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Witness: Darrin R. Ives  
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Sponsoring Party: KCP&L Greater Missouri Operations Company  
Case No.: ER-2016-0156  
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**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO.: ER-2016-0156**

**REBUTTAL TESTIMONY**

**OF**

**DARRIN R. IVES**

**ON BEHALF OF**

**KCP&L GREATER MISSOURI OPERATIONS COMPANY**

**Kansas City, Missouri  
August 2016**

**REBUTTAL TESTIMONY**

**OF**

**DARRIN R. IVES**

**Case No. ER-2016-0156**

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

2 A: My name is Darrin R. Ives. My business address is 1200 Main, Kansas City, Missouri  
3 64105.

4 **Q: Are you the same Darrin R. Ives who pre-filed Direct Testimony in this matter?**

5 A: Yes, I am.

6 **Q: What is the purpose of your Rebuttal Testimony?**

7 A: I will respond to Staff and OPC's direct testimony regarding rate case expense and I will  
8 respond to OPC's direct testimony regarding hedge accounting.

9 **RATE CASE EXPENSE**

10 **Q: What rate case expense issues will you address?**

11 A: Staff and OPC's rate case expense direct testimony raises three sub-issues:

- 12 1) The total level of rate case expense to be recovered in rates;  
13 2) The period of time over which this total amount of rate case expense  
14 should be normalized; and  
15 3) The period of time over which depreciation study costs (an element of rate  
16 case expense) should be normalized. I will address each item in turn.

1       **1) All Prudently Incurred Rate Case Expenses Should be Included in Rates**

2       **Q:     What is the Company’s position regarding the treatment of rate case expense in this**  
3       **proceeding?**

4       A:     The cost of processing a rate case is a normal and essential cost of business of any public  
5       utility. As the Commission acknowledged in its Order in the investigatory docket on rate  
6       case expense treatment (Case No. AW-2011-0330) the Commission’s “current rules and  
7       practice” are such that “regulated utilities generally recover all costs they incur in  
8       presenting a rate case before the Commission.”<sup>1</sup> More precisely, regulated utilities have  
9       generally recovered in rates reasonable and prudently incurred expenses that they incur in  
10      presenting rate cases to the Commission for resolution. Often, the reasonable and  
11      prudently incurred rate case expenses have been converted to an annualized level to be  
12      recovered over a number of years and included in base rates without a tracker mechanism  
13      recognizing that rate cases are not filed annually. The Company believes that this  
14      approach to rate case expense should be utilized in this case.

15      **Q:     Are Staff and OPC recommending a departure from the Commission’s traditional**  
16      **approach of allowing the recovery of reasonable and prudently incurred rate case**  
17      **expenses in rates?**

18      A:     Yes. Both Staff witness Matthew Young and OPC witness Charles Hyneman recommend  
19      the formula used by the Commission in case ER-2014-0370 ( the “0370 formula”). By  
20      using this formula, the Staff and OPC recommend the disallowance of rate case expenses  
21      incurred by the Company in this case without any evidence (or even so much as an  
22      allegation) of imprudence by the Company. In the 0370 case, the Commission limited

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<sup>1</sup> *Order Directing Staff to Investigate and Opening a Repository File*, Case No. AW-2011-0330 (filed April, 27, 2011).

1 the amount of rate case expense recovered by the utility to the ratio of the dollar revenue  
2 requirement ordered by the Commission to the dollar amount of revenue requirement  
3 sought by the utility. This methodology is an arbitrary disallowance of prudently  
4 incurred rate case costs necessary to provide electric service in Missouri.

5 **Q: Why are Staff and OPC advocating that a portion of rate case expense be disallowed**  
6 **in this case?**

7 A: Staff lists four reasons at p. 141 of the Staff Report. Staff cites the formula ordered by  
8 the Commission in the 0370 case; its unsupported belief that rate case expense sharing  
9 creates an incentive to control rate case expense; its belief that it is fair and equitable for  
10 shareholders to pay some portion of rate case expense; and its belief that both ratepayers  
11 and shareholders benefit from the rate case process. OPC's reasons are similar to Staff's.

12 **Q: Do you agree with the recommendations of Staff and OPC to disallow a portion of**  
13 **the reasonable and prudently incurred rate case expenses in this case?**

14 A: No. As the Staff Report points out, customers benefit from a rate case process that  
15 determines the just and reasonable rates that are to be paid for safe, adequate, and reliable  
16 service. Shareholders also benefit from a rate case process that gives the company a  
17 meaningful opportunity to earn a reasonable return on shareholders' investments in plant  
18 dedicated to the public use. Under the current regulatory system, the only manner in  
19 which these objectives may be accomplished is through the rate case process which is  
20 mandated by law.

21 Rate case expenses are no different from other costs that provide benefits to  
22 customers (i.e. generation, transmission and delivery costs) because both shareholders  
23 and customers benefit from the company's continued operation. Simply put, periodic rate

1 increases are necessary and provide a benefit to the customer by keeping the public utility  
2 financially healthy and in a position to provide the customers with safe and adequate  
3 service at just and reasonable rates. The customer is the primary beneficiary when a  
4 utility is able to fulfill its statutory obligation to provide safe, adequate and reliable  
5 service. This fundamental objective can only be accomplished if the company is able to  
6 attract investment by providing a reasonable return to its shareholders. As we have  
7 suggested throughout this case, rate cases and the regulatory mechanisms approved in  
8 rate cases are necessary and essential if the Company is to be in a position to adequately  
9 attract capital and have a reasonable opportunity to earn its authorized rate of return.

10 It would make no sense to automatically disallow – in the absence of any  
11 evidence or allegation of imprudence – any of the other costs which benefit both the  
12 shareholder and the customer. For example, shareholders benefit from the construction  
13 of new power plants because the construction generally increases the shareholders’  
14 earnings levels, while customers benefit from the additional capacity used to serve them.  
15 Following the logic of Staff and OPC, a portion of those power plant costs would be  
16 disallowed since both the shareholders and customers benefit from those costs. Such a  
17 regulatory practice with power plant costs would quickly drive the public utility into dire  
18 financial straits, and adversely impact its ability to provide safe and adequate service to  
19 its customers.

20 Finally, under long-standing regulatory precedent, shareholders are expected to  
21 have a reasonable opportunity to earn returns authorized by the Commission. An  
22 arbitrary disallowance of rate case expenses (i.e., charging shareholders for the regulatory  
23 costs to in fact establish rates that are to provide them that reasonable opportunity) is

1 indeed an ironic and perverse start in providing the shareholders the opportunity that they  
2 are supposed to be afforded.

3 **Q: The Staff Report asserts at p. 137 that “Generally, utility management has a high**  
4 **degree of control over rate case expense.” Do you agree with this statement?**

5 A: I agree that management has some discretion in how it presents its rate case, but it is also  
6 important to remember that the burden of proof is on the company in rate cases. It is also  
7 true that much of the rate case expenses are driven by the quantity and complexity of the  
8 issues that are raised by other parties to the case. The complexity and number of issues  
9 raised by other parties often drives the need to utilize outside consultants and outside  
10 counsel. While we hope to settle many of the issues raised by the parties before the  
11 hearing, the Company believes it needs to be prepared to try the issues raised by other  
12 parties in the event a settlement is not possible.

13 These cases also typically involve massive amounts of discovery that are issued  
14 by Staff, OPC and numerous intervenors. For example, in this case, as of the date of the  
15 preparation of this Rebuttal Testimony, the Company has answered approximately 804  
16 data requests issued by Staff (with numerous subparts), 281 data requests issued by OPC,  
17 and 46 data requests issued by other intervenors. In addition, the Company has held over  
18 20 meetings with Staff auditors, and completed extensive searches of the Company’s  
19 records and email systems in order to answer the data requests of Staff, OPC and  
20 intervenors. The Company has two full time persons largely dedicated to managing data  
21 requests, as well as many others working to supply answers to this discovery. With this  
22 level of personnel dedicated to providing answers to the data requests and other informal  
23 requests for information from the parties to this case, the Company has been able to

1 largely avoid discovery disputes that would otherwise have been presented to the  
2 Commission or the Regulatory Law Judge for resolution. The level of effort to satisfy the  
3 data needs of the other parties contributes to the overall cost of processing a rate case.  
4 While most of the process of answering data requests utilizes primarily internal KCP&L  
5 personnel, outside consultants and/or outside counsel are sometimes involved in  
6 reviewing the responses.

7 **Q: Are there Commission regulations that contribute to the level of rate case expense**  
8 **that are beyond the control of a utility?**

9 A: Yes and this case is a good example. GMO was required to file this rate case due to the  
10 Commission's fuel adjustment clause ("FAC") regulations. The Company is required to  
11 file a general rate case with the effective date of new rates no later than four years in  
12 order to continue to utilize an FAC.<sup>2</sup> In addition, 4 CSR 20.090 (9) requires a line loss  
13 study be conducted no less than every four years to be used in a general rate proceeding  
14 necessary to continue a FAC. As the Commission knows, the Commission has  
15 promulgated regulations that require the Company to periodically perform depreciation  
16 studies<sup>3</sup>, and explain the Company's rate requests in detail<sup>4</sup>. While the Company believes  
17 these may be appropriate regulations, it is apparent that such requirements will inevitably  
18 add to the cost of processing rate cases.

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<sup>2</sup> See 4 CSR 240-20.090(6)(A).

<sup>3</sup> See 4 CSR 240-2.160(1); 4 CSR 240-3.175.

<sup>4</sup> See 4 CSR 240-3.030; 4 CSR 240-3.160

1 **Q: Do you believe that the 0370 formula creates an incentive, and eliminates a**  
2 **disincentive, on the utility's part to control rate case expense to reasonable levels?**

3 A: No. An arbitrary disallowance using a formula of dividing the revenue requirement  
4 ordered versus the amount requested and multiplying this by the reasonable and  
5 prudently-incurred rate case expense does not create an incentive to control rate case  
6 expenses. This approach merely makes it more difficult for the Company to earn its  
7 authorized rate of return. It is appropriate and reasonable for the Commission to review  
8 rate case expenses as to reasonableness and prudence. The Commission has disallowed  
9 rate case expense costs in the past on grounds of imprudence, and this serves as ample  
10 incentive for the Company to make certain that its rate case expenses are reasonable.  
11 However, an arbitrary disallowance of a portion of all prudently incurred rate case  
12 expenses is not reasonable or good public policy, and appears instead to serve as an  
13 incentive for Staff and parties to forego audit and review of rate case expenses and  
14 instead assert disallowances under the arbitrary 370 formula with no justification or  
15 prudence review.

16 **Q: Does the approach advocated by Staff and OPC raise other concerns?**

17 A: Yes. A fundamental problem with an arbitrary disallowance of prudently incurred rate  
18 case expense is that it effectively restricts the Company's ability and right to direct the  
19 presentation of its case, and to choose its legal and regulatory strategy before the  
20 Commission in rate case litigation that is required to obtain adequate rate levels. In the  
21 past, the Commission has recognized a public utility's right to make these decisions as  
22 long as its costs are prudently incurred: "The Commission is hesitant to disallow  
23 expenses incurred by MGE in prosecuting its rate case. The company is entitled to



1 present its case as it sees fit and the Commission will not lightly intrude into the  
2 Company's decision about how best to present its case."<sup>5</sup>

3 **Q: Does GMO have an incentive to control its rate case expenses?**

4 A: Yes. We strive to balance cost control measures with providing the best level of service  
5 possible. Rate case expense is a normal part of doing business within a regulated system.  
6 Attached as Schedule DRI-9 is a flowchart which depicts the process the Company  
7 utilizes to manage rate case expense. This process helps ensure the monitoring and  
8 control of those costs. Like other expenses necessary to provide service to customers, the  
9 Company strives to be as efficient as possible in the presentation of its case while  
10 attempting to clearly explain its position on the issues to the Commission. The Company  
11 would fully expect that its rate case expenditures will be carefully and thoroughly  
12 reviewed by the Staff and other parties to determine their reasonableness and prudence,  
13 unless of course they are allowed to blindly apply the arbitrary 370 formula in lieu of  
14 performing such work. In addition, the Company does not recover its rate case expenses  
15 on a dollar for dollar basis under the traditional method of handling rate case expenses.  
16 Often, the rate case expenses are amortized or normalized over a greater number of years  
17 than the period between rate cases. For example, in Case No. ER-2014-0370, rate case  
18 expense was normalized over three years, but KCP&L filed another rate case less than  
19 twelve months after the rates from Case No. ER-2014-0370 took effect. As a result, the  
20 normalizations/amortizations are sometimes prematurely terminated before all prudently  
21 incurred rate case expenses are actually recovered. The Company has an incentive to be

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<sup>5</sup> Report And Order, *Re Missouri Gas Energy*, Case No. GR-2004-0209, p. 75.

1 efficient in the presentation of its rate cases as well as with the purchase of other services  
2 necessary to provide safe and adequate electric service to our customers.

3 **Q: The Staff Report at p. 140 analogizes rate case expenses to discretionary expenses**  
4 **such as charitable contributions and lobbying expenses. Do you agree with these**  
5 **analogies?**

6 A: No, that analogy is self-serving for Staff's position and is unreasonable. Unlike  
7 charitable contributions and lobbying expenses, rate case expenses are not discretionary.  
8 If the Company's cost of service has increased, it is necessary for the Company to file a  
9 rate case in order to adjust the rates to reflect its ongoing cost of service. In fact, GMO is  
10 required by Commission regulation to periodically file rate cases if it is to continue to  
11 utilize the FAC. The same is required by Commission rule if a utility makes use of a  
12 demand side investment mechanism. While the Company could have arguably reduced  
13 (or eliminated) its charitable contributions and lobbying expenses during the test year, the  
14 Company was required to file this rate case under the Commission's FAC regulations to  
15 maintain its ability to use the FAC. In other words, this rate case is essential to  
16 establishing just and reasonable rates, and giving the Company a meaningful opportunity  
17 to earn a reasonable rate of return on its investments.

18 **2) Normalization Period for Rate Case Expense**

19 **Q: What is this issue?**

20 A: Staff and OPC have proposed a four-year normalization (i.e., averaging) of rate case  
21 expense, while the Company proposes a three-year normalization.

22 **Q: Why has GMO proposed to normalize rate case expense over three years?**

23 A: Although GMO has filed a rate case every 21 months, on average, since 2006, one of our  
24 goals is to reduce the frequency of rate case filings. While necessary on occasion, rate

1 cases are expensive and time consuming for all parties involved. Company management  
2 knows that customers do not like it when we file rate cases; however, there are times  
3 when we have no alternative to maintain the financial wherewithal to provide the service  
4 our customers expect and deserve.

5 **Q: How does GMO evaluate whether and when to file a rate case?**

6 A: At the most elementary level, we compare cost of service to available revenues, both  
7 currently and into the relatively near-term future (one and two years out), and when there  
8 is, or is expected to be, a significant mismatch between revenues and cost of service, we  
9 make plans to file a rate case.

10 **Q: Can rate case treatment affect the frequency of subsequent rate case filings?**

11 A: It absolutely can and does. If new rates result in a mismatch of costs and revenues, GMO  
12 will be required to begin the analysis necessary to determine when a rate case filing is  
13 justified. For example, if the allowance in rates for a certain cost item falls short of  
14 actual experience for that cost item, this begins to add pressure to file a rate case. If there  
15 are many such mismatches, or if there are just a few such mismatches of substantial  
16 impact, the Company will almost certainly find it necessary to file a rate case. This is  
17 especially true if 1) the cost of service item is not susceptible to significant management  
18 control, 2) revenue growth is minimal, and/or 3) the Company is making substantial  
19 capital expenditures. It should be noted that for GMO, revenue growth is presently  
20 minimal and it expects to continue making substantial capital expenditures.

1 **Q: How do you think rate case treatment to be granted in this case may affect how**  
2 **quickly GMO files its next rate case?**

3 A: Regardless of rate case treatment in this case, GMO will likely need to file a case more  
4 quickly than the three year normalization proposed by the Company as a result of  
5 anticipated future capital expenditures. However, rate case treatment resulting in  
6 insufficient recovery of costs could certainly accelerate further the filing of a case, or  
7 result in a larger revenue deficiency than anticipated with the current filing timeline  
8 creating a more significant customer impact in GMO's next general rate case. If GMO is  
9 permitted to continue to use an FAC and if trackers on forecasted levels of expense are  
10 approved for transmission costs and CIP/cyber security costs, it is possible that GMO  
11 may be able to delay its next rate case filing for some period of time, or at the least GMO  
12 could have a lower revenue deficiency than anticipated with the current filing timeline,  
13 which would create a less significant customer impact in GMO's next general rate case.  
14 Absent the ability to use an FAC and permission to track transmission and CIP/cyber  
15 security costs, GMO will likely need to either file another rate case earlier or file a larger  
16 than otherwise increase request in order to protect its right to earn a fair and reasonable  
17 return.

18 **Q: Does OPC witness Hyneman state that rate case expenses for prior rate cases are**  
19 **included with this current rate case and that they should not be included?**

20 A. Yes he does.

1 **Q. Do you agree with OPC witness Hyneman's statements?**

2 A. No, he is wrong. The Company has not requested past rate case expenses in this rate  
3 case. The Company's request only includes an annualized level of expense over a three  
4 year period for the current rate case costs.

5 **3) Amortization Period for Depreciation Study Costs**

6 **Q: What is this issue?**

7 A: Staff proposes to amortize depreciation study costs over a five-year period, while the  
8 Company proposes to amortize depreciation study costs as part of rate case expense over  
9 a three-year time period.

10 **Q: How frequently must the Company prepare a depreciation study?**

11 A: Pursuant to Commission rule (4 CSR 240-3.160(1)(A)), GMO must submit a depreciation  
12 study (including data base and property unit catalog) with each general rate case filing  
13 unless the Commission's Staff received these items from the utility during the three years  
14 prior to the rate case filing. In any event, the Company must submit a depreciation study  
15 (including data base and property unit catalog) no less frequently than every five years.

16 **Q: How frequently do you expect GMO to file general rate cases in the future?**

17 A: Our goal is to minimize the frequency of future general rate case filings, but our ability to  
18 do so depends significantly on the outcome of this rate proceeding and the other factors  
19 discussed throughout this testimony. Since 2006, GMO has filed rate cases every 21  
20 months, on average. Additionally, according to the Commission's FAC rule (4 CSR 240-  
21 20.090(6)(A)), GMO must file a general rate case to cause new rates to go into effect no  
22 later than four years after the effective date of the commission order implementing the  
23 FAC in order to continue its ability to use the FAC. As a result, I expect GMO will file  
24 its next general rate case no later than three years and one month after new rates from this

1 case take effect. Consistent with Commission rule (4 CSR 240-3.160(1)(A)), and  
2 complying with the Commission's FAC rule (4 CSR 240-20.090(6)(A)), GMO will  
3 necessarily need to file a depreciation study at least every four years, therefore Staff's  
4 position to amortize the depreciation study costs over five years is unreasonable,  
5 inconsistent with GMO's ongoing requirements and should be disregarded by the  
6 Commission.

7 **Q: Does this expected general rate case frequency for GMO support use of a five year**  
8 **amortization period for depreciation study costs as recommended by Staff?**

9 A: No. History since 2006 suggests that GMO will file its next general rate case well before  
10 five years after this case concludes. As I just noted, in fact GMO will be required by the  
11 provisions of the FAC rule cited above to file its next general rate case so that it will  
12 conclude no later than four years after the conclusion of this case.

13 **Q: What amortization period do you recommend for depreciation study costs?**

14 A: I recommend that depreciation study costs be amortized over three years as that is  
15 consistent with GMO's recent rate case history, the Company's goal of reducing the  
16 frequency of rate case filings (provided it can actually achieve earnings close to its  
17 Commission-authorized level), the Commission's rule requiring the Company to  
18 periodically prepare depreciation studies and the Commission's FAC rule requires the  
19 Company to periodically file general rate cases.

## 20 HEDGE ACCOUNTING

21 **Q: What is the purpose of your testimony on this issue?**

22 A: The purpose of my testimony is to rebut certain comments by OPC witness Charles  
23 Hyneman criticizing the Company's accounting related to its hedging program. In

1 response to these criticisms, I will address the accounting for the settlement of natural gas  
2 hedges and natural gas cross-hedges for purchased power. My testimony rebuts OPC's  
3 contention that the Company did not properly account for its hedging gains and losses.

4 **Q: Do you agree with OPC witness Hyneman's interpretation of the 2005 Stipulation**  
5 **and Agreement in Case No. ER-2005-0436 ("2005 Stipulation and Agreement")?**

6 A: No. It is clearly stated that "The Signatory Parties agree, for accounting and ratemaking  
7 purposes, that hedge settlements, both positive and negative, and related costs (e.g. option  
8 premiums, interest on margin accounts, and carrying cost on option premiums) directly  
9 related to natural gas generation and on-peak purchased power transactions under a  
10 formal Aquila Networks-MPS hedging plan will be considered part of the fuel cost and  
11 purchased power costs recorded in FERC Account 547 or Account 555 when the hedge  
12 arrangement is settled." GMO fully complied with this language by recording the hedge  
13 settlements for natural gas generation to FERC Account 547. In addition, natural gas  
14 hedge settlements to mitigate power price volatility were appropriately recorded to FERC  
15 Account 547.

16 **Q: Did the Company receive additional justification from the Commission that the**  
17 **Company's interpretation is correct?**

18 A: Yes. Following the 2011 FAC prudence review (Case No. EO-2011-0390), the  
19 Commission issued a Report and Order on September 4, 2012 which clearly defined  
20 GMO's Accounting for Its Hedging Costs as follows:

21 "The Commission ordered that all of GMO's prudently incurred hedging  
22 costs would be recovered through its FAC. The Commission prescribed  
23 the accounting treatment for GMO's hedging costs by means of the AAO  
24 to ensure the physical and financial transactions would be connected and  
25 booked as fuel costs. The Commission's Staff has alleged that GMO  
26 engaged in improper accounting in order to improperly recover hedging

1 costs associated with purchased power, while at the same time has testified  
2 that it is not opposed to GMO recovering its prudently incurred hedging  
3 costs associated with purchased power through its FAC. And, the record  
4 reflects that GMO has properly, and openly, accounted for its hedging  
5 costs, consistent with the Uniform System of Accounts, previous  
6 stipulations and agreements, and orders of the Commission.  
7

8 The substantial and competent evidence on the record as a whole  
9 supports the conclusions that GMO's accounting practices: (1) were  
10 authorized by the Commission-approved AAO and the relevant tariffs; (2)  
11 are not misleading or deceptive; and (3) do not result in distorted financial  
12 statements. The substantial and competent evidence on the record as a  
13 whole also supports the conclusions that **GMO has consistently followed**  
14 **the USOA, FERC's accounting standards, the GAAP and the**  
15 **Commission's rules for booking its hedging costs since the inception**  
16 **of its hedging program**"  
17

18 **Q: Do you believe that GMO is in violation of FERC's USOA accounting rules for**  
19 **hedging as addressed in General Instruction No. 24 Section D?**

20 A: No. Section D of General Instruction No. 24 is in reference to fair value hedges.

21 **Q: How does GMO designate its natural gas derivatives?**

22 A: GMO designates its natural gas derivatives as economic hedges.

23 **Q: Please identify the different accounting designations for commodity contracts the**  
24 **Company may elect.**

25 A: Normal purchase and normal sale ("NPNS"), cash flow hedge and economic hedge.

26 **Q: Could you please explain the accounting difference between each one?**

27 A: Under the NPNS election, accrual accounting is followed and recognizes the sale or  
28 expense in the period that physical delivery occurs. In order to elect NPNS accounting,  
29 physical delivery of the hedged item must be probable at the inception of the contract.  
30 Under the cash flow hedge and economic accounting model, preparers of financial  
31 statements are required by Accounting Standards Codification ("ASC") Topic 815,



1 “Derivatives and Hedging,” to record the change in fair value of the financial instrument  
2 in the financial statements.

3 **Q: Is there a difference between a cash flow hedge and an economic hedge?**

4 A: Yes. Under a cash flow hedge, the effective portion of the change in fair value of a cash  
5 flow hedge is recorded in a derivative asset or liability with an offset to Other  
6 Comprehensive Income (“OCI”), which is a component of Stockholders’ Equity on the  
7 balance sheet. In summary, the change in fair value of a cash flow hedge is all on the  
8 balance sheet and does not affect the income statement. Upon physical delivery of the  
9 underlying transaction, the realized and/or unrealized gain or loss is moved from the  
10 balance sheet to the income statement. For example, if GMO enters into a natural gas  
11 future to hedge price risk of natural gas in March 2012 for October 2013, then GMO  
12 would recognize the change in fair value in GMO’s financial statements between March  
13 2012 until the hedge is cash settled and becomes a realized gain or loss. In October 2013  
14 when the original underlying hedged transaction occurs, then the realized gain or loss is  
15 recognized in the income statement in October 2013. Under an economic hedge, the  
16 change in fair value is recorded to a derivative asset or liability with the offset to the  
17 income statement in the period the change in fair value occurs.

18 **Q: How would you define fair value?**

19 A: Very simply, it is the market value of the financial instrument.

20 **Q: What happens to the unrealized gains or losses on the natural gas hedges for fuel  
21 and power?**

22 A: Unrealized gains and losses are incurred from the date of entering the natural gas futures  
23 or forward contracts until the date the contracts are cash settled. At that time, unrealized

1 gains or losses are converted to realized gains or losses. Then, the realized gains or  
2 losses are recorded in FERC Account 547 in the period when the original underlying  
3 hedged transaction occurs, as described above.

4 **Q: Why does GMO not designate these derivatives as NPNS?**

5 A: Under ASC Topic 815, these natural gas derivative contracts do not qualify for NPNS  
6 accounting designation.

7 **Q: Why don't GMO's natural gas derivatives qualify for NPNS accounting**  
8 **designation?**

9 A: Since GMO is hedging its price risk for both natural gas and purchased power, GMO is  
10 unable to elect NPNS accounting. GMO's natural gas futures will settle in cash and there  
11 is no expectation of physical delivery of natural gas. As mentioned above, NPNS  
12 accounting requires that physical delivery must be probable at the inception of the  
13 contract.

14 **Q: What about cash flow hedge?**

15 A: Pursuant to GMO's 2005 Stipulation and Agreement mentioned previously, GMO is  
16 required by the MPSC to defer the unrealized gains and losses in a regulatory asset or  
17 liability, therefore, GMO chooses to account for these contracts as an economic hedge.

18 **Q: What is the difference between a cash flow hedge and GMO's accounting**  
19 **treatment?**

20 A: Simply, it is the location on the balance sheet.

1 **Q: Please explain.**

2 A: Typically under a cash flow hedge, the unrealized gain or loss on a derivative contract is  
3 deferred in OCI. Like many regulated utilities, GMO's treatment is to defer the gain or  
4 loss in either a regulatory asset or liability.

5 **Q: What about the income statement?**

6 A: As described above, when the underlying transaction that is hedged is completed, the  
7 deferred gain or loss is recorded to the appropriate income statement FERC account.

8 **Q: Would the treatment of these contracts as a cash flow hedge change the FERC  
9 income statement account the cash settled gain or loss is recorded to?**

10 A: No. The cash settled gain or loss would be recorded to FERC Account 547.

11 **Q: OPC witness Hyneman asserts that GMO has violated the accounting requirements  
12 of the 2005 Stipulation & Agreement. Do you believe this is true?**

13 A: No, the reality is quite the contrary. As stated above the Commission in its September 4,  
14 2012 Report and Order affirmed GMO's interpretation of the 2005 Stipulation and  
15 Agreement, which is consistent with GMO's accounting treatment disputed by witness  
16 Hyneman in this case. Thus, witness Hyneman's position is the one that is inconsistent  
17 with the 2005 Stipulation & Agreement. Further, as described in the rebuttal testimony  
18 of GMO witness Blunk, GMO acknowledges that there are two sides to every hedge. In  
19 this scenario the unrealized gains or losses for purchased power are recorded in FERC  
20 Account 555, while the realized gains or losses for the derivative instrument are recorded  
21 in FERC Account 547.

1 **Q: Could you please explain the two sides of a hedge further?**

2 A: Yes. Every hedge has two sides to the transaction, a gain and a loss. For financial  
3 instruments, the cash settlement is easy to identify because it is cash settled. The other  
4 side of the hedge is non-cash but impacts the Company. For example, when the price of  
5 natural gas decreases in a financially hedged transaction for purchased power, then the  
6 natural gas hedge decreases in value and the underlying hedge for purchased power has  
7 an offsetting non-cash increase in value (i.e. – market prices of purchased power are  
8 decreasing).

9 **Q: How are hedge costs associated with the cross-hedges included in FERC Account**  
10 **555?**

11 A: Sometimes GMO will convert a natural gas cross-hedge to an electricity forward. When  
12 that happens the hedge adjustment from the natural gas contract that effectively fixed the  
13 future price of electricity through the cross-hedge is recorded in Account 547. The price  
14 fix which began as a natural gas cross-hedge is converted from one derivative to another  
15 derivative. It is converted from a NYMEX futures contract for natural gas to a forward  
16 contract for electricity. Much like the hedge adjustment recorded in Account 547 which  
17 occurred because the natural gas market had moved from the time the hedge was initiated  
18 to the time it was closed, the Company is locked into a price for electricity that ends up  
19 being either less or more than the prevailing spot price for electricity. That non-cash  
20 opportunity gain or loss on the electricity forward which began as a NYMEX natural gas  
21 futures contract is included in Account 555.

1 **Q: How is the change in value related to purchased power accounted for in the**  
2 **Company's ledger?**

3 A: In FERC Account 555. Forward physical electricity contracts are hedges that are  
4 designated as NPNS. As I discussed previously, these contracts are accounted for under  
5 accrual accounting and the Company records the contractual price per MWh in FERC  
6 Account 555. Forward contracts will always have a different price than the spot market.  
7 The difference between the forward contract price and the spot market price is the non-  
8 cash hedge cost included in FERC Account 555.

9 **Q: How did the Company record the cost of purchased power costs during the time**  
10 **period related to the natural gas hedges?**

11 A: The actual price of the purchased power was recorded in FERC Account 555. Again, this  
12 includes the non-cash gain or loss from the spot market or physical side of the hedge.

13 **Q: Why doesn't the Company record this unrealized gain in its purchased power costs?**

14 A: There is no need. The unrealized gain (i.e. lower price than expected) is included in the  
15 price the Company pays for its spot purchase of power.

16 **Q: Have you read the Entergy Order (ER07-684-000) issued by FERC on May 25,**  
17 **2007?**

18 A: Yes.

19 **Q: Do you believe this order is relevant to Mr. Hyneman's arguments in this case?**

20 A: No. In the Entergy case, the basis of the Louisiana Commission's complaint is that fuel  
21 hedging costs were removed from the production cost formula used for comparison  
22 among the Entergy Operating Companies. Entergy's losses for fuel hedging historically  
23 recorded in FERC Account 501 were moved to FERC Account 557 which is not a part of

1 the Entergy production cost formula. Additionally, FERC Account 557 is not where fuel  
2 is recorded causing the physical and underlying financial transactions to become  
3 unconnected and booked as fuel costs and other production O&M. In GMO's case, GMO  
4 has repeatedly provided a fact pattern that all its natural gas hedging activities are  
5 recorded to FERC Account 547 and 555 in order to ensure the physical and financial  
6 transactions remain connected on the Company's books.

7 **Q: Finally, OPC witness Hyneman suggests GMO has not sought the opinion of any**  
8 **CPA to confirm GMO's hedge accounting. Do the Company's external auditors**  
9 **express an opinion on the Company's FERC Form 1 filings?**

10 A: Yes. GMO's external auditors express an opinion on GMO's financial statements. Since  
11 GMO began hedging natural gas for fuel and purchased power, the Company's external  
12 auditors expressed an unqualified opinion on the Company's financial statements. I  
13 would remind the Commission that the Company's financial statement disclosures  
14 regarding these transaction are robust and very transparent and are part of the document  
15 reviewed by the external auditors in expressing their unqualified opinion.

16 **Q: Would you agree that the Company's external auditors are experts in GAAP and**  
17 **FERC accounting?**

18 A: Yes.

19 **Q: Do you have any other concerns with OPC witness Hyneman's testimony?**

20 A: Yes, Mr. Hyneman's continues to assert there was not an agreement among the parties  
21 that were signatories to the 2005 Stipulation and Agreement. As noted earlier, the 2005  
22 Stipulation & Agreement clearly stated that "The Signatory Parties agree, for accounting  
23 and ratemaking purposes, that hedge settlements, both positive and negative, and related

1 costs (e.g. option premiums, interest on margin accounts, and carrying cost on option  
2 premiums) directly related to natural gas generation and on-peak purchased power  
3 transactions under a formal Aquila Networks-MPS hedging plan will be considered part  
4 of the fuel cost and purchased power costs recorded in FERC Account 547 or Account  
5 555 when the hedge is settled.” (emphasis supplied) As such, the Company believes an  
6 agreement was reached in 2005 to record hedging costs in FERC Accounts 547 or 555.

7 **Q: Does that conclude your testimony?**

8 A: Yes, it does.

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

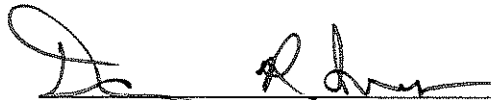
In the Matter of KCP&L Greater Missouri Operations            )  
Company's Request for Authority to Implement                )  
A General Rate Increase for Electric Service                 )            Case No. ER-2016-0156

**AFFIDAVIT OF DARRIN R. IVES**


STATE OF MISSOURI    )  
  ) ss  
COUNTY OF JACKSON )

Darrin R. Ives, being first duly sworn on his oath, states:

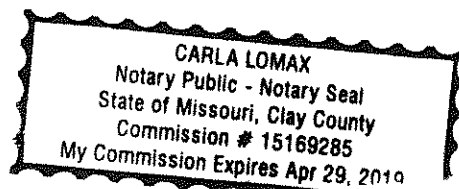
1. My name is Darrin R. Ives. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Vice President – Regulatory Affairs.
  
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of KCP&L Greater Missouri Operations Company consisting of twenty-three (23) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.
  
3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

  
\_\_\_\_\_  
Darrin R. Ives

Subscribed and sworn before me this 15<sup>th</sup> day of August, 2016.

  
\_\_\_\_\_  
Notary Public

My commission expires: Apr. 29, 2019





KCP&L GREATER MISSOURI OPERATIONS COMPANY  
Rate Case Expense Controls

