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 Adjustment Clause of the Empire District Electric Company	))))	Case No. EO-2017-0065

SECOND APPLICATION FOR REHEARING

COMES NOW the Office of the Public Counsel ("OPC") pursuant to section 386.500, RSMo[1] and for its Application for Rehearing of the Public Service Commission's ("Commission") February 28, 2018, Amended Report and Order ("Amended Order") states that OPC seeks rehearing of the Commission's Amended Order approving Staff's Sixth Prudence Audit Recommendation because the Amended Order is unlawful, unjust and unreasonable. In support, OPC states as follows:

I. The Commission's Amended Order is Unlawful.

This Commission's Amended Order may also be reviewed for unlawfulness. *In re Liberty Energy (Midstates) Corp*, 464 S.W.3d 520, 524 (Mo. Banc 2015). The Commission's Amended Order was unlawful because the Amended Order relies upon a promulgated rule that is inapplicable, focuses on facts not specific to the prudence review period and ignores facts that are specific to the prudence review period and because the Commission approached the case unlawfully as shown by comments made during the agenda meetings.

[1] All statutory references moving forward are to the Revised Statutes of Missouri, as amended.

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A. The Commission's reliance upon 4 CSR 240-40.018(1)(A) is Unlawful Because that Rule is Superseded by State Statute

The Commission's Amended Order relied, in part, on 4 CSR 240-40.018(1)(A) ("the Gas Rule") in its determination that Empire's hedging practices are prudent. The Amended Order, in its Conclusions of Law, states:

> I. The Commission has, by rule, encouraged natural gas distribution utilities to engage in hedging practices to ensure price stability. Commission rule 4 CSR 240-40.018(1)(A) urges natural gas utilities to " 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." Subsection (1)(B) of that rule indicates "[f]inancial 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." Finally, and most importantly, subsection (1)(C) of the Commission's rule recognizes that "[p]art of a natural gas utility's balanced portfolio may be higher than spot market prices at times, and this is recognized as a possible result of prudent efforts to dampen upward volatility." While Empire is an electric utility, not a natural gas distribution utility, its relatively heavy reliance on natural gas-fired electric generation increases its need to hedge to ensure price stability.[2]

In the Decision section of the Amended Order, in quoting the Gas Rule, the Commission states:

> Rather, consistent with the Commission's regulation of natural gas distribution companies, with which it shares some characteristics, Empire hedges to "structure [its] portfolios with 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." The Commission's regulation recognizes that at times hedging will mean that the prices the utility will pay for gas will be higher than the spot price subject to the

[2] Amended Order, page 17, ¶I.

> fluctuations of the market, but understands the value of price certainty to both the utility and its customers.[3]

There are several problems with the Commission citing to the Gas Rule in an electric utility case. First, and most importantly, to the extent that the Gas Rule has any bearing on electric utilities, the Gas Rule is superseded by state statute. The Gas Rule, promulgated in 2002, was followed by the fuel adjustment clause in 2005. The statute and the promulgated rule both address the same subject: price volatility. The title of the Gas Rule states "Natural Gas Price Volatility Mitigation." Section 386.266.1 is to address "increases and decreases in…prudently incurred fuel and purchased-power costs…." Thus, both the statute and the Gas Rule were written to address volatility, such as increases and decreases in the fuel market, which in this case is gas. Where the Gas Rule's focus is on "efforts to ensure price stability," the state statute's focus is to "improve the efficiency *and cost-effectiveness* of its fuel." 4 CSR 240-40.018(1); Section 368.266.1. (Emphasis added). When there is a direct conflict *or inconsistency* between a statute and a regulation, the statute which represents the true legislative intent must necessarily prevail. *Parmley v. Missouri Dental Bd.*, 719 S.W.2d 745, 755 (Mo. banc 1986) (emphasis added). Because both the statute and rule focus on volatility/price increases and decreases, and because the statute focuses on cost-effectiveness rather than price stability, the statute conflicts with and is inconsistent with the Gas Rule and supersedes the rule. The Commission must justify the prudency of Empire's hedging without looking to the Gas Rule.

Even looking past the legality of citing to the Gas Rule, that Rule also is not persuasive. First, the Gas Rule is for gas utilities. Chapter 386.020, RSMo, defines of

[3] Amended Order, page 20.

gas and electric utilities, as well as commission rule, note they are independently defined to be different entities. Thus, a gas rule is inapplicable to Empire. The Commission's reliance on the gas rule for analogy support is misplaced. Empire is a consumer of gas which it uses to create a commodity, electricity, for its customers. It is not a provider of natural gas to its electric utility customers.

In addition, the Gas Rule was written at a time when this Commission had different factors and information to consider. Most importantly, as the record in front of this Commission reflects, gas prices in 2002, when the Gas Rule was promulgated, were very volatile. Thus, hedging in larger quantities and at higher premiums may very well have been prudent in 2002. In the five years leading up to and during the prudence review period, gas prices were stable and declining. Second, at the time that the Gas Rule was promulgated, the fuel adjustment clause was not available to electric utilities. Now, there is a mechanism in place to protect electric utilities from price volatility. Merely citing to a fifteen year old rule, without accounting for these factors, does not make the rule persuasive.

B. The Commission's Amended Order is unlawful because it focuses on factors other than the prudency of the investments made within the eighteen-month interval at issue, in that it does not analyze whether Empire's hedging was reasonable at *the* time, but rather analyzes whether hedging is reasonable at *any* time.

1. The Commission's focus was on issues external to the eighteen month test period.

The Fuel Adjustment Clause of section 386.266.1, RSMo, 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." The law requires companies with FACs to be subject to "provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals…." 386.266.4. Thus, it was the legislature's intent to revisit the prudency of the costs at frequent intervals. Accordingly, it is unlawful to assume that a cost that was once prudent will always be prudent. Despite that, this Commission's Amended Order focused on factors not specific to the prudence review period, while neglecting factors that were specific to the period.

An administrative agency must make findings of fact sufficient to support a lawful conclusion. *See Rednam v. State Bd. of Registration For Healing Arts*, 316 S.W.3d 357, 361 (Mo. Ct. App. 2010) (holding "[w]hen an agency fails to make sufficient findings of fact and conclusions of law to explain the basis for its decision, 'judicial review is inappropriate.' In such circumstances, the proper course of action is to remand the case to the agency to make sufficient findings"). By focusing heavily on factors not specific to the prudence review period, and by being non-specific regarding the prudence review period itself, the Amended Order is unlawfully deficient in its findings of fact and conclusions of law.

i. The Amended Order improperly focuses on if hedging is permitted generally.

The Commission's Amended Order used the earthquake insurance metaphor that, "there is value in purchasing earthquake insurance even if no earthquake occurs."[4] In doing so, the Commission makes the case that there is value in hedging, just as there is value in having insurance, even if no disastrous event ends up occurring. However, the Commission misses Public Counsel's point. The proper question using this metaphor is

[4] Amended Order, page 13, ¶29, see also page 20.

not whether there is value in insurance. The proper question is whether it is prudent for Missouri citizens to pay California earthquake insurance premiums.

Just as there is low risk of earthquakes in Missouri, the gas market also presented low risk of volatility subsequent to the shale gas revolution. Despite that, Empire continued to pay gas premiums as if the marketplace remained volatile. The question of prudency is not whether Empire can hedge. Rather, the review should focus on the reasonableness of decision of the company to hedge at the time it entered the contracts. Specifically, it is how Empire hedged during the 6th prudence audit review period. However, the Commission's Amended Order focused on whether hedging is good practice generally, rather than whether how Empire hedged was prudent during a time of natural gas price stability. It erred in doing so.

The Amended Order doubled down on this unlawful approach. In a paragraph added to the original Order, the Amended Order states that "Empire convincingly established that it operated a prudently designed and reasonable hedging program based on the information available to it at the time it made decisions."[5] This sentence is telling. The commission did not find that the hedging done during the test period was prudently designed. Rather, it found that the "program" was prudently designed. By doing so, the Commission was not focusing on the test period. It focused on the program globally. That approach is inconsistent with the statute.

The Commission's Amended Order focused heavily on justifying why Empire needs to hedge. It identified that the prices might be volatile in the future.[6] It stated that

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[5] Amended Order, page 19.
[6] Amended Order, page 11, ¶22.

the objective is not to beat the market price or to get the lowest price.[7] It also identifies "wild cards" of hurricanes, earthquakes, pipeline breaks, and other events.[8] The Commission, in its Decision section, goes on to state that "at times hedging will mean that the prices the utility will pay for gas will be higher than the spot price subject to the fluctuations of the market, but understands the value of the price certainty to both the utility and its customers."[9] Most tellingly, the Commission in its Amended Order states that "No one can truly know the future *and not purchasing a hedge position* because of a belief that the price of natural gas will decrease in a few years is analogous to not buying earthquake insurance because of a belief that there will not be an earthquake."[10] The Commission focuses on the question "can Empire hedge?" instead of "is Empire prudently hedging?" With its analogy, the Commission answers the question "Should I purchase earthquake insurance?" when the question it should have answered is "What should I pay for earthquake insurance?"

In an attempt to remedy this flaw in the original Order, the Commission added facts to its Amended Order in paragraphs 24-26. Those facts, even if accepted as true,[11] would only establish that before December 2011 prices were still projected at rates of $5.00-7.00. But what about the hedges purchased from December 2011 forward?

The fact that the Commission's focus was misplaced on hedging generally is further evidenced by the Amended Order's heavy reliance upon the Gas Rule which, as

[7] Amended Order, page 12, ¶28.
[8] Amended Order, page 12, ¶30.
[9] Amended Order, page 20.
[10] Amended Order, page 21. (Emphasis added).
[11] The NYMEX Henry Hub is not a reliable source for futures prices. Riley Surrebuttal 4, 6. As testified to by Aaron Doll on cross-examination, from reviewing the NYMEX, a party can only discern a price and a volume for contracts; and cannot determine the buyer or seller, whether either are speculators, utilities, natural gas local distribution companies; whether those contracts were bid under another company's risk

stated above, was itself unlawful. But the citation to the Gas Rule illustrates the Commission's unlawful approach as well. The Gas Rule states generally that gas hedging is prudent. But, the fact that hedging on gas *can* be prudent does not mean that all hedging *is* prudent. Certainly there exists imprudent hedging in some form. Just because Empire was permitted to hedge does not mean that is was prudent for Empire to pay exorbitant natural gas prices and knowingly lose millions of dollars per year to the detriment of its customers. If approving the inclusion of a cost in a utility's FAC, when that FAC is designed in a rate case were enough, the legislature would not have required eighteen-month prudence reviews.

OPC does not disagree that Empire could prudently hedge natural gas costs. But where the Commission errs is it does note address in its Amended Order Empire's specific hedging practices during the 6th prudence review period. Was Empire's loss of $16,785,521 in just eighteen months prudent? Were the prices it paid and the quantities purchased prudent? Did Empire justify why it overpaid for gas by such a significant number? Could Empire have hedged in such a way as to reduce that number? The Commission answers none of these questions in its Amended Order.

ii. The Amended Order improperly focuses on the fact that Empire had been approved for hedging in the past and that Empire has hedged in the past.

The Commission gives heavy attention to the fact that Empire has hedged for a long time, noting that there has been "no indication of imprudence in each of Empire's five previous prudence audit reports,"[12] that "Empire utilizes a formal Risk Management

management policy; or whether either party reviewed United State Energy Information Administration forecasts to determine whether the price is commensurate with forecasts. Transcript, pages 175-176.

[12] Amended Order, page 7, ¶6.

Policy and has done so since 2001,"[13] that "Empire has always hedged at least the minimum amounts…,"[14] and that "Empire's approved tariff provides that hedging costs…are to be recovered under the fuel adjustment clause."[15] However, again, the FAC prudency reviews are not to determine whether a company utilizing a fuel adjustment clause is able to hedge, it is to determine whether the electric utility prudently incurred the costs that flowed through its FAC during each prudency review period. Section 386.266.4, RSMo. A finding that Empire's past hedging was prudent does not address the review period specifically.

Instead, in its Decision the Commission focuses on the facts and conclusions of law quoted in the previous paragraph. This Commission identified as its pertinent question: "whether Empire acted prudently in *continuing* to hedge its natural gas purchases using its established risk management policy."[16] The Commission answered that question as follows: "Empire first implemented its risk management policy in 2001."[17] "In the first years in which that hedging policy was followed, natural gas prices trended upward, meaning purchases of hedge positions in the years before the gas was needed were profitable."[18] The Commission labels Empire's Risk Management Policy a "consistent hedging strategy."[19] Finally, as outlined in the previous subsection, the Commission is supportive of hedging generally. Thus, the Commission's holding reasons that 1) in 2001 (13 years before the test period) gas prices trended upward, 2) at *that* time gas prices were on the rise and were volatile, 3) Empire has been consistent in how it has

[13] Amended Order, page 7, ¶9.
[14] Amended Order, page 9, ¶15.
[15] Amended Order, page 17, ¶J.
[16] Amended Order, page 19. (Emphasis added).
[17] Amended Order, page 19.
[18] Amended Order, pages 19.
[19] Amended Order, page 21.

hedged, and 4) hedging itself is good; therefore, Empire's hedging was prudent. In other words, the Commission employs a "once prudent, always prudent" logic. Such logic undercuts what the statute demands: frequent oversight to evaluate prudency during discrete, separate periods of time. Because the Commission's Order analyzes prudency by focusing on factors outside of the 6th prudency review period, the Order is unlawful.

iii. The Amended Order dismisses imprudent decisions regarding physical forward contracts because they were accounted for correctly.

The Commission's Amended Order summarily dismisses losses, which are recoverable from customers, due to physical forward contracts or hedges with the finding that "for accounting purposes, physical forward contracts for the purchase of natural gas are treated a normal purchase used in the ordinary course of business."[20] While a prudence review should include a review as to whether or not a cost is appropriately accounted for, the statutorily required prudency reviews are to also determine whether the costs incurred in the ordinary course of business were prudently incurred. Section 386.266.4, RSMo. Determining that Empire has appropriately accounted for physical hedges does not address the question of whether or not these costs were prudently incurred. Such logic undercuts what the statute demands: frequent oversight to look for prudency even if costs are recorded correctly. Because the Commission's Amended Order dismisses physical hedging losses solely because they were recorded correctly, the Amended Order is unlawful.

2. The Amended Order improperly treats Empire's Risk Management Policy as controlling policy.

[20] Amended Order, page 14, ¶33.

The Commission finds in its Amended Order that because Empire's Risk Management Policy was in effect during prior rate cases and prudency audits where the Commission approved Empire's hedging costs managed under that policy, that future compliance with that same policy makes the hedging prudent. The Commission's findings of fact rely heavily on the fact that the Commission previously authorized Empire's hedging under its risk management policy. The Commission unlawfully treats Empire's risk management policy as if it is a promulgated rule rather than a policy that Empire may unilaterally change at any time. "The Commission first *authorized* Empire to utilize a fuel adjustment clause…in a 2008 general rate case."[21] The Commission emphasizes this is "Empire's sixth prudence review since it was *authorized* to utilize an FAC."[22] Likewise, the Commission quotes Empire's risk management policy several times. The Commission highlights Empire's stated goals and objectives. For example, the Commission makes sure to highlight that Empire's own policy states that its objective is to "provide a predictably priced reasonable cost gas-supply,"[23] implying that merely stating within the policy that their goal is to make the costs "reasonable" makes them so.

Most tellingly, the Commission states, "In adjusting its hedge purchases closer to the minimum bands established in its policy, Empire has shown appropriate consideration of current market conditions."[24] Empire's risk management committee "meets quarterly and monitors Empire's aggregate risks and ensures they are managed in accordance with Empire's Risk Management Policy."[25] "Empire has always hedged at least the minimum amounts required by its policy, although in recent years it has moved closer to the

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[21] Amended Order, page 5-6, ¶2. (Emphasis Added).
[22] Amended Order, page 6, ¶3.
[23] Amended Order, page 7, ¶10, see also ¶9.
[24] Amended Order, page 21, FN 63.

minimum hedging bands established in its policy."[26] Accordingly, the Commission seems to take note of the fact that Empire remains consistent with its own risk management policy. There was no analysis as to whether the "minimum bands" themselves are prudent.

In its Decision section, the Commission continues to place weight on the fact that Empire remains consistent with its own policy. It states "while Empire has reviewed and modified aspects of [the] policy, the structure of the policy regarding the hedging of certain percentages of its anticipated natural gas needs up to four years before the gas is needed has not changed."[27] Again, it frames the question as to whether "Empire acted prudently in continuing to hedge its natural gas purchases using its *established risk management policy."*[28] OPC complained that the policy is unduly rigid because the policy itself became imprudent once the market stabilized. The Commission answered that complaint by stating that "what Public Counsel decries as rigidity is really just an aspect of applying a consistent hedging strategy."[29] In other words, the Commission's approach is to say that, as long as Empire sticks to its own policy consistently, it is prudent.

This is further evidenced by Staff's position. Staff took the position that "Staff auditor Ashley Sarver reviewed the RMP for compliance by the company and did not review the RMP for prudence…"[30] Sarver, when asked whether she "review[ed] it for compliance with the policy or did you conduct a prudence audit?" answered "the

[25] Amended Order, page 8, ¶13.
[26] Amended Order, page 9, ¶15.
[27] Amended Order, page 19.
[28] Amended Order, page 19. (Emphasis added).
[29] Amended Order, page 21.
[30] Staff Initial Brief, page 2.

compliance."[31] When asked if she conducted a prudence audit, she testified "No, because the rate case did a prudence of the policy."[32] Despite that, the Commission in its Amended Order states as a finding of fact, which it relied upon, that "Staff 'did not find Empire acted imprudently in the administration of its risk management strategies during the review period.'"[33]

But such an approach is unlawful. There is nothing in Missouri state statutes, the Commission's regulations, Empire's tariff, or anywhere else that forces Empire to keep to its risk management policy. There is nothing to prevent it from amending it. Thus, the question cannot be whether a company is consistent to its own policy. That approach would only enable self-serving internal policies. Rather, the Commission must evaluate whether, for the eighteen-month period, Empire's prudently incurred its costs. Whether Empire has remained consistent with its own policy that it is not bound to follow is irrelevant to that discussion.

3. The Amended Order does not acknowledge that significant loss is a factor for prudency.

"A prudent utility would prefer to save money." *State ex rel. Noranda Aluminum v. PSC*, 356 S.W.3d 293, 314 (Mo. App. S.D. 2011). The Commission appropriately recognizes that the losses incurred created "serious doubt" as to the prudency of Empire's hedging.[34] Yet, in its Amended Order the Commission dismissively states that "the mere fact that Empire's hedging program sustained financial losses does not mean that

[31] Transcript, page 260, lines 2-4.
[32] Transcript, page 260, lines 5-8.
[33] Amended Order, page 6, ¶4.
[34] Amended Order, page 19.

program was imprudent"[35] and that "it would be terribly unfair to penalize the utility for following a hedging policy just because it did not correctly anticipate the fluctuations of the natural gas markets."[36]

Empire recorded a loss of $14.3 million in 2010, $9.5 million in 2011, $14.4 million in 2012, $9.0 million in 2013, $1.3 million in 2014, $11.1 million in 2015, and $7.5 million in 2016.[37] Even the anomaly in that pattern was a mere $1.8 million dollar loss in 2014.[38] These huge losses, year after year, put Empire on notice that its hedging policy was losing millions of dollars every year. Yet, it did nothing to adjust to the changed market conditions. The fact that Empire's losses ranged anywhere from $10,712,168 to $13,104,811 for the March 1, 2015, to August 31, 2016, 6th prudence review period should not be ignored in light of the pattern of disregard for hedging losses seen by Empire. The Commission did nothing to determine whether Empire's hedging policy was prudent in attempting to save ratepayers money. Should Empire have spent less on fuel costs? The Commission's Amended Order does not answer that question. To use the Commission's metaphor again: it did nothing to evaluate whether ratepayers were paying Missouri premiums for Missouri earthquake insurance.

More concerning, however, is that the Commission's Amended order was dismissive of the fact that the program sustained financial losses. OPC focused on losses because harm is a factor. "In order to disallow a utility's recovery of costs from its ratepayers, the PSC must find both that (1) the utility acted imprudently, and (2) such imprudence resulted in *harm to the utility's ratepayers*." *State ex rel. KCP&L v. PSC*,

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[35] Amended Order, page 19.
[36] Amended Order, page 20.
[37] Riley Surrebuttal, Ex. 3, JSR-S-1
[38] Id.

408 S.W.3d 153, 163 HN10 (Mo. App. W.D. 2013) (internal citations omitted)(emphasis added).

Rather than recognizing that the harm is a factor, the Commission treat the facts establishing harm as OPC's entire case. Financial loss was not the entirety of OPC's case-in-chief. Rather, it was one piece of the puzzle. It was unlawful for the Commission to only focus on that one issue and to ignore all the evidence of imprudence that led to the financial losses.

C. The Commission applied an unlawful procedure regarding how and when the Commission is to review Empire's hedging for prudence.

During the November 16, 2017, agenda meeting, the Majority Commissioners made several statements that demonstrate that the Commission is applying section 386.266 unlawfully.

- **Commissioner Hall**: "It is inappropriate to Monday Morning Quarterback."
- "If a party had a concern about the hedging policy in question it should have been raised at the time…The hedges at issue here took place between 2010 and 2015, that was the time period when a party or this Commission should have told Empire that that policy was imprudent or inappropriate."
- "There were six rate cases at which any party or this Commission could have instructed the Commission that this policy was imprudent or inappropriate." (another section).
- **Commissioner Stoll**: "The review of the prudence of the overall policy needs to be done in the next rate case."

- **Commissioner Kenney**: "It is difficult to go back and look and now try and punish the company for what I look at as a failure, it did not work."
- In reference to a docket in 2014, "the Commission recommended no policy changes at that time." (another section)

The comments at the February 28, 2018 agenda mirror these selected quotes.

This line of thinking is consistent with the Commission's Amended Order. "It would be terribly unfair to penalize the utility for following a hedging policy just because it did not correctly anticipate the fluctuations of natural gas markets."[39] "It is very easy to look back at gas market spot prices with perfect 20-20 hindsight to say that Empire's decision to continue its hedging program has cost its ratepayers a definite amount of money."[40]

However, the statute is designed expressly to accomplish that purpose. Section 286.266.4(4) requires "prudence reviews of the costs subject to the adjustment mechanism *no less frequently than at eighteen-month intervals*." (Emphasis added). Thus, the legislature intended for electric utilities, if they are to take advantage of the fuel adjustment clause, to be subject to frequent prudency reviews *in between rate cases*. The word review means "a retrospective view or survey,"[41] meaning the audit is done after the fact, not contemporaneously. To find otherwise would create an absurdity wherein the Commission avoids considering the prudency of incurred from certain hedges. At issue in this case are hedges for fuel delivered from the March 1, 2015, to August 31, 2016, prudence audit period were entered into prior the review period, but not realized until the review period. If the Commission is believes it is incapable of reviewing the

[39] Amended Order, page 20.
[40] Id.

prudency of such costs or otherwise lacks the authority to authorize the statutory relief identified for imprudent costs, the question of whether any such hedging costs are within the Commission's authority to grant in any FAC proceeding or tariff.

Additionally, it is the intent of the legislature to give 20-20 hindsight with regard to what imprudent expenditures have cost ratepayers. The imprudent costs "shall require refund of *any* imprudently incurred costs *plus interest*." Section 386.266.4(4). (Emphasis added). Not only is this Commission to identify ***specific*** costs, but it is to award ***interest***, which is further evidence that the statute contemplates a 20-20 Monday morning quarterback, type review with regard to the costs to be returned to ratepayers.

It is true that this Commission is to review the conduct as to whether "the conduct was reasonable at the time, under all circumstances."[42] However, as demonstrated in the other sections of this Application, plenty of evidence was introduced into the record that would indicate that OPC is not challenging the result (significant losses), but rather the decisions made at the time of the hedging. The Amended Order, and the Commission's statements at its agenda meeting, is in error because it takes this standard one step further than what the law states. The Commissioner Hall's statement that the "question should have been raised at the time," would have required OPC to not identify the issue during a prudency audit, but rather identify the imprudency as hedges were made. This is not contemplated by the statute, which propounds a specific proceeding to consider prudency. Furthermore, the Chairman's statement is inconsistent with the prudence standard. The two-fold prudency standard requires an unreasonable action and *a negative customer impact*. As such, until a negative customer impact is realized in the form of an

[41] Merriam-Webster, https://www.merriam-webster.com/dictionary/review
[42] Amended Order, page 16, ¶D.

economic harm, and as the statute constricts the review of the prudency of the costs ran through an FAC to the prudence review audits, there is no opportunity for OPC to raise such allegations at an earlier time.

Commissioner Stoll's comment that "the review of the prudence of the overall policy needs to be done in the next rate case" would require OPC to wait, and not be able to challenge prudency every eighteen months between rate cases as the statute requires and would not allow for refund of any imprudently incurred costs plus interest as required by Section 386.266.4(4). Commissioner Kenney's comment that "it is difficult to go back and look and now try and punish the company for what I look at as a failure" indicates that parties cannot seek a refund for imprudently incurred costs after the fact, even though the statute permits that action.

Accordingly, OPC requests this Commission to rehear the facts put on the record, review those facts in light of the Commission's ability to declare past actions imprudent, and to not require OPC to bring this action as the events occur, or to have to wait until the next rate case to address the problem.

II. The Commission's Amended Order is unreasonable because the Commission abused its discretion when it arbitrarily and capriciously found that OPC's "proposed adjustment was based on the prudence of Empire's overall hedging program, not any particular hedging transaction."

The Court of Appeals may review and overturn this Commission's Amended Order if it is not reasonable. *Liberty Energy*, 464 S.W.3d at 524. The Amended Order is not reasonable if it is not "supported by substantial, competent evidence on the whole record; the decision is not arbitrary or capricious; and where the Commission has not abused its discretion." *Id*. "Arbitrary and capricious has been defined as willful and unreasoning action, *without consideration of and in disregard of the facts and* *circumstances*." *Beverly Enterprises-Missouri v. Department of Social Services*, 349 S.W.3d 337, 345 (Mo. App. W.D. 2008). (emphasis added). A fact finder "abuses discretion if its order is clearly against the logic of the circumstances, is arbitrary and unreasonable, *and indicates a lack of careful consideration*." *General Motors Acceptance Corp. v. Standridge*, 181 S.W.3d 76, 77 (Mo. banc 2006)(internal citations omitted). (Emphasis added).

This Commission's assertion that OPC's position "was based on the prudence of Empire's overall hedging program, not on any particular hedging transaction"[43] establishes on its face that the Commission's Amended Order was "without consideration of…facts and circumstances" and "indicates a lack of careful consideration." This is particularly true when in light of the Commission's finding that "Empire convincingly established that it operated a prudently designed and reasonable hedging *program*…."[44] The record and OPC's filings demonstrate that OPC was not challenging the program itself, but rather the hedging specific to the test period. Further, the finding that "the *mere fact* that Empire's hedging program sustained financial losses does not mean that program was imprudent"[45] demonstrates that the Commission did not give careful consideration to the evidence regarding gas projections and forecasts. The use of the words "mere fact" show that the Commission only considered financial losses, not the data that should have alerted Empire to price stabilization.

A. John Riley's Testimony

One would only need to read the written testimony of John Riley to see that OPC was not challenging Empire's hedging *program*, but rather the hedging *specific to the test*

[43] Amended Order, page 19.
[44] Amended Order, 19.

period. The testimony was supplemented by detailed charts and graphs which specifically identified the imprudent hedging purchases made by Empire during the test period.

Riley's testimony began by establishing that Empire was aware of the stabilization of the gas market during the test period.[46] These facts were also established by OPC Exhibit 17, which was put into a graph in OPC's Initial Brief. Therefore, the record contains evidence, which was identified by OPC, of numerous specific instances of knowledge on the part of Empire of the stabilization and decline in prices of the gas market during the test period. Each of those instances represent a separate acknowledgement on Empire's part that it continued to hedge on the assumption of a volatile market when it knew the market to be non-volatile.

Riley also gives data that was available to Empire that demonstrated the decline in gas prices.[47] A chart on page 9 of Riley's rebuttal testimony shows that gas prices were projected to remain below $4 MMBtu into 2020.[48] Yet, in 2011, Empire "acquire[d] 1 million Dth of natural gas for ** " **[49]

Second, Riley's testimony identified specific portions of Empire's hedging policy that were too rigid to be able to adequately adjust to the gas market during the test period.[50] He informed the Commission that the policy was "inflexible and costly,"[51] "mostly unchanged since 2001,"[52] despite the fact that "natural gas prices ha[d] declined"

[45] Amended Order, 19.
[46] Riley Direct, Ex. 1, Pg. 6, lines 7-27.
[47] Riley Rebuttal, Ex. 2, pages 7-8.
[48] Riley Rebuttal, Ex. 2, page 9.
[49] Riley Rebuttal, Ex. 2, page 11, lines 17-19.
[50] Riley Direct, Ex. 1, pages 9-12.
[51] Riley Direct, Ex. 1, page 9, line 16.
[52] Riley Direct, Ex. 1, page 9, lines 7-8.

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since 2009[53] and were "steady."[54] Riley states that "the question of prudency comes in when it is realized that the company has not changed its business policies or its practices regarding hedging while the regulatory environment and natural gas volatility and prices have changed significantly," and, that "the company now has an FAC."[55] Riley bolsters his allegations of inflexibility by quoting Aaron Doll, who stated that "Empire has recognized that the market was trending downward and made a conscious effort to react to the market *while still remaining within the RMP guidelines*"[56] that require a minimum volume amount to be purchased by each year-end.

Riley gives specific instances of purchases by volume:

> Q. Can you provide any specific hedging transactions that indicate the Company buys for volume?[57]
>
> A. Yes. Reviewing transactions from the year end 2011 Gas Position Report, in October of 2010, the Company bought swaps for 400,000 dekatherms ("DTh") to come due in 2015. This was actually more than half a year earlier than required by its hedging policy. Empire's next purchase for 2015 was 300,000 DTh swaps in June of 2011, and its final purchase for 2015 that occurred during 2011 was in October of 2011 where it contracted for 310,000 DTh.

Riley demonstrates that Empire is an outlier in hedging that far in advance during this time period.[58]

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[53] Riley Direct, Ex. 1, page 6, lines 16; 19.
[54] See generally Ex. 17, see also OPC Brief 26-29.
[55] Riley Direct, Ex. 1, page 14, lines 17-21.
[56] Riley Rebuttal, Ex. 2, page 5, lines 8-12. See also lines 13-19. (Emphasis added).

After identifying the problems with Empire's hedging policy on a conceptual level, Riley also identified specific instances where the bad policy decisions injured ratepayers. In answer to the question "what *specifically* makes this an imprudent practice?", Riley stated that the hedging practice caused Empire to purchase gas "at prices well above current and forecasted prices."[59] He provided examples. "In December of 2011, Empire hedged over **

**[60] In December of 2011, natural gas was $3.17.[61] And, as Riley had already established, and Empire had already acknowledged, prices were set to *decline* in 2011 and were "falling nearly every month."[62] As a result of these hedging practices, "Empire paid $5,494,400 for fuel that in 2015 (more than two years later) would have cost $2,565,400."[63] As Riley stated in his Direct Testimony, "this is not an isolated incident. OPC attached the Company's gas summary reports for every month of the prudence review as JSR-D-4. These reports show the Company lost money in every month it hedged."[64]

The Commission's Amended Order states that OPC showed that Empire "experienced financial losses" but that "the mere showing that losses were incurred on some transactions was not sufficient to overcome the presumption of prudence…."[65] But, a simple reading of Riley's testimony, OPC's briefs, and the record as a whole demonstrates that the problems identified by OPC were not just about financial losses,

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[57] Riley Rebuttal, Ex. 2, pages 5-6; see also Riley Surrebuttal, Ex. 3, page 5.
[58] Id.
[59] Riley Direct, Ex. 1, page 17, lines 4-8 (emphasis added).
[60] Riley Direct, Ex. 1, page 17, lines 14-16.
[61] Riley Direct, Ex. 1, page 17, line 19.
[62] Riley Direct, Ex. 1, page 17, lines 20-22.
[63] Riley Direct, Ex. 1, page 18, lines 5-6.
[64] Riley Direct, Ex. 1, page 18, lines 11-13. See also JSR-D-3.
[65] Amended Order, page 19.

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though they were substantial. It was Empire's practice of purchasing large quantities of gas at rates far above market rate, despite projections for decline in gas prices. Riley's testimony both written and in the hearing[66] made that point very clear. OPC's briefing made that clear. It is arbitrary, capricious, and an abuse of discretion to find otherwise.

The commission's analysis focuses on Empire's hedging over the course of time rather than focusing on their policy *during the test period.* In doing so, the Commission ignores the evidence put on by OPC, which did focus on the test period.

B. **Empire's losses**

The Amended Order acknowledges the enormous financial losses that Empire burdened ratepayers with, but is ultimately dismissive of those losses. The Amended Order states that "the mere fact that Empire's hedging program sustained financial losses does not mean that program was imprudent."[67] And, "this case is not about whether Empire has made or lost money as a result of its hedging program."[68] But the Amended Order misses the point. OPC is not making the case that the evidence of losses alone makes the hedging imprudent. Rather, OPC is making the case that 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."[69] "Ignoring the gas market dynamics and racking up tens of millions of dollars in unnecessary hedging losses is the very type of imprudence the Legislature

[66] Tr. page 149 -152 (Aug. 31, 2017).
[67] Amended Order, page 19.
[68] Amended Order, page 19.
[69] OPC Initial Brief, page 19.

intended to protect against when it limited cost recovery to only prudently incurred costs."[70]

The losses were, in fact, massive. In the prudence review period of this case, Empire had hedging losses of $16,786,521.65 and charged $13,104,811.18 to its Missouri rate payers.[71] From 2009 through 2011, the policy had resulted in $46 million in hedging losses.[72] At the end of 2012, the losses since 2009 were over $60 million.[73] What this means is that, during the time in which Empire was making hedging decisions regarding the purchase of gas for the prudence review period, Empire was already losing huge amounts of money due to hedging. This, combined with the facts that Empire knew of the price of gas was projected to stabilize with a slight decline in prices,[74] and the fact that Empire purchased gas at ** ** in 2011[75] when natural gas cost $3.17,[76] shows that Empire was willfully taking large losses. To be dismissive of the fact that Empire lost over $90 million in hedging from 2009-2016, when Empire knew it could reduce that number significantly with little risk, is an abuse of discretion, is arbitrary and capricious.

The evidence demonstrates something more than "mere…financial losses." Rather, Empire knew they would sustain bigger losses than are necessary, but hedged at higher rates anyway. By mischaracterizing OPC's position, or perhaps missing the point entirely, the Commission demonstrated a lack of careful consideration and a disregard for the facts and circumstances presented to the Commission.

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[70] Id.
[71] Riley Direct, Ex. 1, page 2.
[72] Riley Surrebuttal, Ex. 3, Schedule JSR-S-1.
[73] Id.
[74] OPC Initial Brief, pages 26-29, quoting Exhibit 17.
[75] Riley Direct, Ex. 1, page 17, lines 14-16.
[76] Riley Direct, Ex. 1, page 17, line 19.

WHEREFORE the Amended Order is unlawful, arbitrary, capricious and constitutes an abuse of the Commission's discretion. The Office of the Public Counsel respectfully seeks rehearing for all the reasons identified above.

Respectfully submitted,

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I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 1st day of February 2018.

/s/ Curtis Schube