

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

In the Matter of the Third Prudence Review of	)	
Costs Subject to the Commission-Approved Fuel	)	<b><u>Case No. EO-2011-0390</u></b>
Adjustment Clause of KCP&L Greater Missouri	)	
Operations Company.	)	

**JOINT STIPULATION OF NON-DISPUTED  
MATERIAL FACTS**

**COME NOW** the Staff of the Missouri Public Service Commission and KCP&L Greater Missouri Operations Company ("GMO"), and, for their *Joint Stipulation of Non-Disputed Material Facts*, state as follows:

**Introduction And Procedural History**

1. On June 9, 2011, the Staff filed its *Notice To Start Third Prudence Review* which initiated this case.

2. On November 29, 2011, the Staff filed its Staff Report, *Prudence Review Of Costs Related To The Fuel Adjustment Clause For The Electric Operations Of KCP&L Greater Missouri Operations Company* ("Staff Report") This matter arises out of Staff's recommendation in its Staff Report that certain costs, incurred by GMO between June 1, 2009, and November 30, 2010 ("the review period"), and passed on to ratepayers through its fuel adjustment clause ("FAC"), be disallowed as imprudent and that GMO be required to make corresponding refunds to ratepayers, with interest at the short term interest rate, through its FAC.<sup>1</sup>

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<sup>1</sup> A fuel adjustment clause is a device authorized by statute that permits an electric utility to pass fuel price changes on to customers through a surcharge without the requirement of a general rate case. One requirement of the authorizing statute is a prudence review at 18-month intervals. This is the third such review since GMO was granted its FAC.

3. In its Staff Report, the Staff recommended that “the Commission find GMO imprudent for including costs and revenues associated with GMO’s hedging future purchases of spot market power by buying options to purchase natural gas during that period in determining the associated FAC charges both because such costs and revenues are not within the scope of GMO’s FAC and because such “hedging” is in and of itself imprudent, and order GMO to refund to its customers, in the aggregate, \$18,755,865 plus interest accrued at GMO’s short-term interest rate until refunded by an adjustment to its FAC charge.”<sup>2</sup> On December 5, 2011, GMO filed its *Request For Hearing* which disputed the Staff’s claim of imprudence and requested a hearing in the matter.

4. On February 22, 2012, GMO filed testimony of Dr. C.K. Woo, Wm. Edward Blunk, Tim M. Rush, and Scott H. Heidtbrink which explained the reasons that GMO disputed Staff’s claims.

5. On March 21, 2012, the Staff filed the Direct/Rebuttal Testimony of Dana E. Eaves, Rebuttal Testimony of Lena Mantle, and Rebuttal Testimony of Charles R. Hyneman which explained the Staff positions in this case.

6. On May 10, 2012, GMO filed its Surrebuttal Testimony of Dr. C.K. Woo, Wm. Edward Blunk, Tim M. Rush, Gary L. Clemens and Ryan A. Bresette.

7. In its *Order Modifying Procedural Schedule* of April 23, 2012, the Commission directed that a *Joint Stipulation of Non-Disputed Material Facts* be filed no later than May 25, 2012.

8. On May 24, 2012, the Commission extended the due date until June 1, 2012,

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<sup>2</sup> Staff Report, p. 4.

in response to Staff's *Motion to Modify Procedural Schedule by Extending Date for Joint Stipulation of Non-Disputed Material Facts*.

9. Staff and GMO have cooperated in producing this procedural history and the list of facts below, which are tendered in satisfaction of the Commission's order of April 23, 2012.

### **Non-Disputed Facts**

#### ***Jurisdiction:***

10. GMO is a Delaware general business corporation in good standing, duly authorized to do business in Missouri. Its principal place of business is located at 1200 Main Street, Kansas City, Missouri 64105, and its registered agent is National Registered Agents, Inc., 300 B East High Street, Jefferson City, Missouri 65101.

11. GMO has been, since July 14, 2008, a wholly-owned subsidiary of Great Plains Energy, Inc. ("GPE"), a publicly-traded, unregulated, public utility holding company that also owns Kansas City Power and Light Company ("KCP&L"). Collectively, KCP&L and GMO operate and present themselves to the public under the brand and service mark "KCP&L." The workforce for GMO consists of KCP&L employees; GMO has no employees of its own. Before it was acquired by GPE, GMO was named Aquila, Inc., and before that, Utilicorp United, Inc.<sup>3</sup>

12. GMO is in the business of owning, controlling and operating electric plant, as defined at § 386.020(14), RSMo, used for generating, transmitting and distributing electricity for sale to the public for light, heat and power. According to GPE's Form 10-K

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<sup>3</sup> For convenience, the Company will be uniformly referred to as GMO in this document, regardless of its historic name during the period under discussion.

filed with the United States Securities and Exchange Commission in February, 2010, GMO is “an integrated, regulated electric utility that primarily provides electricity to customers in the state of Missouri [and] also provides regulated steam service to certain customers in the St. Joseph, Missouri area.” GMO has approximately 312,000 customers, including 273,500 residential customers, 38,000 commercial customers, and some 500 industrial, municipal, and other utility customers. To serve these customers, GMO owns 2,182 MW of generating capacity, of which 1,025 MW is coal capacity, 1,094 MW is natural gas-fired combustion turbine capacity, and 63 MW is oil-fired combustion turbine capacity.

13. By virtue of its activities described in Paragraph 12, above, GMO is an “electrical corporation” within the intendments of § 386.020(15), RSMo, and a public utility within the intendments of § 386.020(43), RSMo, and therefore "subject to the jurisdiction, control and regulation of the commission and to the provisions of this chapter[.]"

14. In addition to -- or in place of -- energy generated by its native capacity described above in Paragraph 12, GMO also purchases power on the spot market when prices are such that purchased power is the least cost alternative for serving its native load. Spot market purchased power currently represents about 35.8% of the energy sold at retail by GMO.

***GMO's Fuel Adjustment Clause (FAC):***

15. The Commission authorized a FAC for GMO on May 27, 2007, in Case No. ER-2007-0004, finding that fuel and purchased power costs constituted approximately 46% of GMO's test year operations and maintenance expenses; that

GMO's fuel and purchased power costs increased on average between 13% and 20% annually; that GMO had "heavy reliance" on both purchased power and gas-fired generation; that the purchased power and natural gas markets were characterized by "high volatility"; and that these factors were outside of GMO's control.<sup>4</sup> The Commission authorized-FAC included two annual adjustments<sup>5</sup> and a 95% pass-through cap to encourage efficient management.<sup>6</sup> These features continue to characterize GMO's FAC.

16. GMO's FAC allows GMO to recover from its ratepayers 95% of its prudently incurred variable fuel and purchased power costs above a base amount that is set in a general rate case. Likewise, 95% of any reduction of GMO's fuel and purchased power costs below the base amount is returned to ratepayers through the FAC. GMO's fuel and purchased power costs are accumulated during six-month accumulation periods; each of which is followed by a 12-month recovery period during which the under-recovery or over-recovery is flowed through to ratepayers by an increase or decrease in the Cost Adjustment Factor ("CAF"). Adjustments to the CAF are designed to offset the under-recovery or over-recovery by the end of the 12-month recovery period. GMO's FAC is also designed to true-up any over-recoveries or under-recoveries during recovery periods. Any disallowance made by the Commission due to a prudence review is accounted for as an adjustment to the next CAF filing. As required

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<sup>4</sup> See *In the Matter of Aquila, Inc.*, Case No. ER-2007-0004 (**Report & Order**, eff. May 27, 2007) at pp. 30-38.

<sup>5</sup> *Id.*, at 48. In other words, the FAC permits two price adjustments per year. Each 6-month adjustment period is referred to as an "accumulation period."

<sup>6</sup> *Id.*, at 51-55.

by statute and Commission rule, GMO's FAC is subject to prudence reviews at intervals not longer than 18 months.

17. In the *Stipulation And Agreement As To Certain Issues* in Case No. ER-2007-0004, the Signatories, including Aquila and the Staff, agreed: "The Signatories agree that ultimate settlement values of Aquila's hedge contracts in place on March 27, 2007 for the period June 1, 2007 through December 31, 2009 will be subject to the provisions of any fuel cost recovery mechanism approved by the Commission in this case. However, the ultimate settlement values will not be subject to challenge as to a prudence disallowance relative to Aquila's original decisions to enter into these hedge positions."<sup>7</sup>

18. In the Commission's Order Clarifying Report and Order issued on May 22, 2007 in Case No. ER-2007-0004 (Aquila's 2007 rate case), the Commission stated on page 1: "Under the Stipulation and Agreement, prudently incurred hedging costs will flow through the fuel adjustment clause..."<sup>8</sup>

### ***The Prudence Reviews:***

19. The first prudence review of GMO's FAC, Case No. EO-2009-0115, concerned accumulation periods 1 and 2, June 1, 2007, through May 31, 2008. Staff did not recommend any disallowance in the first prudence review. In its report, Staff noted regarding hedging that "the Company attempts to hedge against the fluctuations of natural gas, coal and diesel prices."<sup>9</sup> The *Report* went on to state with respect to

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<sup>7</sup> Stipulation And Agreement As To Certain Issues, Case No. ER-2007-0004, pp. 5-6.

<sup>8</sup> Order Clarifying Report & Order, Case No. ER-2007-0004, p. 1 (May 22, 2007).

<sup>9</sup> See *In the Matter of Aquila's First Prudence Review*, Case No. EO-2009-0115 (**Staff Report**, filed Dec. 1, 2008) at 9.

natural gas hedging costs:<sup>10</sup>

The Company had a net loss through its natural gas hedging program of approximately \$7 million for the June 1, 2007 to May 31, 2008 time period of this audit. The program had losses through the months of June 2007 through March 2008 – the first 10 months of the audit year. In the last two months of the audit year, the company's hedging program produced a gain of approximately \$1.5 million.

The *Report* did not expressly refer to the cross-hedging of purchased power spot market price risk with financial instruments based on natural gas futures.

20. The second prudence review of GMO's FAC, Case No. EO-2010-0167, concerned accumulation periods 3 and 4, June 1, 2008, through May 31, 2009. Staff did not recommend any disallowance in the second prudence review. Staff's report included a section headed, "Financial Hedges of Natural Gas."<sup>11</sup> The *Report* went on to state with respect to natural gas hedging costs:<sup>12</sup>

The Company had a net gain, i.e., it was able to purchase natural gas at a price lower than the market price, through its natural gas hedging program of approximately **\*\* \$2 million \*\*** for the June 1, 2008 to May 31, 2009 time period of this audit. The program had a gain or increase of approximately **\*\* \$5 million \*\*** through the months of June 1, 2008 through December 31, 2008 – the first seven months of the prudence review period. In the last five months of the prudence review period, the company's hedging program produced a loss or decrease of approximately **\*\* \$3 million \*\***. Because the company's financial hedging program is used to avoid market fluctuations in natural gas prices, there will be times that GMO benefits and times that they do not. If it was found that GMO had been imprudent in its financial hedges and natural gas fuel purchases, ratepayer harm could result from an increase in fuel costs recovered through the FAC. The Company had a net loss through its natural gas hedging program of approximately \$7 million for the June 1, 2007 to May 31, 2008 time period of this audit. The program had losses through the months of June 2007 through March 2008 – the first 10 months of the audit year. In the last two months of the audit year, the

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<sup>10</sup> *Id.*

<sup>11</sup> See *In the Matter of KCP&L GMO's Second Prudence Review*, Case No. EO-2010-0167 (*Staff Report*, filed May 28, 2010) at 6.

<sup>12</sup> *Id.*, at 7.

company's hedging program produced a gain of approximately \$1.5 million.<sup>13</sup>

The *Report* did not expressly refer to the cross-hedging of purchased power spot market price risk with financial instruments based on natural gas futures.

21. This case is the third prudence review of GMO's FAC and concerns accumulation periods 5, 6 and 7, June 1, 2009, through November 30, 2010. Staff recommended the disallowance of \$18,755,865 reflecting GMO's use of natural gas hedges to mitigate risk associated with its future purchases in the spot power market.<sup>14</sup> Staff characterized that practice as imprudent.<sup>15</sup> Staff recommended that GMO be required to refund that amount, plus interest at the short term rate, to ratepayers through the FAC.<sup>16</sup> This is the first FAC prudence review in which Staff has specifically alleged that Aquila or GMO's cross-hedging activities related to the use of natural gas futures contracts to hedges spot purchased power costs were imprudent.<sup>17</sup>

22. In its *Position Statement* filed on May 25, 2012, Staff revised the amount of its proposed disallowance and refund recommendation. Staff stated: "GMO must refund \$14.9 million, with interest at its short-term borrowing rate, to ratepayers through its FAC mechanism."<sup>18</sup>

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<sup>13</sup> The numbers contained in this paragraph that were originally designated as highly confidential are no longer considered as confidential by the Company.

<sup>14</sup> See *In the Matter of KCP&L GMO's Third Prudence Review*, Case No. EO-2011-0390 (*Staff Report*, filed Nov. 28, 2011) at 2. Staff has since agreed that the figure in question is \$14.9 million.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> Deposition of Dana E. Eaves, p. 41.

<sup>18</sup> *Staff Position Statement*, p. 2 (filed on May 25, 2012).



23. There is no formalized market that allows GMO to buy electric futures contracts in the Southwest Power Pool region.<sup>19</sup>

24. In the ***Non-Unanimous Stipulation and Agreement*** in Aquila's 2005 rate case, Case No. ER-2005-0436, the Signatory Parties, including Aquila and Staff agreed to the following language for an Accounting Authority Order to Aquila in the Stipulation and Agreement:

Accounting Authority Order

17. The Signatory Parties agree, for accounting and ratemaking purposes, that hedge settlements, both positive and negative, and related costs (e.g. option premiums, interest on margin accounts, and carrying cost on option premiums) directly related to natural gas generation and on-peak purchased power transactions under a formal Aquila Networks-MPS hedging plan will be considered part of the fuel cost and purchased power costs recorded in FERC Account 547 or Account 555 when the hedge arrangement is settled. These hedging costs will continue to be recorded on a Mark-To-Market basis, as required by Financial Accounting Standard No. 133, with an offsetting regulatory asset FERC Account 182 .3 or regulatory liability FERC Account 254 entry that recognizes the change in the timing of value recognition under Financial Accounting Standard No. 71 . Aquila agrees there will be no rate base treatment afforded to hedging expenditures recorded on the Mark-To- Market basis. Aquila agrees to maintain separate accounting in Accounts 547 and 555 to track the hedging transaction expenditures recorded under this agreement.<sup>20</sup>

**WHEREFORE**, GMO, on behalf of itself, and the Staff submit their Joint Stipulation of Non-Disputed Material Facts for consideration by the Commission.

Respectfully submitted,

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<sup>19</sup> *Id.* at 52.

<sup>20</sup> Non-Unanimous Stipulation And Agreement, Case No. ER-2005-0436, p. 10 (filed January 31, 2006).

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### **CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 1st day of June, 2012.

/s/ James M. Fischer  
James M. Fischer