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**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO.: ER-2016-0285**

**REBUTTAL TESTIMONY**

**OF**

**WM. EDWARD BLUNK**

**ON BEHALF OF**

**KANSAS CITY POWER & LIGHT COMPANY**

**Kansas City, Missouri  
December 2016**

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**REBUTTAL TESTIMONY**

**OF**

**WM. EDWARD BLUNK**

**Case No. ER-2016-0285**

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

2 A: My name is Wm. Edward Blunk. My business address is 1200 Main Street, Kansas City,  
3 Missouri 64105.

4 **Q: Are you the same Wm. Edward Blunk who pre-filed Direct Testimony in this matter**  
5 **on behalf of Kansas City Power & Light Company (“KCP&L” or the “Company”)?**

6 A: Yes.

7 **Q: What is the purpose of your Rebuttal Testimony and who are the witnesses you will**  
8 **be responding to?**

9 A: My Rebuttal Testimony serves three purposes. First, my Rebuttal Testimony will  
10 respond to Mr. David C. Roos’ testimony dealing with hedging as embodied in the  
11 Missouri Public Service Commission Staff’s (“Staff”) Revenue Requirement Cost of  
12 Service Report (“Report”) and its recommendation regarding hedging. Second, my  
13 Rebuttal Testimony will dispel doubts that may have been sown by the Office of the  
14 Public Counsel (“OPC”) witness Mr. John S. Riley regarding KCP&L’s use of natural  
15 gas derivatives to cross-hedge electricity price risk. Finally, I respond to portions of OPC  
16 witness Ms. Lena M. Mantle’s testimony related to the Fuel Adjustment Clause (“FAC”).

1 **Q: Given that your Rebuttal Testimony addresses hedging and risk, do you have**  
2 **special experience and expertise with regard to hedging and risk?**

3 A: Yes. While I first became acquainted with hedging in high school, it was my studies in  
4 agricultural economics at the University of Missouri that truly introduced me to hedging  
5 with futures contracts. That was more than a decade before the NYMEX began trading  
6 natural gas futures. The first futures markets were developed to meet the needs of  
7 farmers and agricultural producers, so agriculture has used hedging and similar concepts  
8 probably longer than any other industry. I have been involved in hedging coal and coal  
9 prices for Kansas City Power & Light Company (“KCP&L”) since the early 1980s. I was  
10 instrumental in the design and implementation of KCP&L’s natural gas hedging program  
11 in 2001 and have been involved with its implementation and modifications since then.  
12 Following the acquisition of Aquila, Inc., now known as KCP&L Greater Missouri  
13 Operations Company (“GMO”) by KCP&L’s holding company, Great Plains Energy  
14 Incorporated (“GPE”), I have also been instrumental in the design and implementation of  
15 GMO’s hedging program. Finally, as I mentioned in my Direct Testimony, the Global  
16 Association of Risk Professionals has certified me as an Energy Risk Professional.

17 **Q: What is an Energy Risk Professional?**

18 A: Energy Risk Professional (“ERP”) is an international designation awarded by the Global  
19 Association of Risk Professionals to individuals who work in the oil, coal, natural gas and  
20 alternative energy industries. As a certification it is designed to measure and attest to a  
21 candidate’s knowledge of the major energy markets and gauge their ability to manage the  
22 physical and financial risks inherent in the complex world of energy.

1 **I. Response to Staff's Report**

2 **Q: What is Staff's position regarding KCP&L's hedging programs?**

3 A: Staff is recommending the Commission order for KCP&L some of the same terms GMO  
4 agreed to in a Non-Unanimous Stipulation and Agreement, filed on September 20, 2016,  
5 in Case No. ER-2016-0156 ("GMO Rate Case"). The essence of those terms is that the  
6 Company suspend all of its hedging activities (cross hedging and natural gas fuel  
7 hedging) associated with natural gas, and notify Staff and OPC should the Company  
8 decide to resume its natural gas hedging activities in the future.

9 **Q: Was that Stipulation and Agreement the result of finding imprudence regarding the**  
10 **Company's hedge practices?**

11 A: No. Neither KCP&L's nor GMO's practice of using natural gas derivatives to cross-  
12 hedge power prices has been found imprudent.<sup>1</sup> Likewise, neither KCP&L's nor  
13 GMO's practice of using natural gas derivatives to hedge expected purchases of natural  
14 gas as fuel for generating electricity has been found imprudent. The Company agreed to  
15 stop hedging as part of a larger settlement agreement.

16 **Q: What is the current status of the Company's hedging programs?**

17 A: When the parties negotiated the Non-Unanimous Stipulation and Agreement in the GMO  
18 Rate Case, the Company made it clear that if it was to stop hedging with natural gas  
19 derivatives for GMO, it would also stop for KCP&L. After the Order approving that  
20 Non-Unanimous Stipulation and Agreement became effective, the Company liquidated  
21 all of its open hedge positions for both GMO and KCP&L. Currently neither KCP&L

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<sup>1</sup> GMO's practice of using natural gas derivatives to cross-hedge power price risk was the subject of EO-2011-0390. At 49, the Report and Order states, "The substantial and competent evidence on the record as a whole supports the conclusion that GMO's hedging practices during the relevant review period were prudent."

1 nor GMO has any natural gas hedge positions. Given the Company's position to operate  
2 GMO and KCP&L similarly, Staff's recommendation is unnecessary.

## 3 **II. Response to OPC**

4 **Q: What is Mr. Riley's allegations regarding KCP&L's practice of using natural gas**  
5 **derivatives to cross-hedge power price risk?**

6 A: Mr. Riley alleges that given the implementation of Southwest Power Pool's ("SPP")  
7 Integrated Marketplace ("IM"), it is imprudent for KCP&L to continue using natural gas  
8 derivatives to cross-hedge power price risk.

9 **Q: As you understand it, what is the Commission's prudence standard?**

10 A: Although I am not a lawyer, I have reviewed the Commission's statements of the  
11 standard, such as on pages 74-77 of the Report and Order in KCP&L's rate case No. ER-  
12 2010-0356, and pages 13-14 of the Report and Order in KCP&L's rate case No. EO-  
13 2011-0390. The Commission stated that a utility's costs are presumed to be prudently  
14 incurred. That presumption, however, does not survive a showing of inefficiency or  
15 improvidence. The reasonableness of the company's conduct is based on information  
16 known or knowable at the time a decision was made, and is not based on hindsight. The  
17 Commission's responsibility is to determine how reasonable people would have  
18 performed the tasks that confronted the company. If a participant in a proceeding creates  
19 a serious doubt as to the prudence of an expenditure, then the utility has the burden of  
20 dispelling those doubts and proving the questioned expenditure was prudent.

21 In determining if a company's conduct was imprudent, the Commission looks at  
22 whether the utility's conduct was reasonable at the time, under all of the circumstances,  
23 considering that the company had to solve its problem prospectively. The fact that

1 external factors outside the company's control later produce an adverse result does not  
2 make a decision imprudent. Moreover, if costs are to be disallowed, there must also be a  
3 Commission finding of detrimental impact upon customers from the company's alleged  
4 imprudence.

5 **Q: Did OPC allege that KCP&L improperly administered its hedging program or that**  
6 **it was inefficient in its implementation of its hedge program?**

7 A: No.

8 **A. At The Time A Decision Was Made**

9 **Q: Focusing on the question of improvidence, how can you determine if a company's**  
10 **conduct was reasonable "at the time" a decision was made?**

11 A: The first thing to do is determine when was "at the time" and what were the relevant  
12 circumstances.

13 **Q: Why is it important to start with the relevant circumstances "at the time"?**

14 A: Julie Ryan and Julie Lieberman said it well in the February 2012 issue of *Public Utilities*  
15 *Fortnightly*.

16 While it's tempting to look at historical hedging based on current  
17 information and perfect hindsight, the regulatory standard for what is  
18 reasonable and prudent must consider the availability of information and  
19 what was known at the time hedging decisions were made.<sup>2</sup>

20 Implementing a hedge program is much like buying insurance and, as with buying  
21 insurance, there is a price to pay for someone else to be responsible for that risk. A hedge  
22 program is expected to have a net cost to consumers which makes it vulnerable to *ex post*  
23 regulatory review. After the fact second guessing would discourage future hedging.

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<sup>2</sup> "Hedging Under Scrutiny: Planning ahead in a low-cost gas market", Julie Ryan and Julie Lieberman, *Public Utilities Fortnightly*, February 2012, p. 12.

1 **Q: What “time” does OPC point to?**

2 A: At page 2, Mr. Riley says that “given the recent changes in KCPL’s regulatory  
3 environment, primarily the development of the Southwest Power Pool’s (“SPP”)  
4 Integrated Marketplace in 2014, it is imprudent for KCPL to continue what it refers to as  
5 cross-hedging.”

6 **Q: Did the implementation of SPP’s IM reduce power price volatility?**

7 A: No. Power price volatility increased quite substantially with the implementation of the  
8 IM.

9 **Q: How did you determine that the implementation of SPP’s IM increased power price  
10 volatility?**

11 A: The SPP Market Monitoring Unit (“MMU”) reported on page 17 of the Spring 2016 State  
12 of the Market Report:

13 Although overall **volatility is higher than experienced in the EIS**  
14 **market**, the relative patterns remain similar. The entities in the northern  
15 portion of the footprint tend to experience the lowest average prices while  
16 they typically see the most volatility in pricing. Some higher volatility in  
17 the Integrated Marketplace can be attributed to scarcity pricing.<sup>3</sup>  
18 [emphasis added]

19 I verified that statement with my own calculations. SPP’s MMU uses the coefficient of  
20 variation as a measure of volatility, so I conducted an analysis of the LMPs (locational  
21 marginal prices) for each of KCP&L’s coal-fired generators. I compared the coefficient  
22 of variations for real-time prices for the two-year period of December 16, 2014 through  
23 December 15, 2016, with real-time prices for the two years leading up to the March 1,  
24 2014 implementation of the IM. Using that measure, power price volatility at Hawthorn,

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<sup>3</sup> SPP Market Monitoring Unit, “State of the Market Report: Spring 2016 March-May 2016,” p. 17 (June 24, 2016). [https://www.spp.org/documents/39211/spp\\_qsom\\_2016spring.pdf](https://www.spp.org/documents/39211/spp_qsom_2016spring.pdf), accessed August 10, 2016. EIS refers to the Energy Imbalance Service market which preceded SPP’s Integrated Marketplace,



1 LaCygne and Montrose increased from about 50% before the IM to about 75% or more  
2 under the IM. At Iatan, it increased from 87% before the IM to 91% under the IM.

3 **Q: At page 8 of his direct testimony, Mr. Riley states, “the SPP has so many input**  
4 **options that it acts as a buffer to the possibility of a spike in power prices. In this**  
5 **way it is a hedging mechanism in itself.” Is SPP a hedging mechanism in itself?**

6 A: No, SPP is not a hedging mechanism. The SPP Integrated Marketplace was designed to  
7 optimize the total cost of power for the market participants. One of the ways it does that  
8 is by reducing the volume of unnecessary or slack resources online at any time. Those  
9 slack resources had a side benefit of being price shock absorbers. Consequently, the  
10 efficiencies resulting from SPP’s optimization have actually reduced the volume of price  
11 shock absorbers online at any time. I would expect that optimization to result in lower  
12 total cost but at the price of greater volatility.

13 **B. Under All Of The Circumstances**

14 **Q: Another aspect of the prudence standard is “under all of the circumstances.” In**  
15 **other words, did KCP&L’s hedging practices adjust to changes in market**  
16 **conditions?**

17 A: Yes. KCP&L employed two different programs that used natural gas derivatives to  
18 hedge market price risk, one for natural gas that was expected to be used as fuel and the  
19 other as cross-hedges for power transactions. Exactly how those programs adjusted  
20 varied by program. Most of KCP&L’s risk was for power transactions. That program  
21 was guided by a team that monitored power and fuel markets. That team met regularly to  
22 discuss market developments and changing operational considerations occurring since the  
23 last meeting. It then made tactical decisions to manage the hedge portfolio.

1 **Q: Do other Missouri utilities hedge power price risk?**

2 A: Yes. Ameren Missouri uses derivatives to manage risk of changes in market prices for  
3 natural gas and power.<sup>4</sup> Empire District Electric also hedges a portion of its power price  
4 risk.<sup>5</sup> Prior to the Non-Unanimous Stipulation and Agreement in the GMO Rate Case,  
5 GMO hedged market price risk for power purchases. In other words, all four of  
6 Missouri's electric utilities hedge or have hedged some portion of their power price risk.  
7 Both KCP&L and GMO have used natural gas derivatives to cross-hedge power price  
8 risk, so at least half of the electric utilities in Missouri have cross-hedged power price  
9 risk.

10 **Q: Do other utilities hedge power price risk?**

11 A: Yes. I recently reviewed the 2015 annual reports of the investor-owned members of SPP  
12 regarding their hedging activities. Of the nine investor-owned members of SPP<sup>6</sup>, six  
13 discuss hedging power price risk and another two discuss using derivatives to hedge a  
14 component of power price risk. It is clear, therefore, that the vast majority of investor-  
15 owned SPP members hedge power price risk.

16 **Q: Do other utilities cross-hedge power price risk?**

17 A: Yes. Cross-hedging power price risk with natural gas is a relatively common practice.  
18 For example, in 2014 Dynegy reported that it used natural gas swaps as "cross-  
19 commodity correlated hedge for our power revenue."<sup>7</sup> In a letter to David Stawick,

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<sup>4</sup> Ameren Corp., 2015 Annual Report, Dec. 31, 2015, p. 66, from <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NjE0MTA3fENoaWxkSUQ9MzI4MTMyfFR5cGU9MQ==&t=1>, accessed Aug. 10, 2016.

<sup>5</sup> The Empire District Electric Co., 2015 Annual Report, Dec. 31, 2015, p. 54, from <https://www.snl.com/IRWebLinkX/file.aspx?iid=3005475&fid=33503526&osid=9&o=3>, accessed Aug. 10, 2016.

<sup>6</sup>All companies and subsidiaries reported in one annual report were considered part of one company.

<sup>7</sup> Dynegy Inc., 2014 Annual Report, p. 85, from [http://www.dynegy.com/sites/default/files/Dynegy\\_2014\\_Annual\\_Report.pdf](http://www.dynegy.com/sites/default/files/Dynegy_2014_Annual_Report.pdf), accessed Aug. 10, 2016.

1 Secretary of the Commodity Futures Trading Commission, from the electric trade  
2 associations of the Edison Electric Institute, Electric Power Supply Association, National  
3 Rural Electric Cooperative Association, Large Public Power Council, and American  
4 Public Power Association stated:

5 It is not uncommon for load-serving energy companies to hedge multiple  
6 commodity risks, such as an electric utility hedging the commercial risks  
7 of its input (natural gas as fuel) and output (electric generation/deliverable  
8 electric energy). **Cross-commodity hedging is also commonplace.**<sup>8</sup>  
9 **[emphasis added]**

10 **C. Had To Solve Problem Prospectively**

11 **Q: How did KCP&L’s hedging practices aid the Company in solving the problem of**  
12 **price volatility prospectively when market prices were driven by external factors**  
13 **outside the Company’s control?**

14 **A:** KCP&L’s hedge strategy was market sensitive. As I discussed earlier, the hedge  
15 program was guided by current market trends and pricing environment.

16 **D. No Detrimental Impact**

17 **Q: In your response to the question about the Commission’s Prudence Standard you**  
18 **referred to the Commission evaluating whether there was harm to customers from**  
19 **the Company’s actions. In the case at hand, was there any harm caused by**  
20 **KCP&L using natural gas futures contracts to hedge the price of electricity?**

21 **A:** No. When both sides of the hedge transaction are considered—the physical market and  
22 the futures market—and the fact that KCP&L had to solve its problem prospectively,

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<sup>8</sup> The “Electric Trade Associations” letter to David Stawick regarding Comments on Joint Proposed Rules and Proposed Interpretations on Further Definition of “Swap,” “Security-Based Swap,” “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (17 CFR Part 1) RIN No. 3038-AD46. July 22, 2011, pp. 34-35, accessed Aug. 10, 2016, <https://www.publicpower.org/files/PDFs/CFTCDefinitionSwapCommentLetter07222011.pdf>.

1 there is no detrimental impact of the Company's cross-hedging activities on customers.  
2 So-called hedge costs are offset by gains on the physical market side of the hedge. As a  
3 result, there is no detrimental impact of using natural gas futures contracts to hedge the  
4 price of electricity. It would be incorrect to consider only one side of hedge transactions  
5 in evaluating its prudence.

6 **Q: What do you mean by considering "both sides of the hedge transaction"?**

7 A: Hedging is a risk management strategy that transfers risk without buying insurance. It  
8 employs various techniques but, basically, involves taking equal and opposite positions in  
9 two different markets as offsets to one another. The Energy Information Administration  
10 defines hedging as:

11 Taking a position in a futures market opposite to a position held in the  
12 cash market to minimize the risk of financial loss from an adverse price  
13 change; a purchase or sale of futures as a temporary substitute for a cash  
14 transaction that will occur later.<sup>9</sup>

15 In other words, there are two parts to a hedge. The gain or loss in one market offsets the  
16 loss or gain in another market. To look at the gain or loss in only one of those markets  
17 misrepresents the true effect of the hedge.

18 **Q: What are futures contracts?**

19 A: A futures contract is a standardized forward contract. That is, it is an agreement for one  
20 party to sell and another to buy a specified quantity and quality of a particular asset or  
21 commodity at a specified price with delivery at a specified location and time in the future.  
22 With all terms except price being standardized, futures contracts are easy to trade.  
23 Typically futures contracts are traded at an exchange like the New York Mercantile

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<sup>9</sup> Energy Information Administration, *Derivatives and Risk Management in the Petroleum, Natural Gas, and Electricity Industries*, October 2002, p. 84, available at: [http://www.eia.gov/oiaf/servicrpt/derivative/pdf/srsmg\(2002\)01.pdf](http://www.eia.gov/oiaf/servicrpt/derivative/pdf/srsmg(2002)01.pdf), accessed Aug. 10, 2016.

1 Exchange (“NYMEX”) and do not result in actual delivery but are traded out or  
2 converted to a different form of contract prior to delivery. That gain or loss from buying  
3 and selling the futures contract is then recorded in the Company’s books. As a hedger,  
4 that gain or loss from buying and selling futures contracts is used to offset the opposite  
5 position in the cash market where we do take or make delivery.

6 **Q: Is there a difference between forward contracts and futures contracts?**

7 A: Yes. While both effectively lock in prices and shield one from price movement, using  
8 futures contracts creates separate accounting events. The gain or loss from buying and  
9 selling futures contracts that is used to offset the physical market price movement is  
10 recorded in the Company’s books because there was a purchase and a sale of the futures  
11 contract. Mark-to-market accounting aside, the physical market price movement is not  
12 recorded in the Company’s books because there is not both a purchase and sale which  
13 would result in a gain or loss but only the ultimate purchase or sale.

14 **Q: If you could effectively get the same price for power or natural gas using futures**  
15 **contracts as forward contracts, why do you use natural gas futures contracts and**  
16 **options to cross-hedge electricity price risk?**

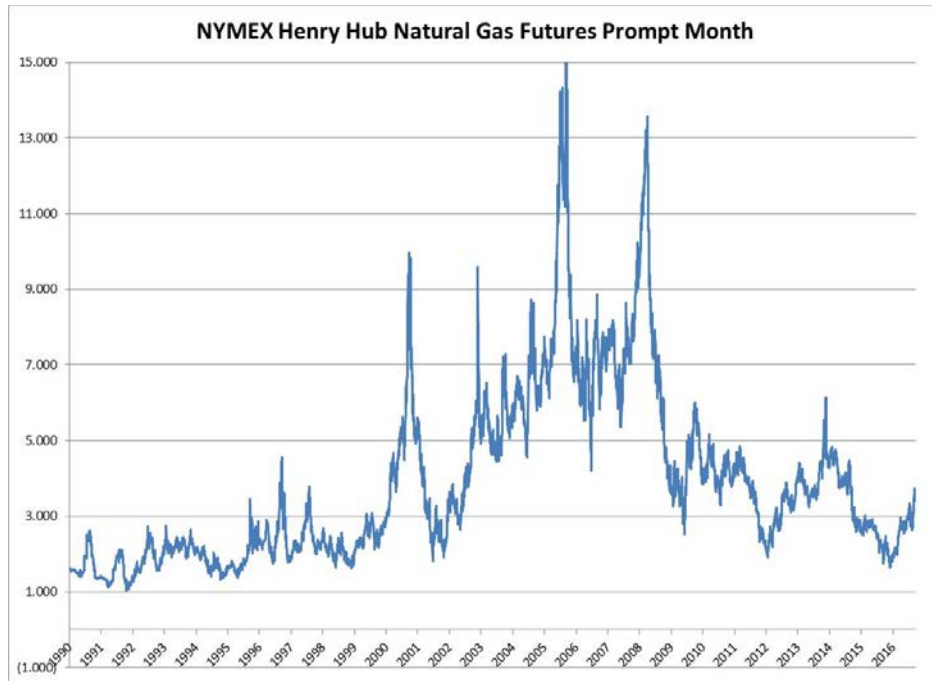
17 A: Perhaps the three most significant benefits of using NYMEX natural gas futures contracts  
18 and options to hedge electricity price risk are:

19 1) Liquidity – the NYMEX natural gas market is very liquid. That is NYMEX  
20 natural gas contracts can easily be bought or sold quickly. There are large numbers of  
21 buyers and sellers ready and willing to trade at any time during market hours. Because of  
22 high trading volumes, there tend to be low spreads between asking and selling prices  
23 which results in little to no premium when entering or exiting a position.



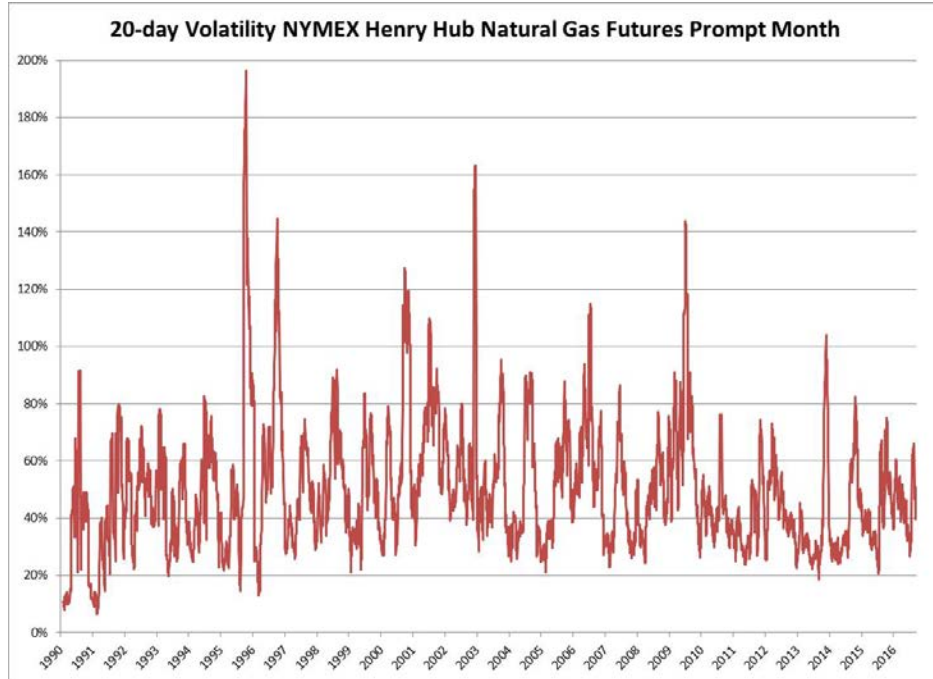
1 shows that while natural gas prices are lower than they were from 2003 through 2008,  
2 they are still higher than they were before 2002. Figure 2 shows that price volatility still  
3 ranges from 20 to 80%. For November 2016 alone, the 20-day volatility averaged a little  
4 more than 60%.

5 Figure 1



6

1            Figure 2



2    **Q:    Given that the natural gas market is still volatile and KCP&L’s hedging program is**  
3            **prudent, why is the Company agreeing to stop hedging?**

4    A:    There are two key reasons why the Company is agreeing to stop hedging. First, with the  
5            FAC, hedging is for the benefit of the customer. Staff and OPC representing the  
6            customer have asked us to stop. Second, the Company’s FAC mechanism mitigates  
7            market volatility for the customer by first accumulating costs over six months and then  
8            recovering those costs over the next 12 months. In effect, the Company’s FAC averages  
9            the price of fuel and power over a 12 to 18-month period. Our hedge program in effect  
10            averages the price of fuel and power over about a 9 to 20-month period. In other words,  
11            the FAC mechanism mitigates rate volatility similar to a hedge program.



1 IV. FAC

2 Q: Starting at page 16 of her Direct Testimony, OPC Witness Lena Mantle purports to  
3 advise the Commission on how to avoid disincentives for efficiencies in fuel. Will  
4 Ms. Mantle's recommendations limit disincentives for implementing fuel related  
5 efficiencies?

6 A: No. Ms. Mantle uses an example that is wrong or in error on multiple points. Even with  
7 those errors, if we use her example and follow it to the next step, it is clear that her  
8 proposal could actually result in higher costs to the customer.

9 Q: How is Ms. Mantle's example wrong?

10 A: Her first error deals with the chemistry and operation of controlling mercury emissions  
11 from coal combustion. As explained in my response to her Data Request No. 8013, trona  
12 is an alkaline sorbent that is used to improve the performance of powder activated carbon  
13 ("PAC") for increased mercury control. Ms. Mantle's scenario assumes that "various  
14 products can be used in the Air Quality Control Systems" and PAC and trona can be  
15 exchanged one for the other. Trona can be used to enhance the performance of PAC but  
16 it is not used in place of PAC.

17 Her second error deals with the terms of the FAC tariff. Regarding fuel additives  
18 for air quality control systems, the Company's proposed FAC tariff at page 3 says

19 Subaccount 501300: fuel additives and consumable costs for Air Quality Control  
20 Systems ("AQCS") operations, such as ammonia, hydrated lime, lime, limestone,  
21 powder activated carbon, sodium bicarbonate, trona, sulfur, and RESPond, **or**  
22 **other consumables which perform similar functions;** [emphasis added]  
23

24 Our existing tariff also says "or other consumables which perform similar functions."

25 We used this terminology in our FAC tariff because additives and consumables for the

1 AQCS are essential components of the complex interrelated fuel choice decisions for our  
2 units. Because both our existing and proposed tariffs allow us to use “other consumables  
3 which perform similar functions” we do not have the disincentive described by Ms.  
4 Mantle.

5 **Q: Are there other issues with Ms. Mantle’s recommendation?**

6 A: Ms. Mantle is proposing to ignore the complex trade-offs in fuel and “cherry pick” which  
7 various interrelated costs are included in the FAC and which are not. That micro-  
8 management scheme could result in higher costs to our customers.

9 **Q: How could Ms. Mantle’s recommendations to micro-manage the Company’s**  
10 **operations result in higher costs to the customers?**

11 A: Let’s for the sake of an example temporarily ignore Ms. Mantle’s errors that I discussed  
12 earlier and use her example regarding PAC and trona but simply take it to the next logical  
13 step. Ms. Mantle presents a hypothetical scenario where either PAC or trona could be  
14 used in the AQCS for essentially the same purpose. She recommends that both PAC and  
15 trona be moved from the FAC to the revenue requirement to incent the utility to use the  
16 least cost product. What Ms. Mantle fails to recognize is by using the FAC to micro-  
17 manage the utility into saving \$20, she is actually incenting the Company to increase  
18 customer costs by more than the amount of the purported savings.

19 Given the very clear incentive to minimize all costs retained in fixed rates, if the  
20 utility were to follow Ms. Mantle’s incentive to the next logical step, it could avoid using  
21 PAC or trona by using a more expensive fuel such as natural gas or purchasing higher  
22 priced power neither of which require additives such as PAC to control for mercury  
23 emitted from coal combustion. The net result of following Ms. Mantle’s apparent

1 recommendation regarding fuel additives and plant operations would be higher costs for  
2 customers. Micro-management edicts designed to maximize regulatory lag and prevent  
3 various components of prudent fuel and power costs from being reviewed in a timely  
4 fashion will likely cost customers more than they save through regulatory loss. That is  
5 why I recommend the Commission recognize there are ever changing complex trade-offs  
6 in fuel, power, transportation, and transmission and the Company is in a much better  
7 position to make those day-to-day decisions than parties not actively engaged in either  
8 the market or energy operations.

9 **Q: Has Ms. Mantle claimed that any of these costs are imprudent or unnecessary?**

10 A: No. She is merely proposing the Commission use the FAC and the rate-making process  
11 to micro-manage how the Company runs its plants and provides service to its customers.  
12 All of the costs that flow through the FAC are audited at least every eighteen months.  
13 Moreover, the Company reports in great detail all of the costs that are accumulated every  
14 six months. If there is any concern about the prudence of an expenditure, the FAC's  
15 reporting requirements provide Staff with ample opportunity to review and audit such  
16 cost. Ms. Mantle's recommendation fails to recognize the complex trade-offs that  
17 KCP&L faces as it tries to minimize the cost of providing electricity to its customers.

18 When considering the need for an FAC, the Commission considers whether prices  
19 are volatile. In other words, the Commission recognizes that prices sometimes go up and  
20 sometimes go down. If one has the flexibility to manage all of the components of the  
21 complex trade-offs between fuel, power, transportation, transmission and their various  
22 components, those price movements afford opportunities to lower total cost. OPC's  
23 micro-managed FAC limits that flexibility and thereby limits the opportunity to take

1 advantage of market volatility and associated complex trade-offs. Ms. Mantle's  
2 approach of putting the Commission in the position of trying to guess as much as four  
3 years in advance which combination of interrelated costs that trade-off against one  
4 another will be prudent or imprudent does not seem consistent with the need to consider  
5 whether the utility's conduct was reasonable at the time, under all of the circumstances,  
6 based on information known or knowable at the time the decision was made.

7 **V. Recommendations**

8 **Q: Do you have any recommendations for the Commission regarding the FAC?**

9 A: Yes. As my analyses and that of the SPP MMU discussed above shows, recognize there  
10 is volatility in power and fuel markets which justify the FAC.

11 **Q: Do you have any recommendations for the Commission regarding hedging?**

12 A: Yes. Given, the Company made it clear when negotiating the GMO Rate Case  
13 Stipulation and Agreement that if it was to stop hedging with natural gas derivatives for  
14 GMO, it would also stop for KCP&L and the Commission approved that agreement, I do  
15 not believe Staff's recommendation for KCP&L to stop using natural gas derivatives to  
16 hedge natural gas and power is necessary but, I will yield to it.

17 **Q: Do you have any recommendations for the Commission regarding Ms. Mantle's**  
18 **testimony on the FAC?**

19 A: Yes. It should recognize there are complex trade-offs in fuel, power, transportation,  
20 transmission, and their various components. Trying to "cherry-pick" pieces out of that  
21 complex interrelated conglomeration of trade-offs will create disincentives for total cost  
22 minimization. The Company is in the better position to make those day-to-day decisions.  
23 Attempting to incent the Company through micro-management edicts advocated every

1            few years by parties without fuel, power, transportation, or transmission market and  
2            operational experience will likely have unintended results. Therefore, I recommend the  
3            Commission give the Company the latitude to make those complex interrelated trade-offs  
4            recognizing that the words fuel, purchased power, and transportation from Section  
5            386.266.1 RSMo are defined more broadly than OPC's limitations. Through the existing  
6            reporting and audit requirements, Staff will have ample opportunity to review and  
7            challenge any cost charged to the FAC.

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

9    **A:    Yes.**

