

Exhibit No.:
Issue: Crossroads and Fuels
Witness: Wm. Edward Blunk
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Sponsoring Party: KCP&L Greater Missouri Operations Company
Case No.: ER-2012-0175
Date Testimony Prepared: September 12, 2012

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2012-0175

REBUTTAL TESTIMONY

OF

WM. EDWARD BLUNK

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

**Kansas City, Missouri
September 2012**

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Pursuant To 4 CSR 240-2.135.

REBUTTAL TESTIMONY

OF

WM. EDWARD BLUNK

Case No. ER-2012-0175

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 and Supplemental**
5 **Direct Testimony in this matter?**

6 A: Yes, I am.

7 **Q: On whose behalf are you testifying?**

8 A: I am testifying on behalf of KCP&L Greater Missouri Operations Company (“GMO” or
9 the “Company”) for St. Joseph Light & Power (“L&P”) and Missouri Public Service
10 (“MPS”) territories.

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

12 A: I will rebut certain portions of Staff’s Revenue Requirement/Cost of Service report
13 (“Staff Report”). First, I will respond to the natural gas reservation costs used for
14 Crossroads. Regarding the Staff Report statements at pages 273-275, I will provide the
15 context or “rest of the story” for the few lines that Staff snipped from my hearing
16 testimony in GMO’s third prudence review, Case No. EO-2011-0390 relating to hedging
17 gains and losses with regard to fuel and purchased power costs. I will also address the
18 hedging cost issue Staff raised on page 278 of its Report. Finally I acknowledge my
19 limited agreement with the fuel prices Staff used for its filing.

1 **I. Natural Gas Transportation to Raccoon Creek and Goose Creek**

2 **Q: Staff valued Crossroads based on the 2006 sale prices of Raccoon Creek and Goose**
3 **Creek. Are Raccoon Creek and Goose Creek served by the same natural gas**
4 **pipeline that serves Crossroads?**

5 **A:** No. Crossroads is served by Texas Gas Transmission Corporation (“TXGT”). Raccoon
6 Creek is served by Trunkline Gas Co. (“Trunkline”) and Goose Creek is served by
7 Natural Gas Pipeline Company (“NGPL”).

8 **Q: Did Staff include the incremental cost of firm natural gas transportation to either**
9 **the Raccoon Creek or Goose Creek site in its revenue requirement for GMO?**

10 **A:** No.

11 **Q: Is the value of a power plant affected by its location and fuel transportation**
12 **options?**

13 **A:** Yes. “Location, location, location” is a familiar aphorism regarding the value of real
14 property. When dealing with a power plant, a major location factor affecting the value of
15 the plant is the cost of transporting fuel to the site. Another major location factor is the
16 cost of transporting power from the site.

17 **Q: In your Direct Testimony at pages 25-30 you identified the cost of pipeline**
18 **reservation charges for Crossroads as if it was located at the South Harper site in**
19 **Cass County, Missouri, instead of Mississippi. If Crossroads was located at either**
20 **the Goose Creek or Raccoon Creek site in Illinois would it incur similar pipeline**
21 **reservation charges?**

22 **A:** Yes. If Crossroads was located at the Goose Creek site in Piatt County, Illinois it would
23 incur \$9.1 million per year in pipeline reservation charges for firm transportation. If it

1 was located at the Raccoon Creek site in Clay County, Illinois it would incur \$8.8 million
2 per year in pipeline reservation charges. Those charges are comparable to the **
3 ██████████** range I previously identified for using the South Harper site.

4 **Q: How much did Staff include in its revenue requirement for natural gas**
5 **transportation reservation charges to Crossroads?**

6 A: Staff included **██████████** for firm natural gas transportation to the Crossroads plant
7 located in Mississippi.

8 **Q: Would the amount Staff included in its revenue requirement be sufficient to provide**
9 **the necessary firm natural gas transportation to either the Raccoon Creek or Goose**
10 **Creek plants located in Illinois?**

11 A: No.

12 **Q: How much should Staff include in its revenue requirement for pipeline reservation**
13 **charges if it is using the value of Raccoon Creek and Goose Creek as the value of**
14 **plant for Crossroads?**

15 A: If Staff is going to use the value of plants located in Illinois, it should use pipeline
16 reservation charges for plants located in Illinois. When using the value of Raccoon Creek
17 and Goose Creek for Crossroads, Staff should include at least \$8.8 million per year in its
18 revenue requirement for pipeline reservation charges for Crossroads. That would be
19 consistent with using the value of plants located in Illinois.

20 **Q: Are there other location or transportation related adjustments that should be made**
21 **to values derived from the sale prices of Raccoon Creek and Goose Creek?**

22 A: Yes. A similar adjustment should be made for the incremental cost of power
23 transmission. Mr. Crawford addresses those costs in his Direct and Rebuttal Testimony.

1 **II. Hedging and Fuel Purchases: The “Rest of the Story”**

2 **Q: The Staff Report at pages 273-75 quoted a few lines from your redirect testimony at**
3 **the hearing in Case No. EO-2011-0390, asserting that GMO is indifferent to its**
4 **actual amount of fuel and purchased power costs net of off-system sales revenues.**

5 **Did Staff correctly characterize your testimony?**

6 A: No. If my testimony is taken as a whole, the Commission will see that GMO is
7 concerned about the cost of fuel and purchased power that flows through the FAC.
8 Moreover, when the portions of my testimony that are quoted in the Staff Report are
9 taken in context, those statements themselves demonstrate GMO’s concern about its
10 customers’ interests. To say GMO is indifferent and not motivated “to keep its fuel and
11 purchased power costs down” is a mischaracterization of my testimony.

12 **Q: Did Staff correctly establish the context of the testimony it quoted?**

13 A: No.

14 **Q: What was the context of your testimony in Case No. EO-2011-0390?**

15 A: The issues in Case No. EO-2011-0390 related to GMO’s hedging and hedge accounting
16 practices. As the following points from Staff’s Report¹ show, Staff found no indications
17 of imprudence, except for the practice of using natural gas futures contracts to hedge
18 purchased power risk. Ultimately the Commission denied that allegation of imprudence.²

- 19 • Staff found no indication GMO imprudently dispatched its units during the
20 Prudence Review Period. At 6.
21 • Staff found GMO’s long-term, base-load agreements to be reasonable as
22 they are below both the cost of generating power with its own peaking
23 units and the cost of purchased power. Staff found GMO’s short-term
24 contracts to be reasonable as they were used to meet GMO’s short-term

¹ Missouri Public Service Commission Staff Report, Prudence Review of Costs Related to the Fuel Adjustment Clause for the Electric Operations of KCP&L Greater Missouri Operations Company, June 1, 2009 through November 30, 2010, File No. EO-2011-0390, November 28, 2011.

² Report and Order, Case No. EO-2011-0390, page 66, September 4, 2012.

1 peaking capacity requirements at a cost below the cost of generating
2 power of GMO's highest cost peaking generating units. Staff found no
3 indication of imprudence by GMO for entering into long-term and short-
4 term purchased power contracts. At 8.

- 5 • The Staff does not find GMO's actions related to PPA costs to be
6 imprudent; however, after reviewing the "PP" component of GMO's FAC,
7 Staff does not find that the costs of hedging natural gas costs to mitigate
8 risk associated with purchases of spot market power are recoverable as a
9 component of "PP" in GMO's CAF calculation. At 9.
- 10 • Staff found no indication GMO's plant outages were imprudent during the
11 time period examined in this prudence review. At 11.
- 12 • Staff found GMO's hedging activities related to natural gas used for
13 electric generation to be in compliance with GMO's natural gas price
14 hedge plan. However, Staff finds GMO's actions imprudent as related to
15 the use of futures contracts to purchase natural gas as a means of
16 mitigating risk associated with spot market purchased power. At 13.
- 17 • Staff found no indication GMO's purchases of natural gas for the fifth,
18 sixth and seventh accumulation periods reviewed in this case were
19 imprudent. At 14.
- 20 • Staff found no indication GMO's purchases of coal for the fifth, sixth and
21 seventh accumulation periods of GMO's FAC from June 1, 2009 to
22 November 30, 2010 were imprudent. At 15.
- 23 • Staff found no indication GMO's costs associated with its fuel oil
24 contracts in place for June 1, 2009 to November 30, 2010, the prudence
25 review period in this case, were imprudent. At 16.
- 26 • Staff found no indication GMO's use of alternate fuels for the time period
27 June 1, 2009 through November 30, 2010, was imprudent. At 17.
- 28 • Staff found no indication GMO was imprudent in its purchases, banking or
29 usage of SO2 allowances. At 19.
- 30 • Staff found no indication GMO included in its FAC charges any costs for
31 the air pollution control projects at Sibley and Jeffrey Energy Center
32 during the three six-month accumulation periods from June 1, 2009
33 through November 30, 2010. At 20.
- 34 • Staff found no indication GMO was imprudent with regard to its fuel and
35 purchased power associated with Iatan 2 for the fifth, six, and seventh
36 accumulation periods of GMO's FAC which cover the period June 1, 2009
37 to November 30, 2010. At 21.
- 38 • Staff has not determined GMO acted imprudently in its actions relating to
39 OSSR during the review period. At 22.
- 40 • Staff found no indication GMO has acted imprudently regarding the C. W.
41 Mining settlements with respect to its FAC. At 25.
- 42 • Staff found no evidence GMO imprudently determined the monthly
43 interest amount that was applied to the under-recovered or over-recovered
44 fuel and purchased power costs. At 26.

1 **Q: Given that the issue in EO-2011-0390 was hedging and not fuel or power purchases,**
2 **how would you characterize that part of your testimony which Staff quoted in its**
3 **Report in light of Staff’s allegation at page 274 “that the current [5%] sharing**
4 **mechanism is not a proper incentive for GMO to keep fuel and purchased power**
5 **costs down?”**

6 A: Staff quoted the following dialogue from my testimony:

7 **Q. From the shareholder perspective, assuming that you have an**
8 **FAC in place, do you care if a Katrina hits?**

9 A. As a share – well, from the company’s perspective, its risk goes
10 through the fuel clause, so no. As a ratepayer, I’m a GMO
11 ratepayer, I do care.

12 **Q. You care very much?**

13 A. I do.³

14 That dialogue followed a lengthy discussion about GMO’s hedging program. These
15 questions in particular dealt with hedging against a natural disaster induced spike in the
16 price of natural gas like the one caused by Hurricane Katrina. My answer was explaining
17 how such market price risk is managed for both the Company and ratepayers.

18 **Q: On page 275 the Staff Report quotes testimony which Staff says implies “GMO’s**
19 **indifference” to fuel and purchased power cost.⁴ What was the context of that**
20 **testimony?**

21 A: I had just walked through an example of how a hedge acted as insurance against
22 skyrocketing prices. In essence, I was saying that if you are properly hedged or insured
23 against such a risk, then you are indifferent. Given that context you can see that GMO’s
24 “indifference” really was a reflection of its significant concern for the costs that flow

³ Transcript for EO-2011-0390v4, page 130, line 9 through 16.

1 through the FAC. It was only with a hedging program such as the one used by GMO to
2 protect its ratepayers could we say there is indifference to skyrocketing prices. Let me
3 quote the same dialogue Staff cited on page 275 but with a couple of the questions and
4 answers that proceeded the snippet included in the Staff Report. Just those two extra
5 questions and answers are enough to clearly show how “indifference” was taken out of
6 context.

7 **Q. -- what would you expect electric prices to be doing?**

8 A. They also would skyrocket.

9 **Q. Now, on the derivative side, what would you expect in your**
10 **hedging program?**

11 A. The natural gas futures contracts would have a significant gain. In
12 other words, we'd make a lot of money there. That would fill my
13 little bucket of money that I keep referring to, and I can then use
14 that bucket of money to offset what's happened on the cash or the
15 physical market for electricity. I've got all this, if you will, this
16 insurance proceeds to help pay for this now higher price electricity.

17 **Q. Well, since you had all those gains, is that a good thing?**

18 A. I don't know if you'd say it's good or bad. It's -- you need to take
19 the two, and the two of them wash each other out.

20 **Q. So the company's indifferent, is that what you're saying?**

21 A. Yes. Doesn't matter to the company.⁵

22 **Q: Is GMO motivated by the 5% share?**

23 A: Yes. GMO is either penalized or rewarded for every penny of the 5%. GMO is not
24 indifferent about the 5%.

⁴ Staff Report, page 274.

⁵ Transcript for EO-2011-0390v4, page 136, line 7 through page 137, line 2.

1 **Q: Will increasing GMO's share of the FAC from the current 5% to the 15% proposed**
2 **by Staff increase the Company's motivation?**

3 A: No. As shown by the results of the Staff's FAC audit, the Company is prudent in its
4 operation of the FAC. Since 2007 when GMO's FAC was first implemented, only in the
5 most recent FAC accumulation period have fuel and purchased power costs dropped
6 enough for the Company to share in those savings. A mechanism that penalizes the
7 Company 9 out of 10 times is not an incentive.

8 **III. Hedging Costs**

9 **Q: What did Staff recommend regarding hedging costs?**

10 A: Staff recommended that costs associated with cross-hedging not be allowed to flow
11 through GMO's FAC.

12 **Q: Is that the same position Staff took in its recent prudence review of GMO's FAC**
13 **costs?**

14 A: Yes. In Case No. EO-2011-0390 Staff recommended that costs associated with cross-
15 hedging not be allowed to flow through GMO's FAC.

16 **Q: What did the Commission decide regarding Staff's recommendation to disallow**
17 **costs associated with cross-hedging in Case No. EO-2011-0390?**

18 A: The Commission ordered that Staff's allegations and requests be denied. That is, the
19 Commission allowed the costs associated with cross-hedging to remain in GMO's FAC.

20 **Q: Why does GMO purchase natural gas futures contracts?**

21 A: GMO uses natural gas futures contracts to hedge two variants of the same risk. The risk
22 GMO is hedging with natural gas futures contracts is the uncertainty in the cost of
23 providing power to its customers. In one form that risk is the price risk of natural gas the

1 company burns to generate power which it delivers to its customers. In the second form,
2 that risk is the price risk of power purchased by the company which it delivers to its
3 customers. In both scenarios the Company uses natural gas futures contracts to hedge the
4 market price risk of providing power to its customers.

5 **Q: What is hedging?**

6 A: Hedging is the process of protecting oneself against risk. Hedging employs various
7 techniques but basically, involves taking equal and opposite positions in two different
8 markets as offsets to one another.

9 **Q: Do those two different markets have to be for the same commodity?**

10 A: No.

11 **Q: How do you hedge power if there is no futures market for it?**

12 A: GMO uses natural gas futures contracts to “cross-hedge” power price risk.

13 **Q: What is cross-hedging?**

14 A: Cross-hedging is a risk management strategy that involves offsetting a position in one
15 commodity with an equal position in a different commodity with similar price
16 movements. Cross-hedging is often used in markets where there is no active futures
17 trading for the commodity of concern.

18 **Q: Do natural gas and power prices in Southwest Power Pool (“SPP”) have similar
19 price movements?**

20 A: Yes. Power prices in SPP have a long history of moving similarly to the price of natural
21 gas. Below I list key phrases from some of SPP’s annual “State of the Market Reports”⁶

⁶ Southwest Power Pool’s annual *State of the Market Reports* are available at:
<http://www.spp.org/section.asp?group=642&pageID=27>.

1 which illustrate that SPP has believed for years there is a strong link between natural gas
2 and electricity markets:

- 3 • 2004: Rising natural gas prices are a driving force in the increase of on-
4 peak electricity prices in the current bilateral electricity market in the SPP
5 footprint. This is to be expected given the region's heavy dependence on
6 natural gas for power generation, and a range of statistical tests confirms
7 this result. At 3.
- 8 • 2005: Rising natural gas prices are a driving force in the increase of on-
9 peak electricity prices in the current bilateral electricity market in the SPP
10 footprint. This is to be expected given the region's heavy dependence on
11 natural gas for power generation, and a range of statistical tests confirms
12 this result. At 4.
- 13 • 2008: This is important because, in SPP, natural gas-fired resources are
14 at the margin (and therefore setting the price) more during on-peak
15 periods than during off-peak periods. In 2008 in SPP, natural gas was at
16 the margin about 89% of the time during on-peak periods, while only
17 54% of the time during off-peak periods. At 5.
- 18 • 2010: Gas prices are very closely associated with average system prices
19 in the SPP region. This is logical, because the marginal resources that set
20 overall prices are most often gas units. At 36.
- 21 • 2011: Gas prices are very closely correlated with average system prices
22 in the SPP region because the marginal resources that set overall prices
23 are most often gas units. At 38.

24 **Q: How does GMO use natural gas futures contracts to hedge the price risk of power**
25 **purchased by the Company and delivered to its customers?**

26 A: GMO uses natural gas derivatives to hedge "on peak" purchased power price risk. The
27 Company's projected "on peak" purchased power requirement is converted into a natural
28 gas equivalent using the market implied heat rate from the Company's market model.
29 That natural gas equivalent is added to the volume of natural gas the Company projects to
30 burn for generation. The Company purchases futures contracts or options to offset up to
31 67 percent of that total volume. The change in value for those futures contracts offsets
32 the change in market value for the natural gas or power the Company purchases.

1 **Q: Is this the same issue that was at the heart of Case No. EO-2011-0390?**

2 A: Yes.

3 **IV. Fuel Prices**

4 **Q: Do you agree with the fuel or fuel additive prices Staff used in its filing?**

5 A: Staff's filing was based on its March 31, 2012 cut-off date in this case. The fuel and fuel
6 additive prices that Staff recognized contained certain significant price changes that were
7 effective April 1, 2012. I do not disagree with Staff's use of the April 1 prices for its
8 historical filing, however, the Company plans to update all fuel and additive prices to
9 those known as of August 31, 2012 for the true-up portion of this case, and expects that
10 Staff will do the same.

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

12 A: Yes, it does.

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

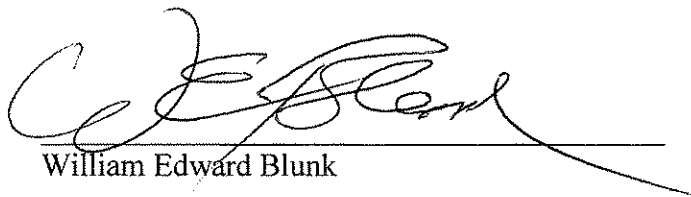
In the Matter of KCP&L Greater Missouri)
Operations Company's Request for Authority to) Case No. ER-2012-0175
Implement General Rate Increase for Electric Service)

AFFIDAVIT OF WILLIAM EDWARD BLUNK

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

William Edward Blunk, appearing before me, affirms and states:

1. My name is William Edward Blunk. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Supply Planning Manager.
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 eleven (11) 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 affirm and state 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.



William Edward Blunk

Subscribed and affirmed before me this 12th day of September, 2012.



Notary Public

My commission expires: Feb. 4 2015

