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Hedging Expenses
Riley/Rebuttal
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ER-2016-0156

REBUTTAL TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

KCP&L GREATER MISSOURI OPERATIONS COMPANY

CASE NO. ER-2016-0156

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Denotes Highly Confidential Information that has been Redacted

August 15, 2016

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OF

JOHN S. RILEY

KCP&L GREATER MISSOURI OPERATIONS COMPANY

CASE NO. ER-2016-0156

I. INTRODUCTION

Q. Please state your name and business address.

A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102

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

A. I am employed by the Missouri Office of the Public Counsel (“OPC”) as a Public Utility Accountant.

Q. Are you the same John Riley that filed testimony before the Missouri Public Service Commission (“Commission”) in this matter?

A. Yes I am.

Q. What is the purpose of your rebuttal testimony?

A. I will comment on KCP&L Greater Missouri Operations Company (“Company” or “GMO”) witness Wm. Edward Blunk’s contention that:

1. GMO market purchases of fuel and purchase power face market volatility;
2. Market impact on fuel costs is substantial; and
3. Market impact on fuel costs is beyond the control of utility management.

I will also respond to Staff witness Mr. Dana Eaves’ proposal that the Company suspend its hedging activities at this time and eliminate wording in the FAC tariff so that the Company not be allowed to include purchase power hedging costs in the Fuel Adjustment Clause (“FAC”).

1 **Q. What is the importance of volatility in commodity prices?**

2 A. Volatility is one of the three main considerations that the Commission rule requires in the
3 determination if a fuel cost should be included in a company's FAC.¹ GMO's lack of any
4 significant volatility in natural gas prices over an extended period of time is OPC's chief
5 argument why GMO should discontinue hedging for natural gas and purchase power at this
6 time.

7 The Commission has approved 4 CSR 240-20.090 *Electric Utility Fuel and Purchased*
8 *Power Cost Recovery Mechanisms* to set forth definitions, structure, operation, and
9 procedures relevant to the filing and processing of applications to reflect prudently incurred
10 fuel and purchased power costs through an FAC.

11 The Commission also explains the main considerations used to determine if a cost should be
12 included in subsection (2) (C):

13 In determining which cost components to include in [an FAC], the
14 commission will consider, but is not limited to only considering, the
15 **magnitude of the costs**, the **ability of the utility to manage the costs**, the
16 **volatility of the cost** component and incentive provided to the utility as a
17 result of the inclusion or exclusion of the cost component. The commission
18 may, in its discretion, determine what portion of prudently incurred fuel and
19 purchased power costs may be recovered in [an FAC] and what portion shall
20 be recovered in base rates. (Emphasis added)

21
22 **Q. Mr. Blunk testifies that there is "significant volatility" in the price of natural gas. Do**
23 **you agree?**

24 A. No. Mr. Blunk spends a great deal of effort trying to convince the Commission that, even
25 though the price of natural gas has fallen from \$6.15 to a low of \$1.91, there is still
26 considerable volatility in the natural gas market. The U.S. Energy Information
27 Administration ("EIA") reports that from January 2014 through December 2015 natural gas

¹ 4 CSR 240-20.090(2)(C)

1 prices have stabilized below \$3.00/mmBtu and there has only been one month where the
2 monthly average price has changed by more than 16%.

Henry Hub Natural Gas Spot Price (Dollars per Million Btu)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2014	4.71	6.00	4.90	4.66	4.58	4.59	4.05	3.91	3.92	3.78	4.12	3.48
2015	2.99	2.87	2.83	2.61	2.85	2.78	2.84	2.77	2.66	2.34	2.09	1.93

4

5 Natural gas prices for these two years have shown a steady decline.

6 The Commission has pointed out in a past report and order that “[M]arkets in which prices
7 are volatile tend to go up and down in an unpredictable manner”². There is simply no
8 evidence that the current natural gas price market is unpredictable. Even Mr. Blunk points
9 out in his testimony **“...the development of shale based natural gas resources has
10 greatly increased the expected supply of natural gas. That in turn has depressed the
11 long-term outlook for natural gas prices.”**³

12 **Q. You pointed out in your direct testimony that a majority of the Company’s hedging
13 losses in the test year were due to cross hedging purchase power. Does Mr. Blunk
14 describe how cross hedging work?**

15 **A.** Mr. Blunk explains in his testimony that “(c)ross hedging is a risk management strategy that
16 involves offsetting a position in one commodity with an equal position in a different
17 commodity with similar price movements”⁴ Mr. Blunk goes on to state he believes there is
18 a strong correlation between the price of purchase power and the price of natural gas.

² Report and Order, Ameren Missouri, ER-2007-0002, p. 23 line 4,5

³ Direct testimony, Ed Blunk, ER-2016-0156, p21 lines 14-16

⁴ Blunk Direct p. 26 lines 20-22

1 **Q. Does GMO purchase power to serve its native load?**

2 A. Yes, GMO is a member of the Southwest Power Pool (“SPP”). GMO participates in the
3 SPP Integrated Market. When it is less expensive to buy from the market than to generate,
4 GMO buys from the SPP market. Because market prices have been lower than GMO’s cost
5 to generate power with its peaking capacity, GMO has been purchasing energy from the
6 SPP’s Integrated Market.

7 **Q. Assuming the argument that purchase power and natural gas prices have a strong**
8 **correlation, is there a lack of significant volatility in the purchase power market**
9 **similar to the natural gas market?**

10 A. Yes. As I explained in my direct testimony, GMO benefits from SPP’s coordinated effort to
11 provide power to its members on a least-costs basis⁵. As can be seen on page 9 of my direct
12 testimony schedule (JSR Schedule D-2), which I have reattached as JSR Schedule R-1, On-
13 Peak Market prices have followed the price of natural gas. In January 2015, MWh prices
14 were \$28.46 and natural gas was \$2.99/MMBtu and then by May of 2016, MWh prices were
15 \$19.65 and natural gas was \$1.89/MMBtu.

16 **Q. What has been GMO’s net average purchase price for power from the SPP over a**
17 **recent 12 month period?**

18 A. Reviewing company witness Mr. Burton L. Crawford’s workpapers that he used to develop
19 his direct testimony, net monthly power purchase costs ranged from ** ** in
20 August to a low of ** ** in November.⁶ The average monthly price paid for
21 the 12 month period was ** ** which is only 9.53% less than the August
22 high. These prices do not reflect the volatility Mr. Blunk claims is present. The rise and fall
23 of the monthly power purchase prices appears predictable.

⁵ FERC summary of the SPP, Riley direct p. 9

⁶ Crawford HC workpapers, SPPIM Summary, Net monthly \$ purchases divided by Net monthly MWh purchased

1 **Q. Does Mr. Blunk testify to volatility in the coal market as well?**

2 A. Yes. Mr. Blunk points out that the Company's practice of laddering a portfolio of coal
3 contracts mitigates short term volatility. He explains that, by the third quarter of the year,
4 the Company has all of next year's expected coal requirements under contract as well as
5 65% of the following year and 50% of the year after that. So a major portion of the
6 Company's coal requirements between expected rate case filings is locked in at a known
7 price.

8 **Q. Mr. Blunk has a section in his testimony⁷ where he points out that market volatility**
9 **has a substantial impact on the company fuel costs and he explains the price risk on**
10 **GMO's coal purchases is approximately ** **million over a four year period.**
11 **Do you agree with Mr. Blunk's assessment?**

12 A. No. Mr. Blunk explains that he uses a low forecast and a high forecast to calculate the
13 Company's coal price exposure. As my answer to the previous question points out that the
14 Company has a great deal of the coal under contract for the next few years so most market
15 risk has been mitigated.

16 **Q. The third point Mr. Blunk mentions in his argument for fuel and its inclusion into a**
17 **FAC is that "fuel costs are beyond the control of management." Do you agree?**

18 A. No. As I mentioned earlier in my testimony, the three main components the Commission
19 listed in Paragraph (2)(C) of 4 CSR 240-20.090 are:

- 20 1. Magnitude of the costs
21 2. Volatility of the costs, and
22 3. Ability of the utility to manage the costs.
23

⁷ Blunk Direct, page 20 lines 6-17

1 GMO cannot control the market price of fuels but, with the exception of hedging for
2 natural gas and purchased power, it has been able to reasonably manage the majority of
3 its fuel costs.

4 **Q. Please explain.**

5 A. As noted earlier, Mr. Blunk's testimony points out that 100% of GMO's 2016 coal
6 purchases are under contract, 67% of 2017's requirements, and 50% of 2018 coal
7 purchase requirements are under contract.

8 **Q. Is coal GMO's primary fuel expense?**

9 A. Yes. Coal represents nearly ** ** of GMO's fuel expense.⁸ Therefore, GMO is able
10 to manage, through laddering of coal purchase and transportation contracts, a majority of
11 its fuel costs.

12 **Q. Does GMO face any near-term natural gas price volatility?**

13 A. No. Natural gas prices have been declining over the past several years and remain at a
14 historically low level. OPC has seen no evidence of any indication of an increase in
15 natural gas prices or purchased power prices. Purchased power from the SPP has proven
16 to be an efficient, low cost method for the Company to meet its native load requirements
17 without the need for hedging GMO's exposure to the SPP's integrated market power
18 prices.

19 **Q. How does OPC respond to Staff's recommendation that the Company suspend its
20 hedging activity and cease including purchase power hedging costs in its FAC?**

21 A. OPC agrees with Staff's position as supported by Staff witness Dana Eaves. Mr. Eaves'
22 inclusion of a table outlining the Company's historical hedging losses since 2009

⁸ Crawford direct, HC Schedule BLC-4, Cost of Service Model

1 reinforces OPC's position that hedging for purchase power is not necessary and results in
2 GMO incurring excessive and unnecessary costs which result in higher bills for GMO's
3 customers. OPC witness Lena M. Mantle, in her rebuttal testimony, describes reporting
4 requirements that OPC is recommending if GMO suspends natural gas hedging.

5 **Q. Does this conclude your rebuttal testimony?**

6 A. Yes it does.

7

8

9

SPP Real-Time Energy Market Prices

Month	Year	ATC (\$/MWh)	Off-Peak (\$/MWh)	On-Peak (\$/MWh)	Henry Hub Gas Prices (\$/mmBtu)
Jan	2015	\$ 24.62	\$ 21.09	\$ 28.46	\$ 2.99
Feb	2015	\$ 24.34	\$ 20.95	\$ 28.06	\$ 2.83
Mar	2015	\$ 22.83	\$ 19.57	\$ 26.06	\$ 2.79
Apr	2015	\$ 23.40	\$ 22.39	\$ 24.43	\$ 2.58
May	2015	\$ 21.83	\$ 20.07	\$ 24.12	\$ 2.83
Jun	2015	\$ 22.28	\$ 19.04	\$ 25.56	\$ 2.75
Jul	2015	\$ 25.95	\$ 21.79	\$ 30.18	\$ 2.82
Aug	2015	\$ 22.62	\$ 19.95	\$ 25.83	\$ 2.76
Sep	2015	\$ 21.77	\$ 17.88	\$ 26.03	\$ 2.65
Oct	2015	\$ 18.95	\$ 15.68	\$ 22.39	\$ 2.33
Nov	2015	\$ 18.71	\$ 16.11	\$ 21.73	\$ 2.07
Dec	2015	\$ 17.19	\$ 14.77	\$ 20.04	\$ 1.86
Jan	2016	\$ 19.33	\$ 17.45	\$ 21.83	\$ 2.27
Feb	2016	\$ 16.97	\$ 15.87	\$ 18.09	\$ 1.97
Mar	2016	\$ 16.67	\$ 14.14	\$ 18.93	\$ 1.69
Apr	2016	\$ 18.49	\$ 15.55	\$ 21.54	\$ 1.90
May	2016	\$ 17.17	\$ 15.00	\$ 19.65	\$ 1.89

Note: SPP prices at GMO load hub