In 2003, the Company hedged for regulatory lag and price certainty to help manage its risks. Empire was not focused on protecting the ratepayer from price spikes, rather it was focused on what it could recover in a rate case given regulatory lag. Now that the Company has a FAC, these opening paragraphs have been replaced with a description of the FAC but nothing within the policy is different.[8] As Mr. Blake Mertens, Vice President of Energy Supply and Delivery Operations for Empire Electric attest to in his surrebuttal in Case No. ER-2016-0023:

> **Q. Does Empire have a comprehensive hedging policy in place?**
>
> A. Yes. Empire first implemented its Energy Risk Management Policy ("RMP") in 2001. While slight modifications have been made throughout the years largely to update organizational or nomenclature changes, the most substantive of which was prior to the SPP IM going live to reflect changes in daily processes and reflect transmission congestion rights procurement practices, our natural gas hedging policy and practices have remained consistent.[9]

Q. How is Empire having the same policy concerning natural gas purchases for over the past 16 years imprudent?

A. The question of prudency comes in when it is realized that the Company has not changed its business policies or its practices regarding hedging while the regulatory environment and natural gas volatility and prices have changed significantly. The Company now has an FAC. Gas prices and volatility are at lows and are predicted to stay low for several more years. The Southwest Power Pool ("SPP") has initiated the Integrated Market in 2014 garnering a mention in the opening paragraphs of the hedging strategy, yet the Company keeps plowing ahead with the same hedging strategy when it should have stepped back and reviewed the business climate and natural gas forecasts. As the Commission points out within the prudence standard: **"our responsibility is to**

[8] Please review the Hedging Strategy Section quoted on pages 9, 10, 11 and 12 of this testimony

[9] Mertens surrebuttal, page 2, first question

determine how reasonable people would have performed the tasks that confronted the company"[10] (emphasis added)

The facts show that, due to the Company's inflexible and unreasonable hedging strategy that resulted in millions of dollars in excessive natural gas costs, Empire conducted its natural gas purchases in an imprudent way. Given the fact that Empire's 2003 hedging strategy was to defeat regulatory lag, a reasonable person would never had made those transactions if they had not had the ratepayer as their backstop when predictions showed lower gas prices in the future.

Q. How can the OPC make this argument when the Company has been adhering to this policy for 16 years?

A. First of all, the Company never initiated this policy to save the ratepayer any money. It did not begin hedging to prevent ratepayer shock, pain or to protect the ratepayer from gas cost volatility. As I pointed out before, Empire implemented this policy (2001) prior to the Commission formalizing concerns about price spikes (2003) and when Empire was allowed an FAC (2008). The Company policy has never changed and its hedging practices have never changed. ** **Empire consistently, hedged 10% of year four expected burn, 20% of year three burn, 40% of year two burn and 60% of year one expected burn.** ** If a company like Empire is hedging greater than ** 60% ** of its gas needs then its hedging program is a budgeting forecaster, not a price spike mitigator.

Secondly, without highly volatile natural gas prices, this method of hedging becomes very transparent for its simplicity and cost to the ratepayer. When the hedging strategy section of the RMP is reviewed it is clear that this hedging method is a "lock and leave" approach where there is no real strategy and no loss limits or market considerations to

[10] Quote from page 2 of this testimony. *State ex rel. Associated Natural Gas Co. v. Public Service Commission of State of Missouri*, Western District Court of Appeals summarization