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Witness: Tim M. Rush
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: HC-2012-0259

REBUTTAL TESTIMONY

OF

TIM M. RUSH

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City, Missouri
July 2012

"[redacted]**" Designates "Highly Confidential" Information Has Been Removed Pursuant To 4 CSR 240-2.135.**

REBUTTAL TESTIMONY

OF

TIM M. RUSH

Case No. HC-2012-0259

Q: Please state your name and business address.

A: My name is Tim M. Rush. My business address is 1200 Main Street, Kansas City, Missouri 64105.

Q: By whom and in what capacity are you employed?

A: I am employed by Kansas City Power & Light Company ("KCP&L") as Director, Regulatory Affairs.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of KCP&L Greater Missouri Operations Company ("GMO" or the "Company").

Q: What are your responsibilities?

A: My general responsibilities include overseeing the preparation of the rate case, class cost of service, and rate design for both KCP&L and GMO. I am also responsible for overseeing the regulatory reporting and general activities as they relate to the Missouri Public Service Commission ("Commission").

Q: Please describe your education, experience and employment history.

A: I received a Master of Business Administration degree from Northwest Missouri State University in Maryville, Missouri. I did my undergraduate study at both the University of Kansas in Lawrence, Kansas and the University of Missouri in Columbia, Missouri. I

received a Bachelor of Science degree in Business Administration with a concentration in Accounting from the University of Missouri in Columbia.

Q: Please provide your work experience.

A: I was hired by KCP&L in 2001 as the Director, Regulatory Affairs. Prior to my employment with KCP&L, I was employed by St. Joseph Light & Power Company ("Light & Power") for over 24 years. At Light & Power, I was Manager of Customer Operations from 1996 to 2001, where I had responsibility for the regulatory area, as well as marketing, energy consultant and customer services area. Customer services included the call center and collections areas. Prior to that, I held various positions in the Rates and Market Research Department from 1977 until 1996. I was the manager of that department for fifteen years.

Q: Have you previously testified in a proceeding before the Commission or before any other utility regulatory agency?

A: I have testified on several occasions before the Commission on a variety of issues affecting regulated public utilities. I have additionally testified at the Federal Energy Regulatory Commission and the Kansas Corporation Commission.

I. OVERVIEW

Q: What is the purpose of your testimony in this case?

A: This is the second complaint raised by Ag Processing Inc. ("AGP") pertaining to the Company's hedging program for steam customers. AGP's first steam hedging complaint, Case No. HC-2010-0235, concerned the hedge costs from 2006 and 2007. The current case complains of hedge costs from 2009. However, AGP's witness Donald E. Johnstone presents no evidence in his Direct Testimony filed on June 1, 2012 about the period in

question in the current case, *i.e.* 2009. All of the information Mr. Johnstone presents pertains to the 2006 period, regarding which the Commission has already issued its Report and Order in HC-2010-0235. In that Report and Order, the Commission did not find fault with the design or implementation of the hedging program, but found that the Company relied on its customers for determining their steam needs and that such reliance led to the 2006 and 2007 steam hedge costs that the Commission disallowed. Furthermore, Mr. Johnstone relies heavily on the year 2006 for his position that the hedging program's implementation and design were imprudent. The Commission concluded in HC-2010-0235 that the implementation and design of the hedging program was prudent; it was the administration of the hedging program that caused the Commission to issue its finding of a refund.

My testimony addresses the merits of the complaint filed by AGP and puts it into its proper context, given the long and complex relationship that the Company has had with AGP at the Lake Road Generating Station in St. Joseph ("Lake Road Plant"). Such proper context requires that I give an overview of the operations of the Lake Road Plant and an explanation of the Company's longstanding efforts to provide AGP and the other Lake Road Plant steam customers with highly reliable steam service, given their operational needs and their lack of alternative steam resources. I also address the Company's rate case and Quarterly Cost Adjustment ("QCA") history as they pertain to AGP's Complaint. Finally, I address the Direct Testimony of AGP's witness Mr. Johnstone and his statement that GMO was imprudent and the hedge costs are the direct result of the imprudence.

Q: What is the basis of the complaint filed by AGP as you understand it?

A: The complaint alleges that GMO's use of a natural gas hedging program to mitigate price volatility for its Lake Road Plant steam operations resulted in imprudent costs in 2009, a portion of which was charged to customers during the QCA periods applicable to that year. The QCA was established pursuant to the 2005 Nonunanimous Stipulation and Agreement ("Stipulation") that settled Aquila's 2005 steam rate case, Case No. HR-2005-0450 ("2005 Steam Rate Case"). In the instant case, AGP seeks an order from the Commission requiring GMO to refund $1,224,510, with interest, by check to the steam customers in proportion to the amounts of such hedging cost paid by each customer.

Q: What are the specific allegations of AGP?

A: Mr. Johnstone set forth allegations of imprudence in his Direct Testimony on pages 3 and 4. They include his view that:

1) The QCA was sufficient to mitigate the effects of fuel cost volatility without a hedging program;
2) GMO's customers were not consulted with regard to the hedging program;
3) The hedging program's design was adopted without consideration of the uncertain nature of its natural gas usage as a "swing fuel" in its steam operations;
4) GMO's previous presentations have conflated the cooperation of customers in their provision of expected steam usage with its own forecasts of steam load;
5) Because of the design of the hedging program and because of the forecast of natural gas usage requirements, the hedge program created volatility in fuel costs;
6) The hedging program in some months was so extreme as to move prices up sharply in a down market;

7) GMO sold puts for profit;

8) When GMO began its hedging program on February 16, 2006, its forecast natural gas usage requirements were immediately out of kilter with reality;

9) GMO stopped the hedge program in 2007, but allowed the existing hedge positions to run their course; and,

10) GMO states that it could have cashed out of the troubled program in the spring of 2008 with roughly a $2,000,000 surplus.

Q: How does the Company respond to these opinions?

A: Former Aquila employee Gary Clemens explains in his direct testimony that the hedging program was an original part of the QCA mechanism, was discussed with AGP, and was presented to the Commission at an on-the-record presentation in the 2005 Steam Rate Case at which both Mr. Johnstone and Stuart W. Conrad, counsel for AGP, were present. Mr. Clemens rebuts Mr. Johnstone's statements that the natural gas hedging program was implemented without any customer input, testifying that he was personally present with AGP representatives when they talked about the hedge program. Mr. Clemens also testifies that the hedging program was something that AGP specifically wanted, that AGP wanted the hedging program that Aquila was currently using in its electric business, and that AGP agreed to include the hedging costs in the QCA.

KPC&L employee Joseph G. Fangman, who worked for Aquila and its predecessors, explains how budgets were developed and updated through close cooperation with the Lake Road Plant steam customers. He describes his regular communications with customers regarding their need for industrial steam and the Company's efforts to provide them with reliable service.

KPC&L employee Timothy M. Nelson, who worked for Aquila and its predecessors, explains how forecasts and budgets were developed and updated through close cooperation with the Lake Road Plant steam customers. Mr. Nelson developed the forecasts and budgets in close cooperation with Mr. Fangman, who regularly communicated with steam customers regarding their anticipated needs. Mr. Nelson further explains the impact of natural gas as the incremental fuel at the Lake Road Plant, and explains that AGP is the swing load.

KCP&L employee Gary L. Gottsch, also a former Aquila employee, describes the design and administration of the natural gas hedging program for the Lake Road Plant's steam operations. He also rebuts Mr. Johnstone's allegations regarding the hedging program and explains why the actions taken were not only prudent, but completely consistent with a typical hedging program.

KCP&L employee Wm. Edward Blunk explains the purpose of hedging programs in general, and the specific circumstances that occurred in 2009 regarding natural gas markets. He also refutes Mr. Johnstone's opinions and states why the hedging program adopted by Aquila for the steam business in St. Joseph was both reasonable and prudent.

Q: Do you agree with AGP's allegation that the Company's hedging program was imprudent?

A: No. It is the purpose of my testimony and the testimony of the Company witnesses noted above to explain why the allegations presented by AGP are unsubstantiated and not based on fact. AGP fails to set forth any provision of a tariff, rule, or decision of the Commission that GMO has allegedly violated. The Company further believes that AGP's claims should be denied under the terms of GMO's tariff, as any prudence review

should have been completed no later than 225 days after the end of each QCA year, pursuant to the specific terms of Paragraph 7, Original Sheet No. 6.4 of GMO's steam tariffs. This section states: "Such full prudence review, if pursued, shall be completed no later than 225 days after the end of each year." In the present case, AGP waited until January 29, 2012, nearly 760 days after the end of the 2009 QCA period to file this complaint.

While customers are not required to wait for a prudence review of the Staff of the Missouri Public Service Commission ("Staff") to bring a complaint under the QCA tariff provisions, I believe that the lack of a Staff prudence review does not relieve a customer like AGP from initiating its complaint in a timely manner so that the Commission can complete the prudence inquiry within the 225 days required by the QCA tariff.

II. LAKE ROAD PLANT OPERATIONS

Q: How many customers does the Lake Road Plant serve today?

A: Today there are five customers at the Lake Road Plant: AGP; Triumph Foods, LLC; Albaugh Chemical; Nestlé/Purina PetCare, and Land O' Lakes, Omnium Division, a chemical company.

Q: When did steam operations begin at the Lake Road Plant?

A: The industrial steam business began in the 1930s. Originally, the Lake Road Plant only produced industrial steam, serving the animal packing industry in the south side of St. Joseph. Later, electric generators were installed and the plant provided both electricity and industrial steam from the same operations. As the packing industry declined, with the last pork processing plant moving out in the 1980s, the customer base changed. In the early 1980s AGP became a new steam customer, taking over one of the Farmland

Industries plants, previously known as FAR-MAR-CO. Since that time, AGP has expanded its facilities at the site. An 850-PSI (pounds per square inch) line was added to the Lake Road Plant's boiler system so that AGP is able to receive both 150 PSI steam and 850 PSI steam to support its operations. The other four customers receive 150 PSI steam. Currently, AGP is the largest steam customer for GMO.

Triumph Foods, which joins AGP in this complaint and has adopted the testimony of Mr. Johnstone, is a large pork processing plant and the system's newest industrial steam customer. It began full-scale operations in January 2006 and is now St. Joseph's largest employer.

Q: What are the current operations of the Lake Road Plant?

A: Today the Lake Road Plant generates electricity for the grid and supplies steam for its five industrial steam customers. For these customers, the plant maintains redundant steam generating capabilities because the existing customers rely so heavily on the steam supplied by the plant. Because steam supply reliability is critical to these customers, the Company strives to maintain 99.9% reliability.

Q: Is reliability critical to steam customers?

A: Reliability is one of the most critical factors for the steam customers. Based upon my interaction with steam customers, I understand that if the steam service is interrupted for any reason, even for a moment, it can cause significant problems for their operations, both in time and production costs. We are in regular contact with the operations personnel at AGP, addressing its reliability needs. Beyond the normal day-to-day contact with AGP, the Company and AGP meet semi-annually with operations, maintenance, and

administrative personnel to address reliability and other issues and concerns. Reliability is critical to AGP, Triumph Foods, and the other steam customers at the Lake Road Plant.

Q: How does the Company achieve the level of service it provides?

A: The portion of the Lake Road Plant that supplies steam is a common-header system, referred to as the "low side" or the "900-PSI Plant." The 900-PSI Plant consists of six boilers, three steam turbine generators, the industrial steam distribution system, and related equipment as listed below.

Table 1.

Boiler No.	Year Installed	Capacity (lb/hr)	Steam Pressure (psig)	Steam Temp. (°F)	Fuel	Status
1	1961	85,000	900	900	Natural Gas; No. 2 Oil	Standby
2	1961	85,000	900	900	Natural Gas; No. 2 Oil	Standby
3	1938	140,000	750	900	Natural Gas	Standby
4	1950	200,000	900	900	Natural Gas; No. 2 Oil	Backup to 5 & 8
5	1957	250,000	900	900	Pulverized Coal; Natural Gas	Base Load
8	2006	250,000	750	750	Natural Gas; No. 2 Oil	Base Load

In addition to providing industrial steam to the five customers, the 900-PSI Plant can provide up to 60 MW of peaking electric capacity via the three steam turbine generators. Since all three turbines are powered by the boilers that produce steam for sale to the industrial steam customers, any increase in steam sales to steam customers reduces the amount of steam available to generate electricity.

Q: Has the Company continued to invest in the industrial steam business?

A: Yes. As a result of the growth in customer demand for steam, in 2006 the Company installed Boiler No. 8 to serve the steam load at a cost of over $7.3 million. In 2009, the Company invested nearly $6 million in Boiler No. 5, which included over $2 million in new controls and related equipment to help maintain and improve the boiler's performance. The Company continues to invest in the steam operations at the Lake Road Plant.

Q: Please explain fuel procurement at the Lake Road Plant as it relates to steam operations.

A: The Lake Road plant utilizes coal as its least expensive and primary fuel, serving both the 1800 lb. Boiler 6 and the 900 lb. Boiler 5. Natural gas is the next least expensive fuel source, and No. 2 fuel oil is the most expensive fuel source. Natural gas can be utilized in all of the Boilers. The coal purchases are primarily under fixed price contracts supplemented with some spot purchases. While natural gas can be used for either steam or electric operations, the needs of each operation are quite different. The electric operations do not depend on natural gas as a primary fuel. This is due to the economics of coal from the overall coal fleet at GMO and the current ability to purchase spot energy at lower costs than operating the Lake Road Plant using natural gas as a fuel source. On the other hand, natural gas is necessary to meet the steam customer's demands on a continual basis. The Company could not meet its steam customers' needs without natural gas.

Q: How does the procurement of natural gas and the hedging of natural gas for steam relate to coal supply issues at Lake Road?

A: Annually, coal usage for the steam provides about 70% of the steam customer energy needs on an MMBtu basis, while natural gas provides the remaining 30%. Number 2 Oil is negligible. However, the price of coal has ranged from 20% of the cost of natural gas in 2006 to 54% in 2009. While coal has increased nearly 29% in those four years, natural gas has decreased 53%. Coal is still much cheaper than natural gas. While natural gas has recently declined in price, natural gas historically has experienced much greater price volatility. The natural gas volatility can be seen in the testimony of Mr. Blunk at Schedule WEB-13, as well as in Table 2 below. It is because of this dramatic volatility that the hedge program was initiated.

Table 2.

	April - December 2006	Annual 2007	Annual 2008	Annual 2009
Coal $	$ 2,726,465	$ 3,794,605	$ 3,672,423	$ 4,832,541
Gas $	$ 4,773,566	$ 9,043,917	$ 9,214,702	$ 4,648,408
Oil $	$ -	$ 54,684	$ 52,201	$ 2,288
Coal mmBtu	1,463,038	2,032,663	1,778,687	2,013,074
Gas mmBtu	508,194	970,293	1,435,632	1,051,497
Oil mmBtu	-	7,648	3,641	157
Coal $/mmBtu	$ 1.8636	$ 1.8668	$ 2.0647	$ 2.4006
Gas $/mmBtu	$ 9.3932	$ 9.3208	$ 6.4186	$ 4.4208
Oil $/mmBtu	$ -	$ 7.1501	$ 14.3371	$ 14.5716

Q: How does the Lake Road Plant serve its current steam customers?

A: The Lake Road Plant is the sole source of steam for the five industrial steam customers. None of these customers has back-up boilers or an alternative energy supply for their operations. Therefore, the continuous reliability of the 900-PSI Plant, described above in

Table 1, is critical since steam is required for the proper functioning of each customer's business.

Table 3 below sets forth the 2009 steam sales for each customer. There are a total of eight customer metering points, with the meters located on or close to the customers' property lines. Steam pressure is reduced to maintain a nominal pressure of 850 PSI and 150 PSI, respectively, at the metering points.

Table 3 (HC).**

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Customer demand and, accordingly, the Company's steam sales have grown significantly since 2005 with the addition of Triumph Foods and the expansion of the plant facilities of AGP, Albaugh, and Nestlé. Based on the projections provided by customers in 2005, steam load was expected to grow considerably in fewer than two years. Consequently, the Company quickly added Boiler No. 8 to the Lake Road Plant because the existing equipment would not have been able to reliably meet the forecasted increase in steam load while maintaining its required capacity for electric generation. As I noted above,

reliability is critical to the steam customers because of their lack of a back-up steam supply system. When the Company became aware that the steam load was going to increase based on what it learned from customers, the Company quickly responded. Mr. Fangman describes this further in his Rebuttal Testimony. See Fangman Rebuttal at 4-8.

Q: How does the Company address the changing plans of customers in order to meet their steam requirements?

A: The Company has a robust planning process that it has utilized for years. The Company has a Key Account representative who has regular contact with the customers to address both customer needs and Company needs. Through this process, the Company representative gathers information and data relating to the plans for changes in customer usage. This goes into the budget and forecasting process that is a primary driver in the overall planning process of the Company. Periodic updates and revisions are incorporated into the plan as new information becomes available from customers.

Q: Was one of AGP's complaints in this case that the Company relied on information from customers in putting together its forecasts and that the forecasts were inaccurate?

A: Yes, AGP made that claim.

Q: Do you believe that the claim is valid?

A: No. The Company's Key Account representative spends a great deal of time with the customers in order to gain an understanding of their needs. If customers advise of an anticipated significant increase in their steam load and the Company does not meet it, all steam customers could suffer because the Company did not operate a reliable system to

meet their needs. Customers do not have an alternative if the Company is unable to serve their needs.

Q: Does the Company change its budgets in response to information provided by customers?

A: Yes. As Mr. Fangman and Mr. Nelson explain in their Rebuttal Testimony, budget information is updated at least annually, as well as when new material information is obtained. These updates are then given to the Resource Planning group, which implements the changes. See Fangman Rebuttal at 3-7; Nelson Rebuttal at 3-8. Updates are then forwarded throughout the organization and used for operational and planning purposes. This would include the overall fuels areas, where natural gas hedge buying decisions are made.

III. RATE CASE HISTORY

Q: Please summarize the results of recent steam rate cases.

A: The following is a summary of recent industrial steam rate cases.

1. Case No. HR-94-177 (1993): $800,000 rate increase.
2. Case No. HR-99-245 (1999): $ 25,000 rate reduction.
    a. The Company requested an Energy Cost Adjustment (ECA), but the case was settled and the ECA was not in the final settlement.
3. Case No. HR-2004-0024 [consolidated with ER-2004-0034] (2004): $1.3 million increase for steam.
    a. The Company agreed to a special 5-year contract with AGP to provide a $35,000 monthly credit to AGP.
4. Case No. HR-2005-0450 (2006): $4.5 million increase.

a. The Company agreed to extend the AGP contract until April 21, 2010.

b. The Company implemented the QCA mechanism.

5. Case No. HR-2009-0092 (2010): $384,000 increase.

a. The Company rebased the QCA, adjusted certain performance mechanisms associated with steam operations, and changed the sharing mechanism from 80/20 to 85/15.

b. No change occurred in the Company's hedging policy.

Q: Were you involved in the last rate case, Case No. HR-2009-0092?

A: Yes. I was the lead witness and chief negotiator for the Company in that case.

Q: Did Mr. Johnstone file testimony in that case?

A: Yes. He was the lead witness for AGP in that case.

Q: Did Mr. Johnstone describe how the "*sharing mechanism*" of the QCA might bear on prudence considerations?

A: Yes. In the testimony of Mr. Johnstone, he described why AGP had not pursued a prudence adjustment in the QCA proceeding when he stated:

> "A part of the consideration has been the fact that cost tracking was already less than 100% due to the 80/20 and due to the coal performance standard. There is some sense of rough justice as a result." See Schedule TMR-1.

Q: What issues regarding the hedging program did Mr. Johnstone address in Case No. HR-2009-0092?

A: In his Direct Testimony in Case No. HR-2009-0092, Mr. Johnstone wrote about each of the main issues he has raised in this case. He addressed the "extraordinary" costs passed

through the QCA. Id. at page 6, lines 1–5. He said "a particular problem was that too much gas was hedged relative to system needs." Id. at page 8, lines 1–9. He also raised his concerns about the design and implementation of the plan, and stated that "Aquila failed to consider that gas in the steam context was a swing fuel." Id.

Q: Was Case No. HR-2009-0092 a settled case, in which a stipulation and agreement was entered into among all the parties?

A: Yes. It was a settled case.

Q: Was AGP a signatory of the settlement?

A: Yes. AGP was a signatory of the stipulation and agreement in Case No. HR-2009-0092.

Q: What were the results of Case No. HR-2009-0092?

A: The 2009 steam case resulted in a base rate increase of $384,000. The Company had originally filed for an increase of $1.3 million. Additionally, the parties agreed to modifications to the QCA. The modification included increasing the base rate for fuel from $3.005 per MMBtu to $3.95 per MMBtu in the QCA and base rate tariffs. Additionally, several modification were made to the QCA. The parties agreed to change the QCA quarterly rate adjustments to reflect eighty-five percent (85%) of the actual fuel costs above or below the base amount, rather than eighty percent (80%). The parties also agreed to change the performance standards for coal for the three month and twelve month levels. The nine- and six-month coal performance standards were removed. GMO also agreed not to seek to implement an increase in the base (non-QCA) rates for steam service sooner than fourteen (14) months following the effective date of the tariffs.

While the Stipulation and Agreement addressed many issues, it did not deal with hedging policy or practices. While GMO had ceased its hedging plan, it was still completing the hedges for those entered into prior to the time it ceased the program.

IV. QCA HISTORY

Q: How has the QCA operated since it began?

A: As described in the Rebuttal Testimony of Mr. Clemens, the QCA was first initiated in March 2006, as an outcome of the 2005 Steam Rate Case, Case No. HR-2005-0450. See Clemens Rebuttal at 2-4. Since its establishment, the Company has filed quarterly cost adjustments with the Commission for approval. None of the Company's adjustments has been rejected or found deficient in the QCA dockets. The only case where the Commission found any deficiency was in AGP's prior steam complaint that is described above, Case No. HC-2010-0235, where the Commission found that the hedging costs should be excluded from recovery through the QCA. The cases in which the QCAs were filed are: HR-2007-0028; HR-2007-0399; HR-2008-0340; HR-2010-0028; HT-2010-0288.

Each filing by the Company has been reviewed by Staff with a recommendation for approval. The Commission has approved every request submitted by the Company. The only issue that the Company has had is with the refund of the outcome of the prior steam complaint case, Case No. HC-2010-0235. In the QCA immediately following the Report and Order in that complaint case, Staff recommended that the QCA include the refund Ordered in that complaint case. The Company then included the refund in that QCA filing. The Company originally had not included the refund in the QCA, because it

was pending before the courts. The Order is still on appeal in the Missouri Court of Appeals.

Q: What does the QCA review process look like?

A: The review process is initiated on a quarterly basis when the Company files a request with the Commission to change the QCA rate. Included in the filing is all of the supporting documentation regarding costs, sales, and general requirements prescribed in the QCA tariff. This would include any issue with meeting the performance metrics of the coal performance standards. A review of the filing is then made by the Staff of the Commission to ensure compliance with the tariff and address any concerns Staff may have. AGP and the Office of the Public Counsel also receive copies of the filing. Ultimately a recommendation is made by the Staff to the Commission for either acceptance or rejection of the QCA filing.

Beyond the filing of the QCA, the Company provides a monthly surveillance report showing the financial condition of the steam business.

Since the initiation of the QCA process, Staff has requested and received data supporting the Company's filings. To date, no reports have been issued by Staff questioning the prudence of the amounts reflected in the QCA filings. Staff has 225 days to complete its prudence review after the end of the calendar year. Staff is not required to file a report on prudence, if it determines that the Company has not been imprudent.

The review process by the Staff is a two (2) step approach. In Step One, the Staff review considers:

1) That the concept of aligning of the Company and customer interests is working as intended.

2) That no significant level of imprudent costs is apparent.

The review may be entirely a part of surveillance activity. Customers are to be given notice of the results of the Step One review no later than 75 days after the end of each year.

Staff may proceed with Step Two, a full prudence review, if deemed necessary. Such full prudence review, if pursued, shall be completed no later than 225 days after the end of each year. Such full prudence review shall be conducted no more often than once every twelve months (12) and shall concern the prior twelve (12) month period or calendar year.

To date, the Staff has never issued a report addressing the Step Two prudence review.

Q: Please explain how the QCA process worked after it was first initiated in March 2006.

A: A QCA filing is made quarterly through the Commission's electronic filing and information system. Contained in the filing is a substantial amount of detailed data that reflects the fuel costs and other data necessary to determining the QCA rate. Hedge costs are clearly identified in the filing. For example, in Case No. HR-2007-0028, Aquila filed a steam tariff sheet with the current QCA data reflecting fuel costs and other data for the second quarter (April–June) of 2006. Under the heading "Fuel Costs - 2006" was the line item: "Hedging Costs - 2006." AGP was a party to this proceeding. This information is provided to AGP and Staff. Staff takes the information, reviews it in detail, and makes a recommendation to the Commission on its acceptance or rejections. This process is followed in each quarter, and AGP has been a party to each QCA filing.

Each of these QCA filings included the calculation of the new QCA rate, which specified gas hedging costs as a separate item within the accumulation of the quarterly fuel costs. Each of the QCA filings made by the Company has contained all of the information, in monthly detail, on coal and natural gas costs, including hedge costs, sales, coal performance standards and the computation of the rate change. AGP received and reviewed these QCA filings, but raised no objection to these costs at the time of review or shortly thereafter.

Q: Mr. Johnstone states in his first factor that he believes contributed to the alleged imprudence of the Company's hedging program that "the QCA mechanism effectively mitigates the effects of fuel cost volatility and price spikes by design." Do you agree with this statement?

A: No. The QCA mechanism does not address the same issues as the hedging program. The QCA mechanism simply spreads out the changes in steam fuel cost, while the hedging program is designed to protect steam costs from price volatility or price spikes that would impact the steam business. While the QCA may spread the costs, it does not protect the steam customers from the cost increases as does the hedging program. For example, if hedges were purchased based on a price of $4 per MMBtu for some period out in time, and the actual price were $7 per MMBtu, the hedging program would protect customers from paying the $7 price. However, without that hedge, customers would pay the $7 price and the only thing the QCA would do is to spread out the recovery over a longer period of time.

Q: Mr. Johnstone describes the coal performance standard included in the QCA at pages 13-16 of his Direct Testimony. How is this standard relevant to the case at hand?

A: It is not. The coal performance standard is a mechanism agreed to by the Company, which establishes levels of performance that are the basis for the QCA rate determination. While coal is a less expensive fuel than natural gas, it is in the benefit of the customers and the Company to maximize its availability and use in the production of steam for customers.

Q: Please summarize the Company's testimony and provide your conclusions.

A: The Company has presented a number of points that refute Mr. Johnstone's testimony and the Complaint made by AGP, as well as that demonstrate that the Company had a prudently designed and administered natural gas hedging program for its steam operations. The following points summarize my conclusions:

1.) As described by Mr. Clemens, AGP wanted the Company to provide a hedging program for the Lake Road Plant steam customers consistent with its hedging program for electric customers.

2.) Mr. Conrad and Mr. Johnstone were well aware of the plan to provide hedging for steam customers. Both were present when Mr. Clemens, Commissioner Davis, and Commissioner Clayton discussed the hedging plan for steam customers at the on-the-record presentation regarding the Stipulation and Agreement that implemented the QCA.

3.) AGP was well aware of the intent to use the QCA mechanism to recover hedge costs, as Mr. Johnstone was one of the primary participants in its design.

4.) The Company regularly updated its forecasts to reflect any changes in its customers' anticipated loads.

5.) AGP was the primary contributor to the usage variance in 2009. While customers Albaugh and Triumph had swings in usage from their forecasted loads for 2006 and 2007, which caused overall steam loads to be less than budgeted, it was AGP that had the most significant load variance from forecasted to actual burn in 2009.

6.) The hedging program in 2009 was successful as demonstrated by Mr. Blunk in Schedule WEB-3.

7.) The Company's natural gas hedging program for its steam operations was prudently designed, implemented, and administered.

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

Ag Processing, Inc., Complainant,	)	
v.	)	Case No. HC-2012-0259
KCP&L Greater Missouri Operations Company, Respondent.	)	

AFFIDAVIT OF TIM M. RUSH

STATE OF MISSOURI)
) **ss**
COUNTY OF JACKSON)

Tim M. Rush, being first duly sworn on his oath, states:

1. My name is Tim M. Rush. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Director, Regulatory Affairs.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of KC&PL Greater Missouri Operations Company consisting of twenty-two (22) 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.

Tim M. Rush

Subscribed and sworn before me this 2nd day of July, 2012.

Nicole A. Wehry
Notary Public

My commission expires: Feb 4, 2015

NICOLE A. WEHRY
Notary Public - Notary Seal
State of Missouri
Commissioned for Jackson County
My Commission Expires: February 04, 2015
Commission Number: 11391200

Exhibit No.:	
Issues:	Quarterly Cost Adjust.
Witness:	Donald Johnstone
Type of Exhibit:	Direct Testimony
Sponsoring Party:	AGP
Case Number:	HR-2009-0092
Date Testimony Prepared:	February 27, 2009

Aquila, Inc. / dba
Kansas City Power & Light Company
Greater Missouri Operations

Case No. HR 2009-0092

Prepared Direct Testimony of

Donald Johnstone

On behalf of

AG PROCESSING INC, A COOPERATIVE

February 2009

Competitive Energy
DYNAMICS

Schedule TMR-1

Before the
Missouri Public Service Commission

Aquila, Inc. / dba
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Direct Testimony of Donald Johnstone

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Prepared Direct Testimony of Donald Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A My name is Donald Johnstone and my address is 384 Black Hawk Drive, Lake Ozark, Missouri, 65049. I am employed by Competitive Energy Dynamics, L. L. C.

Q ON WHOSE BEHALF ARE YOU APPEARING?

A I am appearing on behalf of intervenor AG PROCESSING INC, A COOPERATIVE (AGP). I have also been retained by Triumph and Omnium, each of whom is a steam customer of the applicant utility.

Q PLEASE STATE YOUR QUALIFICATIONS AND EXPERIENCE.

A I have been working in the utility business since 1973. I started as an engineer for the Union Electric Company, where I had assignments in power operations and corporate planning. Since 1981 I have worked as a consultant in the field of utility regulation. My work has taken me to many states and I have addressed various matters including rate design, the cost of service, fuel costs, forecasting, resource planning, and

industry restructuring. My experience has included electric, gas, water, sewer, and steam utility services. A more complete description is set forth in Appendix A.

SUMMARY

Q WHAT ARE THE SUBJECTS ADDRESSED IN YOUR TESTIMONY?

A I address the Quarterly Cost Adjustment mechanism. I oppose the QCA as modified by Aquila dba KCPL/GMO ("Aquila" or "Company") and recommend elimination of the QCA if Aquila's proposal were to be the form.

In the alternative I recommend the continuation of the current QCA with an adjustment to reflect the current base cost of fuel and an adjustment to the coal performance standard to reflect reasonable operational experience and capability.

QCA HISTORY

Q DID AGP SUPPORT THE ADOPTION OF THE RATE MECHANISM THAT IS KNOWN AS THE "QUARTERLY COST ADJUSTMENT" OR "QCA"?

A Yes. The QCA is the product of a stipulation and agreement to which AGP and Aquila were parties. AGP was then, and remains now, the largest of the customers on the steam system. (Triumph and Omnium are also large steam customers with an interest in this matter.) While I am not an attorney and do not offer a legal interpretation of the agreement, I will speak to my understanding of that agreement and the value of the present QCA.

Q PLEASE SUMMARIZE THE OPERATION OF THE QCA.

A The QCA tracks changes in the cost of the coal, natural gas and oil fuels that are used to produce steam. Like the Aquila and UE electric fuel riders, it collects cost variations over a period of several months and then recovers the accumulated variations in overlapping 12-month periods. This approach mitigates the volatility in retail rates and avoids sharp and extraordinary increases or decreases in rates.

An important goal from the perspective of AGP was to provide substantial, but not complete, cost tracking with respect to the price of fuels. The goal of the substantial tracking was to provide more durable earnings for Aquila and to extend the time between rate cases for the benefit of both Aquila and its steam customers. On the other hand, the goal of less than complete tracking of the fuel cost was to provide for mechanisms that would maintain an alignment of the financial interests of Aquila and the financial interests of its customers in a low cost for fuel.

The QCA includes some innovative techniques that were the product of the give and take that resulted in the stipulation. The first innovative mechanism is the provision that tracks 80% of fuel cost changes through the QCA while leaving the remainder for traditional base rate regulation. At the time, the several Missouri electric FAC's that employ a similar approach did not exist. Thus, this was the first such sharing mechanism in the State. The second innovative aspect of the QCA established a performance threshold for the coal-fired boiler that produces most of the steam. An important consideration is that Aquila makes decisions on a regular basis that affect the availability of the boiler. The impact of those operating and maintenance decisions properly belongs to Aquila.

From another perspective, there can be no contention that the price of fuels impacts Aquila's ability to operate and maintain its boiler. Yet operating and maintenance matters have a large and direct impact on the total cost of fuel. That is because natural gas is a much more expensive fuel that is used when coal-fired steam is limited. Thus, in this regard an important goal of AGP was to ensure Aquila remained financially accountable for the operating performance of the coal-fired boiler in the event that it did not meet reasonable expectations.

Q HOW WAS THE PERFORMANCE THRESHOLD FOR THE COAL-FIRED BOILER DETERMINED?

A It was set by an agreement contained in the stipulation. In evaluating the acceptability of the agreed performance threshold, I considered two factors. First was the level of the coal-fired steam production that was being used to develop and support the revenue requirements in the Staff's production cost model. The second was the company's forecast of future usage. The intent was to provide a threshold that would generally allow costs to pass through, thereby allowing costs to be tracked without adjustment due to the performance threshold. The concept was intended to protect customers from the costs occasioned by any significant unexpected shortfall in the performance of the coal boiler. This performance threshold, like all other aspects of the QCA, was agreed to and supported by Aquila as well as AGP.

Q DID THE COAL PERFORMANCE STANDARD WORK AS DESIGNED?

A Yes and no. I think it is fair to say that both AGP and Aquila were surprised by the extent to which cost adjustments occurred pursuant to this provision. That is both

good news and bad. The bad news is that the performance of the coal-fired boiler was below the performance threshold and, all other things held equal that had an adverse impact on Aquila's earnings. The good news is that customers were protected from the consequence of performance below the threshold.

Q DOES THE QCA MAKE IT IMPOSSIBLE FOR CUSTOMERS TO KNOW WHAT THEIR RATES WILL BE AFTER THE RATE CASE?

A Unfortunately, the QCA changes rates every quarter and this rate case will be only one aspect of the change in costs. The total rate increase for the next year remains unknown. It also complicates the comparison of present and proposed rates.

Q IS THERE REASON FOR CONCERN WITH AQUILA'S PAST FUEL PURCHASE PRACTICES?

A Yes. Prior to approval of the QCA the fuel related operations of the steam system and the electric system were integrated. It came as a surprise when it was learned that Aquila had developed a gas hedging program for the steam operation that was separate from the electric operation. Another surprise was that the hedging approach was simply patterned after one Aquila had used for it gas LDC business. Finally, Aquila's hedging of its natural gas supplies was based on a simple approach intended to stabilize costs. Even that aspect did not perform well because Aquila failed to consider that gas in the steam context was a swing fuel that was used only to the extent necessary after operation of the coal-fired boiler (the base load supply). This was a particular problem because forecast load growth did not materialize.

Q WHAT ACTIONS WERE TAKEN TO ADDRESS THE CONCERNS WITH THE HEDGING PROGRAM?

A Aquila ceased operation of the program. However, the costs incurred before the program ceased operation, some of which were extraordinary, were passed through to customers pursuant to the QCA.

QCA RECOMMENDATIONS

Q IF THERE CONTINUES TO BE A QCA, IS THE INITIAL EXPERIENCE WITH THE COAL PERFORMANCE STANDARD REASON TO ELIMINATE THE PROVISION?

A No. The logic for it continues to be sound. Due to the vast difference in the cost of steam from coal versus natural gas it is important to maintain a focus on high performance for the coal-fired steam production.

As a practical matter there is only one coal-fired boiler that produces steam and as a consequence any loss of production from that boiler creates a large operating cost penalty. Absent a performance threshold, the FAC would function as replacement cost insurance for the steam produced by that unit. That insurance function is something quite different from an adjustment intended to accommodate changes in the price of fuels. Therefore, another function of the coal performance threshold is to limit the operation of the QCA to the matter it is intended to resolve – changes in the prices of fuels.

Q IF THERE CONTINUES TO BE A QCA SHOULD THE 80/20 TRACKING APPROACH CONTINUE?

A Yes. There are several reasons why this should continue. First, the 80% factor provides very substantial protection for Aquila's cost of fuels. No doubt in part due to the QCA, Aquila did not apply for a steam rate increase along with its last prior application for an electric rate increase. The current steam rates have been effective since March 6, 2006, so by the time new rates take effect in this case it will have been more than three years. Of course, under the recently enacted Missouri electric FAC legislation a rate case is required every four years. In comparison, Aquila has almost gone that long.

Q HAVE THE ANNUAL AUDITS OF THE QCA COSTS BEEN RESOLVED?

A No.

Q ARE YOU AWARE OF ANY BENEFITS THAT HAVE ACCRUED TO AQUILA DUE TO THE QCA?

A Yes. Substantial changes in cost have been passed on to customers, thereby shielding Aquila from a large measure of the impact of the cost increases while customers have been on the receiving end of the costs.

Q HAVE ANY CONCERNS BEEN RAISED BY AQUILA?

A Yes. Aquila has stated that both the coal performance threshold and the 80/20 mechanism have resulted in less than 100% pass through of the costs. 100% pass through is the apparently the current goal of Aquila according to the testimony of Mr. Rush.

Q HAVE ANY CONCERNS BEEN RAISED BY AGP?

A Yes. One important concern was Aquila's design and implementation of a hedging program for natural gas. A particular problem was that too much gas was hedged relative to system needs. That occurred in large part because forecast increases in steam sales did not materialize as planned. Another concern was the overall approach to the design of the hedging program and its implementation. Generally speaking, hedging, if used, must be designed to fit the nature of the loads and ought to be integral to a purchasing approach designed to minimize the cost of gas purchased over time.

Q HAS AGP PURSUED A PRUDENCE ADJUSTMENT IN THE QCA PROCEEDINGS?

A No. A part of the consideration has been the fact that cost tracking was already less than 100% due to the 80/20 and due to the coal performance standard. There is some sense of rough justice as a result. Nevertheless, I can make no commitments as to any future positions that may be pursued by or on behalf of my clients.

Q DO YOU SEE A REASONABLE BALANCE OF COMPANY AND RATEPAYER INTERESTS IN THE QCA, ASSUMING APPROVAL OF THE MINOR ADJUSTMENTS THAT YOU RECOMMEND?

A On the one hand, it is impossible to predict the future circumstances that may affect cost recovery under the QCA. On the other hand, there are continuing concerns about coal performance and gas purchasing for the steam system. At this point I think the QCA as designed has worked reasonably well and should be continued in its present

form with minor adjustments limited to the establishment of a new base fuel cost and an adjustment to the coal performance standard to reflect current experience.

Q ARE YOU OPPOSED TO THE QCA AS MODIFIED IN THE PROPOSAL OF MR. RUSH IN THIS PROCEEDING?

A Yes, strongly opposed. The 100% pass-through of costs, including the elimination of the coal performance standard, would create a mechanism with no direct financial incentive to encourage cost-effective operations, maintenance, and fuel procurement. Furthermore, it would offer no protection to customers in the event of poor performance of the coal-fired boiler until after the fact and then only in the event of a determination of imprudence by the Commission. The only protection would be the after-the-fact prudence review, and as a practical matter, that shifts a great burden to Staff and customers. In my opinion, realistically, only the most egregious imprudent actions would ever be pursued so the value of the prudence review as an incentive or a remedy is very limited.

Q DO YOU SUPPORT THE CONTINUATION OF THE CURRENT QCA?

A Yes. It is far superior to use a mechanism such as the current QCA that encourages a cost-effective result in the first place and minimizes the reliance on after-the-fact reviews.

Q PLEASE SUMMARIZE THE MINOR ADJUSTMENTS YOU RECOMMEND.

A The base cost of gas should be reset. Also, the coal performance standard should be reset at a level of roughly 90% to 95% of the continuing level of operation. Also, the

blocking structure of the coal performance standard should accommodate reasonably expected outages.

Q DOES THIS CONCLUDE YOUR TESTIMONY?

A Yes it does.

Appendix A
Qualifications of Donald E. Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A Donald E. Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, MO 65049.

Q PLEASE STATE YOUR OCCUPATION.

A I am President of Competitive Energy Dynamics, L. L. C. and a consultant in the field of public utility regulation.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A In 1968, I received a Bachelor of Science Degree in Electrical Engineering from the University of Missouri at Rolla. After graduation, I worked in the customer engineering division of a computer manufacturer. From 1969 to 1973, I was an officer in the Air Force, where most of my work was related to the Aircraft Structural Integrity Program in the areas of data processing, data base design and economic cost analysis. Also in 1973, I received a Master of Business Administration Degree from Oklahoma City University.

From 1973 through 1981, I was employed by a large Midwestern utility and worked in the Power Operations and Corporate Planning Functions. While in the Power Operations Function, I had assignments relating to the peak demand and net output forecasts and load behavior studies which included such factors as weather, conservation and seasonality. I also analyzed the cost of replacement energy associated with forced outages of generation facilities. In the Corporate Planning Function, my assignments included developmental work on a generation expansion

planning program and work on the peak demand and sales forecasts. From 1977 through 1981, I was Supervisor of the Load Forecasting Group where my responsibilities included the Company's sales and peak demand forecasts and the weather normalization of sales.

In 1981, I began consulting, and in 2000, I created the firm Competitive Energy Dynamics, L.L.C. As a part of my twenty-five years of consulting practice, I have participated in the analysis of various electric, gas, water, and sewer utility matters, including the analysis and preparation of cost-of-service studies and rate analyses. In addition to general rate cases, I have partici¬pated in electric fuel and gas cost reviews and planning proceedings, policy proceedings, market price surveys, generation capacity evaluations, and assorted matters related to the restructuring of the electric and gas industries. I have also assisted companies in the negotiation of power contracts representing over $1 billion of electricity.

I have testified before the state regulatory commissions of Delaware, Hawaii, Illinois, Iowa, Kansas, Massachusetts, Missouri, Montana, New Hampshire, Ohio, Pennsylvania, Tennessee, Virginia and West Virginia, and the Rate Commission of the Metropolitan St. Louis Sewer District.

BEFORE THE

PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Aquila, Inc. d/b/a KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Steam Heating Service	)))))	Case No. HR-2009-0092

Affidavit of Donald Johnstone

State of Missouri)
) ss
County of Camden)

Donald Johnstone, of lawful age, on his oath states: that he has reviewed the attached written testimony in question and answer form, all to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; that such matters are true to the best of his knowledge, information and belief.

Donald Johnstone

Subscribed and sworn before me this 11th day of February, 2009

Notary Public

CYNTHIA E. BALLIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Camden County
My Commission Expires: July 18, 2012
Commission Number: 08379951

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