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

REPLY BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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Public

Summary of Argument

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. Empire did not exercise reasonable diligence in mitigating its hedging losses by failing to change its hedging policy in light of a non-volatile gas market and exorbitant losses incurred from its hedging policy. As a result of operating its imprudent hedging policy; Empire's customers wasted millions of dollars to pay for Empire's physical and financial hedging losses. The facts of this case demonstrate a pattern of imprudent management decisions; 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.

I. Applicable Evidentiary and Prudence Standards

The applicable evidentiary standard before the Commission is a preponderance of the evidence, meaning a party must convince the Commission it is "more likely than not" that its allegations of imprudence are true. Dill v. Dill, 304 S.W.3d 738, 743 (Mo. App. 2010). The Commission must find sufficient evidence to support OPC's allegations and demonstrate that Empire violated the prudence standard in operation of company's hedging program.

As discussed at some length in OPC's initial brief,[1] past Commission practice "has been to apply a "presumption of prudence" in determining whether a utility properly incurred its expenditures." Office of the Pub. Counsel v. Mo. PSC, 409 S.W.3d 371, 376, (Mo. 2013). The presumption is defeated once another party raises a "serious doubt" about the prudence of the

[1] *Initial Brief of the Office of the Public Counsel*, ER-2017-0065, pp. 3 – 9.

expenditure. State ex rel. Associated Natural Gas Co. v. P.S.C., 954 S.W.2d 520 (Mo. App. 1997). Once defeated, "then the applicant [utility] has the burden of dispelling these doubts and proving the questioned expenditures to have been prudent." *Id.* After the presumption is overcome, the Commission then determines the prudence of the costs at issue.

The prudence standard in FAC proceedings asks the Commission to consider whether the utility's conduct was reasonable at the time, under all of the circumstances, considering the company had to solve its problem prospectively rather than in reliance on hindsight. State ex rel. GS Technologies Operating Co., Inc. v. Public Service Comm'n, 116 S.W.3d 680, 694 (Mo. App. 2003). The pivotal question to determine is whether the company exercised prudence in formulating its decision. *See* State ex rel. Missouri Power and Light Co. v. Public Service Comm'n, 669 S.W.2d 941, 947-948 (Mo. App. 1984).

A. The Commission Should Not Apply The Negligent Or Wrongful Standard

In its initial brief, Empire accuses OPC of failing to meet a "negligent or wrongful" standard in this case.[2] OPC has no such obligation or burden to prove negligence or any additional legal standards than those applied by the Commission in the past and previously articulated hereinbefore. Empire poses a syllogism as a legal argument when it claims that a Commission definition of "prudently incurred cost" which states "costs [that] do not include any increased costs resulting from negligent or wrongful acts or omissions by the utility" exclusively defines the term "imprudent" as only negligent or wrongful acts.[3] While the Commission's rule prohibits consideration of negligent and wrongful acts as "prudent", this definition is anything but comprehensive to all acts that may be determined by the Commission to be imprudent. Section 386.233.4(4) standard requires a for refund all "imprudently incurred costs[.]" The Legislature did not expressly define the term "imprudent" in Section 386.233

[2] *Empire's Initial Post-Hearing Brief*, EO-2017-0065, p. 1.
[3] *Id.*

RSMo. In applying the statute, the Commission should recognize the definition of imprudent as "not prudent; unwise or indiscreet."[4] The Legislature intended a far broader application of the term imprudent than that argued by Empire. As such, Empire's argument fails syllogistically because while all negligent and wrongful acts are defined as imprudent; all unwise, indiscreet and imprudent acts may not be exclusively negligent or wrongful acts. Consequently, the Commission should set aside Empire's exaggerated application of the definition of "prudently incurred costs" and apply the previously articulated "reasonable person" standard.

A. Applicable Harm Standard

For the Commission to direct a refund for imprudently incurred costs, it must find: (1) the utility acted imprudently when incurring such costs and, (2) such imprudence resulted in harm to the utility's ratepayers. State ex rel. Associated Natural Gas Co. v. Public Service Comm'n, 954 S.W.2d 520, 529-530 (Mo. App. 1997). Finding harm requires evidence that the increased costs recovered through the FAC from ratepayers is causally related to the imprudent action, and evidence as to the amount of expenditures would have been had the utility acted prudently.[5] Harm occurs in FAC cases where ratepayers lose "the benefit of the bargain reflected in the tariff." State ex rel. Union Elec Co v PSC, 399 SW3d 467, 464 (Mo. App. 2013).

II. Argument

Empire ignored (1) non-volatile gas markets and (2) tens of millions in gas hedging losses from the operation of its hedging policy, Empire's failure to act was imprudent. OPC contends that a reasonable utility would revise its hedging policy considering both circumstances; and Empire's

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[4] The American Heritage Dictionary, Second College Edition 1989 Houghton Mifflin Company, Pg 648.
[5] *Id.*

failure to do so and continue applying its program constitutes imprudence.[6] Further, through Empire's imprudent actions, the application of its rigid, market-insensitive hedging policy, Empire's ratepayers incurred a harm totally $13.1 million in imprudently incurred costs.

OPC has produced evidence showing that gas market was not volatile during the period in which Empire entered into hedging contracts that delivered during this audit period. Further, OPC shows that Empire was cognizant of massive losses due to its application of its rigid, market-insensitive hedging policy. Finally, OPC has provided evidence from which the Commission can determine ratepayer harm for the purpose of providing a refund pursuant to a finding of imprudence.

A. Summary of Empire's FAC Tariff

Empire's FAC tariff controls the costs authorized for recovery through Empire's FAC clause. The Commission initially approved Empire's FAC tariff in 2008 and included hedging costs as a permissible cost to flow through the FAC.[7] Relevant to this case, Empire's tariff defines "Fuel Costs Incurred to Support Sales" recoverable through the FAC to include fuel hedging costs for natural gas.[8] The definition shows that 'hedging costs' consist of the "realized losses and costs…minus realized gains associated with mitigating volatility in the company's cost of fuel...including futures contracts and forward contracts…"[9] In addition, the Commission approved tariff also states that "any such costs which are determined by the Commission to have been imprudently incurred or incurred in violation of the terms of this rider shall be returned to customers."[10] This language mirrors the authority identified in Section 386.266, RSMo.

Importantly, Empire's authorized FAC tariff sheets <u>does not incorporate any portion of</u>

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[6] Riley Direct, Ex. 1, p. 20.

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

[8] The Empire District Electric Company Schedule of Rates for Electricity, P.S.C. Mo. No. 5, Section 4, Sheet No. 17a.

[9] *Id.* at Sheets No. 17b and 17g.

[10] *Id.* at Sheet No. 17s.

Empire's self-promulgated hedging policy. Rather, the FAC tariff sheets provide general parameters; such as accumulation periods, base factors, definitions, the fuel and purchased power adjustment formula, etc.

The Commission reauthorized Empire's FAC in Case Numbers ER-2018-0130, ER-2011-0004, ER-2012-0345, ER-2014-0351 and ER-2016-0023. No Commission order from these cases incorporates, acknowledges or otherwise authorizes Empire's hedging policy.

In this proceeding, OPC is not objecting to Empire's hedging costs *because* they are hedging costs. Rather, OPC alleges that the hedging costs incurred by Empire during the audit period were *imprudent*, and consequently subject to refund. OPC's position is not contrary to the FAC statute and Empire's tariff, as OPC's position seeks to exercise the force and effect to the Commission approved FAC tariff sheets.

B. Summary of Empire's Hedging Policy

i. History of Empire's Hedging Policy

In 2001, Empire created its hedging program "to lessen the impact of expense volatility and establish a more predictable basis for future rate cases."[11] As of 2003, Empire's hedging policy adopted a procedure requiring that set minimum volumetric percentages hedges be executed up to four years in advance.[12] Since the early 2000s, Empire's hedging policy has not been altered, edited or amended.[13] Empire's hedging policy is currently published in its Risk Management Policy.[14] While edits to Empire's overall Risk Management Policy may have occurred, no revisions occurred to its hedging policy.[15]

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[11] Hyneman Rebuttal, Ex. 6, p. 20.
[12] Riley Direct, Ex. 1, p. 13.
[13] Hyneman Direct, Ex. 5, p. 10.
[14] Riley Direct, Ex. 1, Schedule JSR-D-2 HC.
[15] *Id.*

Empire's hedging policy is overseen by its Risk Management Oversight Committee, comprised exclusively of Empire employees.[16] Staff and OPC are not members of this group.[17] Empire's hedging policy is implement at the discretion of its management.[18]

ii. **Explanation of Empire's Hedging Policy**

Empire's hedging policy mandates predetermined minimum volumes of gas be hedged as follows: ten percent (10%) four years in advance, twenty percent (20%) three years in advance, forty percent (40%) two years in advance and sixty percent (60%) one year in advance of delivery.[19] It is possible for Empire to hedge above these minimums in any given period. However, Empire's hedging policy does not permit hedging *below* these minimum thresholds. Empire's minimum hedging policy makes no consideration for price. Empire's minimum hedging policy has no consideration for market volatility. Regardless of the circumstance, Empire's hedging policy requires minimum purchases of 10%-20%-40%-60%.

iii. Empire's Mandatory Minimums Hedging Policy are Imprudent

The prudence standard asks the Commission to determine whether the company exercised prudence in formulating its decision. Mo Power and Light Co. v. PSC, 669 S.W.2d 941, 947-948. Given Empire's mandatory minimum volume policy, no decision is made at the time the hedges are contracted. As OPC witness John Riley testified, under Empire's "lock and leave" strategy, an employee entering hedges has no ability to hedge below the minimums.[20] This means that Empire is entering hedges, up to four years in advance of delivery, without consideration of price or market volatility, making Empire's hedging policy is *prima facie* imprudent. Empire has created a policy

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[16] *Id.* at p. 5.
[17] *Id.*
[18] Empire Brief, p. 12.
[19] Riley Direct, Ex. 1, Schedule JSR-D-2 HC, p. 11.
[20] Riley Direct, Ex. 1, p. 16.

where the decision to set minimums is made at a management level – therefore the only "decision" to consider relevant to this case is the decision of the Risk Management Policy Board to not revise its policy.

iv. **Staff Reported Concerns About Empire's Hedging Policy to Empire in 2012**

In 2012, 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 change in the natural gas market and the lack of flexibility in Empire's policy in its 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. 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.[21]

v. **KCC Denied Ratepayer Recovery for Costs From Empire's Hedging Policy**

Empire is incorrect in stating that the Kansas Corporation Commission decision "cannot be used as evidence".[22] The decision is relevant because it proves that Empire had knowledge of regulatory concerns regarding its hedging program. Despite having its costs disallowed, Empire still did nothing to correct the deficiencies of its hedging program articulated three years before entering into the first round of hedging contracts that would be considered in this proceeding. When determining whether it was reasonable for Empire to operation of its rigid, market-insensitive hedging policy, the Commission should consider that Empire had already faced scrutiny against the very same program in effect during the audit period.

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[21] *Staff Report Cost of Service*, November 2012, Case No. ER-2012-0345, p. 89.
[22] Empire Brief, p. 7.

C. No Evidence Supporting the Prudence of Empire's Hedging

i. NYMEX Future Curves

The company has not submitted evidence substantiating its decisions to hedge contemporaneous to the period in question. Instead, Empire casts aspersions on OPC's position because OPC's analysis does not incorporate NYMEX forward price curves.[23] However, NYMEX futures prices cannot to accurately forecast natural gas prices beyond the near-term, because beyond a year in advance there is a lack of liquidity in the market, meaning little or no trading on the contracts.[24] Consequently, reviewing NYMEX futures prices to inform a decision whether or not to hedge serves little value since futures prices are not designed to forecast natural gas prices.[25] In short, NYMEX futures prices are a bad predictor of natural gas futures prices, and should not serve as a basis on which a utility determines whether or not to hedge.

ii. NYMEX Prices are Inflated with Premiums

Additionally, NYMEX futures market prices are inaccurate representations of futures prices, because they carry a "premium for term", or a premium to compensate for the lack of market liquidity price risk.[26] The further into the future a utility is entering into hedging contracts, the more price risk they incur.[27] Empire's rigid, market-insensitive hedging policy requires the company to enter into hedging contracts over four years in advance at premium prices to account for incurring unnecessary risk of the long-term contract.[28]

iii. No Evidence Establishing Correlation Between NYMEX futures and Actual Natural Gas Prices is in the Record

[23] Empire Brief, p. 7.
[24] No more than a few months. Hyneman Surrebuttal, Ex. 7, p. 4.
[25] Hyneman Surrebuttal, Ex. 7, p. 5.
[26] Hyneman Rebuttal, Ex. 6, p. 6
[27] *Id*.
[28] *Id*.

Empire has not provided any analysis identifying a correlation between NYMEX futures prices as an accurate predictor of actual natural gas prices. As such, the Commission should not assume such a correlation. Further, Empire did not submit any future price curves that it alleged it based its hedging purchases on.

D. No Individual Transaction Analysis is Required

Empire argues that OPC has not identified individual imprudent hedging transactions.[29] However, the record includes unchallenged evidence of imprudent individual transactions. Before addressing those transactions, it is important to reiterate that Empire's hedging is imprudent in that *all* of Empire's hedges in a non-volatile market were unreasonable and not permitted by Empire's tariff. Empire should not have incurred *any* hedging costs for the reasons explained in this brief, and parsing out each one of those imprudent transactions is unnecessary. Each hedging transaction would show Empire hedged gas during a non-volatile market, and hedged during a time when its gas position summary reports showed each hedge recorded as an anticipated loss almost immediately.

On an individual transaction level, the evidence before the Commission shows concerning transactions that exemplify Empire's practices that aided in the resulting hedging losses. For example, on October 29, 2010, Empire hedged for 200,000 Dkth at $5.50 ($1,100,000 contract) for gas to be delivered in July 1, 2015.[30] At the time Empire executed that hedge, the NYMEX futures Empires claims it relies upon listed the market price at $5.39 per Dkth.[31] In that one hedge, for that one day, Empire hedged for $22,000 more than the NYMEX futures. Also on October 29, 2010, Empire

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[29] Empire Brief, p. 10.

[30] Riley Surrebuttal, Ex. 3, p. 11.

[31] *Id.*

hedged 200,000 Dkth at $5.50 ($1,100,000 contract) for gas to be delivered on August 1, 2015.[32] The NYMEX futures listed the market price at $5.43 per Dkth.[33] In that one hedge, for that one day, Empire hedged $16,000 more than the market price. These two hedges are also concerning because Empire placed those hedges a full year ahead of when the RMP indicates Empire should have hedged for 2015. Not only is Empire hedge further ahead than other companies, Empire creates further separation from its peers by hedging *more* than four years ahead into an even less liquid gas market.

In another instance, the prices Empire hedged for were 38% above the current spot prices. Empire's first hedge for the audit period occurred between October 8, 2010 and November 5, 2010, when Empire hedged 400,000 Dth for delivery in 2015 at $5.50 per Dth. ($2.2 million contract).[34] The average spot price in October 2010 was $3.43 per MMBtu, and the average spot price in November 2010 was $3.71 per MMBtu approximately $2.00 below the price Empire hedged for 2015.[35] Empire essentially bet the gas market would undergo a significant 38% increase in gas prices, despite the lack of any evidence or forecast that such increase was reasonably likely or even remotely likely to occur. To put the company's hedging losses into perspective, for every $1.00 Empire's customers paid for natural gas in the audit period, 38.5 cents was for Empire's hedging losses.[36]

E. OPC's Review and Recommendations in Accordance With Commission FAC Order

In its Report and Order in ER-2008-0093, the case initiating Empire's FAC, the Commission expressed concerns about the adequate resources available to conduct prudence reviews, stating:

> A prudence review can be expected to evaluate major decisions a utility makes. However, an electric utility makes thousands of small decisions

[32] *Id.*

[33] *Id.*

[34] Doll Rebuttal, Ex. 101, pp. 3-4; Ex. 16.

[35] Hyneman Direct, Ex. 5, p. 12; One dekatherm, or Dth, is equal to one MMBtu, as "therm" is defined as "a unit of heat equal to 100,000 British thermal units." The American Heritage® Dictionary of the English Language, Fifth Edition copyright ©2017 by Houghton Mifflin Harcourt Publishing Company.

[36] Riley Direct, Ex. 1, p. 20 and Schedule JSR-D-5.

> every hour regarding fuel, purchased power, and off-system sales. It is not practice to expect a prudence review to uncover and evaluate every one of those decisions.[37]

While Empire alleges some deficiency with the breadth of OPC's audit,[38] or complains of the absence of transactional minutia,[39] OPC's case centers around Empire's decision, in light of significant gas market changes that took place in 2009, to maintain its decade-old hedging policy to enter contracts incurring substantial and sustained hedging losses. OPC's case is presented in accordance with the Commission's Report and Order.

F. Staff's Report Does Not Independently Evaluate the Prudence of Costs

During this proceeding, OPC has identified several critical omissions made by Staff in preparation of its report. The extent of Staff's review in the case was to determine if the hedging costs were in compliance with the Empire's hedging policy and FAC tariff.[40] According to Staff, Staff's recommendation was formulated on three sources; Empire's FAC tariff sheets, Empire's Risk Management policies, and Empire's hedging results.[41] Staff's data requests sought only information "for the period March 1, 2015 through August 31, 2016. Staff's review neglected to obtain data from periods between October 2010 and February 2015, when Empire was entering into physical and financial hedges in accordance with its rigid, market-insensitive program.[42]

Staff's investigation failed to produce and review the operative Energy Risk Management Policy in effect during the period of time when Empire was entering hedging contracts that would deliver during the audit period.[43] Staff did not review any articles or forecasts that the company may

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[37] Hyneman Rebuttal, Ex. 6, p. 21.
[38] Empire Brief, p. 4.
[39] *Id.* at p. 10.
[40] Tr. Vol 2, p. 261 (Sarver).
[41] Hyneman Rebuttal, Ex. 6, Schedule CRH-R-5 p. 8.
[42] Hyneman Rebuttal, Ex. 6, pp. 22-23
[43] Hyneman Rebuttal, Ex. 6, Schedule CRH-R-5 p. 2.

have relied on at the time they were making hedges.[44] Staff did not review contemporaneous filings with the Commission, such as Empire's IRP.[45] Staff did not review the NYMEX charts Empire purports to base its future curves on.[46] Staff did not review the meeting minutes of Empire's RMOC.[47] The Commission has the authority to weigh evidence before it, and should be mindful of the foregoing in its deliberations.

II. No Market Volatility at the Time Empire Entered Hedges

Empire has failed to establish the market as volatile during the period in which it entered hedges that delivered during the audit period. Empire's FAC tariff defines hedging costs' as "realized losses and costs…minus realized gains associated with <u>mitigating volatility</u> in the company's cost of fuel[.]"[48] Commission defined volatility in ER-2007-0002 as "[m]arkets in which prices are volatile tend to go up and down in an unpredictable manner."[49] When asked "What market conditions support *not* hedging fuel and purchased power?" Empire responded, "Hedging is an integral part of any commodity market where prices are volatile. <u>If there is no market risk, then there is no need to hedge to mitigate risk</u>."[50] Based on a review of contemporaneous information, Empire failed to respond to the shift to a non-volatile gas market and was imprudent in maintaining and operating its rigid, market-insensitive gas hedging policy incurring millions in imprudent hedging losses.

A. The Shale Gas Revolution Created Non-volatile Gas Markets

Starting in 2009 the natural gas market changed from a market characterized by high prices and

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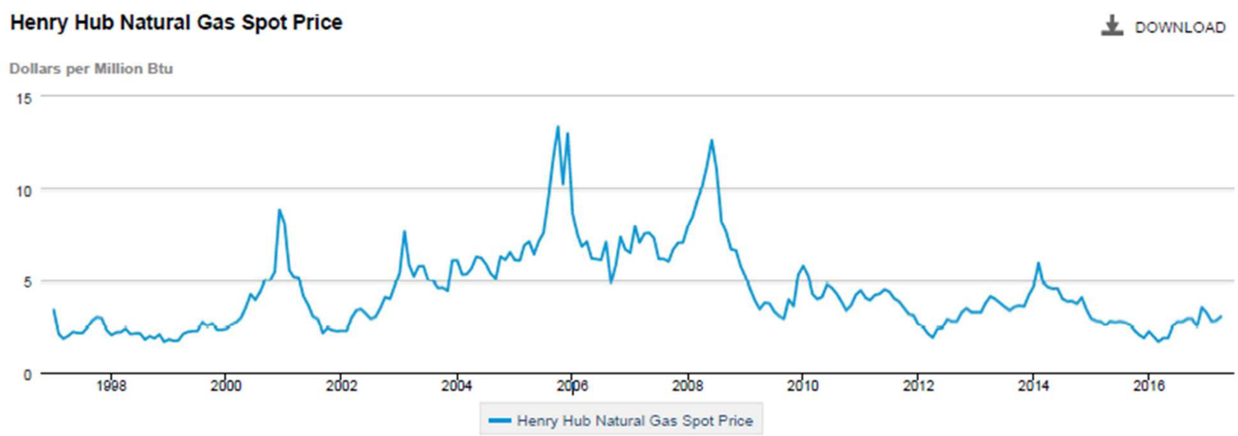
44 Tr. Vol 2, p. 241 (Sarver)
45 *Id.* at p. 244.
46 *Id.*
47 *Id.* at p. 267.
48 tariff
49 Hyneman Rebuttal, Ex.6, pp. 13-14.
50 *The Empire District Electric Company's Responses to Staff's* Questions, In the Matter of a Working Docket to Address the Hedging Practices of Electric Utilities Used to Mitigate the Rising Costs of Fuel, EW-2013-0101, Page 2.

high volatility to one that consistently reflects low prices and low volatility.[51] The impact of shale gas is clearly visible in follow chart published by EIA: [52]



This chart was captured in 2017; while Empire would not have had the benefit of future information, this market information from EIA, and also forecasts, were available at the time Empire was entering into hedging contracts.

B. EIA Forecasts from the Hedging Period for the Audit Period Identify Non-Volatile Gas Markets

In December 2011, the United States Energy Information Administration ("EIA") published its Short-Term Energy Outlook forecast for natural gas market expectations, stating "[n]atural gas working inventories ended November 2011 at a record high…EIA expects that Henry Hub spot prices will continue to decline in 2012, average $3.70 per MMBtu, $0.43 per MMBtu lower than in last month's *Outlook*."[53] This report was filed before Empire had entered into 91.83%[54] of its hedged amounts at issue in this audit period. Empire had an opportunity to avoid nearly all of the hedging costs based on the information provided by the Federal government, and failed to do so.

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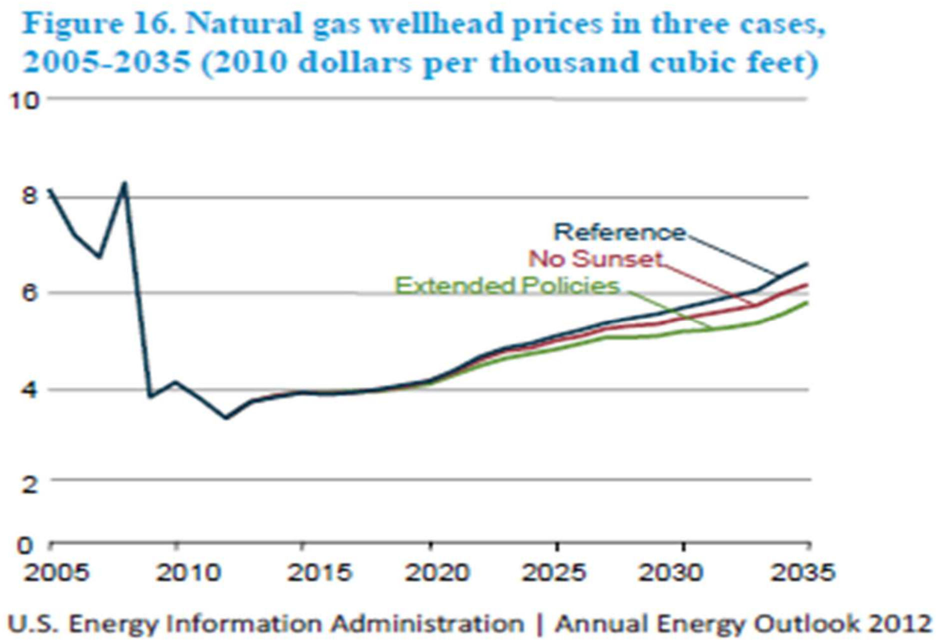
[51] Riley Direct, Ex. 1, Schedule JSR-D-1
[52] *Id.* at JSR-D-1.
[53] Riley Rebuttal, Ex. 2, p. 8.
[54] Ex. 16.

In June 2012, the EIA's *Outlook* provided a projection into 2035 that show non-volatile conditions for the duration of the audit period[55]:



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This report was filed before Empire had entered into 85.46%[56] of its hedging contracts at issue in this audit period. Empire had an opportunity to avoid nearly all of the hedging costs based on the information provided by the Federal government, and failed to do so.

In November 2013, the EIA published its *Outlook* forecasting a slight increase of $.16 per MMBtu between 2013 and 2014, a 4.2% increase.[57] This report was filed before Empire had entered into 50.6%[58] of its hedging contracts at issue in this audit period. Empire had an opportunity to avoid nearly half of the hedging costs based on the information provided by the Federal government, and failed to do so.

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[55] Riley Rebuttal, Ex. 2, p. 9, Quoting EIA Annual Energy Outlook 2012, p. 23.
[56] Ex. 16.
[57] *Id.*
[58] *Id.*

OPC has provided evidence in the record identifying contemporaneous forecasts available to Empire during the time it entered hedges delivered within this audit period. The information from EIA show steady gas inventories and non-volatile prices. OPC contends that a reasonable person would consider forecasts published by the EIA when contemplating whether or not to hedge. It is important to note that *even if* Empire had relied on this information, its hedging policy would still have required the utility to enter hedges.

C. Empire Meeting Minutes Reported a Non-Volatile Gas Market

In the *Initial Brief of the Office of the Public Counsel***,** pages 24-31, OPC details thirty-six recorded reports into the meeting minutes of Empire's Risk Management Oversight Committee ("RMOC") during the period of time Empire was entering hedges subject to this audit period identify stable gas markets. The minutes indicate that (1) Empire was aware the gas market changed and was no longer volatile; **

** Empire's RMOC <u>never</u> referred to the gas market as volatile during the timeframe Empire acquired gas for the audit period. Empire did not revise its hedging policy through the RMOC, despite having many opportunities to convene.[61] These minutes clearly state Empire's understanding of the stable market conditions at the time it entered into the hedges at issue.

D. Empire Reported to the Commission a Non-Volatile Gas Market

In 2012, in a filing with the Commission, Empire reported:

> 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

[59] Ex. 17, p. 72.
[60] RMOC Meeting Minutes, Exhibit 17, p. 2.
[61] Ex 17, pp. 1-111.

> 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. EIA expects the Henry Hub spot price will begin to recover after this winter's inventory draw season ends and will average $3.35 per MMBtu in 2012 and $4.07 per MMBtu in 2013.[62]

This statement was filed before Empire had entered into 91.83% of its hedging contracts at issue in this audit period.[63] Empire knew the market changed, recognized the non-volatility in the market, acknowledged the low prices, and projected ample supply of gas "large enough to supply the U.S. for decades" and *still* hedged, incurring millions in losses.

E. Staff Recognized a Non-Volatile Gas Market

In 2012, Staff recognized changes in the gas market due to increased production and supply, 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.[64]

Again in 2012, Staff also identified the gas markets as non-volatile in ER-2012-0345, cited on pages 7 and 8 of this brief.

F. Utility Companies Changed Their Hedging Programs in Response to Market Developments

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[62] *2012 Integrated Resource Plan Annual Update Report*, Case No. EO-2012-0294 (March 2012).
[63] Ex. 16.
[64] *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.

The prudence standard asks the Commission to determine if a utility's actions were prudent at the time. Despite the changes in market conditions in 2009, Empire made no adjustments to its rigid, market-insensitive hedging policy. OPC has submitted evidence for the Commission's consideration of how commissions and similarly situated utility companies' changed their hedging policies to the normalization of gas markets.

In December 2010, the Nevada PUC approved a stipulation that included the requirement that Nevada Power not proceed with any additional financial gas hedges "in light of prevailing market fundamentals and conditions."[65] In July 2011, British Columbia Utilities Commission rejected FortisBC's "Price Risk Management Plan" writing: "in light of the recent exploitation of shale gas, the likelihood for more stable natural gas prices is significantly greater and the risk of dramatically higher natural gas prices, excepting short periods of price disconnects, is significantly lower than it has been in many years."[66] Colorado Utilities, a municipal utility, described its hedging policy revisions in 2010 and 2011 to scale back its hedging program because "[p]rolonged, poor economic conditions and a fundamental supply increase from widespread use of horizontal drilling and formation fracturing technologies kept prices relatively low."[67] Later, in 2014, Liberty Utilities proposed to eliminate a hedging program whose exclusive focus was the use of NYMEX/Henry Hub futures contracts in favor of fixed basis supply contracts because "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."[68]

While Empire is correct in asserting that the evidence proffered by OPC regarding the national movement against natural gas hedging cannot solely substantiate a refund, the evidence is not offered

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[65] Hyneman Direct, Ex 5, p. 14, Quoting 2012 Public Utilities Fortnightly.
[66] *Id.*
[67] *Id* at 15.
[68] Hyneman Rebuttal, Ex. 6, p. 25; quoting New Hampshire Public Utilities Commission Docket No. DG-13-133.

for that purpose. OPC asks the Commission to consider the actions of other commissions and similarly situated utilities addressing the same changing market conditions; many responded by changing their programs. It is important to note that Empire offered no evidence to the contrary.

When considering whether Empire was reasonable in ignoring market developments and maintaining its rigid, market-insensitive hedging policy, the Commission should bear in mind that in the face of the same conditions, other commissions and similarly situated companies responded by changing their hedging policies. Empire failed to do so.

G. Polar Vortex Should Not Be Weighed As Evidence of Market Volatility

From February of 2010 through today, the average price of natural gas went above $5 for only one month in the entire seven years.[69] That one month was the "Polar Vortex" of February 2014 where the spot price on the Henry Hub reached $6 but fell $1.10 the following month.[70] However, a singular weather event should not be the basis to design or substantiate an FAC. The courts have held that FACs are "neither designed nor permitted to address (or remediate) every variable which may affect the sufficiency of a utility's rates or its return on investment." State ex rel. Union Elec. Co., v. PSC, 399 SW3d 467 (Mo. App. 2013). As such, this singular occurrence should not substantiate the years of hedging losses and failure to revise its hedging policies.

H. Empire Has Provided No Evidence of Market Volatility During the Audit Period

Central to Empire's argument is convincing the Commission that during this audit period, and period when Empire entered its hedges for the audit period, the gas markets were volatile. Empire provides no evidence of what information it relied on during the audit period to determine it was a volatile market. Empire witness Doll cites an article public on July 19, 2017,[71] and an article

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[69] Riley Direct, Ex. 1, p. 5.
[70] *Id*.
[71] Doll Surrebuttal, Ex. 102, p.6.

published on December 21, 2015.[72] This is not evidence of information Empire relied on to make its decision to hedge from 2011 – 2015. Staff witness Dana Eaves similarly points to 2017 markets as an example.[73] However, the activity of 2017 markets could not have been relied on my Empire when it entered hedging contracts from 2011 – 2015. Empire has failed to substantiate its assertion that markets were volatile during the audit period. OPC, however, has presented evidence that the Company was aware of the non-volatile markets and continued with its rigid, market-insensitive hedging policy to inevitably incur losses during the audit period.

I. Claims of Volumetric Risk Without Hedging Are Unsubstantiated

Both Empire and Staff intimate an additional hedging objective to volatility mitigation is maintain "a stable supply of gas."[74] There is no incident in the record reported that Empire has experienced a disruption in is distribution. Also, nearly seventy-percent of Empire's load is purchased at the spot-market,[75] so Empire's hedging program does not segregate its fuel sources from the marketplace, even with hedges. Finally, the distribution systems for spot-market purchases and hedging contracts is similar – a physical disruption to a distribution pipeline will have the same effect on a utility's supply of gas, regardless if it is purchased through long-term hedging or spot purchase.

J. Past Prudence Review Results Are Uninformative To This Proceedings

Empire references five prior prudence reviews from Case Numbers EO-2010-0084, EO-2011-0285, EO-2013-0114, EO-2014-0057 and EO-2015-0214, touting no findings of imprudence or disallowances authorized.[76] However, such averments have little evidentiary value in determining the prudence of the company's decision for this unique 18 month audit period. The costs challenged in

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72 Doll Rebuttal, Ex. 101, Appendix AD-1.
73 Eaves Rebuttal, Ex. 202, p. 6.
74 Empire Brief, p. 9.
75 Ex. 16.
76 Empire Brief, p. 3.

this case have never been considered before by the Commission. In the past the Commission has ordered its Staff to perform audits in accordance with generally accepted accounting standards ("GAAS"). OPC observes that Staff did not follow basic GAAS standards in its FAC reviews.[77] These basic GAAS standards include due professional care, professional skepticism and auditor proficiency. Therefore, OPC does not believe the results of Staff prudence review in his case and in past case can be relied upon by the Commission.[78]

OPC has shown that Empire knew or had reason to anticipate stable gas markets at the time it entered into gas hedging contracts that incurred millions in hedging losses. Applying Empire's re-ported standard; when the markets are not volatile, then utilities should not be hedging. OPC believes that a reasonable person, knowing the stability of near-term gas markets, they would have revised the hedging policy to avoid unnecessary hedging losses. Empire did not. As such, the Commission should determine Empire's failure to respond to non-volatile markets as imprudent, and refund the costs attendant thereto.

III. **Persistent and Sustained Hedging Losses Prove Hedging Policy Imprudent**

OPC believes that evidence is sufficient to show that Empire knew its hedging policy incurs substantial losses, and that Empire's failure to address this financial crisis constitutes imprudence. Since the approval of Empire's FAC in 2009, Empire has recorded nearly $90 million in hedging losses.[79] In 2011, when Empire's policy demanded that 10% hedging for gas burned in 2015, Empire lost $9 million from hedging costs.[80] In 2012, when Empire's policy demanded 20% hedging for gas burned in 2015, and 10% hedging for gas burned in 2016, Empire lost $14 million from hedging

[77] *See* Tr. Vol 2 (Sarver).
[78] Hyneman Rebuttal, Ex. 6, pp. 5-6.
[79] Riley Surrebuttal, Ex. 3, Schedule JSR-S-1.
[80] OPC Brief, p. 15.

costs.[81] In 2013, when Empire's policy demanded that 40% hedging for gas burned in 2015, and 20% gas burned in 2016, Empire lost $9 million from hedging costs.[82] In 2014, when Empire's policy demands that 60% hedging for gas burned in 2015, and 40% gas burned in 2016, Empire lost $2 million from hedging costs.[83] In 2015, when Empire's policy demands 60% gas burned in 2016, Empire lost $7 million from hedging costs.[84] As Empire continued to incur these multi-million dollar losses annually, Empire did not make efforts to revise its hedging policy to mitigate the hedging losses, entering into hedging the contracts at issue in this case.

In applying the prudence standard, OPC submits that a reasonable person would have taken steps to revise the rigid, market-insensitive hedging policy. Empire did not.

A. **Gas Position Summary Reports**

Exhibit 16 are the gas summary position reports prepared by Empire and submitted to the Commission monthly.[85] This document shows for the duration of a hedges life-span Empire is tracking the cost as a loss. With this knowledge, Empire continues to enter new hedging agreements despite projecting negative market position on existing hedges. The *Initial Brief of the Office of the Public Counsel*, pages 15 – 22, includes a detailed discussion of these summary reports. They show that Empire was aware, from the time it entered the hedges, that its policy was producing substantial losses. In applying the prudence standard, OPC submits that a reasonable person would have taken steps to revise the rigid, market-insensitive hedging policy. Empire did not.

B. **OPC Has Not Argued For "Lowest Cost Fuel" Analysis**

Empire argues that the Commission should not rely on OPC's characterization of imprudent

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[81] *Id.*
[82] *Id.*
[83] *Id.*
[84] *Id.*
[85] Ex. 16.

costs because Empire's hedging policy is not designed "to ensure the lower possible price for fuel[.]"[86] OPC has not offered testimony or a recommendation based on a "least cost" analysis. OPC based its determination that Empire's hedging costs are imprudent based on cheaper prices; OPC's determination has been based on the information available to the Company, the Company's own filings and averments towards this Commission, all of which state a lack of market volatility.

C. **Mark-to-Market Is Reasonable In Reviewing Costs**

Empire argues that OPC and the Commission may not determine whether its hedging policy, and the hedges made thereto, are imprudent by comparing the "mark-to-market".[87] However, according to Empire's Resource Management Plan, "mark-to-market" is how Empire tracks all positions to determine "current value and cash flows associated with open positions and to provide timely information regarding the Company's market risk and exposure."[88] A weekly analysis is compiled by SMG and given to Empire.[89] The use of mark-to-market quite literally is the method that Empire uses to determine its market risk and exposure. If Empire believes this information is inadequate for the Commission to determine imprudence, then likewise the information should be inadequate for Empire to determine its market risk and exposure. Given that this information is available and relied upon by the utility, the Commission should give due consideration to these figures, be the report to determine what information the company knew at the time it continued to enter hedges for the audit period. Also, OPC's allegations regarding imprudence are not tied to hindsight review of existing losses. OPC's position is that *before* Empire entered into the hedges closed during the audit period, Empire knew that gas markets had become non-volatile and the exorbitant losses incurred from its rigid, market-insensitive hedging policy.

[86] Empire Brief, p. 2.
[87] Empire Brief, p. 8.
[88] Riley Direct, Ex. 1, Schedule JSR-D-5, Appendix 10, p. 34.
[89] *Id.*

D. **Staff's "15%" Total Natural Gas Figure Is Misleading**

Staff's points to the "total natural gas cost" in support of its endorsement of Empire's hedging losses, claiming Empire's hedging losses only represent 15% of Empire's total natural gas cost. Staff identified Empire's total natural gas costs as $69,301,828, which includes transportation costs.[90] However, transportation costs to move fuel are not relevant to the issue of hedging costs before the Commission. Staff's figure underreports the impact of Empire's hedging losses. OPC submits for the Commission's consideration a more accurate illustration of degree of $16.8 hedging losses, before jurisdictional allocation, to the $43,604,132 actual fuel expense.[91] This results in a "hedging loss premium" of 38.4% premium on every dollar it spends to purchase natural gas.[92] In other words, for every dollar Empire customers reimburse Empire for its gas purchases, ratepayers have to pay an additional 39 cents for natural gas hedging losses.[93]

IV. Proof of Harm

For the Commission to direct a refund of imprudently incurred costs, it must find: (1) the utility acted imprudently when incurring those costs and, (2) such imprudence resulted in harm to the utility's ratepayers. <u>State ex rel. Associated Natural Gas Co. v. Public Service Comm'n, 954 S.W.2d 520, 529-530 (Mo. App. 1997)</u>. Finding harm requires evidence that the increased costs recovered through the FAC from ratepayers is causally related to the imprudent action, and evidence as to the amount of expenditures would have been had the utility acted prudently.[94] Harm occurs in FAC cases where ratepayers lose "the benefit of the bargain reflected in the tariff." <u>State ex rel. Union Elec Co v P.S.C., 399 SW3d 467, 464.</u>

A. **Harm to Ratepayers**

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[90] Tr. Vol. 2, p. 251.
[91] Hyneman Direct, Ex.5, p. 21.
[92] *Id.*
[93] *Id.*
[94] *Id.*

Empire's ratepayers incurred millions of dollars in unnecessary utility charges because of Empire's imprudent hedging policy. Empire's FAC is designed to split costs 95%/5% with its ratepayers; meaning the vast majority of the hedges losses are borne by the ratepayers.[95] Empire's hedging policy incurs costs that are passed through directly to ratepayers.[96] As such, there exists a causal link between the imprudent action, the failure to revise and maintained operation of the hedging policy, and that ratepayers incurred increased costs as result. While spot-market prices have dropped, Empire's customers have not experienced that bargain since a majority of the utility's gas purchases are hedges.

B. **Refund Amount is $13,104,811.18 Plus Short-Term Interest**

OPC recommends the Commission find Empire's costs incurred plus applicable interest pursuant to its operation of its hedging policy imprudent for the audit period of March 2015 through August 2016.[97] OPC calculates harm incurred by Missouri ratepayers to be $13,104,811.18 by considering both physical and financial hedging net losses.[98] OPC's witness John Riley provided three rounds of testimony explaining OPC's figures used to demonstrate a proper refund amount.[99] While accusing OPC of not substantiating its figures through testimony;[100] OPC notes that Empire failed to cross-examine Mr. Riley.[101]

C. **Staff Calculation Omits Physical Hedging Losses**

Both Staff and OPC identify hedging net losses on natural gas derivatives.[102] However, Staff's

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95 Empire tariff, P.S.C. Mo. No. 5, Section 4, Sheet 17t.
96 *Id.*
97 *Id.*
98 Riley Direct, Ex.1, p. 2.
99 Riley Direct, Ex. 1; Riley Rebuttal, Ex. 2; Riley Surrebuttal, Ex. 3.
100 Empire Brief, p. 11.
101 Tr. Vol. 1.
102 Staff Report, Ex. 200, p. 16; Riley Direct, Ex. 1, p. 2.

calculation of $10,712,168 only considered financial hedging losses.[103] Staff witness Mr. Dana Eaves claims that losses related to Empire's physical hedging are not allowed to be refunded because they are simply a gas cost, and therefore excluded from Staff's calculation of hedging net loss on natural gas derivatives. Empire has already recovered the costs associated with its physical hedging losses through its FAC, and therefore if found imprudent the Commission is directed by statute to refund such imprudent costs.[104]

D. AUTHORIZING A REFUND DOES NOT REQUIRE MODIFICATION OF EMPIRE'S TARIFF

Staff argues that OPC's recommendation to the Commission to authorize a refund of imprudently incurred costs would be prohibited under Section 386.266.4 RSMo. because the Commission cannot modify an FAC tariff outside of a general rate proceeding.[105] Staff's argument misrepresents OPC's request. OPC's request to the Commission to authorize customer refunds upon a determination that such costs were imprudently incurred is expressly permitted in Empire's FAC tariff. Empire's FAC tariff states "any such costs which are determined by the Commission to have been imprudently incurred...shall be returned to customers." Furthermore, Section 386.266.4(4) states that the Commission "shall require refund of any imprudently incurred costs" accumulated through an FAC; even if there were not express authority identified in Empire's tariff, the FAC statute compels the Commission to direct such refunds. Therefore, the Commission is not prohibited to authorize such refunds to customers as such authority is expressly provided for in the authorizing statute.

E. A Refund Authorized Pursuant to § 386.266 Does Not Constitute an Unlawful Taking

Empire argues that, even if the Commission determines costs recovered through the FAC to be

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103 Staff's calculation of financial hedging losses is total company. OPC's calculation of $13.1 includes both physical and financial heading for only Empire's Missouri jurisdictional losses and adjusted for 95/5 sharing.
104 Section 386.233, RSMo. (2017).
105 Staff Brief, p. 3.

imprudent, the Commission should not authorize a refund as such a "disallowance of fuel costs would constitute an unlawful taking".[106] Empire's allegation has no foundation in law or fact. The plain language of Section 386.266 RSMo. expressly authorizes the Commission to direct a company to provide a refund of imprudently incurred costs. The Commission has recognized this statutorily proscribed authority to authorize refunds of imprudently incurred costs. 23 Mo. P.S.C. 3d. Courts have recognized the Commission's statutorily proscribed authority in cases considering refunds of imprudently incurred costs. *See* State ex rel. Associated Natural Gas Co. v. Public Service Comm'n, 954 S.W.2d 520, 529-530 (Mo. App. 1997). Observe that Empire offered no legal citation or authority in support of its argument. Empire's allegation has no basis in law.

If the Commission determines imprudent hedging costs have already been recovered through the FAC, a refund would serve as remediation for the Company's unlawful taking. An FAC is an extraordinary ratemaking mechanism which allows a utility to obtain rate recovery of costs *before* they are proven to be prudent. Under the Empire's theory, the Commission would not have an opportunity to exclude ineligible costs in an FAC case as it would in a general rate case.[107] Empire's allegation inverts the circumstances, because in the event the Commission determines FAC costs to be imprudent, then the Company had no lawful authority to recover the imprudent costs through rates, and is compelled to provide a refund by the plain language of Section 386.266.4(4) RSMo.

F. **No "Overall Impact" Test to Weigh Against Imprudent Costs**

Empire argues that OPC's calculations should not be relied up by the Commission because OPC failed to consider the "overall impact" of the other sections of Empire's RMP.[108] Since the only

[106] Empire Brief, p. 4.
[107] "All charges made or demanded by any such gas corporation, electrical corporation, water corporation or sewer corporation for gas, electricity, water, sewer or any service rendered or to be rendered shall be just and reasonable and not more than allowed by law or by order or decision of the commission." § 393.130.1 RSMo.
[108] Empire Brief, p. 1.

costs eligible for recovery under the FAC are those associated with fuel costs or purchased power, the Commission does not need to consider the "overall impact" of any countervailing expense or profit in determining the prudence of a cost. The Missouri Supreme Court understands the purpose of a fuel adjustment clause as a rate structure which "enables the utility to pass on to the consumer any increase (or decrease) in the cost of fuel automatically and without any need for further consideration of compensatory decreases (or increases) in other operating expenses." State ex rel. AG Processing v. Pub. Serv. Comm'n, 340 S.W.3d 146, 151 (Mo App. 2011) *quoting* State ex rel. Util. Consumers Council of MoInc. v. Pub. Serv. Comm'n, 585 S.W.2d 41, 57 (Mo. Banc 1979). The Commission is not required to consider or grant deference to any alleged "overall impact" beyond the costs recovered through an FAC. Neither 386.233 nor Empire's tariff demands "overall impact" analysis to determine the prudence of specific expenses. To do so would lead to an absurd result which would have the Commission entertain the question 'what percentage of imprudent costs would a utility be permitted to unlawfully seize through its tariff?' Notably Empire cites to no legal authority to support its assertion.[109]

G. **OPC's Position Does Not Constitute a "Collateral Attack"**

Empire argues that OPC's allegations should be dismissed by the Commission as it represents a prohibited collateral attack against Empire's prior cases regarding its FAC.[110] Empires argument is legally tenuous, lacks factual foundation, and should be determined non-meritorious by the Commission.

Section 386.550 RSMo. states, "[i]n all collateral actions or proceedings the orders and decisions of the commission which have become final shall be conclusive." The court defined the

[109] *Id.* at p. 3.
[110] *Id.* at p. 2.

term "collateral attack" as: "Where a judgment is attacked in other ways than by proceedings in the original action to have it vacated or reversed or modified or by a proceeding in equity to prevent its enforcement, the attack is a 'collateral attack.'" State ex rel. Fischer v. Public Service Com., 670 S.W.2d 24, 26, (Mo. App. 1984), *see* Flanary v. Rowlett, 612 S.W.2d 47, 49 (Mo. App. 1981). In determining whether it applies, the court uses the same four-part test used in any other setting for determining whether collateral estoppel applies: (1) was the issue in the prior proceeding identical to the one in present litigation; (2) did the prior adjudication result in a judgment on the merits; (3) is the doctrine being asserted against a person who was a party to the previous litigation or in privity with such a party; and (4) did the party have a full and fair opportunity to litigate the issues previously decided. State ex rel. Mo. Gas Energy v. PSC, 224 S.W.3d 20, 26 (Mo. App 2007), *quoting* Egan v. Craig, 967 S.W.2d 120, 124 (Mo. App. 1998).

In *Fischer v. Public Service Commission*, the court held that reviews of orders entered in ancillary proceedings does not constitute a collateral action, where OPC sought review of an interim rate in a subsequent general rate proceeding. State ex rel. Fischer v. Public Service Com., 670 S.W.2d 24, 27, Mo. App. 1984 ("Thus, in the case at bar the interim rate proceeding is ancillary to the permanent rate proceeding, and review in the permanent rate case includes review of the order made in the interim proceedings. Such review does not constitute a collateral attack on those orders made in the interim proceedings.").

i. **Empire's Accusation Fails to Meet the Court's Estoppel Test**

Empire's collateral action allegation fails on all four measures of the court's test in determining the applicability of collateral action. (1) This proceeding commenced pursuant to Section 386.266.4(4), which requires "prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals[.]" The concern raised by OPC in this proceeding have not been addressed by the Commission in a prior proceeding, because prudence review proceedings are limited in scope to a specific eighteen-month period. This proceeding considers costs from an eighteen-month period that has never been reviewed by the Commission. (2) There has never been a prior adjudication of the prudence of the costs incurred during the eighteen-month audit period, therefore no prior judgment on the merits considered in this case has occurred. (3) As previous litigation has not occurred regarding the costs considered in this proceeding, OPC has not been a party a proceeding on the facts of this case. (4) This proceeding is the only case to consider the prudence of the costs of this eighteen-month audit period, OPC has not had a prior opportunity to litigate the issues before the Commission. This review has been undertaken at the express direction of the Legislature. Empire's suggestion is clearly contrary to the plain language of the statute and should be determined non-meritorious.

ii. Review of Ancillary Proceedings Do Not Constitute a Collateral Action

Empire's demand that previous FAC orders, in both rate cases and prudence audits, foreclose OPC's ability to question the prudence the costs recovered during this FAC audit period from March 1, 2015 to August 31, 2016. Like the decision in *Fischer*, the case before the Commission today does not constitute a collateral attack because OPC is not seeking a reversal of Commission orders regarding Empire's FAC from ancillary proceedings. Rather, OPC alleges imprudent costs have been incurred during the audit period. Accepting Empire's argument that Commission orders in prior cases or prudence reviews forecloses any opportunity for OPC or Staff to scrutinize the prudence of costs recovered through an FAC during a unique audit period, and is contrary to the plain language of Section 386.266.4(4). Empire's suggestion should be determined non-meritorious.

V. Conclusion

As discussed at length in OPC's initial brief, OPC has met its burden to overcome the presumption of prudence. The evidence presented at the hearing casts serious doubt that Empire's hedging policy and strict adherence to its hedging policy were prudent. It is Empire's burden to produce evidence proving its gas hedges were prudent. 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 a serious doubt as to the prudence of an expenditure, then the applicant [utility] has the burden of dispelling these doubts and proving the questioned expenditures to have been prudent.") (Emphasis added)._However, Empire failed to establish by a preponderance of the evidence in the record that its inaction was prudent in maintaining its gas hedging policy and entering hedging contracts for delivery during the audit period.

If the Commission finds that the burden of proof remains with OPC, the evidentiary record shows that OPC has established that Empire was aware of market non-volatility and choose to maintain its rigid, market-insensitive hedging program by a preponderance of the evidence. In addition, Empire was aware that its hedging policy had been incurring substantial losses that, through the FAC, 95% of which are passed directly to ratepayers. On both allegations, OPC believes that a reasonable person would have changed their hedging strategy, like many utilities did. The record supports a finding of imprudence.

Empire's actions caused direct harm to the 300,000 Missouri citizens and 22,000 Missouri businesses relying upon Empire's management to incur only prudent fuel expenses. Throughout this proceeding, the Commission has witnessed, through Empire's testimony and cross-examination, a lack of concern regarding the hedging losses. Unless the Commission holds Empire accountable for its managerial imprudence, which has resulted in tens of millions of dollars in excessive costs, ratepayers will not receive the benefit of their bargain.[111]

[111] Courts have identified a *quid pro quo* in FAC programs between utilities and ratepayers, stating that ratepayers are obligated to pay an increased rate "in the event that fuel prices rose…but would benefit from a decreased rate if fuel prices dropped." State ex rel. Union Elec. Co. v. PSC, 399 S.W.3d 467 (Mo. App. 2013).

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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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 26th day of October 2017.

/s/ Hampton Williams