Exhibit No.:	
Issue:	Proof of Aquila and GMO Imprudence
Witness:	Donald E. Johnstone
Type of Exhibit:	Direct Testimony
Sponsoring Party:	AGP
Case Number:	HC-2012-0259 HC-2010-0235
Date Prepared:	May 15, 2013

Kansas City Power and Light
Greater Missouri Operations
Steam Business
HC-2012-0259
Consolidated with
HC-2010-0235

Supplemental Direct Testimony of

Donald E. Johnstone

on behalf of

AG PROCESSING INC, A COOPERATIVE

May 2013

Competitive Energy
DYNAMICS

HC-2012-0259
And
HC-2010-0235

Supplemental Direct Testimony of Donald E. Johnstone

TABLE OF CONTENTS

AG PROCESSING INC, A COOPERATIVE, Complainant,
v.
KCP&L Greater Missouri Operations Company, Respondent

HC-2012-0259
and
HC-2010-0235

Supplemental Direct Testimony 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. My qualifications and experience are attached to my earlier direct testimony (Hearing Exhibit 1) in this matter.

Q ON WHOSE BEHALF ARE YOU APPEARING?

A I am appearing on behalf of AG PROCESSING INC A COOPERATIVE ("AGP"). AGP is one of several steam customers of KCP&L, Greater Missouri Operations Company (GMO) in the St. Joseph District.

<u>PURPOSE OF THIS SUPPLEMENTAL DIRECT TESTIMONY</u>

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A As a consequence of court action the burden of proof has shifted from GMO to AGP and the Commission has provided the opportunity for additional testimony. I begin with a quote from Mr. Conrad: “Under the legal standards, AGP needed only to raise a "serious question" to overcome the initial presumption of prudence. But AGP has gone well beyond this standard and has proved affirmatively that Aquila was imprudent.” (AGP Reply Brief, February 9, 2011, p.32) In this context, my purpose is to identify several facts that may be useful to the Commission.

Q DO YOU WISH TO SUBMIT NEW FACTS?

A No. My objective is to highlight facts already in the record.

<u>AQUILA’S DESCRIPTION OF THE HEDGE PROGRAM</u>

Q WHAT WAS TO BE THE HEDGE PROGRAM?

A It was first described by Mr. Clemens on the record in HR-2005-0450 on February 2006. Although the settlement of the case was pending, Mr. Clemens described a program that had already been implemented. The program was first described as 2/3 hedged and 1/3 unhedged.

> “COMMISSIONER CLAYTON: What price are you hedged at? Is that public?
>
> MR. CLEMENS: It's $8.42 is what we're hedged in for 2006. That's only for two-thirds of our gas. We still have another third that we aren't hedged.” (Transcript, HR-2005-0450, Vol. 7, Feb. 27,2006, p. 57)

The Hedge Program was addressed in a further exchange among Chairman Davis, Commissioner Clayton, Mr. Conrad, and Mr. Clemens. Here the program for the 2/3 that was already hedged for 2006 was addressed.

CHAIRMAN DAVIS: Okay. So you're telling me that -- that it is feasible then, that you could potentially beat this number and Aquila could actually make some money on this?

MR. CLEMENS: It's feasible.

CHAIRMAN DAVIS: But not likely?

MR. CLEMENS: With current prices, possibly not, but I don't know. See how the market goes in the future.

MR. CONRAD: Judge, one way to look at this is, springing from what Mr. Clemens has said, the predominant quantity of the MM Btu's are raised from coal. The predominant dollars come from the gas cost. So if -- if in that scenario, if the gas costs were to drop, and praise the Lord if they would do that --

COMMISSIONER CLAYTON: They've dropped significantly today, Mr. Conrad. I don't know how much further they'll drop, but they've dropped significantly today.

MR. CONRAD: -- then there would be some potential for both of the utility and for the customer to have some benefit from that. Certainly as compared with locking in a hard number.

MR. CLEMENS: I might add **on our two-thirds hedge, half of that are call options which we would just pay the premium, so I mean, we would have an advantage to buy the cheaper gas. If they weren't -- weren't in the money, we would just pay the costs of that premium and then buy gas at the market rate. So we'd still have some opportunities to lower that gas price.**"

(emphasis supplied) Transcript, HR-2005-0450, Vol. 7, Feb. 27, 2006, pp. 78,79)

At the very beginning of the Gas Hedging Program, Commissioner Clayton noted a significant gas price reduction occurring that day. Mr. Clemens, testified that 2/3 of the gas would follow the market down and the QCA could operate to reduce steam generation costs.

In the very context of falling gas prices, Mr. Clemens described the Hedge Program to the Commission and to customers as providing participation for 2/3 of the gas if prices fell, as they did on that day. The sale of "puts" that would limit participation in a down market were not testified to be a part of the program. Per Mr. Clemens' testimony, the only cost that would offset the benefit would be the initial cost of the call options.

The Hedge Program began with promises of 2/3 participation in a down market – and with the possibility of falling prices illuminated by the observation from the bench.

Q HAS THE COMMISSION FOUND FAULT WITH EITHER THEORY OR CONCEPT OF WHAT MR. CLEMENS DESCRIBED AS THE STEAM GAS HEDGING PROGRAM?

A No. Not in 2006 and not in its final Report and Order in HC-2010-0235. It is the prudence of Aquila's administration of the program that has always been questioned.

SCOPE OF DOCUMENTS PROVIDED BY GMO

Q HOW CAN THE COMMISSION BE SURE THAT EVERYTHING THAT COULD HAVE BEEN USED TO PROVE PRUDENCE, OR IMPRUDENCE, HAS BEEN CONSIDERED?

A I cannot provide a legal opinion. That said, I can report that AGP asked for all documents. To paraphrase GMO's answer, the relevant documents have been provided. Hearing Exhibit 3 in HC-2010-0235 contains GMO's response to AGP's requests for admissions. The pages of Hearing Exhibit 3 on which I rely in this answer are in Schedule 1. Additionally, in response to requests to produce, GMO produced additional documents many of which have been provided as exhibits in the earlier proceeding.

Q HOW IS GMO'S PROVISION OF RELEVANT DOCUMENTS IS IMPORTANT TO THE ANALYSIS OF PRUDENCE, OR IMPRUDENCE, AS THE CASE MAY BE?

A In order to prove imprudence, the AGP task at this juncture, it is important to know that the relevant documents have been provided and considered. Of course, AGP has also supplemented those documents with exhibits drawn from GMO's document production that are also now part of the record.

Q DID GMO DESCRIBE THE HEDGING PROGRAM IN ITS ANSWERS PROVIDED IN HEARING EXHIBIT 3?

A Yes, as follows: "The purpose of the Aquila Steam Hedging Program was to mitigate the impact of high natural gas prices while still providing some opportunity to participate in low natural gas prices. The premise of the program was that if the market went up, 66% of your budgeted volumes protected. Conversely, **if the market went down, a benefit would be derived from the 33% of the budgeted volumes left to float with the markets, as well as the 33% that was covered in call options, minus the premiums. The program was designed to be market neutral**." (emphasis supplied) (see Schedule 1 for complete Q and A)

GMO described 2/3 participation in the benefits if market prices were to fall as the effect of a program designed to be market neutral. There was no discussion of the use of "puts" that were not neutral.

Q WHAT IS THE EXTENT OF THE ANALYSIS THAT GMO PERFORMED THAT IS REFLECTED IN THE GMO DOCUMENTS THAT WERE PROVIDED?

A No documents were provided by GMO that evidence any analysis of natural gas' use as a swing fuel at the Lake Road Station. GMO provided no documents that evidenced any analysis of the efficacy of the 1/3 strategy that Mr. Clemens described to the Commission. GMO provided no evidence that it had ever studied its deviation from the stated 1/3 strategy to incorporate the sale of puts. Aquila implemented and administered a program different from Mr. Clemens' description of the program – without study or explanation that has been provided by GMO.

Q IS THERE ANYTHING BESIDES THE SWORN TESTIMONY, OR THE CERTIFIED RESPONSES IN HEARING EXHIBIT 3 THAT DOCUMENTS THE HEDGE PROGRAM?

A An email from Mr. Williams was provided and was admitted as Hearing Exhibit 4 and is included here as Schedule 2. It's date is February 15, 2006, several days prior to the HR-2005-0450 hearing on February 27, 2006. It speaks in generalities without the explanations of Mr. Clemens and Hearing Exhibit 3. No other contemporaneous documentation nor studies that evidence the analysis of the program Mr. Clemens described was provided, nor has GMO provided any evidence that it analyzed the effect of the modification to include the sale of puts.

Q DID GMO CITE THE COMMISSION'S RULES FOR LDC'S?

A Yes. GMO referenced Rule 4 CSR 240-40.018 which in part provides:

> "In making this planning effort, natural gas utilities should consider the use of a broad array of pricing structures, mechanisms, and

> instruments, including, but not limited to, those items described in (2)(A) through (2)(H), to balance market price risks, benefits, and price stability. Each of these mechanisms may be desirable in certain circumstances, but each has unique risks and costs that require evaluation by the natural gas utility in each circumstance." (4 CSR 240-40.018.1.B, see Schedule 3 for a copy of the rule)

Q IF THERE WERE NO STUDIES AND NO EVALUATIONS, WHO AT AQUILA MADE THE DECISIONS?

A In his testimony at the hearing Mr. Clemens deferred to Mr. Gottsch. Mr. Gottsch disclaimed these decisions but did what he was told to do by his superiors. Neither Mr. Blunk nor Mr. Rush were Aquila employees although both provided answers in Hearing Exhibit 3. Per discovery, GMO purportedly provided all relevant documents. These documents did not contain either studies or evaluations by Aquila "management."

THE HEDGED GAS VOLUMES FOR 2006 AND 2007 WERE WRONG 100%

Q IS THERE A GMO EXHIBIT THAT ILLUSTRATES THE MAGNITUDE OF THE ERROR?

A Yes. Hearing Exhibit 109 (included as Schedule 4) was introduced by GMO. In the first column GMO shows the "actual burn" for April 2006 through December 2007 of just under 1.5 million mmBtu. Per Mr. Clemens' earlier testimony about the design of the hedging program, the Hedge volumes for this burn of gas would have been 1/3 for futures, roughly .5 million mmBtu, and 1/3 for call options for another roughly .5 million mmBtu. The total hedges according to the advertised program would have been just under 1 million mmBtu. The remaining 1/3 of the burn would have been purchased at market prices with no hedge effect.

In the second column GMO shows the actual hedges. The total hedges were over 2 million mmBtu, which is more than 100% greater than what they should have been based on actual burn volumes.

Hearing Exhibit 109 does not show the volumes to be purchased at market prices. The budget burn was 100% greater than actual, the futures were 100% greater, and the calls (actually collars) were 100% greater. Hearing Exhibit 109 shows no gas purchased at market prices.

Q CAN YOU BREAK DOWN THE ERROR INTO THE QUARTERLY PERIODS?

A Yes. Please see Schedule 5. The errors were less than 100% in some quarters, but well over 100% in others. Averaging roughly 100% for the 2006-2007 years, the quarterly errors are shown.

Q WHAT WAS THE IMPACT OF THESE ERRORS IN THE BURN FORECAST?

A The market price part of the plan never came into play. Schedule 6 shows that the volume variations were greater than the 1/3 that was intended to be priced at market, excepting only the first Quarter of 2007 during which the market priced volumes were greatly reduced.

Q IS THE NATURAL GAS BURNED IN THE STEAM BUSINESS IN THE NATURE OF A SWING FUEL?

A Yes. GMO acknowledged that natural gas use at the Lake Road Station is used as a "swing" fuel. Schedule 7 illustrates the wide month to month swings. The monthly changes in the downward direction exceeded 50% a number of times. In the positive direction there were monthly swings of over 50% and even above 100%. In contrast, the variations in customer load were small.

Q WHAT CAN BE GLEANED FROM SCHEDULE 7.

A First, that gas is a swing fuel is well illustrated as well as acknowledged by GMO. Second, in comparison, the volatility in customer loads is small.

Q DID AQUILA DISTINGUISH BETWEEN "BASE LOAD" GAS AND SWING GAS FOR THE PURPOSES OF ITS PHYSICAL PURCHASES?

A Yes. Hearing Exhibit 8, authored by Mr. Blunk, states:

> "Physical natural gas for steam production is typically purchased either as a monthly product with daily pro rata deliveries or as a daily product. Typically about one-third (20-40%) of the expected usage based on historical usage patterns is purchased as a monthly or "base load" product. The remainder is purchased as a daily product. The daily purchased volumes are based on day ahead or that day usage estimates." (Schedule 8)

In the physical world of gas deliveries only 20-40% could be purchased as base load.

Q DID AQUILA AND GMO EFFECTIVELY MONITOR THE GAS REQUIREMENTS AND MAKE THE NECESSARY ADJUSTMENTS?

A No.

Q DID GMO USE DOLLAR COST AVERAGING IN THE PURCHASE OF THE HEDGE POSITIONS?

A According to Hearing Exhibit 14 (which I have attached as Schedule 9) there was an intent to dollar cost average. However, 2006 hedges were all purchased at one time in February, 2006 and 2007 hedges were all purchased between February and October 2006 although the program was "suspended" beginning November 1, 2007.

<u>**COST TO AGP**</u>

Q WHAT ARE THE COSTS INCURRED BY AGP DUE TO THE HEDGE PROGRAM ACTIVITY

DURING 2006 AND 2007?

A The costs incurred were originally passed through to all steam customers based on their usage pursuant to the terms of the QCA. In accordance with the earlier Commission Report and Order, all hedge program costs for 2006 and 2007 have been refunded to all customers through the QCA mechanism. Thus, at this time the answer is zero as regards costs for years 2006 and 2007. AGP makes no further claim so long as this result is maintained.

Q IS IT PRUDENT TO OPERATE WITHOUT A HEDGE PROGRAM AND WITH ONLY THE QCA MECHANISM IN PLACE?

GMO has now operated since November 2007 without a natural gas hedge program and there has been no suggestion that operations without the past hedge program have been imprudent as a result. This also illustrates that a zero hedge program cost is a reasonable level of costs.

Q WHAT ARE THE COSTS INCURRED BY AGP DUE TO THE HEDGE PROGRAM ACTIVITY DURING 2008?

A In 2008 there was no Staff or customer initiated prudence review and no complaint. Although there were errors in estimations, the errors were within the 10% tolerance band of the QCA mechanism. Accordingly, hedge program costs were collected through the QCA mechanism and there has been no effort to disturb that result.

Q WHAT ARE THE COSTS INCURRED BY AGP DUE TO THE HEDGE PROGRAM ACTIVITY DURING 2009?

A AGP shared in the costs according to the QCA tariff charges. The amount in total is $1,244,510.

Q SHOULD THE AGP COSTS FOR THE HEDGE PROGRAM BE ZERO?

A Yes, based on two different lines of reasoning. First, based on experience, it would have been reasonable to go forward without a hedge program and rely on the operation of the QCA. Indeed GMO at the behest of AGP terminated the program November 1, 2007 and there has been no suggestion by anyone that the termination of and absence of a hedge program has been anything other than cost effective. With no hedge program there would have been no hedge program costs. Thus, zero is the amount of prudent cost that should be recovered for this period. Given that these excessive costs have already been passed through to all steam customers through the QCA mechanism based on their respective usage, refund should be directed in the amount noted above.

Second, once the hedge program was terminated, GMO reports that remaining hedges could have been liquidated with no cost. GMO action to extinguish these costs would have been reasonable. Conversely, given GMO's knowledge of its ability to cash out at zero cost, the decision to maintain hedge exposures in the face of a troubled and already "suspended" program was not reasonable. Thus, the entire cost should be disallowed and refunded to the steam customers through the QCA mechanism.

Q DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A Yes.

19. The Aquila Steam Hedging Program was a financial program that had no effect on the physical adequacy of steam service provided to customers.

Response: Assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism" described in Section 8 of the Stipulation and Agreement approved by the Commission in Case No. HR-2005-0450, GMO denies Request No. 19.

20. The Aquila Steam Hedging Program was a financial program that had no effect on the physical reliability of the steam generation and distribution system.

Response: Assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism" described in Section 8 of the Stipulation and Agreement approved by the Commission in Case No. HR-2005-0450, GMO denies Request No. 20.

21. The Aquila Steam Hedging Program was intended solely to stabilize the cost of natural gas used in the generation of steam for service to steam customers.

Response: Assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism" described in Section 8 of the Stipulation and Agreement approved by the Commission in Case No. HR-2005-0450, GMO denies Request No. 21 because that was not the sole intention.

22. The Aquila Steam Hedging Program was designed solely to stabilize the cost of natural gas used in the generation of steam for service to steam customers.

Response: Assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism" described in Section 8 of the Stipulation and Agreement approved by the Commission in Case No. HR-2005-0450, GMO denies Request No. 22 because that was not the sole reason for the design of the program.

23. The Aquila Steam Hedging Program was financially independent of any and all other natural gas hedging programs used by Aquila, Inc. and any of its affiliates or divisions.

Response: GMO objects to this request because it is vague and ambiguous, calling for speculation, and potentially calls for a legal conclusion in that the term "financially independent" is not defined and subject to interpretation. Subject to and without waiving these objections, and assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism"

a. & b. The hedges placed under the Aquila Steam Hedging Program were a collection of NYMEX futures contracts and NYMEX call options. Through August 2009 Aquila and then GMO have settled those hedges financially. The NYMEX however does provide that buyer or seller may exchange a futures position for a physical position or a swaps position of equal quantity by submitting a notice to the Exchange. An alternate delivery procedure is also available to buyers and sellers who have been matched by the Exchange subsequent to the termination of trading in the spot month contract. Buyers and sellers can agree to consummate delivery under terms different from those prescribed in Exchange's contract specifications.

c. All of the hedges under the Aquila Steam Hedging Program that have settled through August 2009 have been settled financially. Consequently it appears the Aquila Steam Hedging Program has not had a direct impact on the physical reliability of the steam generation and distribution system. To determine if the Aquila Steam Hedging Program could have an impact on the physical reliability of the steam generation and distribution system would require speculation and conjecture to identify such effects. Therefore this subpart is objected to as requiring speculation.

d. Objection. It is unduly burdensome to list "all facts" that may support our position. Subject to and without waiving this objection, facts that support our position are presented above.

e. Objection. It is unduly burdensome to list "all persons known" to have information. Subject to and without waiving this objection, Ed Blunk has general knowledge.

f. Objection. It is unduly burdensome to identify "all documents" containing information regarding a hedging programs effect on physical supply. Subject to and without waiving this objection, the fact that NYMEX futures contracts can be exchanged for physical is supported by public information that is readily available from NYMEX.

25. If your response to First Request for Admissions of Fact by KCPL-GMO No. 21 tendered herewith is anything other than an unqualified admission:

a. Identify the intended goals, purposes and objectives of the Aquila Steam Hedging Program as implemented by Aquila, Inc.

b. Identify whether these goals, purposes and objectives of the design of the Aquila Steam Hedging Program were achieved and by what index of measurement they were evaluated.

c. Identify all facts that you contend support your contention.

d. Identify all persons known to you to have any information regarding such contention.

e. Identify all documents in your possession, custody or control that you believe contain information regarding your contention.

ANSWER: Assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism" described in Section 8 of the Stipulation and Agreement approved by the Commission in Case No. HR-2005-0450, GMO states:

a. The purpose of the Aquila Steam Hedging Program was to mitigate the impact of high natural gas prices while still providing some opportunity to participate in low natural gas prices. The premise of the program was that if the market went up, 66% of budgeted volumes protected. Conversely, if the market went down, a benefit would be derived from the 33% of the budgeted volumes left to float with the markets, as well as the 33% that was covered in call options, minus the premiums. The primary intent of the program was to average the market cost over an extended period of time.

b. When actual volumes were substantially less than budgeted volumes, the 33% of budgeted volumes left to float with the market was effectively reduced. In other words, lower than expected volumes reduced the program's ability to benefit from lower market prices and during a declining market resulted in a higher average cost of natural gas. The Aquila Steam Hedging Program was implemented in February 2006 and suspended about 21 months later. To determine if the program achieved its goals, purposes and objective of the design would be speculative conjecture. Therefore this subpart is objected to as requiring speculation.

c. Objection. It is unduly burdensome to list "all facts" that may support our position. Subject to and without waiving this objection, facts that support our position as presented above.

d. Objection. It is unduly burdensome to list "all persons known" to have information. Subject to and without waiving this objection, Ed Blunk has general knowledge.

e. Objection. It is unduly burdensome to identify "all documents" containing information regarding the intention or design of the Aquila Steam Hedging Program. Subject to and without waiving this objection, responsive documents will be provided.

26. If your response to First Request for Admissions of Fact by KCPL-GMO No. 22 tendered herewith is anything other than an unqualified admission:

a. Identify the design goals, purposes and objectives of the Aquila Steam Hedging Program as implemented by Aquila, Inc.

b. Identify whether these goals, purposes and objectives of the design of the Aquila Steam Hedging Program were achieved and identify the index of measurement of measurement by which they were evaluated.

c. Identify all facts that you contend support your contensions.

d. Identify all persons known to you to have any information regarding such contentions.

e. Identify all documents in your possession, custody or control that you believe contain information regarding your contentions.

ANSWER: Assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism" described in Section 8 of the Stipulation and Agreement approved by the Commission in Case No. HR-2005-0450, GMO states:

a. The purpose of the Aquila Steam Hedging Program was to mitigate the impact of high natural gas prices while still providing some opportunity to participate in low natural gas prices. The premise of the program was that if the market went up, 66% of your budgeted volumes protected. Conversely, if the market went down, a benefit would be derived from the 33% of the budgeted volumes left to float with the markets, as well as the 33% that was covered in call options, minus the premiums. The program was designed to be market neutral.

b. When actual volumes were substantially less than budgeted volumes, the 33% of budgeted volumes left to float with the market was effectively reduced. In other words, lower than expected volumes reduced the program's ability to benefit from lower market prices and during a declining market resulted in a higher average cost of natural gas. The Aquila Steam Hedging Program was implemented in February 2006 and suspended about 21 months later. To determine if the program achieved its goals, purposes and objective of the design would be speculative conjecture. Therefore this subpart is objected to as requiring speculation.

c. Objection. It is unduly burdensome to list "all facts" that may support our position. Subject to and without waiving this objection, facts that support our position are presented above.

d. Objection. It is unduly burdensome to list "all persons known" to have information. Subject to and without waiving this objection, Ed Blunk has general knowledge.

e. Objection. It is unduly burdensome to identify "all documents" containing information regarding the intention or design of the Aquila Steam Hedging Program. Subject to and without waiving this objection, responsive documents will be provided.

27. If your response to First Request for Admissions of Fact by KCPL-GMO No. 23 tendered herewith is anything other than an unqualified admission:

a. Identify any interrelationship that you contend existed between the Aquila Steam Hedging Program and any other natural gas hedging program used by Aquila, Inc. or by any of its affiliates or divisions.

b. Identify the manner in which this interrelationship you contend existed was implemented by Aquila, Inc. or by any of its affiliates or divisions.

c. Identify all facts that you contend support your contentions.

d. Identify all persons known to you to have any information regarding such contentions.

e. Identify all documents in your possession, custody or control that you believe contain information regarding your contentions.

ANSWER: GMO objects to Request No. 23 and Interrogatory No. 27 because it is vague and ambiguous, calls for speculation and potentially calls for a legal conclusion in that the term "financially independent" is not defined and subject to interpretation. Subject to and without waiving these objections, and assuming that AgP is referring to the timeframe associated with the "Fuel Cost Customer/Utility Alignment Mechanism" described in Section 8 of the Stipulation and Agreement approved by the Commission in Case No. HR-2005-0450, GMO admitted that the Aquila Steam Hedging Program was separate from the other Aquila hedging programs, but denies all other allegations contained in Request No. 23 and Interrogatory No. 27.

Gottsch Gary

From: Williams, Denny
Sent: Wednesday, February 15, 2006 10:17 AM
To: Gottsch Gary; Heidtbrink Scott
Cc: Clemens, Gary; Lowsley, Tom; Korte, Andrew
Subject: RE: St. Joe steam usage volumes

The sharing mechanism in the steam case provides for the flow through of hedge costs into the fuel sharing mechanism. Therefore, I believe that hedging of the anticipated gas volumes necessary to serve the steam load is prudent and that a policy similar to the one for electric volumes (1/3, 1/3, 1/3) if stated in advance in writing would be deemed prudent.

Just one note of clarification. The steam settlement has not been filed with the Commission yet pending some last minute Staff review. However, I do not think that impacts the prudence of our decision to hedge the gas volumes. We should follow whatever procedure we would normally take whether or not there is sharing mechanism.

From: Gottsch, Gary
Sent: Wednesday, February 15, 2006 10:07 AM
To: Williams, Denny; Heidtbrink, Scott
Cc: Clemens, Gary; Lowsley, Tom; Korte, Andrew
Subject: FW: St. Joe steam usage volumes

I will draft a procedure for the Risk Management committee review. At this point we would envision a procedure similar to the plan already in place for Missouri Electric designed for budgeted volumes, using the 1/3, 1/3, 1/3 strategy. We are assuming that the procedure would be deemed prudent with respect to the rate stipulation's risk sharing design.

From: Gottsch, Gary
Sent: Wednesday, February 15, 2006 9:46 AM
To: Heidtbrink, Scott; Korte, Andrew
Cc: Lowsley, Tom
Subject: St. Joe steam usage volumes

I have received from Tim Nelson a budget for steam usage volumes for St.Joe due to new and expanding existing customers. I have a breakdown by month for Nat Gas consumption for this purpose which amounts to around 1.5 BCF for '06, and around 2.4 BCF for '07 & '08 each. The discussion in the past is that we may want to incorporate these volumes into our Missouri Electric gas hedge plan. l) Is that still the case? 2) If so, when can I begin to implement? 3) Do we want to keep these volumes seperated or just fold them into the existing Missouri Electric Hedge plan? 4) Is the 1/3, 1/3, 1/3 approach still acceptable?

Gary Gottsch
Aquila Networks-Energy Resources
816-737-7825 work
816-896-9282 cell

included in the fully distributed cost calculation through a general allocation.

(D) HVAC services means the warranty, sale, lease, rental, installation, construction, modernization, retrofit, maintenance or repair of heating, ventilating and air conditioning (HVAC) equipment.

(E) Regulated gas corporation means a gas corporation as defined in section 386.020, RSMo, subject to commission regulation pursuant to Chapter 393, RSMo.

(F) Utility contractor means a person, including an individual, corporation, firm, incorporated or unincorporated association or other business or legal entity, that contracts, whether in writing or not in writing, with a regulated gas corporation to engage in or assist any entity in engaging in HVAC services, but does not include employees of a regulated gas corporation.

(2) A regulated gas corporation may not engage in HVAC services, except by an affiliated entity, or as provided in sections (8) and (9) of this rule.

(3) No affiliated entity or utility contractor may use any vehicles, service tools, instruments, employees, or any other regulated gas corporation assets, the cost of which are recoverable in the regulated rates for regulated gas corporation service, to engage in HVAC services unless the regulated gas corporation is compensated for the use of such assets at the fully distributed cost to the regulated gas corporation.

(A) The determination of a regulated gas corporation's cost in this section is defined in subsection (1)(D) of this rule.

(4) A regulated gas corporation may not use or allow any affiliated entity or utility contractor to use the name of such regulated gas corporation to engage in HVAC services unless the regulated gas corporation, affiliated entity or utility contractor discloses, in plain view and in bold type on the same page as the name is used on all advertisements or in plain audible language during all solicitations of such services, a disclaimer that states the services provided are not regulated by the commission.

(5) A regulated gas corporation may not engage in or assist any affiliated entity or utility contractor in engaging in HVAC services in a manner which subsidizes the activities of such regulated gas corporation, affiliated entity or utility contractor to the extent of changing the rates or charges for the regulated gas corporation's services above or below the rates or charges that would be in effect if the regulated gas corporation were not engaged in or assisting any affiliated entity or utility contractor in engaging in such activities.

(6) Any affiliated entities or utility contractors engaged in HVAC services shall maintain accounts, books and records separate and distinct from the regulated gas corporation.

(7) The provisions of this rule shall apply to any affiliated entity or utility contractor engaged in HVAC services that is owned, controlled or under common control with the regulated gas corporation providing regulated services in the state of Missouri or any other state.

(8) A regulated gas corporation engaging in HVAC services in the state of Missouri five (5) years prior to August 28, 1998, may continue providing, to existing as well as new customers, the same type of services as those provided by the regulated gas corporation five (5) years prior to August 28, 1998.

(A) To qualify for this exemption, the regulated gas corporation shall file a pleading before the commission for approval.

1. The commission may establish a case to determine if the regulated gas corporation qualifies for an exemption under this rule.

(9) The provisions of this section shall not be construed to prohibit a regulated gas corporation from providing emergency service, providing any service required by law or providing a program pursuant to an existing tariff, rule or order of the commission.

AUTHORITY: sections 386.760.1, RSMo Supp. 1998 and 393.140, RSMo 1994. Original rule filed Dec. 17, 1998, effective Aug. 30, 1999.*

**Original authority: 386.710.1, RSMo 1998 and 393.140, RSMo 1939, amended 1949, 1967.*

4 CSR 240-40.018 Natural Gas Price Volatility Mitigation

PURPOSE: This rule represents a statement of commission policy that natural gas local distribution companies should undertake diversified natural gas purchasing activities as part of a prudent effort to mitigate upward natural gas price volatility and secure adequate natural gas supplies for their customers.

(1) Natural Gas Supply Planning Efforts to Ensure Price Stability.

(A) As part of a prudent planning effort to secure adequate natural gas supplies for their customers, natural gas utilities should structure their portfolios of contracts with various supply and pricing provisions in an effort to mitigate upward natural gas price spikes, and provide a level of stability of delivered natural gas prices.

(B) In making this planning effort, natural gas utilities should consider the use of a broad array of pricing structures, mechanisms, and instruments, including, but not limited to, those items described in (2)(A) through (2)(H), to balance market price risks, benefits, and price stability. Each of these mechanisms may be desirable in certain circumstances, but each has unique risks and costs that require evaluation by the natural gas utility in each circumstance. Financial gains or losses associated with price volatility mitigation efforts are flowed through the Purchased Gas Adjustment (PGA) mechanism, subject to the applicable provisions of the natural gas utility's tariff and applicable prudence review procedures.

(C) Part of a natural gas utility's balanced portfolio may be higher than spot market price at times, and this is recognized as a possible result of prudent efforts to dampen upward volatility.

(2) Pricing Structures, Mechanisms and Instruments:

(A) Natural Gas Storage;
(B) Fixed Price Contracts;
(C) Call Options;
(D) Collars;
(E) Outsourcing/Agency Agreements;
(F) Futures Contracts; and
(G) Financial Swaps and Options from Over the Counter Markets; and
(H) Other tools utilized in the market for cost-effective management of price and/or usage volatility.

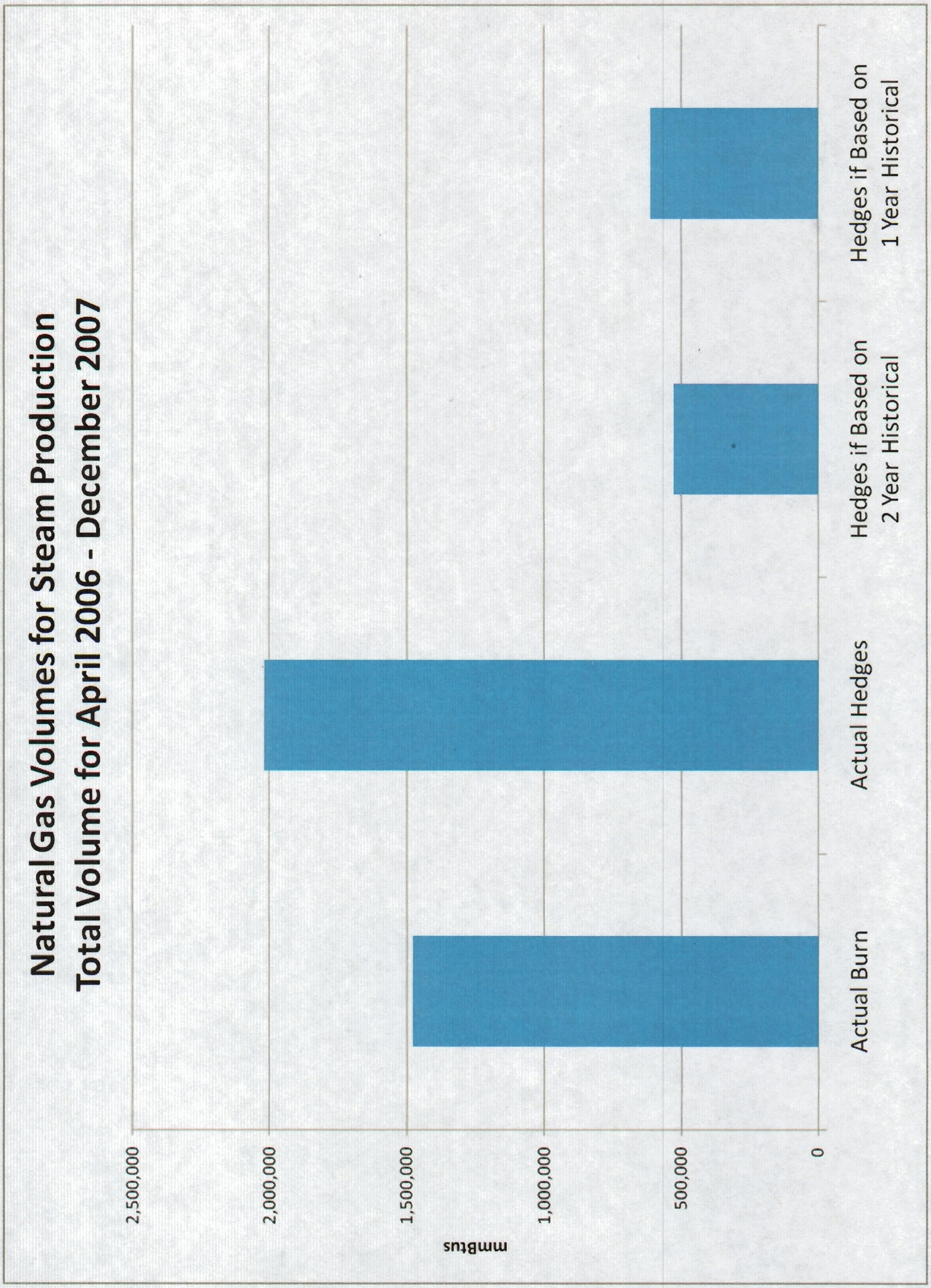
AUTHORITY: sections 386.250, RSMo 2000 and 393.130, RSMo Supp. 2003. Original rule filed May 1, 2003, effective Dec. 30, 2003.*

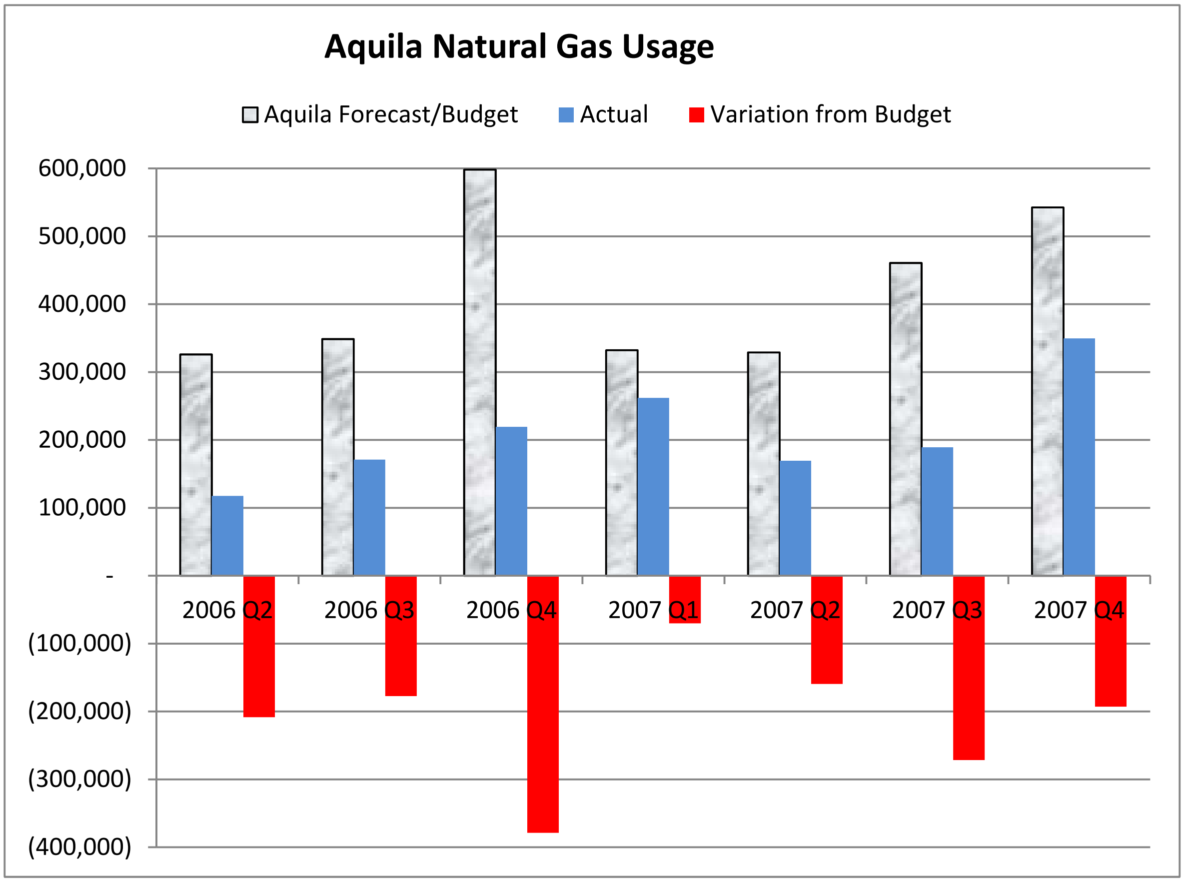
**Original authority: 386.250, RSMo 1939, amended 1963, 1967, 1977, 1980, 1987, 1988, 1991,1993, 1995, 1996; 393.130, RSMo 1939, amended 1967, 1969, 2002.*

4 CSR 240-40.020 Incident, Annual, and Safety-Related Condition Reporting Requirements

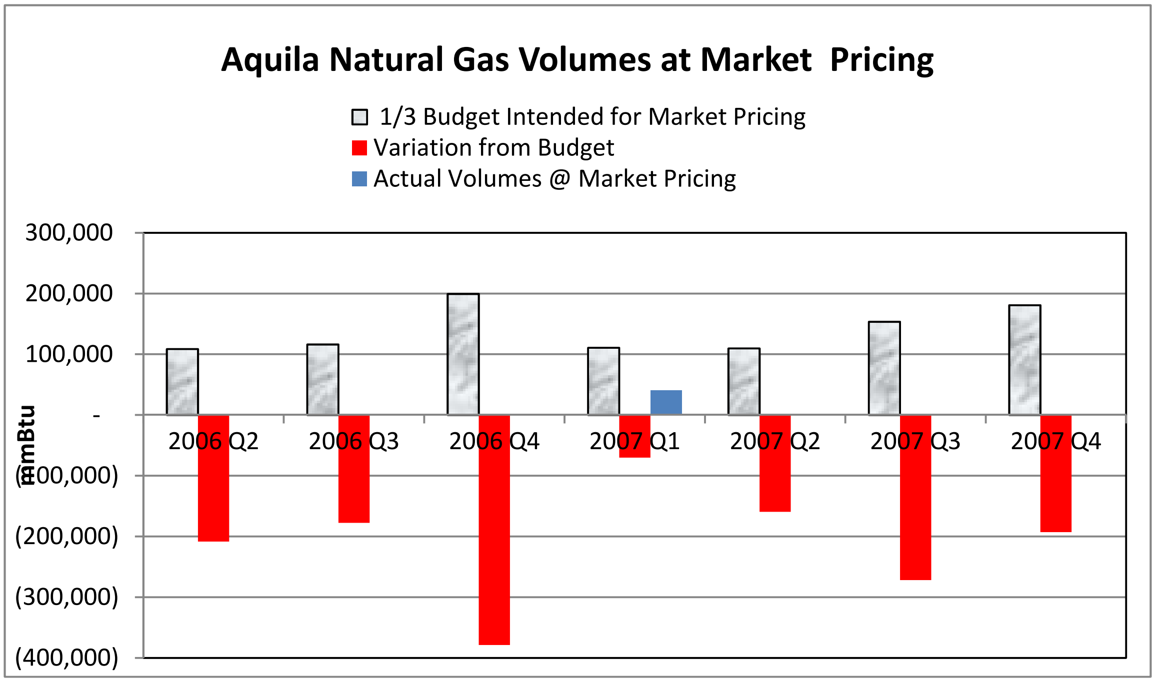
PURPOSE: This rule prescribes requirements and procedures for reporting certain gas-related incidents and safety-related conditions and for filing annual reports. It applies

109

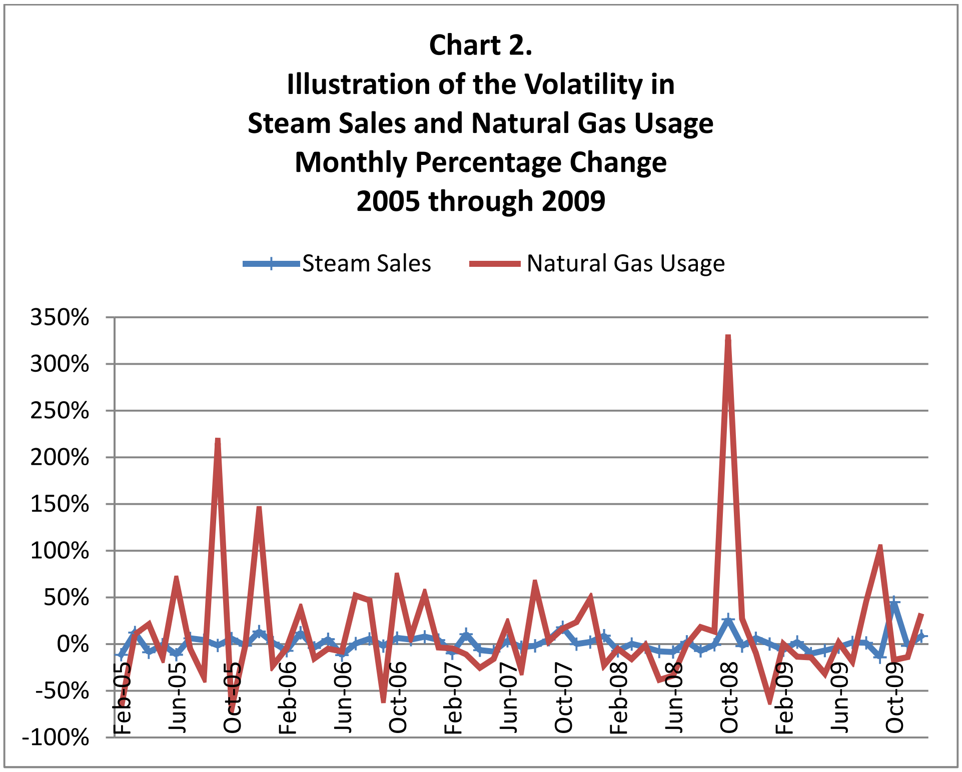

Natural Gas Volumes for Steam Production
Total Volume for April 2006 - December 2007
mmBtus
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
Actual Burn
Actual Hedges
Hedges if Based on 2 Year Historical
Hedges if Based on 1 Year Historical



Source: HC-2010-0235, Donald Johnstone Rebuttal Testimony, p. 22



Source: HC-2010-0235, Donald Johnstone Rebuttal Testimony, p. 7



Source: HC-2012-0259, Donald Johnstone Surrebuttal Testimony, page 14.

Questions from Cary Featherstone regarding Aquila Steam Fuel:

How were the purchases of natural gas and hedging made-- by the use of the forecast/budget expected volumes/ amounts by month or on annual basis?

Were the purchases and hedging instruments made on some type of adjusted budget levels, i.e., as the budget levels didn't materialize were the forecasts adjusted to ensure that quantities of natural gas were not over-purchased?

Cary is trying to gain an understanding of the purchasing policies of the natural gas amounts in volumes and how the expected steam loads impacted, if any, the procurement process of the natural gas commodity both in terms of actual procurement and how much to hedge.

REPLY:

Under Aquila's 1/3, 1/3, 1/3 hedge strategy 1/3 of budgeted volumes were fixed by purchasing NYMEX futures contracts, 1/3 of budgeted volumes were protected by purchasing either vanilla or synthetic NYMEX call options. The remaining 1/3 of budgeted volumes were not hedged. The budgets used to develop those volumetric forecasts were typically developed prior to mid-July of the year preceding the first year of the budget horizon.

By the time it was apparent that actual steam load was significantly less than budgeted volumes it was too late to affect Aquila's natural gas hedge program for the steam system. The hedges would have already been purchased.

Physical natural gas for steam production is typically purchased either as a monthly product with daily pro rata deliveries or as a daily product. Typically about one-third (20-40%) of the expected usage based on historical usage patterns is purchased as a monthly or "base load" product. The remainder is purchased as a daily product. The daily purchased volumes are based on day ahead or that day usage estimates.

10/02/2009
Ed Blunk

BEFORE THE

PUBLIC SERVICE COMMISSION OF MISSOURI

Ag Processing, Inc., a Cooperative, Complainant,	)	
v. KCP&L,	)	HC-2012-0259
Greater Operations Company, Respondent	)	

Affidavit of Donald E. Johnstone

State of Missouri	)	
	)	SS
County of Camden	)	

Donald E. Johnstone, being first duly sworn, on his oath states:

1. My name is Donald E. Johnstone. I am a consultant and President of Competitive Energy Dynamics, L. L. C. I reside at 384 Black Hawk Drive, Lake Ozark, MO 65049. I have been retained by AG PROCESSING INC, A COOPERATIVE.

2. Attached hereto and made a part hereof for all purposes are my testimony and schedules in written form for introduction into evidence in the above captioned proceeding.

3. I hereby swear and affirm that my testimony is true and correct and show the matters and things they purport to show.

Donald E. Johnstone

Donald E. Johnstone

Subscribed and sworn to this 13th day of May, 2013

Christine A. Ferguson

Notary Public

CHRISTINE A. FERGUSON
Notary Public - Notary Seal
State of Missouri
Commissioned for Camden County
My Commission Expires: March 19, 2015
Commission Number: 11390857

Competitive Energy

DYNAMICS