysis (followed by careful monitoring) of the nature of whether the fuel being hedged (natural gas) is being used as a base load fuel or as a "swing" fuel. Aquila did none of this. Rather, as noted by Mr. Featherstone's criticism earlier noted, Aquila continued in a mechanical way, without regard to price, to

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[72/] Tr. 311 (emphasis added).

lay in its hedges. Its methodology was confounded by declining prices in the gas market and by an over-hedged positions that could have been stopped, adjusted, or unwound but Aquila did none of these. As described by Mr. Johnstone:

> If the hedge volume could be made equal to the physical quantity needed, with certainty and at the same price location, the net price of gas could be locked in, regardless of the market price level. If the hedge volume is less than the physical volumes, the change in market price will be mitigated - to a greater or lesser extent, depending on the amount hedged in comparison to physical gas consumed. However, if the hedge volume is greater than the physical volume, the effect of the hedge will be extreme. It will not mitigate volatility in the market price, but instead produce a price change opposite in direction to the change in of the market.[73/]

3. Aquila Made No Adjustment Even Though Variances Were Significant

Even according to Mr. Clemens' understanding of the ***electric*** hedging program, Aquila was supposed to rerun the fuel budget model and represented that this was to be done "no less frequently that three months of the prior (re)run."[74/]

The actual statement in Mr. Clemens' Schedule is: "If there are significant changes in key inputs to the volumetric forecast for natural gas and on peak power . . . Energy Resources will rerun the fuel budget model. These re-runs of the model will be done no less frequently than three months of the prior

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[73/] Johnstone Direct, Exhibit 1, p. 18, ll. 4-11.

[74/] Clemens Direct, Ex. 101, Schedule GLC-2, p. 3; Tr. 155-56.

(re)run." Despite having included this description of the electric program in his testimony and having stressed that the same "philosophy" or "strategy" was used in the steam program and that steam customers should have been aware of this, Mr. Clemens stumbled over the procedures identified in this own Schedule:

> Q. Now, moving on down in that paragraph, when that happens, when there's a significant change, what is energy resources supposed to do?
> A. They would make an adjustment.
> Q. Well, let's read it and see what it says: Energy Resources will re-run the fuel budget model. Do you see that?
> A. Yes.
> Q. What does "re-run" mean?
> A. Run the model with new data.[75/]

If the electric program simply became the steam hedging "program," as appeared to be Mr. Clemens' testimony, then there is simply no excuse for Aquila to have so mismanaged the program by failing to respond to significant volumetric shortfalls. If Aquila had in reality made adjustments as needed, indeed, monthly, the damage of the ill-conceived design and implementation would greatly have been mitigated. It was not.

Mr. Fangman testified that it was his job to obtain significant changes in usage from customers:

> Q. Remind me, if you would, because it's been a few days, your role in this process is to -- to get volume information from customers. I want to focus on the steam customers now. Volume information from the steam customers. And how do you go about doing that?
> A. Well, there's various ways. A lot --
>
> 00269
> when a customer has a significant change as they're going to grow or -- or put on new equipment, they come to me. And like I said, I've been in this role for a long time. They know me very well. And they know they need to come to me with -- if they're going to

[75/] Tr. 156.

6 have some kind of a change.[76]

And Mr. Gottsch had to agree that the variances shown from Aquila's own records (Exhibit 9) were significant:

24 Q. And let's look at -- oh, just pick one
25 here, Triumph. 683-- I'm looking at 2006, at least

00223
1 that's one of the years in concern here. Budget was
2 683,191 MMBTus.
3 A. I see that.
4 Q. And actual 324,637. And then there's a
5 variance calculation. I haven't done the math but
6 I'll -- I'll trust whoever did the spreadsheet here,
7 358,554 variance. Looks about right. ***Would you agree***
8 ***with me that that's a significance variance?***
9 ***A. I would agree.***
10 Q. Look in that same column for Albaugh.
11 And I won't go through the budget numbers. You can
12 read those. But a variance of 307 and change --
13 307,000 MMBTus. MMBTus, by the way, would I be right
14 in equating that to dekatherms?
15 A. Yes.
16 Q. ***Again, a fairly significant variance?***
17 That's a question --
18 A. ***Yes***.[77]

These variances ought to have attracted Aquila's attention. Yet they did not. Instead, Aquila kept on "mechanically and proportionally" purchasing fixed price NYMEX positions.[78] Nor did it timely unwind positions.

4. Aquila Developed the Forecasts, Not Customers

It is also clear on this record that Mr. Fangman developed "numbers" from the customers about steam usage information and passed them up the line. This was his primary responsibility.[79] With all this, it is overwhelmingly clear that

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[76] Tr. 268-69.

[77] Tr. 222-23 (emphasis added),

[78] Clemens Direct, Ex. 101, Schedule GLC-2, p. 4.

[79] Tr. 267, ll. 22-24; Tr. 268-69.

Aquila did the forecasting of its natural gas requirements. Moreover, customers provided Mr. Fangman such numbers as they did with respect to their individual ***steam usage***; it was entirely up to Aquila to turn steam usage numbers -- even if entirely accurate -- into ***natural gas usage*** numbers. This required information that customers would not have.

> A. I believe the forecast is a forecasting of the loads for these customers. A budget entails much more than just the forecast.
> Q. So let me just quickly replay. Sometime I think you said in June of 2005 you would have done a forecast, I think basically -- basically using your terminology. That would have covered '06, '07 and '08. Right?
> A. Correct.[80/]

> A. The actual budgets for those years, those forecasts would have been done in the -- like I said, in the June time frame. So for the 2006 budget, it would have been done in the June of 2005 time frame. And -- and so on. ***And in those -- in those budgets, I would typically work with Tim Nelson who would prepare and -- and do the forecast.***[81/]

And, not only that, but Mr. Rush confirmed, based on his experience, that the process was often unreliable.

> Do you know have the forecasts for this particular process ever been off like they were in this or appear to have been in this particular process in past years?
> A. Yes, they have been. I -- I was actually responsible for the forecasting side at my life at St. Joseph Light and Power Company.[82/]

The evidence is clear. Aquila -- more specifically -- Mr. Tim Nelson for the periods involved -- prepared the forecast of usage by customers in total and of natural gas usage. And

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[80/] Tr. 271.

[81/] Tr. 270.

[82/] Tr. 311.

based on Mr. Rush's testimony, Aquila should have known that there was a good chance that the forecasts were off. Accordingly, locking in a position in a group of hedges based on uncertain volumes, and with a design tantamount to a bet that the market would climb was simply imprudent.

In summary, Aquila did not explain to its six steam customers its intent to implement a particular hedge program for natural gas in the steam business and most certainly did not solicit their input. Mr. Fangman, the man with job of customer communication was not even aware of the program until he was made aware of its existence well after implementation when the problems had surfaced.[83/]

D. Amounts Found Imprudent and Refunded to Customers For The Collection Periods Here In Issue

1. The Amount Previously Found Imprudent And Refunded To GMO Steam Customers For The 2006 Collection Period Was Agreed To By GMO

This issue was not contested. Mr. Johnstone testified that the 2006 net cost of the hedging program was $1,164,960.[84/] This figure was also confirmed on Exhibit 10. 80% of this amount was collected from customers so the refund amount for the 2006 collection period is $931,968. Mr. Rush agreed.[85/]

[83/] Tr. 284.

[84/] Johnstone Rebuttal, Ex. 2, p. 30, l. 9.

[85/] Tr. 297, l. 17.

2. The Amount Previously Found Imprudent And Refunded To GMO Steam Customers For The 2007 Collection Period Was Agreed To By GMO

This issue also was not contested. Mr. Johnstone testified that the 2007 net cost of the hedging program was $2,441,861.[86] This figure was also confirmed on Exhibit 10. 80% of this amount was collected from customers so the refund amount for the 2007 collection period is $1,953,488.[87] Mr. Rush agreed.[88]

IV. CONCLUSION

AGP has raised the issue of Aquila's prudence in several particulars. The initial decision to employ a steam hedging strategy that mimicked Aquila's IEC-driven hedging strategy, without analysis of what was needed, whether portions of the natural gas used for steam was a base load or a swing load, and imprudently completely ignored the implications of the QCA that were germane. Aquila was grossly imprudent in forecasting its natural gas needs.

Aquila was grossly imprudent in failing to monitor adequately. Aquila was grossly imprudent in failing to adjust its hedges downward when the overhedging situation was finally discovered. And Aquila was imprudent in betting against its customers by selling puts in order to collect a small premium

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[86] Johnstone Direct, Ex. 1, p. 30, l. 9.

[87] Johnstone Rebuttal, Ex. 2, l. 11.

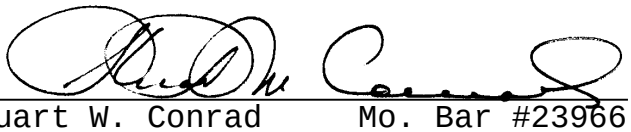
[88] Tr. 297, l. 19.

that was ultimately at its customers' expense, thus attempting to seize a quick profit by selling protection to others in the market and leaving its customers dangling. When this structure collapsed, Aquila asserted that it was "too late" to fix, and charged the customers the cost of the collapse.

Without question Aquila was imprudent and AGP has shown such by a preponderance of the evidence. The factual basis of Aquila imprudence was not challenged by GMO as Aquila's successor by purchase. The charges were collected from customers subject to refund, and GMO as the newly-renamed Aquila, was required to make that refund through the mechanism of the QCA itself. That original decision should now be confirmed.

Respectfully submitted,

FINNEGAN, CONRAD & PETERSON, L.C.



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SERVICE CERTIFICATE

I certify that I have served a copy of the foregoing pleading upon identified representatives of the parties hereto per the EFIS listing maintained by the Secretary of the Commission by electronic means as an attachment to e-mail, all on the date shown below.

Stuart W. Conrad, an attorney for
Ag Processing Inc a Cooperative

January 7, 2013