

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

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|--|---|---------------------|
| AG PROCESSING INC A COOPERATIVE, |) | |
| Complainant, |) | |
| |) | |
| vs. |) | HC-2010-0235 |
| |) | |
| KCP&L GREATER MISSOURI OPERATIONS |) | |
| COMPANY, |) | |
| Respondent. |) | |

**AG PROCESSING INC A COOPERATIVE
RESPONSE IN OPPOSITION
TO APPLICATION FOR REHEARING**

Through this pleading Ag Processing Inc a Cooperative (AGP) responds to KCP&L Greater Missouri Operations Company's (GMO) Application for Rehearing. GMO acquired the assets and operations of Aquila, Inc., then renamed the acquired company as GMO. Included in this acquisition was the St. Joseph, Missouri service territory and the accompanying steam distribution system at the Lake Road Station. Through that acquisition GMO also "stepped into the shoes" of Aquila and took over all its operations and associated liabilities. Given that the terms refer to the same company, the terms Aquila and GMO are used interchangeably save where the context requires a specific reference.

GMO's multiple assertions to justify rehearing distill down to essentially two claims: (a) Aquila was not imprudent in implementing its steam fuel hedging program because it "believed[,] its five industrial customers"^{1/} and that it did not

^{1/} GMO *Application for Rehearing*, p. 3, ¶ 6.

"second guess" customers' estimates; and (b) Aquila should not have had the burden of proof. These points have neither merit nor do they form the basis for rehearing. In fact, each is nothing more than a reargument of GMO's positions in its post-hearing brief. Moreover, GMO continues to miss the point of this prudence case.

There are several other unproductive rabbit trails that GMO would like us to travel including the earlier rejected claim that it has no responsibility under Section 393.130 to operate prudently, and that the Commission cannot award "money damages." But these have all been rejected in earlier Commission decisions. Indeed the Commission, supported by Missouri law,^{2/} has repeatedly found that a utility must operate prudently and, when amounts, as here, are collected subject to refund, directing refund of imprudent collections is not awarding "money damages." Rebutting these repeated assertions, though easy, is simply not deserving of either AGP's or the Commission's time.^{3/}

A. GMO's Imprudence Is Not Justified Because It Relied on Customer-Supplied Information.

Almost from the beginning of this case, GMO has failed to recognize that its steam customers provided estimates of future usage of **steam**. This is not, however, a case involving

^{2/} Section 393.130 RSMo 2000.

^{3/} Doubtless GMO is aware of the rule that it must assert in its Application for Rehearing any ground on which it might ultimately attempt to obtain judicial review. Its "blunderbuss" approach does not, however, mean that absurd and inconsistent points justify response.

imprudent hedging of steam, but rather, of gas used as a swing or "marginal" fuel to generate steam.^{4/}

It was GMO's responsibility to take these estimates and calculate the volumes of gas that would be needed. Mr. Fangman developed "numbers" from his interviews with customers. He then passed them up the line,^{5/} later checking them for "reasonableness."^{6/} The customers didn't do the forecasting; Aquila did, and the record so reflects.

12 A. I believe the forecast is a forecasting
13 of the loads for these customers. A budget entails
14 much more than just the forecast.
15 Q. So let me just quickly replay. Sometime
16 I think you said in June of 2005 you would have done a
17 forecast, I think basically -- basically using your
18 terminology. That would have covered '06, '07 and
19 '08. Right?
20 A. Correct.^{7/}

15 A. The actual budgets for those years, those
16 forecasts would have been done in the -- like I said,
17 in the June time frame. So for the 2006 budget, it
18 would have been done in the June of 2005 time frame.
19 And -- and so on. **And in those -- in those budgets, I**
20 would typically work with Tim Nelson who would prepare
21 and -- and do the forecast.^{8/}

Mr. Nelson never was offered as a witness to explain his methodology. Yet GMO again claims that, somehow, the steam customers should be able to estimate how much natural **gas** GMO should purchase. Given the dual-use facility (electric and

^{4/} "Aquila was obviously aware that natural gas was the marginal fuel at Lake Road" Blunk Direct, Ex. 105, p. 17, ll. 17-18.

^{5/} Tr. 267, ll. 22-24; Tr. 268-69.

^{6/} Tr. 276.

^{7/} Tr. 271.

^{8/} Tr. 270 (emphasis added).

steam) that is Lake Road Station (natural gas being a "swing" fuel with coal as the primary fuel burned), and the difference in MMBtu content between even these two fuels, customers could not have given GMO estimates of **gas** usage.

There was ample evidence that customers' estimates frequently diverged from actual usage. GMO was well aware of these variations. In response to a question from the Regulatory Law Judge, Witness Rush testified:

3 QUESTIONS BY JUDGE DIPPELL:
4 Q. And I'm not sure if you're the right
5 person to ask about this or not, Mr. Rush. On page 11
6 of your testimonies, on line 3 you say: The company
7 has a robust planning process that it has utilized for
8 years.
9 Do you know have the forecasts for this
10 particular process ever been off like they were in
11 this or appear to have been in this particular process
12 in past years?
13 A. **Yes**, they have been.^{9/}

Witness Rush continued to describe additional instances of inaccuracies in forecasting. Usage forecasts are understandably inaccurate and make more critical the need for careful analysis of the nature of whether the fuel being hedged (natural gas) is being used as a base load fuel or as a "swing" fuel. There is ample competent and substantial evidence to support the Commission's decision.

GMO's argument that "a utility's industrial customers are in the best position to estimate their volume requirements"^{10/} does not ring true, nor is it relevant to GMO's imprudence.

^{9/} Tr. 311 (emphasis added).

^{10/} GMO *Application for Rehearing*, p. 3, ¶ 7.

GMO's Witness Fangman testified that he had collected the information from the customers and reported it back to a person identified as Tim Nelson in Kansas City.^{11/} Fangman denied actually doing the calculations and disclaimed any knowledge of how the gas projection was made. Fangman admitted, however, that the estimates that he received were only estimates and often were wrong. In fact, he noted one customer whose estimates were almost always excessive.

GMO now claims that such variations justified the hedging program. That may be, but they do not justify imprudent implementation of purchases under that program in a manner that locked in high prices thereby giving customers no protection whatever if prices declined. GMO attempts to bootstrap its justification for the hedging program into a justification for its imprudent implementation, and on this, they fail.

Nor, contrary to GMO's assertion, is a prudence review impermissible "hindsight." Absent the Commission's direct insertion of itself as a utility "super" management,^{12/} there can be nothing other than an after-the-fact review of a utility's purchasing practices. Sadly, the utility can make mistakes, often major ones as here, but customers should be protected. That is why amounts are collected "subject to refund."

Still GMO resists the obvious conclusion: It was imprudent to "bet the customers' farm" by locking in gas prices

^{11/} Tr. 270.

^{12/} A proposition that GMO would hotly resist.

(in volumes that were in obvious violation of even its own "one-third" plan) thereby permitting no room to capture price decreases or downward changes in customer estimates,^{13/} however those estimates were factored into steam purchases. There is no merit to GMO's point.

B. GMO Did Not Follow Its Own "1/3, 1/3, 1/3" Strategy.

Based on GMO Witness Clemens' testimony, Aquila was supposed to rerun the fuel budget model and represented that this was to be done "no less frequently than three months of the prior (re)run."^{14/}

Nevertheless, despite having included this description of the electric program in his testimony and having stressed that the same "philosophy" or "strategy" was used in the steam program and that steam customers should have been aware of this, Mr. Clemens stumbled over the procedures identified in this own Schedule:

16 Q. Now, moving on down in that paragraph,
17 when that happens, when there's a significant change,
18 what is energy resources supposed to do?
19 A. They would make an adjustment.
20 Q. Well, let's read it and see what it says:

^{13/} As Exhibit 8 acknowledges:

By the time it was apparent that actual steam load was significantly less than budgeted volumes **it was too late to affect Aquila's natural gas hedge program for the steam system. The hedges would have already been purchased. [Emphasis added]**

^{14/} Clemens Direct, Ex. 101, Schedule GLC-2, p. 3; Tr. 155-56.

21 Energy Resources will re-run the fuel budget model.
22 Do you see that?
23 A. Yes.
24 Q. What does "re-run" mean?
25 A. Run the model with new data.^{15/}

Mr. Clemens' testimony appeared to equate the electric program with the steam hedging "program." Regardless, Aquila had no excuse to have so mismanaged the program by failing to respond to significant volumetric shortfalls. As Aquila's own documentation demonstrated, "[b]y the time it was apparent that actual steam load was significantly less than budgeted volumes it was too late to affect Aquila's natural gas hedge program for the steam system. The hedges [had] already been placed."^{16/}

GMO witness Gottsch had to agree that the variances shown from Aquila's own records (Exhibit 9) were significant:

24 Q. And let's look at -- oh, just pick one
25 here, Triumph. 683-- I'm looking at 2006, at least
00223
1 that's one of the years in concern here. Budget was
2 683,191 MMBTus.
3 A. I see that.
4 Q. And actual 324,637. And then there's a
5 variance calculation. I haven't done the math but
6 I'll -- I'll trust whoever did the spreadsheet here,
7 358,554 variance. Looks about right. **Would you agree**
8 **with me that that's a significance variance?**
9 A. **I would agree.**
10 Q. Look in that same column for Albaugh.
11 And I won't go through the budget numbers. You can
12 read those. But a variance of 307 and change --
13 307,000 MMBTus. MMBTus, by the way, would I be right
14 in equating that to dekatherms?
15 A. Yes.
16 Q. **Again, a fairly significant variance?**
17 That's a question --
18 A. **Yes.**^{17/}

^{15/} Tr. 156.

^{16/} Ex. 8.

^{17/} Tr. 222-23 (emphasis added),

Mr. Fangman testified that it was his job to obtain significant changes in usage from customers:

19 Q. Remind me, if you would, because it's
20 been a few days, your role in this process is to -- to
21 get volume information from customers. I want to
22 focus on the steam customers now. Volume information
23 from the steam customers. And how do you go about
24 doing that?
25 A. Well, there's various ways. A lot --

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1 when a customer has a significant change as they're
2 going to grow or -- or put on new equipment, they come
3 to me. And like I said, I've been in this role for a
4 long time. They know me very well. And they know
5 they need to come to me with -- if they're going to
6 have some kind of a change.^{18/}

These variances ought to have attracted Aquila's attention. Yet they did not. Instead, Aquila kept on "mechanically and proportionally" purchasing fixed price NYMEX positions.^{19/}

Moreover, GMO's touted "one-third" plan, seemingly copied from its electric system operations, was to buy its calculated gas requirements in such a way that the customers were protected from variations in gas costs. If costs went up, the costs were mitigated; if prices went down, they were also protected. Unfortunately, what GMO did decimated the possibility of achieving a moderating "market neutral" result that would mitigate the wide price swings of the natural gas market. Contrary to its own "one-third" strategy, GMO locked in more than 100% of its 2006 natural gas requirements at one time^{20/} and at the cur-

^{18/} Tr. 268-69.

^{19/} Clemens Direct, Ex. 101, Schedule GLC-2, p. 4.

^{20/} "2006 purchases were all made in February 2006. . . ." Exhibit 14.

rent high costs leaving GMO with no means of protecting the customers if gas prices dropped.

By the time it was apparent that actual steam load was significantly less than budgeted volumes it was too late to affect Aquila's natural gas hedge program for the steam system. The hedges would have **already been purchased.**^{21/}

As a result, GMO ended up with large quantities of high cost gas hedges on its hands. Prices dropped. GMO's customers ended up holding the bag to support GMO's speculations in the gas market.

There is ample competent and substantial evidence to support the Commission's conclusions and decision.

C. AGP's Complaint is Not Out of Time.

GMO tried this argument without success in its initial Motion to Dismiss. Originally trying to get this prudence complaint dismissed, GMO continues to ignore the explicit language of the QCA Stipulation, even while it asserts part of that Settlement as justifying the hedging program. The prudence review is not time-barred.

These charges were collected subject to refund under refund cases (HR-2007-0028 and HR-2007-0399) and under the terms of the settlement agreement. Provisions that pertain to Staff do not apply to AGP or any other steam customer. GMO continues to press this assertion despite a plain violation of a Commission

^{21/} Ex. 8, GMO # 407 (emphasis added).

Order that directed "signatories" to comply with the terms of the HR-2005-0450 Settlement.^{22/} AGP pursued numerous meetings with GMO (then Aquila) personnel to attempt to negotiate a resolution of these matters,^{23/} meetings that were suspended for a considerable period after the Aquila acquisition (despite efforts by both Staff and AGP to resume them), and even a brief resumption of those meetings quickly made clear that further attempts to resolve the matter without a formal complaint would be a waste of time. These provisions do not apply to AGP.^{24/}

^{22/} The HR-2005-0450 Order Regarding Stipulation and Agreement, attached as Exhibit A to AGP's Complaint, page 3, ORDERED paragraph 2, directs:

2. All signatory parties are ordered to comply with the terms of the Stipulation and Agreement.

^{23/} These meetings are confirmed in Staff pleadings in both HR cases.

^{24/} The entire tariff provision is quoted below:

7. This review may be entirely a part of surveillance activity. Customers will be given timely notice of the results of the Step One review no later than 75 days after the end of each year. In consideration of Step One results, the Staff may proceed with Step Two, a full prudence review, if deemed necessary. A full prudence review, if pursued, shall be complete no later than 225 days after the end of each year. Such full prudence review shall be conducted no more often than once every twelve (12) months and shall concern the prior twelve (12) month period or calendar year only, provided however that the full prudence review addressing the first partial year, if pursued, will be included with a full prudence review of the first full calendar year of operation of this rate mechanism.
8. Any customer or group of customers may make application to initiate a complaint for the purpose of pursuing a
(continued...)

D. GMO Was Correctly Required to Prove That It Was Prudent.

Once again, GMO raises a point that has been raised and ruled upon by this Commission before and should form no basis for a rehearing. The Commission has properly recognized a rule ("modified prudence standard of review").^{25/} that while a utility may enjoy an initial presumption that its activities are prudent, the burden of proof remains on the utility when another party in the case raises serious doubt regarding the prudence of utility expenditures.^{26/}

GMO struggles with the HR-2005-0450 Stipulation and Agreement directing that the complaint **procedure** be used to conduct a prudence review. This case was and is a prudence review of charges included in a **refundable** rate being automatically passed on to steam customers by Aquila through a fuel rate

^{24/} (...continued)

prudence review by use of the existing complaint process. The application for the complaint and the complaint proceeding will not be prejudiced by the absence of a full (Step Two) prudence review by Staff.

9. Pursuant to any prudence review of fuel costs, whether by the Staff process or the complaint process, there will be no rate adjustment unless the resulting prudence adjustment amount exceeds 10% of the total of the fuel costs incurred in an annual review period.

Source: Sheet 6.4.

^{25/} Order, p. 17, ¶ E.

^{26/} *State of Missouri ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 528 (Mo. App. 1997).

rider mechanism approved by the Commission in a previous ratemaking case.

The QCA was approved in a general rate case in which Aquila was seeking approval to automatically pass on continuing steam-related fuel costs^{27/} quarterly. Both the Stipulation and the QCA tariff provide for prudence reviews by the PSC Staff and the steam customers and provide that fuel costs collected in rates "will be refundable based upon true-up results and findings in regard to prudence" when a prudence adjustment exceeds 10% of the total fuel costs incurred each year (as it did here).

Each time Aquila filed a new fuel rider rate, the steam fuel costs were passed on to its steam customers as part of the original ratemaking process. The QCA process is explicitly a ratemaking process and the judicially-confirmed *Associated* rule as to burden of proof of prudence fully applies and GMO has the burden of proof.^{28/}

Thus the rule as to who has the burden of proof as to the prudence of expenditures included in rates is the same as if Aquila had filed a separate ratemaking case each time it increased its QCA Rider.^{29/} Failure to prove prudence results in

^{27/} The QCA mechanism applied to steam fuel costs including coal as well as gas.

^{28/} When another party raises a serious doubt regarding an expenditure, the burden shifts to the utility to prove the prudence of the expenditure.

State ex rel. Nixon v. PSC, 274 S.W.3d 569, 586 (Mo. App. 2009).

^{29/} *Associated Natural Gas, supra*.

Aquila (now GMO) having to refund amounts collected from customers as agreed in the Stipulation and contained in Aquila's QCA Rider with respect to the imprudent costs.

This also disposes of yet another GMO rabbit trail because the Commission found that Aquila did not act prudently with regard to all its steam customers.^{30/} Thus the relief ordered, *i.e.*, refund, properly is directed to all Aquila's steam customers.

Thus the Commission's handling of the burden of proof issue was correct and requires no further action by the Commission. GMO simply failed the test. Moreover, relief to all steam customers through the QCA refund mechanism is proper.

E. The Regulatory Law Judge Did Not Exclude GMO "Rebuttal".

GMO now adds one additional point, claiming that the RLJ excluded rebuttal. Review of the transcript reveals, however, that what was excluded was not "rebuttal." Rather, the exclusion of a proffered Exhibit 109 was ruled out of order on entirely other grounds, *i.e.*, that ***it was not new information.***

11 JUDGE DIPPELL: Are your changes to
12 Exhibit 109 having to do anything with additional
13 information that you just received, change?

14 MR. ZOBRIST: I -- not that I just
15 received this morning or today. ***No, it's not new***
16 ***information.***

17 JUDGE DIPPELL: It's my understanding
18 from Exhibit 109 that that's basically information
19 that was extrapolated from the testimony of the other
20 witnesses; is that correct?

21 MR. ZOBRIST: ***Right. Yeah. This is not***
22 ***new information. It's simply a -- a clarification.***

23 JUDGE DIPPELL: Then I see no -- I see no
24 reason for it, so I'm not going to allow further

^{30/} Order, p. 19, ¶ J.

25 questioning or information about Exhibit 109. I
00338
1 believe it's probably information you can put in your
2 brief that's based on testimony that's already in the
3 record, so --
4 MR. ZOBRIST: **Probably so.** Thank you,
5 Judge.
6 JUDGE DIPPELL: So I'm not going to allow
7 it. Is there anything further?^{31/}

Experienced counsel for GMO also failed to preserve the proffered exhibit by an appropriate offer of proof. GMO's argument for rehearing on this score lacks merit.

F. Conclusion.

GMO's Application for Rehearing completely fails to assert anything that is new or was overlooked by the Commission. It lacks merit and should be denied.

Respectfully submitted,

FINNEGAN, CONRAD & PETERSON, L.C.



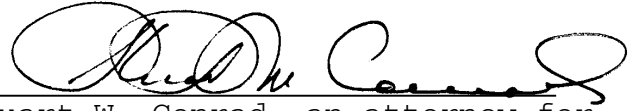
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^{31/} Tr. 337-338 (emphasis added).

SERVICE CERTIFICATE

I certify that I have served a copy of the foregoing pleading upon identified representatives of the parties hereto per the EFIS listing maintained by the Secretary of the Commission by electronic means as an attachment to e-mail, all on the date shown below.

A handwritten signature in black ink, appearing to read "Stuart W. Conrad", written over a horizontal line.

Stuart W. Conrad, an attorney for
Ag Processing Inc a Cooperative

October 17, 2011