Exhibit No.:	
Issue:	Fuel Adjustment Clause
Witness:	Gary L. Clemens
Type of Exhibit:	Surrebuttal Testimony
Sponsoring Party:	KCP&L Greater Missouri Operations Company
Case No.:	EO-2011-0390
Date Testimony Prepared:	April 30, 2012

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: EO-2011-0390

SURREBUTTAL TESTIMONY

OF

GARY L. CLEMENS

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City, Missouri
April 2012

SURREBUTTAL TESTIMONY

OF

GARY L. CLEMENS

Case No. EO-2011-0390

Q: Please state your name and business address.

A: My name is Gary L. Clemens, and my business address is 6805 N. Hardesty Avenue, Kansas City, Missouri 64119.

Q: By whom are you employed, what is your job title, and what are your job responsibilities?

A: I am a self-employed utility consultant.

Q: Please briefly describe your education and work experience.

A: I attended Northwest Missouri State University, Maryville, Missouri, from which I was awarded a Bachelor of Science Degree in Business Administration with a major in Accounting. After graduation in 1980, I joined Aquila, Inc. (Missouri Public Service at that time) as a Staff Accountant in Regulatory Services. From 1980 through July 2008, I held various positions in the Accounting and Regulatory Services departments with my final position being Senior Director of Regulatory Services.

Q: Have you previously testified in a proceeding at the Missouri Public Service Commission ("MPSC" or "Commission") or before any other utility regulatory body?

A: Yes, I have testified on numerous occasions before the MPSC as well as the Federal Energy Regulatory Commission.

Q: On whose behalf are you testifying?

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

Q: What is the purpose of your testimony in this proceeding?

A: The purpose of my testimony is to provide firsthand knowledge relating to the history of Aquila's hedging programs, its initiation and implementation of its Fuel Adjustment Clause ("FAC") as well as some current experience relating to the correlation between natural gas prices and purchased power prices. My testimony will rebut the following claims made by Staff witnesses in this case:

1) Staff witness Dana Eaves claims that the process of hedging on-peak purchased power price risk with natural gas futures is an imprudent practice, that New York Mercantile Exchange ("NYMEX") natural gas prices do not trend with on-peak purchased power prices.
2) Staff witness Chuck Hyneman contends on p 9 of his testimony in this case that Staff did not know the Company was going to continue to hedge on-peak purchased power when it changed to a new hedging program; and
3) Staff witness Lena Mantle claims that hedging costs for that on-peak purchased power were never meant to flow through the FAC.

Q: Since leaving Aquila have you continued working in the utility business?

A: Yes.

Q: Please describe what kind of utility work you have you have been doing.

A: As a Utility Consultant the majority of my work has been as an energy broker for retail customers in states that are deregulated.

Q: Can you identify what you do as an energy broker?

A: Retail customers in deregulated states can choose a provider for electric and gas for the supply portion of their utility bill. As a broker I seek out bids from energy providers and provide recommendations to retail customers for supply contracts.

Q: Do electric energy prices change often when getting bids?

A: Yes. Prices change quite often, in fact they can change hourly, driven primarily by cost of natural gas. NYMEX prices for natural gas directly affects the electric contract prices as gas is the fuel used to produce the incremental electricity.

Q: Can you provide any specific examples of this happening?

A: Yes. On November 1, 2011 the NYMEX 12 month strip price of natural gas was $3.98/mcf. In the Illinois Commonwealth Edison market we were getting energy supply quotes for retail customers in the .058/kwh range in November 2011. On April 19, 2012 the NYMEX 12 month strip price of natural gas was $2.55/kwh, a $1.43/mcf drop. In April 2012, in the same Illinois market we were getting energy supply quotes for retail customers in the $.045/kwh range, a $.013/kwh drop.

Q: Do you monitor the NYMEX to assist you in marketing peak electricity to your customers?

A: Yes, as I indicated, the NYMEX prices for natural gas directly affect the electric contract prices, so each day when I log onto my computer; I pull up the NYMEX web site to monitor current and futures activity.

Q: What is the conclusion you are presenting in this part of your testimony?

A: I have firsthand knowledge of the prudent practice of cross hedging on-peak purchased power needs with natural gas futures and options. This conclusion is further supported by Company witnesses Dr. Woo and Mr. Blunk.

Q: Tell us about your employment history with Aquila.

A: As you can see from my work history in my introduction, I started working for Missouri Public Service (later Aquila, Inc.) in 1980. I began in the regulatory department and have worked there most of my career. I have been involved in each of the rate cases cited in this case. I was instrumental in developing and implementing the FAC (the first in the state of Missouri since the 1980s) for MPS and L&P. I have participated in every Missouri rate case Aquila has been involved in since 1980 until I left the company in July 2008.

Q: How is this information important to this case?

A: There has been a lot of discussion by the Commission Staff in this case relating to adequate knowledge of past decisions, participation in those decisions and/or negotiations, and the purpose and thought process behind certain decisions. I was present for many, if not all, of the events addressed. I would like to provide some background information as to the unfolding of the hedging program as well as the FAC at Aquila.

Q: Please provide a time line as to the initiation, development and implementation of the Aquila hedging program and its inclusion in the FAC.

A: In July of 2004, Aquila began its hedging program to hedge against natural gas and peak purchased power price spikes:

- The costs associated with what the company considered an insurance policy against volatile price shifts were recorded below-the-line.

In February of 2005, Aquila began its 1/3, 1/3, 1/3 (“1/3”) hedging strategy.

- The strategy provided for 1/3 volumes to be hedged with fixed price contracts, 1/3 with options and the remaining 1/3 would float with the market.

In October of 2005, Commission Staff and Intervenor Direct Testimony was filed in Rate Case No. ER-2005-0436:

- Commission Staff witness Chuck Hyneman outlined the company’s 1/3 hedging strategy in his Schedule 2 of the above mentioned testimony. This three page strategy document clearly describes how natural gas for its own generation as well as natural gas to mitigate on-peak purchased power price volatility would be hedged with natural gas fixed price contracts and options.
- In this same testimony on pages 18-19, Mr. Hyneman questioned Aquila’s rigid approach to placing its hedges but did not indicate any issue with the use of natural gas hedges to mitigate the price volatility risk of on-peak purchased power.
- Staff witness Cary Featherstone indicated, on pages 23 and 24, that purchased power costs tend to follow natural gas costs. He also stated on page 32, “The proposed IEC mechanism that may result from the Commission’s decision in this case, should include the results from a well thought out, managed and prudently executed hedging program.”

- Intervener witness Maurice Brubaker indicated on pages 4 and 5 that the company hedges for both its natural gas needs as well as its purchased power risk and that the settlements of those hedges should be recorded above the line.

In March 2006, the Commission issued its order for Rate Case No. ER-2005-0436:

- Beginning on page 5, the order stated, "Aquila, Inc. is authorized, for accounting and ratemaking purposes, to record in FERC Account 547 or Account 555, as part of fuel cost and purchased power cost, hedge settlements, both positive and negative, and related costs (e.g. option premiums, interest on margin accounts, and carrying cost on option premiums) directly related to natural gas generation and on-peak purchased power transactions made under a formal Aquila Networks – MPS hedging plan when the hedge arrangement is settled. Aquila shall maintain separate accounting in FERC Accounts 547 and 555 to track the hedge settlements and related costs."

In July of 2006, Aquila applied for a rate increase. This began Rate Case No. ER-2007-0004:

- Staff witness Cary Featherstone in his Direct Testimony on page 33, indicated that hedging settlements should be included in any fuel clause authorized by the Commission.
- In Staff witness Chuck Hyneman's Rebuttal Testimony beginning on page 14, he criticized the rigidity of the Company's hedging plan but did not disagree with hedging purchased power risk with natural gas futures.
- In Staff witness Chuck Hyneman's Surrebuttal Testimony he described that the Aquila 1/3 hedging plan hedged the risk for both the purchase of natural gas to

burn in its generators as well as to mitigate the price volatility risk of on-peak purchased power. Mr. Hyneman again voiced his concern about the rigidity of the implementation of the 1/3 hedging strategy but offered no criticisms relating to the hedging of purchased power risk (Schdule 4 and page 23).

- Based upon the concerns voiced by the Staff, their favorable review of the Kase and Company, Inc. ("Kase") program used by other utilities in their audit area, specifically KCP&L, as well as research of other products that were available at the time, the Company began discussion with Kase to find a program to replace the 1/3 program. In April 2007, the Company invited MPSC Staff members Mr. Schallenberg, Mr. Featherstone and Mr. Hyneman to attend an overview and training meeting relating to the Kase program of hedging natural gas for peak generation as well as to mitigate the risk of peak purchased power price volatility. *See* Schedule TMR - 6 of Mr. Rush's Surrebuttal Testimony in this case to review the email from Company representative Denny Williams to the MPSC Staff discussing the decision-making process as well as the invitation to participate in the meeting with Kase. Please note from the email that Aquila did not just blindly enter into its hedging program. The Company determined that there was a risk that needed to be mitigated and it analyzed and investigated an appropriate method to mitigate that risk. Mr. Hyneman attended by phone. Staff did not give any feedback relating to the program, other than the endorsement of the KCP&L program mentioned in their testimony. Mr. Hyneman did encourage the Company to continue to hedge its risk but to do it with a program other than the 1/3 program in place.

In May 2007 the Stipulation and Agreement, the Report and Order as well as the Order Clarifying Report and Order were issued in Rate Case no. ER-2007-0004:

- In negotiations, the Company agreed to no recovery of $11.5 million of 2006 hedge settlement costs. Also in this agreement, the ultimate settlement of hedges in place at 3/27/07 were to flow through the FAC (if implemented in the final order) without challenge as to a prudence disallowance relative to its original decision to enter into these hedge positions. This was part of a total settlement of all the issues except the FAC. By not seeking recovery of the $11.5 million of hedge settlement costs Company did not admit the hedges were imprudent.
- The Report and Order implemented the first FAC in the state of Missouri since the FAC mechanism was invalidated by the Missouri Supreme Court in 1979. The tariff included variable costs for 547 and 555. The clarifying order specifically included hedge settlement costs as indicated in the Stipulation and Agreement. S*ee* Schedule TMR - 4 for the original tariff sheet that was associated with this order, Sheet Nos. 124-127.

In October 2007, Aquila began using the Kase program to hedge its natural gas and purchased power price risk:

The company continued to hedge natural gas for its own generation as well as natural gas equivalents for the mitigation of its peak purchased power price risk. *See* Schedules TMR – 7 and 8 for the Risk Management Strategy and Aquila Administrative Procedures associated with the Kase program implemented in 2007 for detail. Chapter 1, Section 1.1 in Schedule TMR – 7 states the following: "Aquila, Inc. (the company) **purchases spot gas and power that equates to approximately 10 BCF per year of natural gas**. In addition, Chapter 1, Section 1.4 states, “Through this program, Aquila will endeavor to ensure that it hedges natural gas equivalent exposure in a manner that is responsive to professional methods of managing risk and price discovery. This program is specifically designed to shift the price risks associated with buying **<u>gas or gas-correlated purchased power</u>** in a volatile, competitive environment to others willing to assume it, such as speculators, inverse hedgers and investors.” **<u>(Emphasis added)</u>**

Q: What is the conclusion you are presenting in this part of your testimony?

A: As can be seen from the progression of the evidence presented above the following facts are clear:

1) Staff was fully aware, or should have been fully aware, of the fact that Aquila hedged for natural gas as well as spot purchased power. This fact has been discussed by both Company and Staff/Intervenor witnesses throughout each case since the inception of the original hedging program.

2) Although the recording of costs in regulated accounts does not guarantee the recovery of those costs, the movement of cost from below-the-line to above-the-line indicates that the costs were to be considered a part of the Company’s cost of service.

3) The Commission Staff encouraged Aquila to mitigate price volatility risk through a hedging program.

4) The Company changed to a program it believed addressed the concerns as expressed by the Staff, i.e. the rigidity and lack of judgment associated with the 1/3 program. We were never made aware of any issues regarding the use of natural gas to hedge on-peak purchased power even after several attempts to engage Staff in discussion on the hedging strategy.

5) Hedge settlement costs (both positive and negative) were intended to flow through the FAC as specified in the Stipulation and Agreement as well as the Clarifying Report and Order from Rate Case No. ER-2007-0004.

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF GARY L. CLEMENS

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Gary L. Clemens, being first duly sworn on his oath, states:

1. My name is Gary L. Clemens. I work in Kansas City, Missouri, and I am self-employed as a utility consultant.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of KC&PL Greater Missouri Operations Company consisting of ten (10) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

Gary L Clemens
Gary L. Clemens

Subscribed and sworn before me this 30th day of April, 2012.

Nicole A. Wehry
Notary Public

My commission expires: Feb. 4 2015

NICOLE A. WEHRY
Notary Public - Notary Seal
State of Missouri
Commissioned for Jackson County
My Commission Expires: February 04, 2015
Commission Number: 11391200