BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Sixth Prudence	)	
Review of Costs Subject to the	)	
Commission-Approved Fuel	)	Case No. EO-2017-0065
Adjustment Clause of The Empire	)	
District Electric Company	)	

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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The Office of the Public Counsel ("OPC") requests a Public Service Commission ("Commission") order finding The Empire District Electric Company's ("Empire" or "Company") natural gas hedging costs for the Sixth Prudence Review Period were imprudently incurred. The evidence before the Commission shows Empire followed a strict self-imposed policy of purchasing set volumetric percentages of natural gas hedges regardless of price, when substantial information available at the time indicated the gas market had significantly changed, and such hedges were inflicting substantial losses which Empire continued to incur unless it suspended or modified its hedging policy. Empire failed to exercise reasonable diligence in mitigating the hedging losses incurred and passed on to customers when it chose not to change its policy and continued to incur hedging losses month after month, year after year, as if the market that existed in 2001 continued through 2016. The facts of this case demonstrate a pattern of imprudent decisions and an unwillingness to change; facts that highlight the very reason the Legislature limited cost recovery to only prudently incurred fuel and purchased power costs, and mandated any imprudently incurred costs is to be refunded to ratepayers. § 386.266.4(4) RSMo.

1. Imprudently Incurred Costs Prohibited

The Commission's authority to approve Fuel Adjustment Clauses (FACs) allows recovery of only prudently incurred fuel costs from ratepayers through an FAC. The law specifically limits "*the commission to approve periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in [the electric company's] prudently incurred fuel and purchase-power costs*." § 386.266.1 RSMo [emphasis added].

Because FAC clauses allow cost recovery from ratepayers *before* the Commission determines whether the fuel costs are prudent, the prudence of such costs is necessarily determined *after* Empire incurs the costs. The law requires FACs to include "*provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus interest at the utility's short term borrowing rate*." § 386.266.4(4) RSMo. The Legislature's decision to provide the Commission with refund authority over FAC costs, and to mandate refunds of any imprudently incurred costs, is indicative of the importance in ensuring all companies operating under an FAC clause are accountable for any instance of imprudence that resulted in ratepayer harm. This strict standard ensures utilities act reasonably, responsibly, and in the interests of their rate-paying customers, but is effective only if enforced by the Commission.

a. Would a Reasonable Person Keep Hedging?

The Commission has employed a "reasonable person" standard in past prudence reviews. *State ex rel. Associated Natural Gas Co. v. P.S.C.,* 954 S.W.2d 520 (Mo. App. 1997). Under the standard, Empire's "*conduct should be judged by asking whether the conduct was reasonable at the time under all circumstances, considering the company had to solve its problem prospectively rather than in reliance on hindsight*." *Id.* The Commission's "*responsibility is to determine how reasonable people would have performed the tasks that confronted the company*." *Id.* The Commission's task is to consider "all circumstances" and determine whether a reasonable person would have continued the hedging policy without modification in light of the facts available to Empire at the time it entered into the hedging transactions in question.

b. Presumption of Prudence Inapplicable

The burden is on the utility to prove that costs it passes along to customers are just and reasonable. § 393.150.2 RSMo; *Office of the Pub. Counsel v. Mo. PSC*, 409 S.W.3d 371, 376, (Mo. 2013) ("*Atmos*"). Despite this burden being placed on the utility by the statutes, past Commission practice "*has been to apply a "presumption of prudence" in determining whether a* *utility properly incurred its expenditures. The presumption of prudence is not a creature of statute or regulation*." *Id.*

In *Atmos,* the Missouri Supreme Court concluded a presumption of prudence is appropriate in arm's length transactions where "*there is a diminished probability of collusion and the pressures of a competitive market create an assumption of legitimacy*." *Id.* In other words, the presumption of prudence occurs where the utility has an incentive to be prudent in its expenditures. The application of such presumption is inapplicable in the present case given the lack of competitive pressures on Empire to conduct transactions prudently since Empire passes along to ratepayers ninety-five percent (95%) of all incremental changes to Empire's fuel costs, meaning Empire recovers well *above* 95% of fuel costs.[1] The incentive that would naturally pressure the utility to act prudently - that is, incurring costs that impact the company's earnings – are not present in mechanisms such as an FAC where essentially all costs are easily recovered from ratepayers.

The prudence review process does not provide the missing incentive since the Commission's Staff does not review the company's transactions for prudency, and only determines whether the company follows its own policy.[2]

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[1] The FAC recovers the incremental difference in fuel costs above the net base energy cost (*See* P.S.C. Mo. No. 5 Sec. 4, Revised Sheet No. 17a to 17e). For example, if the base were $100 and fuel costs were $110, the FAC would allow recovery of an additional $9.50, or 95% of the incremental change to the base amount, but would allow recovery of $109.50, or 99.5% of all fuel costs.

[2] The Staff's witnesses testified that the Staff only reviews FAC costs to ensure compliance with the company's self-imposed policies and the Commission-approved

Following the Supreme Court's reasoning in *Atmos,* without any competitive pressure to behave prudently, there should be no presumption of prudence for Empire's fuel hedging costs, and the burden should be on Empire from the outset to prove all hedging costs were prudent and reasonable.

c. Serious Doubt: Presumption of Prudence Defeated As Empire's Actions Were Inefficient and Improvident

If the Commission concludes that it should apply a presumption of prudence to Empire's hedging losses, the Commission has followed a standard where the presumption is defeated once another party raises a *serious doubt* about the prudence of the expenditure. This standard was explained by the Missouri Court of Appeals in *State ex rel. Associated Natural Gas Co. v. P.S.C.,* 954 S.W.2d 520 (Mo. App. 1997):

> Where some other participant in the proceeding creates serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditures to have been prudent.

The Court further explained the presumption of prudence "does not survive a showing of inefficiency or improvidence." *Id.* If the evidence before the Commission shows Empire was either inefficient in its hedging <u>or</u> Empire was improvident in its hedging, Empire loses its presumption of prudence and must *prove* its gas hedging costs were prudent.

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tariffs, and does not review to determine whether the company's fuel costs were prudent (Transcript ("Tr."), pp. 51, 259-260).

By definition, a utility's gas hedging is "inefficient" when it does not produce the intended result.[3] The intended result of gas hedging is to protect ratepayers from price spikes in a volatile gas market, which translates to the ratepayer as protecting the ratepayer from higher rates.[4] Empire's hedging policy has not produced the intended result. Since 2008, Empire's policy has resulted in $95 million in hedging losses – and caused significantly *higher* rates for ratepayers.[5] Every year since 2008 - eight years straight - Empire's hedging has cost its customers millions of dollars in higher rates, $12 million yearly on average.[6] The purpose of hedging is to protect ratepayers from higher rates. By not producing the intended result, Empire's gas hedging has clearly been inefficient. Empire was additionally inefficient by holding fast to its policy without modification. The evidence before the Commission, as explained below, clearly demonstrates Empire's policy and its actions were imprudent. It is Empire's burden to prove by a preponderance of the evidence in the record that the tens of millions of dollars of inefficient

[3] "*Inefficient: a. lacking the ability or skill to perform effectively…; b. not producing the intended result…*" The American Heritage® Dictionary of the English Language, Fifth Edition copyright ©2017 by Houghton Mifflin Harcourt Publishing Company.

[4] Empire tariff, P.S.C. Mo. No. 5, Section 4, Sheets No. 17b and 17g

[5] Tr. 137; Riley Surrebuttal, Ex. 3, JRS-S-1

[6] Exhibit ("Ex") 3, Schedule JSR-S-1

hedging losses that were already passed onto and paid for by ratepayers were prudently incurred.[7]

By definition, a utility's gas hedging is "improvident" when it does not provide for the future. By not considering forecasts of future price stability, and by continuing hedging month after month despite always reporting its hedges as losses, Empire is not providing for the future. Since Empire hedges for volumes only,[8] and not for price, it is addressing only one aspect of its future gas needs and ignoring another important aspect of its future gas needs. Accordingly, the facts will show Empire's improvidence did not provide for the future gas prices paid by Empire's ratepayers, and it is Empire's burden to show with evidence why its actions were prudent.

The Missouri Supreme Court referenced what it takes to overcome the prudence presumption as "adequate contrary evidence." The Court also determined that even with the presumption, the burden of proof in FAC cases will always be on the utility:

> A change in the presumption of prudence does not change the burden of proof set out in the PSC governing statutes. The presumption of prudence does not address the burden of proof at all. It sets out *an evidentiary presumption* created by the PSC. That standard provides that the utility's expenditures are presumed to be prudent until adequate contrary evidence is

[7] *AG Processing, Inc. v. KCP&L Greater Mo. Operations Co.*, 432 S.W.3d 226 (Mo. App. 2014), burden of proof must be met by a "preponderance of the evidence".

[8] Tr. 221

> produced, at which point the presumption disappears from the case.[9]

There should be no question the wealth of evidence before the Commission presents *adequate contrary evidence* and establishes *serious doubt* about the prudence of Empire's hedging costs. This abolishes the prudence presumption. That evidence, described in detail later in this brief, includes, but is not limited to, the following:

- Tariff limits hedging purpose to mitigating price volatility;
- Self-imposed hedging policy that mandates hedging regardless of whether there is price volatility in the gas market;
- 2009 Shale Gas Revolution eliminated price volatility;
- 8 straight years of huge annual hedging losses since the Shale Gas Revolution; totaling over $95 million and averaging $12 million annually;
- Empire ignored forecasts for low, non-volatile gas prices;
- Staff's 2012 recommendation to Empire to revise its policy;
- Utilities across the United States abandoned hedging;
- Empire repeatedly recognized the non-volatile market, yet Empire failed to modify or suspend its hedging; and
- $13.1 million in hedging losses at issue in this proceeding during the review period.

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[9] *Office of the Pub. Counsel v. Mo. PSC*, 409 S.W.3d 371, 379 (Mo. 2013)

If this evidence does not establish serious doubt about the prudence of Empire's hedging practices, there is no evidence that could ever establish serious doubt absent an admission from the company stating its own practices were imprudent. The burden is upon Empire to prove *with evidence* that its hedging losses were prudent. The evidence presented by Empire falls far short of providing any reasonable justification for Empire's failure to protect ratepayers by revising its hedging policy. Much of Empire's proffered evidence relies upon NYMEX futures from <u>after</u> the review period, and an attempt to pass blame onto the Commission for Empire's own policy, which the Commission has never approved or endorsed. Empire's policy and hedging practices are exclusively the result of its own management decisions, and a complacent belief that ratepayers would always be on the hook for Empire's hedging losses, no matter how egregious.

2. Inflexible and Imprudent Policy

Empire's hedging policy in effect while it hedged gas for the period in question is contained in its Risk Management Policy ("RMP").[10] Empire's stated purpose of its hedge strategy is in the hedging section of the RMP, and states: "*The electric segment's strategic focus addresses the volatility of natural gas prices by attempting to protect against volatile natural gas costs*

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[10] The Empire District Electric Company Energy Risk Management Policy, July 6, 2010, Exhibit 18, pp. 10-12. The hedge policy in place during the hedge transactions is the same as the hedge policy in Exhibit 18 (Tr. 238).

for the electric segments' plants."[11] Clearly, the purpose of Empire's hedge strategy is to mitigate price volatility. The RMP also states, "*The RMP is designed to provide the Supply Management Group (SMG) with a more comprehensive set of tools to mitigate the adverse impacts associated with changing natural gas or wholesale electricity prices*."[12] To accomplish this goal of mitigating volatile fuel prices, the policy requires:

- Hedge a minimum of 10% of year four expected gas burn
- Hedge a minimum of 20% of year three expected gas burn
- Hedge a minimum of 40% of year two expected bas burn
- Hedge a minimum of 60% of year one expected gas burn[13]

Accordingly, Empire's SMG is required to hedge these minimums by year-end, beginning four years before it needs the gas. The policy does not provide Empire's SMG with the flexibility to hedge below these minimums,[14] and since inception, Empire has never hedged below the minimums.[15] The only variation permitted is upward variation that would allow Empire's SMG to hedge above the minimums.[16] The policy specifically provides the SMG with the authority to hedge up to 80% of any future year's expected requirements, but does not include any flexibility to hedge below the

[11] *Id.*, p. 10

[12] *Id.,* p. 11

[13] *Id.*

[14] Tr. 170

[15] Tr. 176-177, 234

[16] Tr. 170

minimums.[17] On its face, Empire's hedging policy is imprudent because it fails to provide Empire's SMG with the flexibility to suspend hedging or hedge less than the minimums in light of a change from a volatile gas market to a non-volatile gas market.[18] In comparison to other electric companies, Empire's hedging strategy is unusual in that it requires hedges further in advance than any other electric company in Missouri.[19]

The only permissible purpose of hedging is to mitigate volatility in gas costs. This was established when the Commission approved Empire's FAC tariff and included hedging costs as a permissible cost to flow through the FAC.[20] Empire's FAC tariff defines hedging as follows:

> HEDGING COSTS: Hedging costs are defined as realized losses and costs (including broker commission fees and margins) minus realized gains <u>associated with mitigating volatility in the Company's cost of fuel</u>, fuel additives, fuel transportation, emission allowances and purchased power costs, including but not limited to, the Company's use of derivatives whether over-the-counter or exchanged traded including, without limitation, futures or forward contracts, puts, calls, caps, floors, collars and swaps.[21]

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[17] Exhibit 18, p. 11

[18] *Id.*

[19] Riley Surrebuttal, Ex. 3, p. 5

[20] *Report and Order,* Case No. ER-2008-0093, July 30, 2008

[21] Empire tariff, P.S.C. Mo. No. 5, Section 4, Sheets No. 17b and 17g, [emphasis added]

Empire's FAC tariff controls the costs authorized for recovery through Empire's FAC clause.[22] If there is no volatility in the cost of fuel, it is imprudent for Empire to continue hedging, and it is unlawful for Empire to recover costs through the FAC for any other purpose not authorized by Empire's tariff.[23] Empire would need to seek a tariff change in its rate case if it seeks to hedge for any other purpose. To find otherwise is inconsistent with all Missouri case decisions on tariffs, and would undermine the Commission's authority to determine the terms of service through tariff approvals.

While Empire and the Commission's Staff have implied that the Commission approved Empire's hedging policy, neither party cite to any order where the Commission ever approved or even acknowledged an awareness of Empire's RMP. The Commission does not mention Empire's hedging policy in the 2008 rate case that first granted Empire an FAC, or any subsequent rate case orders that authorized the FAC to continue.[24] The Commission only approved Empire's FAC tariff, which contains no reference of incorporation by any means of Empire's RMP.

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[22] *State ex rel. Laclede Gas Co. v. P.S.C.,* 156 S.W.3d 513 (Mo. App. 2005); "We analyze tariffs as we do statutes, and if a tariff is clear and unambiguous, we cannot give it another meaning", *State ex rel. Associated Natural Gas Co. v. P.S.C.,* 37 S.W.3d 287, 293 (Mo. App. 2000).

[23] Even if other purposes of hedging were authorized by Empire's tariff, Empire has provided no empirical evidence that any of the other reasons it claims it hedges are legitimate reasons to hedge, much less hedge using Empire's robotic approach.

[24] *See* orders issued in Case Nos. ER-2008-0093, ER-2010-0130, ER-2011-0004, ER-2012-0345, and ER-2014-0351.

In Case No. ER-2004-0570, Empire's then Vice President of Energy Supply, Mr. Brad Beecher, testified to the Commission, "*Empire originally enacted a Risk Management Policy ("RMP") in 2001 that establishes the approach and internal rules that Empire will use to manage specifically its power and natural gas commodity risk. The policy is revised approximately annually to reflect lessons learned and changes in markets and financial instruments.*"[25] The RMP was established prior to the Commission's authorization of Empire's FAC, and therefore was not promulgated to accomplish the purpose of its FAC tariff. Furthermore, Empire has not changed its hedging policy since 2001, and therefore never restructured their hedging policy to accomplish the purpose of its FAC tariff or to reflect the risk of hedging losses foisted onto ratepayers because of its policy.

In the present case, Empire's witness Mr. Sager testified that significant changes in the gas market is a reason to reevaluate Empire's RMP.[26] Mr. Sager also agreed that when gas markets change, market risks also change.[27] Despite Empire's commitment in 2004, and Empire's recognition that market changes prompt a policy reevaluation, Empire failed to respond in any way to protect ratepayers from hedging losses.

Imprudence can occur in two ways – it can occur as an imprudent action and it can occur as an imprudent inaction. To create a policy so

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[25] Hyneman Direct, Ex. 5, p. 9

[26] Tr. 220

[27] *Id.*

inflexible that it cannot respond to significant changes in the gas market, and to continue hedging despite those changes, are imprudent actions. To continue following that policy without modification when all indications show further hedging will likely result in losses is an imprudent inaction. Empire fails on both accounts.

3. What Empire Knew at the Time it Hedged

Prudence reviews are not hindsight reviews. The question to ask is would a reasonable person continue hedging in light of the following facts Empire knew or should have known at the time it hedged natural gas.

a. Shale Gas Revolution Impacts Known to Empire

The Shale Gas Revolution refers to new technologies used to extract natural gas from previously unavailable gas deposits embedded in underground shale formations. The new technologies include horizontal well drilling and hydraulic fracturing, or "fracking", which greatly expanded available natural gas reserves.[28] This new and abundant availability of natural gas caused gas prices to plummet in 2009 and turned a volatile gas market into a non-volatile gas market.[29] "Revolution" is defined as "*a sudden*

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[28] Hyneman Direct, Ex. 5, pp. 13-14

[29] Riley Direct, Ex. 1, Schedule JSR-D-1

or momentous change in a situation",[30] and the impact of the shale gas revolution to the U.S. natural gas markets was both sudden and momentous.

The impact of the shale gas revolution on Empire's hedging was also sudden and momentous. In 2009, Empire recorded **$22.6 million** in hedging *losses*; an unprecedented amount considering that in the prior seven years Empire had experienced losses in only two years, $1.2 million in 2006 and $6.9 million in 2007.[31] The Commission also authorized Empire to use an FAC for the first time in 2008.[32] This means the FAC protected Empire's shareholders from the Missouri portion of the $22.6 million in hedging losses. This is because 95% of the losses were simply passed on to ratepayers through the FAC.[33] Empire recorded another **$14.2 million** in hedging losses in 2010.[34] The losses continued, month after month, year after year. In 2011, Empire recorded another **$9.4 million** in hedging losses; in 2012, another **$14.3 million** loss; in 2013, another **$9 million** loss; in 2015, another **$1.8 million** loss; and 2016, another **$7.4 million** loss.[35]

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[30] The American Heritage® Dictionary of the English Language, Fifth Edition copyright ©2017 by Houghton Mifflin Harcourt Publishing Company.

[31] The $22.6 million is total company losses for 2009, and Missouri ratepayers pay the large majority of this. For example, in the audit period, Empire incurred $16.7 million in total company hedging losses, and Missouri ratepayers were charged $13.1 million, or 78% of the total, for hedging. Empire did not dispute or challenge these hedging loss totals.

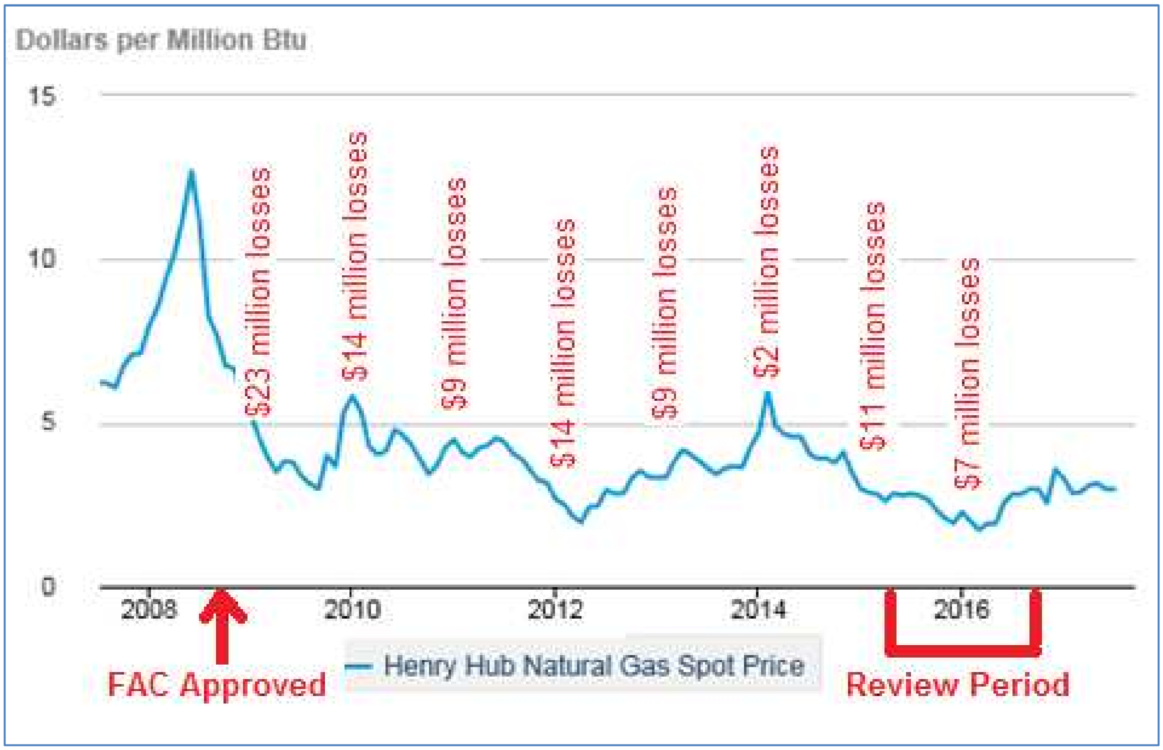
[32] Case No. ER-2008-0093

[33] Riley Surrebuttal, Ex. 3, Schedule JSR-S-1

[34] *Id.*

[35] *Id.*

The following diagram[36] shows the 2008 drop in gas prices, the steady non-volatile gas market from 2010 through 2015 when Empire was hedging for the audit period, and the millions of dollars in yearly hedging losses Empire endured without ever changing its hedging policy.



Prudence reviews are not hindsight reviews, meaning prudence is determined by what the company knew or should have known at the time it made the decisions that resulted in the incurrence of a cost.[37] Under Empire's policy, hedging for gas burned in 2015 was to begin in 2011 and continue through 2014, and hedging for gas burned in 2016 was to begin in 2012 and continue through 2015. Empire knew of the above market prices

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[36] *Id.*, Riley Direct, Ex. 1, Schedule JSR-D-1

[37] *State ex rel. Associated Natural Gas Co. v. P.S.C.*, 954 S.W.2d 520 (Mo. App. 1997)

and hedging losses as it continued its fixed hedging policy without modification. By the end of 2011, Empire's hedging policy had resulted in over **$46 million** in hedging losses since the gas markets changed.[38] By the end of 2012, Empire's hedging policy had resulted in over **$60 million** in hedging losses.[39] The FAC protected Empire's shareholders from these losses in Missouri at the expense of its ratepayers, which did nothing to deter Empire from continuing to hedge.

By the time Empire began hedging for the audit period, it knew the gas market had changed, and it knew its hedging policy had resulted in unprecedented hedging losses. Not only did Empire see these impacts year to year, but Empire saw these impacts month to month as Empire entered into hedging contracts that it recorded as a loss *the very next month.* Evidence showing the repeated failure of Empire's hedging policy is in Empire's first-of-the-month gas position summary reports from January 2009 through the end of the audit period in Exhibit 16.[40]

b. Gas Position Summary Reports Show Imprudence

OPC asks the Commission to review carefully the gas position summary reports prepared by Empire and included in **Exhibit 16**, especially the "Net All Positions Marked to Market" figure, which shows the current

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[38] Riley Surrebuttal, Ex. 3, Schedule JSR-S-1

[39] *Id.*

[40] Exhibit 16

gain or loss position on all Empire hedges.[41] From January 2009 through August 2016, Empire repeatedly recorded its hedges as losses every year, and almost every month.[42] Beginning with the first report in January 2009, Empire reported **$9.3 million** in hedging losses. Every following month Empire's net hedging always showed it would result in a huge loss, and the vast majority of monthly and yearly hedges showed large losses.[43] By the end of 2011, when Empire's policy indicated it needed to begin its hedging for 2015, Empire's recorded net hedging losses exceeding **$19 million** for all future hedges.[44] Yet Empire continued to follow its strict policy of hedging 10% year four, 20% year three, 40% year two, and 60% by the end of year one.[45]

The period under review in this case is the eighteen-month period between March 1, 2015 and August 31, 2016. Empire's gas position report for January 6, 2012 shows that by the end of 2011, four years ahead of 2015, Empire had followed its RMP and hedged 11% of its need for 2015, and was *already* reporting the hedge as an **$861,150** loss.[46] A year later, Empire's January 4, 2013 report showed Empire had increased its 2015 hedges to 20% as required by its RMP, and had increased its anticipated hedging losses to

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[41] *Id.*; Tr. 178

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *Id.*

[46] *Id.*

$1.3 million. Empire had also begun hedging for 2016 and was already showing a **$68,800** loss. By January 2014, Empire had hedged 41% for 2015 per the RMP requirement and anticipated a **$2.3 million** loss, and hedged 22% for 2016 and showed an **$818,800** loss. Despite these persistent and continued losses, Empire continued following its own policy of locking in 10%, 20%, 40% and 60%.

A reasonable person would have looked at these repeated losses and determined that continuing hedging as required by the RMP would continue to result in hedging losses, and would have revised the strategy. The shale gas revolution is recognized across the gas industry as a long-term stabilizer of natural gas prices. Ignoring the gas market and racking up tens of millions of dollars in unnecessary hedging losses is the very type of imprudence the Legislature intended to protect the public against when it limited cost recovery to only prudently incurred costs.

Empire's hedging losses for March 1, 2015 to August 31, 2016 totaled **$16,785,521.65**, of which **$13,104,811.18** were charged to Missouri ratepayers through the FAC.[47] In Kansas, Empire's ratepayers were protected from the Kansas portion of the $95 million in hedging losses Empire incurred since 2008 because Empire is prohibited from passing hedging costs onto its Kansas ratepayers.[48] The Kansas Corporation Commission ("KCC") determined in 2008 that Empire's hedging policy was

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[47] Riley Direct Testimony, Exhibit 1, p. 2

[48] Tr. 197

inconsistent with other hedging policies, and prohibited Empire from passing any hedging costs onto Kansas ratepayers. The KCC stated:

> 7. The Commission concurs with Staff's Memorandum filed in this matter and its determination that Empire's gas hedging program is incompatible with hedging programs currently approved and in place with respect to other public utilities regulated by the Commission. Therefore, the Commission finds that Empire's Application should be dismissed. The Commission further concurs with Staffs additional recommendations that:
>
> (1) Empire will pass no gains, losses, or costs related to its financial hedging activities to Kansas ratepayers through its Energy Cost Adjustment (ECA) mechanism; and
>
> (2) No costs related to Empire's financial hedging activities will be included for rate determination in future proceedings before the Commission. Staff's Report and Recommendation states that counsel for Empire was provided a copy of Staff's Memorandum and Empire has no objection to Staff's recommendations that its Application be denied and that the company be ordered to implement items (1) and (2) referenced above.[49]

The hedging policy denied by the KCC is the same hedging policy in place in Missouri,[50] which caused Missouri ratepayers to pay tens of millions of dollars in hedging costs that Kansas ratepayers did not have to pay. In addition, as shown above, Empire *agreed* not to pass hedging costs onto its Kansas ratepayers.

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[49] *Order Denying Application*, February 4, 2008, Docket No. 06-EPDE-1048-HED, In the Matter of the Application of The Empire District Electric Company, for Approval of its Existing Energy Risk Management Policy, Which Includes Empire's Natural Gas Hedging Program, 2008 Kan. PUC LEXIS 312, *4-5; Tr. 195-196.

[50] Tr. 196-197

Missouri ratepayers pay ninety-five percent (95%) of Empire's hedging losses, while the FAC protects Empire's shareholders against virtually all hedging risks.[51] Unless the Commission finds Empire's hedging costs to be imprudent, this trend will continue into the future since forecasts show natural gas prices will remain low and non-volatile, and Empire continues to argue this policy and these results are reasonable. If Empire were on the hook for 95% of these hedging losses, rather than ratepayers, it is highly unlikely Empire would not have responded to the shale gas revolution by modifying its hedging policy. Empire's shareholders would pressure Empire's management to stop the flow of hedging losses, but since shareholder pressure does not exist for FAC costs passed on to ratepayers, it is up to the Commission to provide the missing pressure and put a stop to the hedging losses by finding Empire imprudently incurred hedging costs.

Empire argues its hedging policy is appropriate because it acts as an "insurance" against the risk of future price spikes. However, when the risk of those future price spikes is virtually non-existent, hedging creates a new risk – a risk that *the hedge itself* will inflate rates. Empire has essentially been paying a $12 million annual "premium" for hedging to protect against price increases that no forecast predicted was remotely likely to occur during the review period. A reasonable person would have realized the hedge itself was risky in the current gas market, and suspended hedging. Piedmont Natural

[51] Tr. 197

Gas Co., Inc. in North Carolina recognized this risk in 2010 and "*shortened the hedging horizon because the hedging is getting too volatile and too costly for the products relative to the value that customers were getting*."[52] Piedmont shorted its hedging from two years ahead to one-year head. Piedmont recognized in 2010 that the hedges themselves were the risk, not the market, and stopped hedging beyond 12 months.[53]

c. Gas Price Forecasts at the Time Empire Hedged

In addition to the shale gas revolution and unceasing hedging losses as obvious reasons to suspend or modify Empire's hedging program, future forecasts at the time Empire entered into its hedging transactions also indicated prices would not be volatile during the review period.

Congress created the United States Energy Information Administration (E.I.A.) in 1979 "to collect, analyze, and disseminate independent and impartial energy information to promote sound policymaking, efficient markets, and public understanding of energy and its interaction with the economy and the environment."[54] The E.I.A. provides short-term and long-term gas price forecasts. In 2011, the same year Empire's policy indicated it should hedge its first 10% for 2015, the E.I.A.

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[52] North Carolina Utilities Commission, *Order on Annual Review of Gas Costs*, February 17, 2010, Docket No. G-9, Sub 569, In the Matter of Application of Piedmont Natural Gas Company, Inc., for Annual Review of Gas Costs Pursuant to G.S. 62-133.4(c) and Commission Rule R1-17(k)(6).

[53] *Id.*

[54] Hyneman Direct, Ex. 5, p. 11

forecasted declining prices.[55] In June 2012, when Empire had hedged only 15% for 2015 and 4% for 2016, the E.I.A. issues its Annual Energy Forecast Outlook 2012 and forecasted steady long-term prices through 2020.[56] Empire placed the vast majority of the hedging transactions for the audit period *after* it should have known the E.I.A. forecasts predicted non-volatile low gas prices through the audit period and beyond.[57]

The E.I.A. also issues a weekly report on natural gas in storage, which is as an indicator that prices will not spike.[58] "There is a strong correlation between natural gas prices and the five year average in natural gas storage."[59] Empire should have been monitoring these reports and seeing the record high storage levels as one more indication that gas in storage would help suppress future price spikes.

The leading publication on utilities, Public Utilities Fortnightly, also recognized the changed gas market in its February 2012 edition, in an article titled "Hedging Under Scrutiny," where it recognized the shale gas revolution was "game changing technology."[60] The article stated:

> Shale gas producers access prolific geological deposits of reserves for production at relatively low costs, which has **led to**

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[55] Riley Rebuttal, Ex. 2, p. 8

[56] *Id.*, p. 9, U.S. Energy Information Administration, Annual Energy Outlook 2012

[57] Neither Empire nor the Commission's Staff presented any evidence to suggest the E.I.A. forecasts are not reliable.

[58] Riley Direct, Ex. 1, p. 7

[59] *Id.*

[60] Hyneman Direct, Ex. 5, p.13

> **significantly dampened price volatility and lower market prices.**
>
> While the emergence of shale gas production is generally well known by intervenors and regulators, the broader market dynamics are less well understood. Equally important is the fact that new pipeline infrastructure has served to deliver shale gas supplies into what historically have been transportation-constrained end markets, thereby changing traditional basis-pricing relationships and further easing price volatility. Additionally, new LNG import facilities and expansions in natural gas storage capacity in recent years have contributed to expanded supply capacity.
>
> These supply and capacity additions have occurred at the same time that demand has declined. On the demand side, increasing energy efficiency measures and declining demand resulting from weak economic conditions have dampened consumption.[61] [Emphasis added]

Empire should have been paying attention to these forecasts and analyses and recognized what the rest of the country was recognizing – the gas market had undergone significant change and gas hedging policies needed to change in response.

d. Empire's RMOC Meeting Minutes Show Imprudence

Empire's Risk Management Oversight Committee ("RMOC") is responsible for Empire's gas hedges.[62] Exhibit 17 is Empire's meeting minutes for all RMOC meetings between January 2010 and April 2017. This includes all minutes during the timeframe when Empire entered the hedging

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[61] *Id.*

[62] Tr. 219

transactions for the review period. The minutes provide the following evidence of Empire's imprudence: (1) Empire was aware the gas market changed and was no longer volatile; **

[63] Ex. 17, pp. 1-71

[64] Ex. 17, p.72. Empire also did not review NYMEX futures in the July 9, 2013 meeting.

** The reasons for Empire's disregard for future gas prices is simple – Empire's policy mandated hedging regardless of price. Because Empire's hedging policy is indifferent to price, Empire's failure to modify the policy shows Empire's indifference towards the impacts on ratepayers. This is an imprudent disregard for Missouri ratepayers.

The RMOC minutes also show Empire's recognition the market changed and gas prices were no longer volatile. In the January 2010 RMOC meeting, before Empire had hedged for the period under review, Empire's meeting minutes show Empire reported the current gas market to be volatile.[66] That was the last report to refer to the current gas market as volatile. As shown in the table below, throughout the time Empire hedged gas for the review period, the RMOC minutes repeatedly referred to the gas market as low-priced and steady:

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[65] Ex. 17, pp. 72-111

[66] Ex. 17, pp. 1, 3

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Empire's RMOC never referred to the gas market as volatile during the timeframe Empire acquired gas for the audit period. Empire's RMOC consistently recognized the market was steady with little changes, prices were low, and with only occasional weather variations. Compared to the volatile market in the seven-year period of 2001 through 2008 where gas prices were consistently above $5.00 per MMBtu and peaked over $10.00 per MMBtu, the gas market between 2009 and 2016 is characterized by low steady prices due to the abundant supply of gas caused by the shale gas revolution.[67] Empire's RMOC meeting minutes show Empire was well aware of these facts, yet chose not to modify its hedging policy. The RMOC minutes also show Empire's focus regarding hedging was only on securing the policy hedging targets or exceeding the targets – i.e., hedging for volumes only, with little regard for price.[68]

Commissioner Rupp asked a key question during the hearing regarding Empire's management decisions when he asked, *"…you've reviewed*

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[67] Riley Direct, Ex. 1, Schedule JSR-D-1

[68] *See* "Current Gas Position Review" section of the RMOC minutes, Ex. 17; Tr. 221

this [policy] thirty-two times and every time Empire has said, yeah, this is still the best policy?"[69] Commissioner Rupp also identified how Empire's lack of incentive to control costs under an FAC contributed to Empire's imprudence when he asked, "*Where is the incentive for Empire to provide the lowest possible price for the customer…when you're only exposed to about 5% of the risk?*"[70] These questions highlight why Empire has little incentive to be prudent with its fuel costs, and how Empire passed on every opportunity to modify its policy in light of the huge losses Empire incurred on its hedges.

Empire's minutes also show Empire's management making hedging decisions based in part on the company's ability to recover hedging costs from ratepayers through the FAC. Empire's January 12, 2010 meeting minutes discuss an accounting treatment used by companies when they hedge too much gas.[71] The company notes that if it followed the new accounting, it would have no impact to the company because Empire recovers hedging losses through the FAC. This was the only concern noted before indicating Empire personnel would consider the new method. This shows Empire making decisions where the first factor considered is their ability to pass the costs along to their customers.

Empire's RMOC minutes are not the only documents showing Empire's obvious awareness of the revolutionary change in gas markets. In March

[69] Tr. 47

[70] Tr. 45

[71] RMOC Meeting Minutes, Exhibit 17, p. 2

2012, before Empire placed the majority of the hedges for the audit period, Empire filed its Integrated Resource Plan ("IRP") with the Commission in Case No. EO-2012-0294. Empire clearly recognized the market changes in its IRP, but failed to act on its own knowledge through its FAC:

> Over the past decade, the combination of horizontal drilling and hydraulic fracturing has allowed access to large volumes of shale gas that were previously uneconomical to produce. The production of natural gas from shale formations has rejuvenated the natural gas industry in the United States. It is believed that the boom in production in shale formations has opened up natural gas reserves that are large enough to supply the U.S. for decades. The added production has boosted natural gas supplies in storage facilities underground to levels that are about 40 percent higher than the five-year average, according to the Energy Department. According to the U.S. Energy Information Administration (EIA) Short-Term Energy Outlook (February 7, 2012), natural gas spot prices averaged $2.67 per MMBtu at the Henry Hub in January 2012, down $0.50 per MMBtu from the December 2011 average and the lowest average monthly price since 2002. Abundant storage levels, as well as ample supply, have contributed to the recent low prices.[72]

This is what Empire knew in March of 2012 – the gas industry was "rejuvenated" by the shale gas revolution, which it referred to as a "boom in production" and "opened up natural gas reserves that are large enough to supply the U.S. for decades."[73] Despite this, Empire continued to lock in its pre-determined hedge volumes.

e. NYMEX Futures Do Not Reflect Future Prices

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[72] Riley Rebuttal, Ex. 2, p. 10

[73] *Id.*

Empire claims to have relied upon NYMEX futures when it entered into hedging transactions. However, NYMEX futures are not a forecast of a future price. NYMEX futures provide no analysis or forecast into whether a hedge price is prudent.[74] NYMEX futures reflect only the price paid currently for gas needed in the future, according to Empire's witness.[75] The further out into the future one hedges, fewer transactions are available upon which to base the average price.[76] Witnesses from Empire and OPC referred to the fewer NYMEX futures transactions occurring further into the future as a gas market lacking liquidity.[77] Empire's witness Mr. Doll included a NYMEX futures chart in his testimony showing the basis of Empire's purchase prices, and there were very few, if any, hedges two years ahead of when Empire needs the gas.[78] If Empire had hedged two years out based upon Mr. Doll's chart, it would have been basing the price it paid on one or two transactions without knowing anything about those transactions to understand if the price paid was reasonable and in line with reputable price forecasts.[79]

Empire's witness Mr. Doll acknowledged Empire knows nothing of the prices shown on the NYMEX futures other than a buyer and a seller agreed

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[74] Ex. 15

[75] Tr. 171

[76] Tr. 174

[77] Tr. 171; Riley Surrebuttal, Ex. 3, pp. 6-7.

[78] Ex. 15

[79] Ex. 15; Tr. 173

upon that price. Empire does not know whether the buyer was an electric company, a gas company, a bank, or a gas speculator.[80] Empire does not know if the buyer purchased for volumes or price.[81] Empires does not know whether the buyer or buyers were experienced and able to negotiate a good price, or whether they were inexperienced.[82] Empire does not know whether the buyer checked E.I.A. forecasts or whether the buyer did not consider forecasted gas prices.[83] The point here is that Empire's reliance on only the NYMEX futures to determine whether it is a good idea to hedge, as shown in the RMOC minutes, means Empire based its decision on a market that lacked liquidity and where Empire knew nothing about the prior transactions. Moreover, Empire's claimed reliance upon NYMEX is a misnomer because Empire's policy requires it to hedge at set percentages *regardless* of price.

f. Staff Warns Empire to Reconsider Hedging Policy

In 2012, when Empire had hedged only a small portion of its hedging policy percentages for the 2015-2016 audit period, the Commission's Staff warned Empire to reconsider its hedging policy in response to the changes in the gas market. The Staff specifically noted the lack of flexibility in Empire's

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[80] Tr. 175

[81] *Id.*

[82] *Id.*

[83] Tr. 176

policy, and the inability to respond to the changed market by hedging less than the policy requires. The Staff cautioned:

> Empire's current policy governing its hedging of natural gas purchases dates back to the early to middle years of the last decade, when natural gas prices were highly volatile. In the last three or four years, natural gas prices have generally become less volatile in nature. Staff recommends that Empire re-examine its hedging policies in light of the current and expected future market for natural gas prices, with the goal of maintaining a reasonable amount of flexibility to allow it to attempt to attain an optimal overall balance between the prices paid for its hedged and spot natural gas purchases.[84]

Empire simply ignored the Staff's recommendations, and there is no indication in the RMOC meeting minutes that Empire ever considered the Staff's recommendation.

g. Other U.S. Utilities Responded to New Gas Market

Empire should also have been aware of what other utilities across the country were doing in response to the new gas market. Colorado Utilities ("CU") stopped hedging immediately upon recognizing the shale revolution had changed the market for the future.[85] CU reevaluated its hedging in 2009, the same year Empire incurred $22.6 million in hedging losses. CU acted immediately to protect its ratepayers, and explained:

> With market costs declining, we began a significant review of our hedging program in 2009, and in 2010 reduced volumes and lengths of hedges. With continuing apparent market stability, all

[84] Staff Report Cost of Service, November 2012, Case No. ER-2012-0345, p. 89

[85] Hyneman Direct, Ex. 5, p. 15

> hedging was suspended in 2011. The small amount of hedged supply still on the books will expire in 2013.[86]

Had Empire been as vigilant in protecting ratepayers as CU, Empire would have also stopped hedging in 2011, and would have saved Missouri ratepayers over $13 million for the audit period, and approximately $12 million annually since 2011.

Other utilities suspending hedging include Nevada Power, as ordered by the Public Utilities Commission of Nevada in December 2010.[87] South Carolina Electric & Gas Company suspended gas hedging in November 2011, as ordered by the Public Service Commission of South Carolina.[88]

Liberty Utilities, now Empire's parent company, also suspended hedging. In a May 2014 filing with the New Hampshire Public Utilities Commission, Liberty's Senior Director, Energy Procurement, testified in support of eliminating Liberty's hedging program:

> Overall, it is my opinion that the hedging program as currently constituted does not provide customers with meaningful benefits. Currently, customers are paying for the option premiums (insurance against escalating prices) used to hedge future firm purchases at the NYMEX/Henry Hub index price and since there has been very little volatility, the options typically expire "out of the money" and customers do not see any offsetting benefit to the premiums they are paying.

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[86] *Id.*

[87] Hyneman Direct, Ex. 5, Sch. CRH-D-1, p. 3, PUC of Nevada Docket No. 1 0-09003

[88] Hyneman Direct, Ex. 5, Sch. CRH-D-1, p. 4, PUC of South Carolina Docket No. 2011-5-G

> In effect, customers are paying for a hedging program that was developed to manage natural gas price volatility at a time when natural gas supplies were tight and gas prices fluctuated considerably. More recently, the market dynamics have changed with the increase of Shale gas production and the volatility in the NYMEX/ Henry Hub futures has been muted and shows continued signs of stability through 2020.[89]

This recognition of a changed market, stability through 2020, and the request to stop hedging were filed in early 2014, before Empire would hedge another 20% for 2015 and 40% for 2016.

h. Staff's Prudence Review Insufficient and Unreliable

The Commission's Staff admittedly did not review whether Empire's hedging policy is prudent. Staff's witness, and Staff's counsel, admit that Staff's review was limited to whether Empire complied with the tariff and complied with its own self-imposed policy.[90] Staff's counsel stated, "*The staff does not make a determination that gas hedging is prudent. That is not staff's job*."[91] Staff's witness assigned to review Empire's hedging, when asked if she conducted a prudence audit testified, "*No, because the rate case did a prudence of the policy*."[92] However, a prudence audit is the sole purpose of this case per § 386.266.4(4) RSMo. The Commission never reviewed or approved Empire's RMP for prudence in the rate case. Moreover, in the 2012 rate case the Staff questioned the prudence of Empire's inflexible policy when

[89] Hyneman Rebuttal, Ex. 6, Schedule CRH-R-6

[90] Tr. 51, 259-260

[91] Tr. 51

[92] Tr. 260

it advised Empire to review its policy in light of the gas market changes following the shale gas revolution.[93]

The Staff's witnesses testified that the Staff only reviews FAC costs to ensure compliance with the company's self-imposed policies and the Commission-approved tariffs, and that Staff did not review Empire's FAC costs to determine whether the company's costs were prudent.[94] Staff could not be further off-base on why it conducts prudence reviews, and this statement should give the Commission concern that no electric company's fuel hedging costs have received proper reviews from Staff. Where the Staff came up with this standard is not stated, but from a customer perspective it falls far short of providing the public and the Commission with the prudency review contemplated by the Legislature when it enacted § 386.266.4(4) RSMo and required "*provisions for prudence reviews of the costs subject to the adjustment mechanism*."

Staff counsel also repeated what is stated in the Staff Report, "*The decisions that were actually made by the company are disregarded and instead the Staff focuses its review on evaluating the reasonableness of the information that the company relied on and the decision-making process at the time those decisions were made*."[95] It is unclear how Staff intends to scrutinize the prudence of a cost when the Staff refuses to consider decisions

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[93] Staff Report Cost of Service, November 2012, Case No. ER-2012-0345, p. 89

[94] Tr. 51, 259-260

[95] Tr. 50; Staff Report, Ex. 200, p. 1

Empire made that resulted in the fuel costs under review. Ensuring costs were prudently incurred is the only task the statute assigns the Commission in a prudence review. Commissioner Rupp identified the concern with the Staff's cursory review when he asked Staff counsel, "*So, as long as they followed their written policy and as long as they applied to the tariff, Staff's like you're good to go?*"[96]

Simply concluding that the costs were prudent because they followed the utility's self-imposed policy is inconsistent with the review required by § 386.266.4(4) and would be an abdication of the Commission's duty. The Missouri Supreme Court warned in regard to fuel clauses, "It would also come at least dangerously close to abdication by the commission of its power to set just and reasonable rates, for the commission [to determine] in advance that any fuel charge made in accordance with the prescribed formula will be proper without regard to whether, in light of other cost factors, the overall charge is reasonable."[97]

Another major problem with the Staff's review is the Staff failed to consider any information that was available to Empire at the time it hedged. The Staff's data requests all sought information from *during* the audit period of March 1, 2015 to August 31, 2016.[98] Limiting the review to what was

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[96] Tr. 55

[97] *State ex rel. Utility Consumers Council, Inc. v. Public Service Com.*, 585 S.W.2d 41, 57 (Mo. 1979)

[98] Tr. 259-260

occurring during the audit period fails to consider a single piece of evidence from the period when Empire was actually entering into the hedging transactions that resulted in the $13.1 million in fuel hedging losses. The Staff's witness, Ms. Sarver, testified:

Q. Did you review any forecasts the company might have been looking at when they made their hedges?

A. No.

Q. Did you review any information that the company looked at when they were making their hedges?

A. I reviewed the -- no.[99]

Ms. Sarver further testified:

Q. So, by only reviewing the costs in the review period, isn't that only reviewing the hindsight information?

A. That's information that we had at that time.[100]

Staff limited review was the result of the Staff's own data requests seeking only irrelevant information to review. Ms. Sarver also admitted she did not look at any of the RMOC meeting minutes, but agreed the minutes would give insight into Empire's decisions.[101]

The Staff's Report is unreliable regarding Empire's hedging because the Staff failed to consider any information relevant to a prudence analysis.

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[99] Tr. 260-261

[100] Tr. 263

[101] Tr. 267

The Staff's cursory review of Empire's hedging practices is partly what prompted OPC to find it necessary to become more involved in this prudence review and conduct its own audit of Empire's hedging practices.[102] For single-issue ratemaking clauses such as the FAC to function consistent with the intent of the Legislature as interpreted by the Missouri Courts, it is imperative that the Commission ensure no less than thorough reviews of all costs flowing through such mechanisms.

The Staff's cursory review and position in this case that Empire's hedging costs were prudently incurred is surprising given the contrary past position taken by the Staff. In 2012, only three years after the gas market changed, the Staff recognized the changes and argued hedging policies are imprudent when they are insensitive to the market:

> GMO's hedging program actually increased the risk to the ratepayers because it was -- and is -- insensitive to the market. The fact is that GMO continued to hedge, despite the collapse of natural gas prices to historic lows, thereby unreasonably exposing its captive ratepayers to the certainty of increased rates due to catastrophic losses in its natural gas futures settlements.[103]

The Commission cannot rely in any way upon the Staff's review of Empire's hedging costs because the Staff's position does not provide the required prudence review, and the Staff fails to recognize the market changes that Staff clearly recognized just five years ago.

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[102] Tr. 147

[103] *In the Matter of the Third Prudence Review of Costs Subject to the Commission-Approved Fuel Adjustment Clause of KCP&L Greater Missouri Operations Company,* Case No. EO-2011-0390, Staff's Initial Brief, July 6, 2012, p. 20.

5. Ratepayer Harm Calculations

OPC's witness, Mr. John Riley, C.P.A., provided OPC's calculations on the impact of Empire's hedging policy. Neither Empire nor the Commission's Staff challenged OPC's calculation of the harm caused by Empire's hedging policy in that neither party asked Mr. Riley a single question over his testimony.[104] While the lack of questions for Mr. Riley's was a surprise, the lack of challenge to Mr. Riley's calculations was no surprise since the hedging loss calculations are the losses recorded by Empire on its own books.

The testimony evidence of OPC witness Mr. Riley includes the month-by-month breakdown of Empire's physical and financial hedging losses, and the portion allocated to Missouri.[105] The total Missouri jurisdictional losses for all eighteen months of the review period was **$13,104,811.18**.[106] This amount represents the harm suffered by Empire's Missouri ratepayers caused by Empire imprudently incurring repeated hedging losses.

These calculations are not "hindsight evidence" as alleged by Empire, because OPC is not asserting the losses incurred during the review period contributed to Empire's decision to hedge. The *only* purpose of calculating the $13.1 million in hedging losses is to determine what Empire's imprudence cost Missouri ratepayers. All losses Empire incurred *before* the review period and during the timeframe while Empire was hedging for gas are proper to

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[104] Tr. 60

[105] Riley Surrebuttal, Ex. 3, Schedule JSR-S-3.

[106] *Id.*

consider as evidence of Empire's imprudence because those facts were known to Empire when it hedged for the audit period.

It should also be clear from the evidence that the $13.1 million is only a fraction of the total hedging losses incurred by Empire since the shale gas revolution. During the evidentiary hearing, Empire entered into the record copies of Commission orders approving FAC rate decreases for Empire. This appears to be an attempt to suggest Empire's FAC was working as intended. However, what Empire failed to explain is that the FAC rate decreases would have lowered rates even more had Empire suspended its imprudent hedging policy.[107] Due to Empire's hedging policy, ratepayers received less of a rate decrease than they should have.

A Commission order requiring Empire to refund back to customers the harm caused by Empire's imprudent fuel costs would not be unprecedented, as the Commission in 2011 found Ameren Missouri to have imprudently incurred fuel costs, and ordered Ameren Missouri to refund over $17 million to its customers.[108] The Commission stated:

> The bargain implicit in the approved fuel adjustment clause is that ratepayers will pay more to help the company when the utility's fuel costs rise or offsetting revenue from off-system sales drop. On the other hand, ratepayers will benefit from decreased rates if fuel costs drop or offsetting revenue from off-system sales increase.

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[107] Tr. 137

[108] *Report and Order,* April 27, 2011, Case No. EO-2010-0255, *In the Matter of the First Prudence Review of Costs Subject to the Commission-Approved FAC of Union Electric Co. d/b/a Ameren Missouri*, p. 36

Empire's customers have not received their end of the bargain in that Empire's hedging policy has prevented Empire's customers from the benefits of the significant drop in gas costs. A Commission order directing Empire to refund $13.1 million will give ratepayers a small portion of the FAC bargain that since 2008 has eluded them due to Empire's refusal to change its policy.

6. Empire Management Seeks to Eliminate its Responsibility

Despite objections from OPC and the Commission's Staff, Empire insisted on adding an issue to this case on the future of Empire's FAC, and whether the Commission should pre-approve Empire's RMP. These issues are irrelevant in this case because the issue before the Commission in a prudence review is the limited eighteen-month period in which Empire incurred fuel costs that flowed through the FAC charge. Whether or not the Commission should approve Empire's hedging policy in the future is an issue for Empire's next rate case, not in this review of a past period.

Empire's motivation in seeking pre-approval is to eliminate management responsibility for ensuring its decision-making regarding fuel costs is reasonable. In this case, Empire has attempted to blame the Commission, Commission's Staff, and OPC for not raising these issues in a prior prudence review. However, Empire's arguments are without merit considering that Empire and only Empire approved Empire's RMP, and only Empire made the repeated decision month after month, year after year, not to revise that policy. Pre-approval would give Empire want it wants in this case – a sharing of responsibility with the regulator.

7. Conclusion

The evidence presented at the hearing casts serious doubt that Empire's hedging policy and strict adherence to that policy were prudent. It is Empire's burden to produce evidence proving its gas hedges were prudent. However, Empire was unable to produce a shred of evidence to suggest it was prudent not to suspend its gas hedges before it hedged for the audit period.

The 300,000 Missouri citizens and 22,000 Missouri businesses relying upon Empire's management to incur only prudent fuel expenses are the same 300,000 Missouri citizens and 22,000 Missouri businesses relying upon this Commission to hold their electric company accountable when management imprudence results in tens of millions of dollars in excessive costs.

Empire's policy and losses are purely management's responsibility, and the Commission does not share in this responsibility unless it declares the policy prudent and allows ratepayers to pay for Empire's hedging losses. The law clearly requires refunds to Empire's ratepayers for imprudent fuel costs. § 386.266 RSMo. For the reasons explained above, Empire's hedging policy and failure to change that policy in response to market changes was negligent and imprudent, and resulted in $13.1 million harm to Empire's Missouri ratepayers. OPC urges the Commission to find Empire's hedging policies and hedging costs imprudent, and order a $13.1 million refund plus interest as required by law.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 5th day of October 2017.

/s/ Marc Poston