BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

Ag Processing, Inc., a Cooperative,	)	
	)	
Complainant,	)	
	)	
v.	)	**File No. HC-2010-0235**
	)	
KCP&L Greater Missouri Operations Company,	)	
	)	
	)	
Respondent.	)	

REPORT AND ORDER

Issue Date: September 28, 2011

Effective Date: October 8, 2011

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KCP&L Greater Missouri Operations Company,	)	
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Respondent.	)	

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Appearances

Stuart W. Conrad, Esq., Finnegan, Conrad & Peterson, 1209 Penntower Office Center, 1109 Broadway, Kansas City, Missouri 64111,

and

David L. Woodsmall, Esq., Finnegan, Conrad & Peterson, 428 East Capitol Avenue, Suite 300, Jefferson City, Missouri, 65101, for Complainant, Ag Processing, Inc., a Cooperative.

Karl Zobrist, Esq., and **Lisa A. Gilbreath, Esq.**, SNR Denton US LLP, 4520 Main Street, Suite 1100, Kansas City, Missouri 64111, for Respondent, KCP&L Greater Missouri Operations Company.

Samuel D. Ritchie, Associate Counsel, Missouri Public Service Commission, Post Office Box 360, 200 Madison Street, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

Judge: Morris L. Woodruff, Chief Regulatory Law Judge.

REPORT AND ORDER

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact:

Procedural History

On January 28, 2010, Ag Processing Inc., a Cooperative, (AGP) filed a complaint against Aquila, Inc., d/b/a Aquila Networks – L&P, now known as KCP&L Greater Missouri Operations Company (KCPL-GMO). The complaint is related to Aquila's provision of industrial steam service to AGP's soybean processing plant in St. Joseph, Missouri.

AGP initially filed its complaint in Case Numbers HR-2007-0028 and HR-2007-0399, which are cases in which the Commission is considering possible Quarterly Cost

Adjustments under KCPL-GMO's steam tariffs. The Commission separated AGP's complaint from those two cases and assigned it its current case number in an order issued on February 11, 2010.

KCPL-GMO filed a timely answer to AGP's complaint on March 15, 2010. Thereafter, AGP and KCPL-GMO prefiled direct and rebuttal testimony. Although the Commission's Staff and the Office of the Public Counsel are parties to this complaint action, neither presented any evidence and neither took any position regarding AGP's complaint.

The Commission conducted an evidentiary hearing on November 18 and 19, 2010. AGP and KCPL-GMO filed initial briefs on January 11, 2011, followed by reply briefs on February 9, 2011.

The Steam Services Provided by KCPL-GMO

1. KCPL-GMO's predecessor companies began making and supplying industrial steam from the Lake Road Plant in St. Joseph, Missouri in the 1930s, originally serving the animal packing plants located in that area. The Lake Road Plant's boilers are also used to produce steam to drive turbines to generate electricity. KCPL-GMO currently has five customers for the steam it produces. They are AGP; Triumph Foods, LLC; Albaugh Chemical; Nestlé/Purina PetCare; and Land O' Lakes, Omnium Division, a chemical company.[1]

[1] Rush Direct, Ex. 104, Pages 6-7, Lines 18-23, 1-2.

2. AGP is KCPL-GMO's largest steam customer. During 2006 and 2007, the period at issue in this case, AGP took about two-thirds of the industrial steam supplied to the steam customers from the Lake Road Plant.[2]

3. The industrial steam is produced primarily from a coal-fired boiler. But, since the steam load exceeds the capacity of the coal-fired boiler, natural gas is also used as a fuel source. Natural gas costs more than coal, so coal is used as the base-load fuel, while natural gas is used as a swing fuel when extra steam production is needed.[3]

The Hedging Program

4. In February 2006, KCPL-GMO's predecessor, Aquila, instituted a program of financial hedging for its natural gas supply. The company continued to purchase physical natural gas supplies in the same manner, but began buying and selling financial instruments to adjust its effective gas cost.[4] Previously, the company had simply purchased the natural gas it needed at market rates.[5]

5. Aquila decided to make all purchases for its 2006 hedging program on February 16, 2006, believing that it had an opportunity to lock in its natural gas needs for the year at a satisfactory price level.[6] Aquila's average hedge purchase price for all of 2006 for steam customers was $8.15 per MMBtu for future contracts, and an average strike price of $8.71 per MMBtu for call option purchases. The company sold puts at a

[2] Johnstone Direct, Ex. 1, Page 2, Lines 6-7.

[3] Johnstone Direct, Ex. 1, Page 2, Lines 8-12.

[4] Johnstone Direct, Ex. 1, Page 2, Lines 13-19.

[5] Transcript, Page 190, Lines 6-13.

[6] Gottsch Direct, Ex. 102, Page 14, Lines 13-16.

$6.00 per MMBtu average. Aquila made these purchases anticipating that natural gas prices would rise throughout the balance of the year.[7]

6. However, natural gas prices did not rise throughout the balance of the year, instead dropping to $4.12 per MMBtu in September 2006.[8]

7. Aquila's natural gas hedge program for its steam production was in place once again for 2007. Aquila also purchased the 2007 hedge positions in 2006, but spread those purchases out over 9 months.[9] Again, natural gas market prices trended lower than the hedge positions.[10]

8. At AGP's request, Aquila suspended its natural gas hedging program for its steam production in October 2007.[11]

9. The net cost of Aquila's natural gas hedge program for its steam production was $1,164,960 in 2006 and $2,441,861 in 2007. Under Aquila's Quarterly Cost Adjustment tariff, 80 percent of those costs were collected from Aquila's steam customers. The net hedging program costs Aquila collected from its steam customers amounted to $931,968 for 2006 and $1,953,488 for 2007.[12] Those are the costs that AGP contends should be refunded to Aquila's steam customers.

Should Aquila have Adopted a Hedging Program?

10. The mere fact that Aquila's hedging program's cost exceeded the savings realized from that program does not mean that Aquila was imprudent or that the hedge

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[7] Gottsch Direct, Ex. 102, Pages 14-15, Lines 23, 1-5.

[8] Blunk Direct, Ex. 105, Page 24, Line 8.

[9] Johnstone Direct, Ex. 1, Page 13, Lines 17-21.

[10] Johnstone Direct, Ex. 1, Page 20, Lines 6-7.

[11] Johnstone Direct, Ex. 1, Page 31, Lines 18-19.

[12] Johnstone Rebuttal, Ex. 2, Page 30, Lines 8-11.

program's net costs should be refunded to Aquila's steam customers. The purpose of a hedging program is not to make money, nor is it to ensure that customers pay the lowest possible cost. Rather the purpose of a hedging program is to mitigate the risk of price volatility. A properly designed and implemented hedging program will reduce peak prices, but may also may limit participation in a falling market.[13] In other words, in some circumstances customers may pay more for natural gas than they would have if the hedging program was not in place.

11. Aquila's hedging program was designed to be market neutral, meaning the company was not supposed to attempt to predict whether the price of natural gas would rise or fall, but rather would purchase financial contracts that would result in an average market cost over a period of time in the future.[14]

12. In general, the Commission has encouraged utilities to implement and utilize hedging programs to mitigate price volatility. In fact, the Commission has a rule, 4 CSR 240-40.018, which requires natural gas utilities to engage in hedging activities to mitigate price volatility. That regulation does not apply to Aquila's steam operations, but it does indicate the Commission's support for hedging activities by Missouri's utilities.

13. Aquila's concerns about price volatility in the natural gas marketplace were certainly justified in 2006 and 2007. Since the winter of 2000-2001, the natural gas marketplace had experienced significant price fluctuations. In that winter alone, gas prices ranged from $4.485/MMBtu to $9.978/MMBtu. In December 2004 gas was at

[13] Gottsch Direct, Ex. 102, Page 5, Lines 3-19.

[14] Gottsch Direct, Ex. 102, Page 8, Lines 1-4.

$6.83/MMBtu. By December 2005, it peaked at $15.378/MMBtu.[15]

14. Volatility did not end in 2006. By September 2006, prices had dropped to $4.120/MMBtu. Prices climbed back to $13.58/MMBtu in July 2008, but then dropped below $4.00/MMBtu in January 2009.[16]

15. In addition, in the summer of 2005, the natural gas producing regions of the United States Gulf Coast had been struck by two severe hurricanes, Katrina and Rita, causing major disruptions in the nation's supply of natural gas.[17] In early 2006, weather forecasters were again predicting an active hurricane season for 2006[18], with a resulting chance for new natural gas price spikes.

16. Because of the history of price volatility and predictions of future volatility due to concerns about the weather and natural gas supplies, Aquila acted prudently when it considered entering into a natural gas hedging program in February 2006.

17. In February 2006, Aquila entered into a stipulation and agreement to resolve Case No. HR-2005-0450, its pending rate case before the Commission. The implementation of a natural gas price hedging program for Aquila's steam operations had been discussed in the testimony filed in that case, including in the testimony filed on behalf of AGP by Maurice Brubaker.[19]

18. The stipulation and agreement that resolved Case No. HR-2005-0450 contemplated the establishment of a natural gas price hedging program by Aquila for its

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[15] Blunk Direct, Ex. 105, Page 24, Lines 1-12.

[16] Blunk Direct, Ex. 105, Schedule WEB-12.

[17] Blunk Direct, Ex. 105, Page 27, Lines 5-21.

[18] Gottsch Direct, Ex. 102, Schedule GLG-4.

[19] Blunk Direct, Ex. 105, Schedule WEB-6, Pages 6 and 7 of 16.

steam operations. Specifically, Section 8.1 of that stipulation and agreement provided that "[t]he cost of gas in Account 501 will include the cost of physical gas deliveries and financial instruments, when settled, associated with gas deliveries in the quarterly period."[20]

19. The parties to the stipulation and agreement discussed and understood the term "financial instruments" as used in Section 8.1 to mean the futures contracts and option contracts that would be used in Aquila's natural gas hedging program for its steam operations.[21]

20. The stipulation and agreement that resolved Case No. HR-2005-0450 created a Quarterly Cost Adjustment (QCA) mechanism. The QCA required Aquila to file quarterly rate adjustments to reflect 80 percent of changes in actual fuel costs above or below an established base amount. Aquila was not allowed to pass 20 percent of its fuel costs to its customers under the QCA to better align its interests with those of its customers. [22]

21. The QCA also contained a coal performance standard that limited the amount of fuel costs that could be passed through to the steam customers. Aquila primarily produced steam using a coal-fired boiler. It used its natural gas-fired boiler only when demand for steam could not be met using the coal-fired boiler. Since coal was a less expensive fuel than natural gas, the QCA established a minimum standard for coal-fired steam production that protected customers from higher fuel costs if Aquila

[20] Clemens Direct, Ex. 101, Schedule GLC-1, Page 5 of 16.

[21] Clemens Direct, Ex. 101, Page 3, Lines 10-14. See also, Transcript, Page 64, Lines 5-25.

[22] Clemens Direct, Ex. 101, Schedule GLC-1, Section 8, Page 4-16.

failed to meet those production standards.[23]

22. Under the QCA, quarterly fuel cost variations are collected from customers over the following twelve-month period. The effect is to protect steam customers from price volatility by increasing retail prices gradually in a period of increasing prices and reducing prices gradually in a period of decreasing prices, thereby averaging the ups and downs as fuel prices move up and down from quarter to quarter.[24]

23. Since the QCA, apart from a separate hedging program, had the effect of reducing fuel cost volatility for customers, AGP contends Aquila was imprudent in not taking that effect of the QCA into account when deciding to implement its natural gas fuel cost hedging program.

24. While the QCA had the effect of reducing fuel cost volatility for Aquila's steam customers, it was not a fuel cost hedging program. The QCA did not affect the effective price that Aquila would have to pay to obtain its natural gas supplies.[25] In other words, the QCA would delay Aquila's ability to pass higher natural gas costs to its customers, but it would only be a delay. Inevitably, those higher costs would be passed to the steam customers. In contrast, a properly functioning hedging program could effectively reduce the costs paid for fuel, to the benefit of both Aquila and its customers.

25. When they created the QCA, the parties to the stipulation and agreement contemplated the creation of a price hedging program as part of the QCA as evidenced by the language in section 8.1 of that stipulation and agreement that allowed the cost of

[23] Johnstone Direct, Ex. 1, Pages 8-9, Lines 7-24, 1-4.

[24] Johnstone Direct, Ex. 1, Pages 6-7, Lines 3-8, 1-9.

[25] Transcript, Page 176, Lines 7-12.

financial instruments to be included as a cost of gas.[26] It is only with the benefit of 20/20 hindsight, knowing that natural gas prices did not rise precipitously during the period in question, that it can be argued that the price protections afforded by the hedging program were not necessary. Therefore, the Commission finds that Aquila was not imprudent in implementing a natural gas price hedging program of some type. The next question is whether the hedging program it actually adopted was prudently designed.

Was Aquila's Hedging Program Prudently Designed?

26. The hedging program that Aquila implemented for its steam operations was taken directly from the hedging program it had been using for its electric operations.[27]

27. Aquila's natural gas hedging program for steam production was to procure one-third of the monthly forecast quantity of natural gas through fixed price New York Mercantile Exchange (NYMEX) futures contracts, one-third in options contracts, and the remaining one-third at the then prevailing spot market.[28]

28. Aquila's one-third program was designed to dampen both upward and downward swings in the market price of natural gas. When natural gas prices went up Aquila's exposure to the increased costs was limited because one-third of those costs would be fixed by the options contracts, one-third would be capped by the options contracts, and only one-third would be subject to market rates. If market prices dropped, Aquila would not have to exercise the options on one-third of the gas

[26] Clemens Direct, Ex. 101, Schedule GLC-1, Page 5-16.

[27] Transcript, Page 164, Lines 17-24.

[28] Gottsch Direct, Ex. 102, Page 3, Lines 15-22.

requirements, while another one-third of those gas requirements would be purchased at market rates. Thus, two-thirds of the gas requirement could be purchased at the lower market cost, to the benefit of both Aquila and its steam customers.[29]

29. Aquila's one-third hedging program for steam production was taken directly from its hedging program for electric production. Aquila did not closely evaluate that program to customize it for application to its steam production, but no evidence was presented to establish that the one-third hedging program was imprudently designed or that it would not have produced reasonable results given appropriate inputs.

30. Indeed, Aquila ran a comparison study of what the results would have been if an alternative gas hedging program administered by Kase & Company known as EZ Hedge had been used in 2006 and 2007. Using the same inputs as Aquila's one-third program, EZ Hedge would have lost $1,457,660 for 2006 and $3,686,720 for 2007. Both amounts are significantly higher than the losses that resulted from Aquila's one-third hedging program.[30]

31. The Commission finds that AGP has failed to present sufficient evidence to create a serious doubt about the prudence of the design of Aquila's natural gas hedging program for its steam operations. Rather, the problem with Aquila's hedging program was with its implementation, not its design. The Commission will address that issue in the next section of this report and order.

Was the Hedging Program Prudently Implemented?

32. AGP alleges that Aquila's hedging program was imprudently implemented in two respects. The first involves Aquila's transactions in financial instruments.

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[29] Gottsch Direct, Ex. 102, Pages 6-7, Lines 17-23, 1-10.

[30] Gottsch Direct, Ex. 102, Page 17, Lines 9-13.

33. As part of its hedging program, Aquila purchased financial instruments to balance the cost of purchasing the physical supplies of natural gas it would need to produce steam. As previously indicated, part of Aquila's hedging program was to purchase options to hedge one-third of anticipated volumes.

34. Options come in two flavors. A call option provides the purchaser with the option to purchase gas in a future month at a price referred to as a strike price. A call option helps protect the purchaser against a rising price.[31] The other flavor of option is a put option. A put option provides the purchaser with the option to sell gas in a future month at a set strike price. Such an option would give the holder of the option an opportunity to participate more fully in a falling price market.[32]

35. AGP criticized Aquila as imprudent for selling put options in the apparent belief that market prices would rise, thereby depriving its customers of protection against the falling market that actually developed.[33]

36. Aquila bought and sold both call and put options to hedge its costs through the use of a price collar. That program applies the premium gathered from selling a put to the cost of the premium of the call.[34] Thus, Aquila's decision to sell puts does not by itself indicate that the company acted imprudently. The prudence standard does not require that Aquila correctly foresee the direction the natural gas market will take. The company's sale of put options in a market in which prices fell does not establish that the company acted imprudently.

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[31] Johnstone Direct, Ex. 1, Page 14, Lines 6-12.

[32] Johnstone Direct, Ex. 1, Page 14, Lines 16-22.

[33] Johnstone Direct, Ex. 1, Page 15, Lines 2-17.

[34] Gottsch Direct, Ex. 102, Page 7, Lines 16-19.

37. AGP's other accusation of imprudence in the implementation of Aquila's hedging program concerns the volumes of gas that Aquila decided to hedge. The problem is that Aquila chose to purchase financial instruments to hedge much more gas than it actually burned.

38. For the period of April 2006 through December 2007, Aquila purchased hedge positions for approximately 2,000,000 mmBtus of gas for steam production. During the same period the company actually burned only 1,500,000 mmBtus of gas for steam production.[35]

39. Remember, Aquila intended to operate a one-third hedging program. That means that one-third of its natural gas purchases for steam production should have been unhedged, to be purchased at market rates. Since its forecasts of usage were so far off, Aquila in effect bought none of its gas supplies at market rates, rendering its one-third hedging program ineffective from the start.

40. Aquila's hedging of more gas than it actually burned is problematic because that position tends to amplify variations in the natural gas market. If the hedged volume is reasonably close to the physical quantity needed, the net price of the amount of gas hedged can be locked in regardless of market price levels.[36] If Aquila's one-third hedging program had been based on a better forecast of gas usage, that program could have worked as designed and Aquila's customers would have benefited from reduced volatility.

41. However, when physical volumes of gas are substantially less that the volumes hedged, the hedging program will create a price change opposite in direction to

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[35] Transcript, Pages 88-89, Lines 3-25, 1-11. *See also*, Ex. 109.

[36] Johnstone Direct, Ex. 1, Page 18, Lines 4-6.

the change in the market. In other words, the net cost of gas under the hedging program will actually go up in a down market and down in an up market. The results will be very volatile and potentially very beneficial or very costly.[37]

42. Since market prices in 2006 and 2007 trended down as compared to the hedge positions, the effect was to substantially increase net gas costs. If costs had gone up instead, windfall benefits would have resulted from substantially decreased net gas costs. But the point of a hedging program is to decrease volatility, not to speculate on windfall profits or losses.[38]

43. The impact of the hedging program on net gas prices in October 2006 provides a good illustration of the problem with the operation of Aquila's hedging program. In that month, the market price of gas had fallen to $4.62. However, under the hedging program, the net cost of gas for that month was $12.76. That extreme price variation occurred because the physical volume of gas purchased was only 25 percent of the design volumes. The first one-third of the hedging program, which was designed to purchase futures contract to protect against rising prices was itself 35 percent larger than the physical volumes used so that losses on that portion of the hedge were amplified. In effect, Aquila had 160,000 mmBtu in costly hedge positions spread over only 58,939 mmBtus physically used to produce steam.[39]

44. Throughout the years in question, Aquila's forecasted/budgeted natural gas usage far exceeded the actual amounts burned for steam production.[40] That

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[37] Johnstone Direct, Ex. 1, Page 18, Lines 15-18.

[38] Johnstone Direct, Ex. 1, Page 20, Lines 6-10.

[39] Johnstone Direct, Ex. 1, Page 21, Lines 1-12.

[40] Johnstone Rebuttal, Ex. 2, Page 22, Chart Reb-2.

variation and its devastating effect on the hedging program is sufficient to demonstrate a serious doubt as to the prudence of Aquila's operation of that hedging program. Thus, the initial presumption of prudence is overcome, and the burden shifts to Aquila to dispel those doubts and prove that the hedging program was operated prudently. Aquila has failed to meet that burden.

45. Aquila explained that its forecast for the volumes of steam it would need to produce, and thus the amount of natural gas it would hedge was based on information submitted by its customers. Aquila had only a handful of large industrial steam customers, so the company simply asked its customers to estimate how much steam they would need in the future. An Aquila employee, Joseph Fangman, periodically spoke with the customers about their anticipated need for steam.[41] Fangman then passed that raw information on to another Aquila employee, Tim Nelson, who did the actual forecasting.[42] The record does not indicate how Tim Nelson prepared his forecasts because he did not testify.

46. AGP offered Aquila reasonably accurate estimates of its steam usage, but the estimates Aquila obtained from some of its other steam customers were described by Fangman as "soft" and "fuzzy", less reliable.[43] In fact, those other customers significantly overestimated the amount of steam they would use.[44]

47. Aquila was aware that its customer's estimates of steam usage were unreliable. In his testimony Fangman described one industrial customer that always

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[41] Transcript, Page 279, Lines 4-12.

[42] Fangman Direct, Ex. 103, Page 4, Lines 13-20.

[43] Transcript, Page 289, Lines 1-22.

[44] Ex. 9.

expected to be ramping up production in the next month, thus requiring more steam, but which never actually increased production as planned.[45]

48. Aquila would place the blame for its inaccurate forecasts squarely on its customers, arguing that as the sole available supplier of steam, it has an obligation to plan to meet all the needs of its customers.[46] While certainly Aquila had an obligation to meet the needs of its customers, it was Aquila's responsibility to determine the reasonableness of its customer's estimates. Aquila knew that those customer estimates were not reliable and had an obligation to structure its hedging program to account for the uncertainty of volumes of gas, yet there is nothing in the record to indicate that it did so. Aquila has not met its burden of proving that it operated its hedging program in a prudent manner.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

Burden of Proof

A. In form, this is a complaint brought by AGP against Aquila/KCPL-GMO. Normally in a complaint brought before the Commission, the burden of proof would be on AGP, the complainant, as the party asserting the affirmative on the issue of the utility's imprudence.[47] However, this case is more complicated than a straight-forward complaint.

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[45] Fangman Direct, Ex. 103, Page 10, Lines 11-19.

[46] Transcript, Page 294, Lines 11-16.

[47] *State ex rel. GS Technologies Operating Co. v. Pub. Serv. Comm'n*, 116 S.W. 3d 680, 693 (Mo. App. W.D. 2003).

B. An approved stipulation and agreement that resolved Aquila's 2005 steam rate case (HR-2005-0450) established a Quarterly Cost Adjustment mechanism that allowed Aquila to make quarterly rate adjustments to reflect 80 percent of the change in its actual fuel costs above or below an established base amount.[48]

C. That stipulation and agreement also establishes a method by which the prudence of Aquila's fuel purchase decisions can be reviewed. The Commission's Staff is required to conduct an initial, first-step, prudence review to determine "that no significant level of imprudent costs is apparent." If it determines a further review is necessary, Staff may also proceed, as a second-step, with a full prudence review.[49]

D. However, the stipulation and agreement also allows any Aquila steam customer, including AGP, to file a complaint to initiate the second-step full prudence review, even if Staff chooses not to pursue such a review.[50] It is just such a complaint that AGP has currently brought before the Commission.

E. Because this is actually a full prudence review of Aquila's fuel purchasing decisions rather than an ordinary complaint, AGP is not saddled with the burden of proof throughout the proceeding. Instead, the Commission's modified prudence standard of review is applicable.

F. Under that standard of review, which the Commission established in a 1985 decision, a utility's expenditures are presumed to be prudently incurred, but, if some other participant in the proceeding creates a serious doubt as the prudence of the expenditure, then the utility has the burden of dispelling those doubts and proving the

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[48] Clemens Direct, Ex. 101, Schedule GLC-1, Page 4 of 16.

[49] Clemens Direct, Ex. 101, Schedule GLC-1, Pages 6-8, of 16.

[50] Clemens Direct, Ex. 101, Schedule GLC-1, Page 8 of 16.

questioned expenditure to have been prudent.[51] The Commission's standard of review regarding prudence decisions has subsequently been accepted by reviewing courts.[52]

G. Based on its findings of fact, the Commission has concluded that AGP has demonstrated serious doubt about the prudence of Aquila's decisions regarding its gas-cost hedging program. Therefore, Aquila/KCPL-GMO must shoulder the burden of proving that those decisions were prudent.

Appropriate Relief

H. The approved stipulation and agreement also affects the degree of relief that is appropriate in this case. In a typical complaint case, the Commission would grant relief only to the party that brought the complaint. Since AGP is the only steam customer that filed a complaint, it would be the only customer that received relief. However, as previously indicated this is not a typical complaint.

I. As the Commission previously concluded in section D of these conclusions of law, the approved stipulation and agreement that resolved Aquila's 2005 steam rate case allowed AGP to initiate a full prudence review of Aquila's fuel purchasing decisions by filing this complaint. Thus, this action took on the character of a prudence review rather than a complaint that would be limited to AGP's specific concerns.

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[51] *In the matter of the determination of in-service criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway rate base and related issues. And in the matter of Union Electric Company of St. Louis, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company*, 27 Mo. P.S.C. (N.S.) 183 (1985).

[52] *State ex rel. Associated Natural Gas v. Pub. Serv. Comm'n*, 954 S.W.2d 520, 528-29 (Mo. App. W.D. 1997).

J. Since this action is a full prudence review, it applies to all of Aquila's steam customers. The Commission found that Aquila did not act prudently with regard to all its steam customers, not just with regard to AGP. Therefore, the relief ordered by the Commission should apply to all of Aquila's steam customers.

Decision

The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision. After applying the facts as it has found them to its conclusions of law, the Commission has reached the following decision.

The evidence showed that Aquila hedged the purchase price of far more natural gas than it actually needed to use to produce steam to serve its customers. By doing so, Aquila operated a hedging program that actually increased rather than reduced price volatility. AGP amply demonstrated serious doubt about the prudence of Aquila's operation of the hedging program. Therefore, Aquila had the burden of proving that it operated the hedging program in a prudent manner. Aquila failed to meet that burden.

Aquila collected net hedging costs from its steam customers amounting to $931,968 for 2006 and $1,953,488 for 2007. The record is not clear about how much net hedging costs Aquila would have incurred if it had properly forecast the amount of natural gas it needed to purchase to supply steam to its customers. Perhaps it would have incurred some costs even if it has been completely accurate in its forecasting.

Neither party presented any evidence that would allow the Commission to make that determination.

However, it appears that net hedging costs would have been small if the required amount of natural gas had been accurately forecast. As AGP's witness, Donald Johnstone, explained, small changes in volumes would have only small effects on the hedging program. Because of the previously described amplification effect, large variations in volumes result in very large problems.[53]

In any event, Aquila had the burden of proving that it operated its hedging program in a prudent fashion. It failed to establish that any part of the cost of operating that program was prudently incurred. Therefore, the Commission finds that Aquila's entire net cost of operating its natural gas price hedging program for steam production in 2006 and 2007 was imprudently incurred and must be refunded to its steam customers through operation of the QCA.

THE COMMISSION ORDERS THAT:

1. KCP&L Greater Missouri Operations Company shall refund to its steam customers, through operation of the Quarterly Cost Adjustment, the net cost of operating its natural gas price hedging program for steam production in the amount of $931,968 for 2006 and $1,953,488 for 2007.

[53] Transcript, Page 110, Lines 2-6.

2. This order shall become effective on October 8, 2011

BY THE COMMISSION

Steven C. Reed
Secretary

(S E A L)

Gunn, Chm., Davis, Jarrett, and
Kenney, CC., concur;
and certify compliance with
Section 536.080, RSMo 2000.

Dated at Jefferson City, Missouri,
on this 28th day of September, 2011.