STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Evidentiary Hearing

June 5, 2012

Jefferson City, Missouri

Volume 4

In the Matter of the Third)
Prudence Review of Costs)
Subject to the Commission-) File No. EO-2011-0390
Approved Fuel Adjustment)
Clause of KCP&L Greater)
Missouri Operations Company.)

HAROLD STEARLEY, Presiding,
DEPUTY CHIEF REGULATORY LAW JUDGE.

STEPHEN M. STOLL,
COMMISSIONER.

APPEARANCES:

JAMES M. FISCHER, Attorney at Law
Fischer & Dority
101 Madison, Suite 400
Jefferson City, MO 65101
(573)636-6758
jfischerpc@aol.com

ROGER W. STEINER, Corporate Counsel
Kansas City Power & Light
P.O. Box 418679
120 Main - 16th Floor
Kansas City, MO 64141
(816)556-2314
Roger.steiner@kcpl.com
FOR: Kansas City Power & Light.

STUART CONRAD, Attorney at Law (Via Telephone)
Finnegan, Conrad & Peterson
3100 Broadway, Suite 209
1209 Penntower Officer Center
Kansas City, MO 64111
(816)753-1122
stucon@fcplaw.com
FOR: SIEUA and AG Processing.

LEWIS R. MILLS, JR., Public Counsel
Office of the Public Counsel
P.O. Box 2230
200 Madison Street, Suite 650
Jefferson City, MO 65102
(573)751-4857
FOR: Office of the Public Counsel and the Public.

KEVIN A. THOMPSON, Chief Staff Counsel
MEGHAN McCLOWRY, Legal Counsel
Missouri Public Service Commission
P.O. Box 360
200 Madison Street
Jefferson City, MO 65102
(573)751-3234
FOR: Staff of the Missouri Public Service Commission.

REPORTED BY:
KELLENE K. FEDDERSEN, CSR, RPR, CCR
MIDWEST LITIGATION SERVICES

(WHEREUPON, the hearing began at 8:29 a.m.)

(STAFF EXHIBIT NOS. 1 THROUGH 3 WERE MARKED FOR IDENTIFICATION.)

JUDGE STEARLEY: All right. Good morning. It is Tuesday, June 5th, 2012. The Commission has set this time for an evidentiary hearing in the File No. EO-2011-0390, which is captioned as in the matter of the third prudence review of costs subject to the Commission's approved fuel adjustment clause, KCP&L Greater Missouri Operations Company.

My name is Harold Stearley, and I'm the Regulatory Law Judge presiding over today's hearing. We will begin by taking entries of appearance, starting with the Commission Staff.

MR. THOMPSON: Kevin A. Thompson and Meghan E. McLowry for the Staff of the Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102.

JUDGE STEARLEY: Thank you, Mr. Thompson. For GMO.

MR. FISCHER: Let the record reflect the appearance of Roger W. Steiner and James M. Fischer. Our contact information is on the written forms.

JUDGE STEARLEY: All right. Thank you, Mr. Fischer. For the Office of Public Counsel.

MR. MILLS: On behalf of the Office of the Public Counsel and the public, my name is Lewis Mills. My address is Post Objection Box 2230, Jefferson City, Missouri 65102.

JUDGE STEARLEY: For the Sedalia Industrial Energy Users Association and for AG Processing? Both represented by same counsel. We'll let the record reflect there's been no entry of appearance.

For the Commercial Group? And we'll let the record reflect there is no entry of appearance for the Commercial Group. This entity and the Federal Executive Agencies, which I also don't believe anyone's here for, were both made automatic parties to this suit by operation of Commission rules. They have not entered appearances or added any filings in any way to this proceeding.

Dogwood Energy, LLC had previously asked to be excused from the hearing, and they were excused.

And Mr. Mills, while we're on entries, I noticed that Public Counsel did not file a position statement in this matter. Would you like to tell us what your position is?

MR. MILLS: Judge, with respect to this case, when Senate Bill 179 was passed by the Legislature in 2005 authorizing the Commission to approve fuel adjustment clauses, the Public Counsel's office said that we needed three additional FTEs in order to be able to handle the additional work. The Legislature did not see fit to give us those FTEs, and as a result, we typically have not been involved in prudence adjustments with -- arising from fuel adjustment clause cases, and the same is the case for this case.

So it's my intention to simply enter an appearance and then ask to be excused from the remainder of the proceedings.

JUDGE STEARLEY: Very well. Do you want to be excused now or did you want to stay for opening statements?

MR. MILLS: I would like to stay and listen to opening statements, but then I plan to excuse myself --

JUDGE STEARLEY: Okay. Very well.

MR. MILLS: -- by your leave. Thank you.

JUDGE STEARLEY: As per usual, I must advise everyone to please turn off your electronic devices, cells phones, Blackberries, et cetera, which can interfere with our recording and webcasting.

Witnesses for today, I know we have the company's witnesses scheduled, which include Dr. C.K. Woo, William Edward Blunk, Scott H. Heidtbrink, Gary L. Clemens, Ryan A. Bresette and Tim Rush. Staff's witnesses -- I don't know if we'll be reaching them today.

They're scheduled tentatively tomorrow -- include Charles R. Hyneman, Lena M. Mantle and Dana E. Eaves. Is that correct?

MR. THOMPSON: That's correct, Judge, and Staff's witnesses are all present and available, and if we do reach them today, we're fully prepared to go forward with them.

JUDGE STEARLEY: All right. Are there any preliminary matters we need to take up at this time?

(No response.)

JUDGE STEARLEY: All right. We'll go ahead and proceed to opening statements. The parties have indicated they were going to allow GMO to go first. Mr. Fischer.

MR. FISCHER: Thank you, Judge. Good morning. May it please the Commission?

My name is Jim Fischer, and Roger Steiner and I will be representing KCPL Greater Missouri Operations Company today. I guess I should welcome Commissioner Stoll back to the Bench. Unfortunately, this is one of the more technical hearings you're going to hear, but welcome to the Commission.

COMMISSIONER STOLL: It will be a good learning experience.

MR. FISCHER: This case involves a prudence review related to GMO's fuel adjustment clause for the period of June the 1st, 2009 through November 30th of 2010. As a result, the Commission's traditional prudence standard, and I'm going to talk about that in a minute, will apply to the issues in this case.

On November 28th of 2011, the Staff filed its Staff Report which gave the company a clean bill of health on everything except one area, and that one area involves GMO's longstanding cross hedging program using natural gas futures contracts to hedge the risk associated with its purchases of electricity, what we call spot purchased power.

Now, the Staff's proposed disallowance and refund of GMO's hedging costs is based upon the contention that Staff has found GMO was imprudent in its use of natural gas hedges to mitigate risk associated with future purchases in the spot power market. That's on the second page of the Staff's Report.

But more specifically, the Staff is contending that the two markets, the purchased power market and the NYMEX natural gas futures markets are not linked sufficiently that a prudent person would use purchases in the natural gas market to prudently offset the risk of price volatility in the spot purchased power market. As GMO's experts are going to tell you today, this Staff position is erroneous and should be rejected by the Commission.

Now, in the position statement that was filed by the Staff on May the 25th, Staff counsel raised a new issue that was not addressed in the Staff Report or the Staff's testimony that I can find. Staff's position statement makes the following new allegation: GMO was imprudent in that it relied on an overly rigid market insensitive cross hedging program.

There's no competent and substantial evidence in the prefiled testimony that supports this allegation, but the evidence will show that GMO has previously addressed a similar Staff concern regarding Aquila, the company that was previously called -- or was known as GMO. Today we're called GMO. We used to be called Aquila, and then we were acquired by Great Plains Energy, part of the Kansas City Power & Light family.

But anyway, the Staff had previously raised a concern regarding Aquila's past hedging program, something that was sometimes called the one-third program, and in that case, the Staff suggested, too, that it was too rigid and too systematic.

Now, after the Staff criticized that one-third program, the company modified its program and began utilizing the same program that's used by Kansas

City Power & Light Company, a program known as the Kase program. Staff had suggested that KCPL's program was better than the Aquila one-third program because it was ledge rigid and allowed the company to use market trends in its decisions about the timing of placing these hedges.

The company specifically adopted this plan and addressed Staff's concerns that the one-third program was overly rigid and market insensitive.

The evidence in this case will show that the Kase program that's used now by both Kansas City Power & Light Company and GMO is not rigid and it's not market insensitive as suggested by the Staff's position statement.

The Commission has previously held in two Iatan 2 rate cases, which is -- was the GMO and KCPL rate cases of 2010, and in an Atmos PGA case as well as the associated Natural Gas case and some older cases involving the Callaway nuclear power plant and the Wolf Creek nuclear power plant that there's a presumption of prudence related to public utility expenditures, and the Commission courts and the Missouri courts have agreed with that.

In particular, the presumption of prudence and the prudence standard has been addressed by the courts in a case known as State Ex rel Associated Natural Gas versus the Public Service Commission, 554 SW 2nd 520.

The Commission and the court's decisions have held that when other parties raise a serious doubt as to the prudence of those expenditures, then the public utility has the obligation to come forward and rebut those allegations to meet its burden of proof.

Now, under this legal standard, it takes competent and substantial evidence to raise a serious doubt of imprudence to shift the burden back to the utility. Now, this legal requirement is different than merely including a proposed disallowance in testimony without any evidence of imprudence to support it.

In this case, the company doesn't believe that the Staff has raised a serious doubt regarding the company's cross hedging program. The Staff has not presented competent and substantial evidence to show that the company's actions were in any way unreasonable or not consistent with accepted industry practices. However, the company will be addressing in quite a bit of detail the allegations of Staff.

The company's conduct under the prudence standard should be judged by asking whether the conduct was reasonable at the time under all the circumstances, considering that the company had to solve the problem prospectively rather than reliance on hindsight.

Finally, in order to support a

disallowance, the Staff or other parties to the case must satisfy a two-pronged test. First, the Staff must demonstrate that GMO had acted imprudently based upon industry standards and the circumstances that occurred at the time the decision was being made. And second, the Staff must provide proof of increased costs that resulted from this imprudent decision.

Now, to meet that standard, a party must provide competent and substantial evidence establishing this causal link or what I call a nexus between the alleged imprudent action and the costs incurred. We don't believe Staff has met that burden either.

In this proceeding, the company will be presenting the testimony of five witnesses who will address the prudence and the accounting issues raised in the case. The company's outside expert, Dr. C.K. Woo, is an economist and a renounced expert on cross hedging. He will explain the basis for using natural gas futures contracts to hedge the price risk associated with spot purchased power.

He's reviewed the level of correlation between the natural gas and the electric prices and will testify that these markets are highly correlated. He will also give his opinion that GMO acted prudently by using this common hedging technique to hedge the price of electricity using natural gas futures.

Mr. Ed Blunk, the company's supply planning manager, will explain how the company uses natural gas futures to mitigate the price risk associated with spot purchased power costs and the reasons for doing so. He will testify that these cross hedges meet the tests that are used by the industry for demonstrating that the hedges are what's called highly effective. He will also address the specifics of GMO's cross hedging program during this particular FAC review period.

Now, Mr. Scott Heidtbrink, KCPL's chief operating officer, will testify about the history of the company's cross hedging program going back to its initiation in 2004. Mr. Heidtbrink was at Aquila during those years, and he can discuss the history around its initiation.

Mr. Gary Clemens was also at Aquila when the cross hedging program began and is personally familiar with discussions with the Staff and other parties in those past Aquila rate cases.

Mr. Ryan Bresette, the company's assistant controller, he oversees margin accounting and derivative accounting. He will explain the basis for the accounting related to these hedges and will address specific accounting questions raised by the Staff.

Finally, Mr. Tim Rush will address the company's interactions with the Staff over the hedging programs and the issues around those programs, the details around the company's fuel adjustment clause tariffs, and he'll rebut suggestions by the Staff that the hedging costs were not expected to be flowed through the fuel adjustment clause mechanism.

I'd like to just briefly highlight some of the major conclusions that will flow from the evidence in this case. The evidence is going to show that first cross hedging spot purchased power with natural gas futures contracts is a widely accepted method of hedging the risk associated with volatile spot purchased power costs.

Second, cross hedging has been used by GMO since 2004. Other companies, Ameren, other major companies around the country also use this particular hedging technique.

Cross hedging has been taught by the Electric Power Research Institute since the mid 1990s, and numerous Staff, including the witnesses in this case, Dana Eaves and Chuck Hyneman, have attended webinars presented by the PGS Energy Training where this cross hedging technique was explained and taught.

The natural gas and electricity markets are highly correlated, and the hedges themselves are considered highly effective judged by the existing energy or industry and accounting standards. Based upon the correlation coefficients for natural gas and electricity prices, Dr. Woo has concluded it is prudent to use cross hedging to effectively manage daily on-peak risk.

Dr. Woo testifies that while the spot electricity market is hourly, NYMEX natural gas futures can still be effectively used to cross hedge the daily on-peak electricity price. And as I'll explain in a moment, Staff doesn't seem to recognize this fact, and I think that's one of the fundamental differences and we believe a flaw in the Staff's analysis in this case.

Staff has been aware of GMO's cross hedging program since 2005 and has never previously suggested that it was imprudent to use natural gas contracts to hedge the price of electricity.

Finally, the evidence is going to show that GMO will stop placing these cross hedges in the future if the Commission believes it should do so. However, it's fundamentally unfair and we believe unlawful for the Commission to order a refund in this case based upon the flawed analysis of the Staff in its hindsight review.

Now, there's also a few takeaways from the evidence that I'd like to mention on the accounting issue. First, the evidence will show that GMO has been properly accounting for its hedging costs since the inception of the program.

Second, in a previous Commission Order in the Aquila 2007 rate case, the Commission clearly and unequivocally held that prudently incurred hedging costs should be flowed through GMO's fuel adjustment clause mechanism.

Third, the evidence will show that GMO has followed the Stipulation & Agreement in various rate cases which was approved by the Commission and under those -- under that stipulation the company was directed to book the hedging costs either to FERC Account 547 or FERC Account 555.

In this case, the Staff is arguing that it's imprudent for the company to hedge the risks related to purchased power costs using the well-accepted hedging technique which I've called cross hedging. GMO's been using the cross hedging technique going back to 2004, and the Staff personnel have been aware of this use for about seven years.

The Staff auditors even attach the company's hedging plan that mention the cross hedging technique in their testimony in the 2005 and the 2007 Aquila rate cases.

Staff witness Chuck Hyneman has candidly acknowledged that the Staff auditors have been aware for six or seven years that GMO had been using natural gas futures contracts to hedge the risk associated with purchased power costs. But even though there have been four rate cases and two previous GMO FAC prudence reviews since the Staff became aware of the company's use of the cross hedging technique, this is the very first case in which the Staff has alleged that it was imprudent.

Now, if the Staff had informed the company of its position that cross hedging was imprudent before the hedges had been placed, it's highly likely that the company would have stopped the practice and simply played the spot market. The company's been attempting to proactively address Staff's various concerns regarding its hedging program over the years, and there's no reason to believe that it would not have addressed Staff's concerns on cross hedging if the Staff had chosen to share them before it filed a Staff Report recommending the disallowance of $18.8 million.

Tim Rush's testimony includes a rather lengthy discussion of how the company has been addressing Staff's concerns regarding GMO's hedging program over the years. In particular, the Commission should review Mr. Rush's schedule, which is TMR-3, which summarizes the numerous activities and interactions between the company and the Staff related to these hedging programs beginning in July 2004. This schedule gives the dates when the Staff raised concerns or criticisms regarding Aquila's hedging programs, the actions that were taken by the company to address those concerns, the rate cases and the fuel adjustment cases that were completed by Staff where the Staff did not mention any concerns about cross hedging, a Stipulation & Agreement to give the Staff updates on its hedging programs as we go along as they change, and Orders of the Commission finding that there was no imprudence in past FAC audits.

The company was surprised and disappointed by Staff's report in this case. Frankly, the company feels it was blind sided because the company thought it had been proactively addressing Staff's past concerns about the hedging program over the years.

Now, as I'll explain in a moment, this hedging practice is designed to benefit customers, not the company shareholders. If the Commission believes that the company should not be hedging its purchased power costs or if it believes it should not be cross hedging using natural gas futures as the Staff is suggesting, then the company will stop the program. The company has no desire to use a hedging practice that the company believes is inappropriate or otherwise unreasonable.

But it's the company's position that it's unfair and unlawful to declare this accepted hedging practice to be imprudent on its face and then order a refund of a substantial amount of money collected under the fuel adjustment clause. This is especially true when the criticisms of the hedging program are based upon the use of hindsight, as the Staff has done in this case.

Frankly, the company does not believe that there is any competent and substantial evidence in the record to support the Staff's proposed disallowance. It would, therefore, be unreasonable to adopt the disallowance being recommended by Staff.

But during the depositions in this case, the Staff witnesses confirmed that they were not aware of any Missouri Commission decision that had held that it was imprudent for a company to cross hedge its power costs using natural gas futures. In fact, Staff wasn't able to give us any examples that they'd heard of around the country where other public service commissions had held that it was imprudent for an electric company to cross hedge the risk of its purchased power costs using natural gas futures.

I've been talking about cross hedging, but what is it? Staff witness Dana Eaves cites the following definition of cross hedging in his testimony from an on-source site, Investopedia.com. He says it's the act of hedging one's position by taking an offsetting position in another good with similar price movements.

Now, that same Investopedia source goes on to give an example of cross hedging. Although the two goods are not identical, they're correlated enough to create a hedge position as long as the prices move in the same direction. A good example is cross hedging a crude oil futures contract with a short position in natural gas. Even though these two products are not identical, their price movements are similar enough to use for hedging purposes.

Now, this definition suggests that it's possible to cross hedge a position in natural gas with futures contracts in crude oil even though those commodities aren't identical. There are many examples around the markets where you see that futures -- that there is cross hedging going on.

Some examples would include hedging jet fuel with oil futures contracts, hedging the price of ethanol with gasoline futures contracts, hedging grain sorghum prices with corn futures contracts, and many other commodities where there's no specific futures market for the hedged commodity but there is a futures market for something that moves in the same direction and is highly correlated with it.

Now, GMO purchases approximate 3 and a half million to 3.9 megawatt hours of power to serve its load at a cost of 120 to $135 million per year. Substantial numbers. Those purchases represent about 40 percent of GMO's energy requirements. As a result, GMO's customers have a significant exposure to this market. If prices go up and they're not hedged, they're exposed.

In the case at hand, the company has used natural gas futures contracts to cross hedge the price of purchased power because there's no viable electric futures market for electricity in the Southwest Power Pool region where GMO operates.

On this point, the company and the Staff agree. There's no organized market where GMO could go out and buy electric futures on an economic basis. Therefore, another alternative from the company's perspective is to cross hedge with a commodity, in this case natural gas, that has similar price movements.

Staff's position seems to be that there is no reasonable method of hedging electric price risk using financial instruments, but instead the only reasonable methods of hedging for electric price risk from the Staff's perspective is to build power plants or to enter into purchased power agreements.

Now, both of these alternatives obviously can be very expensive. If the company stopped its hedging program using financial instruments and then simply played the market and bought purchased power on the spot market at the prevailing price at the time, then the company would just simply pass along those purchased power costs to customers through the fuel adjustment clause, whatever those purchased power costs turned out to be at the time of the purchase.

The downside of this approach, of course, is for the consumer. There's a downside to the consumer because it's likely there will be more volatile prices that they would have to pay for their electricity costs.

Cross hedging spot purchased power with natural gas futures contracts is a widely accepted method of hedging the risk associated with volatile spot purchased power costs. It's been used by GMO. It's been used by Ameren. There are a number of companies that are listed in Mr. Blunk's survey that have used it across the country as it's needed.

Now, GMO's sister company, Kansas City Power & Light Company, has more capacity available to serve its native load than GMO and, therefore, KCPL's customers don't have the same risk associated with price spikes of purchased power. Therefore, Kansas City Power &

Light Company has not historically used natural gas futures to hedge its price risk.

However, both companies, Kansas City Power & Light and GMO, are using the same outside vendor, Kase & Company, to implement their hedging programs. This program helps the company personnel exercise their professional judgment to know when to place various hedges, and it takes away the rigidity and the market insensitivity that had existed in other cost averaging approaches in placing hedges.

Now, who teaches this technique? Well, the Electric Power Research Institute has taught this hedging technique since the mid '90s in seminars it presented to its member electric companies. Staff witness Dana Eaves also testified that he participated in a four-hour webinar training session more than four years ago on January 18, 2008, which was sponsored by the PGS Energy Training that taught the mechanics of the hedging technique that Staff has declared to be imprudent.

PGS Energy Training is an educational organization that specializes in training related to electricity and natural gas markets and industries. Now, over the years at least 55 members of the Commission Staff have attended various PGS Energy Training webinars. Many representatives of companies, natural gas and electric companies, have also attended, including the company's witness Mr. Ed Blunk. He attended the one that Staff witness Eaves also attended, only at a later time.

The webinar that Mr. Eaves and other staff attended on that day in 2008 was entitled How to Financially Hedge Natural Gas and Electricity Price Risk. According to Mr. Eaves, the Staff witness who sponsors the disallowance in this case, this PGS Energy webinar is the only formal training course that he'd taken on the topic of electricity and natural gas pricing -- excuse me, hedging.

Now, in that webinar there were two sections. There was a 90-minute section that addressed the general topic of electric hedging and natural gas hedging, and then the second session was entitled Hedging Electricity Price Risk with Natural Gas Futures Contract. In fact, if you look at the slides, it's obvious that the second half of this webinar focused almost exclusively on the cross hedging technique that's utilized by GMO to cross hedge electricity price risk using natural gas futures.

Now, as I mentioned, Mr. Ed Blunk has attended this webinar at a later time, and he's attached to his surrebuttal testimony the portion of the slide presentation that dealt with cross hedging using natural gas futures contracts.

The academics have also talked about this technique. GMO's outside expert, Dr. C.K. Woo, has written 16 articles on the topic of cross hedging and risk management techniques that are used in the electric industry.

A financial engineering graduate student, I wasn't sure how to pronounce his name, but from the University of Missouri at Rolla wrote a thesis entitled Formulating Hedging Strategies for Financial Risk Mitigation in Competitive U.S. Electricity Markets that specifically discusses cross hedging using natural gas futures.

Now, Dr. Michael Proctor, formerly of the Commission Staff and the most knowledgeable Staff expert on electricity hedging at the time he was with the Staff, according to the deposition testimony of Ms. Mantle, also reviewed the correlations between the electric and natural gas markets.

Dr. Proctor's testimony in the 2009 GMO rate case concluded that 87.23 percent of the variation in the SPP electric prices over a five-year period was explained by variations in the natural gas prices, and there was little doubt that the natural gas prices drove electricity prices for most of the hours of the year in the SPP region. That's included in Dr. Proctor's testimony in that case.

Now, Mr. Blunk's testimony also includes an informal survey of electric companies that indicates that other companies, including Arizona Public Service, Florida Power & Light Company, Madison Gas & Electric, Mississippi Power, the Southern Company, Portland General and locally Ameren uses cross hedging technique to have electric price risk as it's needed.

Mr. Blunk also includes in his testimony tables that shows how natural gas contracts to hedge the electric price risk work. He shows how the gain or the loss on the physical side is offset by the gain or the loss on the futures market.

Now, while the jargon in this case and around hedging is rather technical and it's a bit confusing to me as a layman, the mechanics of cross hedging is really not rocket science. Essentially, when you're constructing a hedge for spot purchased power, you perform two transactions, and they're directly and inseparably linked. The transactions could be described as you buy what you sell and you sell what you buy. That's what locks in the price that you want and when you want it.

The company needs to physically buy

purchased power for its customers. In order to offset the risk of price spikes in electricity, it also enters into natural gas futures contracts for the equivalent, the Btu equivalent of the amount of purchased power that it's going to need to buy. Together these two actions create the hedge. The physical purchase of the spot purchased power, they're actually buying electricity, and entering into the natural gas hedge, the futures contract, for a Btu equivalent of the amount of purchased power that you're going to need to buy.

Now, buying the future -- the purchased power is sometimes referred to as the physical side of the hedge transaction. Buying the natural gas futures contract is sometimes referred to as the derivative side of the hedge transaction. At the same time that the company is buying the power in the physical market, it's also buying a natural gas futures contract that it can sell to offset increased prices in electricity.

This method provides a hedge or insurance against skyrocketing electric prices. For example, GMO knows in February that it's going to need to buy in August electricity to meet the peak demands of its customers. GMO knows that those electric prices could be very volatile in August, and GMO's concerned that the prices for electricity power in August might be higher than are currently expected.

Now, at this point the company has a choice. Either it can attempt to hedge this risk for its customers by substantially -- hedge the risk so to -- to hedge it so we know that the electric prices are going to be kept in a range and they're not going to be volatile, you're hedging the risk that the prices are going to be higher than they expected, or it could just play the market by purchasing spot purchased power at the prevailing price without any kind of a hedge and merely passing along those costs, whatever they turn out to be, through the fuel adjustment clause.

Now, during this particular FAC period, GMO chose to enter into a hedge to protect its customers against skyrocketing electric prices. GMO chose this approach based upon its own professional judgment that hedging was a prudent thing to do to protect its customers.

Also, the policy statement of the Commission that there's a -- on the natural gas side there's a policy statement that's entitled Natural Gas Price Volatility Mitigation Rule that encourages natural gas companies to hedge. They looked at that, too. And there's also Commission Orders and other signals received from the regulatory community that hedging was expected or certainly strongly encouraged.

Now, it's important to note that GMO shareholders do not profit by entering into a hedge. GMO's shareholders don't make money by hedging since the gains and losses in the physical side are largely offset by the gains and losses on the derivative market side.

Typically those gains or losses in the derivative market are passed along to consumers just as the gains and losses on the physical market. Therefore, the hedging process does not create profit opportunities for shareholders. Hedges are designed to protect customers and give them insurance against skyrocketing electric prices and not make money for the company or its shareholders.

However, GMO and its shareholders will be directly and very adversely affected if the Commission adopts the Staff's position in this case and disallows the losses on the derivative side while ignoring the offsetting gains on the physical side.

This is an example I've taken directly out of Mr. Blunk's testimony. You may not be able to read it too well, but you'll find it in his testimony. For sake of an illustration -- and because it's such a technical topic, I'm spending some time on it. I'd like to just go through a very simple illustration of how this works.

Let's assume a market implied heat rate of 10 MMBtus per megawatt hour of electricity, which is the same as 10 MMBtus of natural gas futures. GMO will be buying the same amount of natural gas futures contracts on an MMBtu basis as it will need in purchased power in August. In this particular illustration, GMO would have been forecasting in February that the price in August would be $50 per megawatt hour. It would buy an equivalent amount of natural gas futures assuming a forecasted price of 50 megawatt -- of $50 per megawatt hour.

Since it turned out in this example, though, that when we actually got to August the price was $40 per megawatt hour, less than what had been projected, instead of the $50, there is a $10 gain on the physical side of the ledger. However, there is an opposite and offsetting loss of $10 per MMBtu in the natural gas futures market since the natural gas prices are moving the same direction and are highly correlated and they move in tandem. This is an example of what you may hear referred to as being out of the money in the futures market.

So, was it imprudent for the company to have hedged in this illustration since there was a loss in the futures market? The company doesn't think so. The reason for hedging is to mitigate price risk.

In that regard, hedging is like insurance. To say a ratepayer is harmed when only looking at the derivative side of the hedge, the loss side, is like saying that you were harmed because you paid a premium for fire insurance on your house and the house did not burn down. Since the house did not burn down, you didn't get a payment from the insurance company. But were you imprudent to buy fire insurance? Were you harmed because you paid the insurance premium but the house did not burn down? The company doesn't think so.

The Staff is essentially suggesting by its approach in this case that the house did not turn down during this particular FAC period so they want the premium back. Staff is only looking at the net loss on the futures market or the derivative side of the transaction, but they're not taking into account the house did not burn down, and there was a gain on the physical side compared to the forecasted price.

The actual price of spot purchased power was less than had been forecasted, which was a good thing. So the insurance protection of the hedge wasn't needed, but that doesn't mean that it was imprudent to have hedged against the possibility that the price would have exceeded the forecasted level. If the house had burned down or if the electric prices had skyrocketed above the forecasted level, then the customers would be happy there was insurance.

Now, using the numbers in this illustration, Staff has taken -- not taken issue with the fact that there was $10 less than they expected on the natural gas side. Staff has not recommended that the gain be disallowed in any way. In fact, Staff has found that, in the Staff Report, that the physical price that GMO paid for the purchased power was prudent.

Now, on the other hand, Staff is arguing that the net losses in the futures market side of the hedge are imprudent. Staff has not recognized that the true impact of the hedge shown on this example or in the real world is the sum of the change in the physical market plus the sum of the change in the futures market. So we had a $10 gain and a $10 loss. You net those together, it's zero. They're offsetting changes.

The Commission should not make the same mistake, but it should look at both sides of hedge transaction, the physical side and the derivative side. They can't be separated in this analysis.

Now, until this case, Staff had never suggested disallowing futures markets impacts either when the futures were in the money or when they were out of the money.

So, why did the Staff choose to disallow one side of the transaction in this case when they hadn't in the past? Well, according to the testimony in the depositions, it was the size of the losses in the futures market that caught Mr. Eaves' attention. But as I've explained, there was an equally sizeable corresponding gain in the physical market because the purchased power price was substantially lower than the forecasted price, and the house did not burn down during the FAC period. As a result, the price volatility was mitigated, just as the hedging program was designed to do.

Apparently Mr. Eaves viewed the losses on the derivative side of the hedge transaction as reason enough to declare the cost hedging practice to be imprudent.

When we asked during the depositions if the Staff wanted the company to quit cross hedging, Lena Mantle's answer was yes, because the cross hedging was considered by Staff to be imprudent. From her personal perspective, the company should have built or purchased more power plants or entered into additional purchased power agreements. She does not believe the company should be using natural gas futures contracts or other financial instruments to hedge spot electricity prices. Staff apparently does not believe it's prudent to use financial instruments at all to hedge the price of electricity.

Now, later in the deposition Ms. Mantle did clarify that it was really GMO's management decision on whether to hedge or not, and Staff just didn't like the use of natural gas futures for hedging. She admitted, however, that there's not an organized market in the SPP region where GMO operates that would permit GMO to hedge using electric futures contracts.

Staff didn't suggest either any alternative that could be used, any alternative financial instruments or financial tools that could be used for hedging its spot purchased power risk. Staff is just arguing that the company shouldn't have done what it did in this particular case.

Now, Staff is the taking the position that the purchased power market and the NYMEX natural gas futures markets are not sufficiently linked to allow cross hedging. Certainly GMO disagrees with this point, and I suspect that every PGS Energy Training and the various scholars that teach the mechanics of this technique would also disagree.

While this is a rather technical subject, Dr. Woo can answer your questions, I hope, about cross hedging and why it's reasonable for electric companies to do it, and I would certainly encourage you to ask him questions about it if you have questions because it's a hard topic to understand.

And also, Mr. Ed Blunk, he actually oversees the company's hedging operation. He can answer questions about what the company actually does and why it does it. These company witnesses will demonstrate that the natural gas and electricity markets are highly correlated, and the hedges themselves are highly effective, a term of art, when judged by existing industry and accounting standards.

Let's look at a couple tests for hedge effectiveness. There are two tests that are used by the industry and by the accountants to determine if hedges are considered highly effective. Both are rather technical. The first one is called the R squared test, and the second one is called the dollar offset method.

The first test, the R squared test is based upon a review of the correlation of the data on the prices. This test looks at how closely two data sets in the same direction or are correlated. The evidence will show that the electric industry, that the accounting profession, the Financial Accounting Standards Board and the Staff of the Security and Exchange Commission consider an R squared of around .8 indicative that the daily on-peak electricity and natural gas prices are highly correlated, and these markets are sufficiently linked so that cross hedging would be considered highly effective.

Now, Mr. Blunk used the data on electric and natural gas prices that was contained in the Staff's work papers for the 12 months preceding the FAC audit review to determine the correlation coefficients between SPP's electric prices and the NYMEX natural gas settlement price. This would be the approximate timeframe in which the company's decision-makers would be deciding whether to hedge or not.

For this period, there was a correlation coefficient of .9411 between SPP electric prices and the NYMEX natural gas settlement prices. Now, that equates to an R squared, you basically square that number to come up with an R squared of .89, which means in layman's terms that 89 percent of the changes in the electricity prices were explained by changes in the natural gas prices during that particular period.

Now, as I mentioned, the R squared of .8 is considered by the company, the FASB and the SEC staff to be highly effective.

Dr. Woo's analysis shows that for December 2007 through May 2009, the 18-month period immediately before the 18-month review period for the FAC case, the coefficients of correlation between the daily on-peak price at GMO's interface with Ameren and the daily natural gas price at Henry Hub was .824, and the correlation coefficient is .853 at GMO's interface with the Associated Electric Cooperative interface.

Now, these are the two places that GMO primarily transacts when it purchases for purchased power. This data are indicative that daily natural gas prices and electric prices are highly correlated in Missouri. That's the takeaway.

Now, according to the FASB Opinion No. 133, application of a correlation analysis for purposes of establishing the effectiveness of a hedge requires the derivatives and the hedged item exhibit a correlation coefficient of at least .90, which is an R squared greater than or equal to .80 with respect to price fluctuation in order for the hedge to be classified as highly effective.

If hedges are highly effective, then there's certain accounting treatment that goes along that, and Mr. Ryan Bresette will explain to you, and he does in his testimony, the alternatives on that.

Now, the second method, the dollar offset method, under that method the change in value of the derivative is compared to the change in value of the hedged item. Hedges that yield a ratio within the range of 80 to 120 percent are deemed highly effective.

As our experts will testify, GMO's use of natural gas futures contracts to hedge the spot purchased power cost meets the test for effective hedges during this FAC review period. Schedule WEB-9, which is attached to Mr. Blunk's surrebuttal, I believe, or direct, shows that for the audit review period the estimated physical market change in the value for on-peak electricity was 109.6 percent of the actual change in value of the natural gas cross hedges.

Now, what does that mean? It means that, by accounting standards, GMO's natural gas cross hedges for on-peak electricity were, in hindsight, considered highly effective. That is, the hedges did what they were supposed to do. The electricity price movement was offset by a similar movement in the price of natural gas.

Staff witness Eaves' own analysis contained in his rebuttal testimony at page 15 compares SPP electric prices with the NYMEX natural gas settlement prices for February 2007 through August of 2011. Now, while he disagrees that the markets are highly correlated, he does state on page 15 at lines 9 and 10, and I'll just quote it, Staff would call this relationship as having a strong positive association for the data set in the analysis period.

Mr. Eaves also states that for February --

for the period February 2007 through October 2011, the data has a correlation coefficient of .8941. Now, this correlation coefficient would satisfy the industry standards for determining that hedges are effective.

Well, if Staff agrees that the SPP prices and the NYMEX natural gas prices have a strong positive association and they have a correlation of .8941, why are we trying this case before the Commission?

Well, as I understand the position of Mr. Eaves, he would not be comfortable using cross hedging techniques unless the correlation was almost perfect all of the time. At page 102 of his deposition Mr. Eaves states, and I'll quote, I think with the dollars at risk here, with what we're talking about, that correlation should almost be perfect all of the time and that's what I would be comfortable with.

So Mr. Eaves is not comfortable with anything short of a perfect correlation of the data, even though that's not the standard used by the electric industry, the accounting profession or the SEC. But based upon this subjective comfort level, he's proposed a refund initially in the Staff Report of $18.8 million.

Now, at the time that Mr. Eaves proposed this $18.8 million disallowance in the Staff Report, the evidence will show that he had not even performed a correlation analysis to determine how closely linked the electric and natural gas prices were. He did not have any textbook, article, treatise or public utility commission decision that found that it was imprudent to use natural gas futures to hedge the price of spot purchased power. The only formal training course that he had taken suggested just the opposite, that an electric company can use natural gas futures to hedge the electric price risk.

According to Mr. Eaves' testimony in his deposition, he didn't attach any correlation analysis to support his position that the SPP prices and the NYMEX natural gas prices were not sufficiently linked because he'd not done that analysis at that time. He conducted his analysis after he filed the Staff Report and before he filed his rebuttal testimony about four months later.

All he had done at the time he filed the Staff Report was reviewed the SPP website where he said there were some charts and graphs. These charts and graphs were not included in his work papers or attached to the Staff Report or the Staff testimony in this case.

Sometimes a picture is worth a thousand words they say, but I have a feeling it's worth a million correlation coefficients. I'd like to hand out just one page of Mr. Eaves' testimony that has a picture. This comes from page 15 of Mr. Eaves' rebuttal testimony where he includes a chart of the SPP electric prices and the gas settlements from February 2007 through August 2011.

Now, just by eyeballing that chart -- the blue and the red lines are electric prices and gas prices. Just by eyeballing the chart, I believe you can see how closely the electric and natural gas prices move. This is especially true if you focus on the period of the FAC audit period of June 2009 through November 2010 and for the audit period itself. So just before the audit period and actually during the audit period, you can see how closely those lines go together.

Now, contrary to Mr. Eaves' conclusion, Dr. Woo's first point in his surrebuttal testimony is, while the spot electricity market is hourly, NYMEX natural gas futures can be used to cross hedge the daily on-peak price. Dr. Woo presents his analysis in his surrebuttal testimony that shows that natural gas prices are highly correlated with hourly on-peak electric prices when a reasonable time period is used for that analysis.

Based upon these correlations, he concluded it's prudent to use cross hedging to effectively manage daily on-peak price risk.

Mr. Eaves' analysis fails to recognize that every futures market settles less frequently than the physical market it hedges. The logical extension of the

Staff's argument is that all hedging programs for all commodities across the markets would be imprudent since all futures contracts settle less frequently than the physical market they're hedging. This seems to be the fundamental concern that he has, that you're using a monthly settlement contract to hedge an hourly price.

But in reality, all futures markets settle less frequently than the physical market that it hedges. Therefore, the Staff's criticism isn't realistic or appropriate given the way the futures market works in the real world.

Unfortunately, this case is being tried, I think, because Staff apparently doesn't understand how it's possible to use a natural gas futures contract that is settled on a monthly basis to hedge an electricity price that may change more frequently. And with all due respect for the Staff, this is a fundamental misunderstanding, and I think if you want to ask questions about the fundamental point, this is one of them.

Now, just to reiterate, Dr. Woo testifies that while the spot electricity market is hourly, the NYMEX natural gas futures still can be used to cross hedge the daily on-peak electricity price. And if you have questions on that, please ask Mr. Blunk, too. He's all familiar with that as well. It's a critical point to understand. Mr. Blunk can describe for you how the company also uses other tools, swaps or options, tools in the physical market to manage the price risk associated with daily or intra-month changes in electricity prices.

Okay. Let's move to a different topic, and we're about done, the accounting issues. If the Commission finds that it's prudent to use cross hedging to effectively manage daily on-peak price risk, which is the fundamental issue in this case as Dr. Woo has testified, and that hedging costs should be passed through the FAC as the Commission has already ruled in past orders, then that should resolve the case. That's the fundamental issue in this case.

However, Staff has also suggested that the company accounted for the costs of the electric hedging program in the wrong FERC account. As I understand the position of the Staff, Staff is taking the position that the hedge costs associated with natural gas futures contracts that were part of the cross hedging program should be accounted for in Account 555, the purchased power account, rather than Account 547, the natural gas account.

Staff also states that Staff never intended hedging costs placed in Account 555 to be passed through the fuel adjustment clause anyway. So, therefore, any hedging costs that would be put into the Account 555 would not be recoverable through the FAC mechanism.

Now, the company strongly believes that the Commission should reject this analysis and this position. Previous Commission Orders have made it crystal clear that prudently incurred hedging costs should be flowed through the fuel adjustment clause.

For example, in the Commission's Order Clarifying Report and Order issued on May 22nd, 2007 in Case No. ER-2007-0004, which was Aquila's 2007 rate case, the Commission clearly stated on page 1, under the Stipulation & Agreement, prudently incurred hedging costs will flow through the fuel adjustment clause.

Judge, I don't know whether I need to do this, but I guess because this is such an important piece, I'd like to ask the Commission to take administrative notice of that May 22nd, 2007 Order Clarifying Report and Order in Case ER-2007-0004.

JUDGE STEARLEY: Commission will take administrative notice of that. And, Mr. Fischer, why don't you obtain a certified copy of that Order from the Commission's data center and offer it as an exhibit as well.

MR. FISCHER: I will do that. Thank you. In the Nonunanimous Stipulation & Agreement in Aquila's

2005 rate case, Case No. ER-2005-0436, the signatory parties agreed for accounting and ratemaking purposes that hedged settlements, both positive and negative, will be considered part of the fuel costs and purchased power costs recorded in FERC Account 547 or Account 555 when the hedging settlement is settled.

The company has followed the terms of this Stipulation & Agreement. The stipulation required the company to record the settlement costs in Account 547 or 555 when the hedges were settled and requires the company to maintain separate accounts for those costs.

The company followed that requirement. The company accounted for the natural gas hedge costs associated with cross hedging in Account 547 because, as Mr. Rush testifies in his surrebuttal, at the time the hedges actually settle, the determination of whether the company will generate using the natural gas associated with those futures contracts or whether it will purchase power on the spot market, at that point in time it hasn't been decided. And so since that determination hasn't been made, it's clear that it's still a natural gas settlement and it's put in the natural gas account. Therefore, all hedge settlements are actually natural gas settlement costs and are recorded in 547, the natural gas account.

But from the company's perspective, it

should not matter whether it's Account 547 or 555 that we put the hedge -- costs associated with that cross hedging program into. Both accounts include entries that are related to hedging, and all prudently incurred hedging costs are supposed to be flowed through the fuel adjustment clause as noted by the Commission's Order Clarifying Report and Order in that 2005 Aquila case and agreed to by the parties in the next -- in the Aquila 2005 stipulation.

The company's been recording its costs associated with the cross hedging program in 547 since the 2005 rate case. The company witness Ryan Bresette and Ed Blunk will explain the appropriateness of the accounting practice.

The Staff auditors have been aware that GMO was hedging the purchased power with natural gas hedges, and the Staff never questioned the accounting of these hedges until this case. In fact, until this case, the company had no indication from Staff that it disagreed that the hedged settlement costs should be passed through the fuel adjustment clause mechanism.

Now, if the Commission determines that it would rather have the hedge costs associated with the cross hedging program booked in Account 555 rather than 547, then the Order should clearly say so, and the company will book those costs in the preferred account in the future. However, it would be unreasonable and we believe unlawful for the Commission to disallow these prudently incurred costs on the ground that they were placed in the wrong bucket.

In conclusion, Staff is arguing that GMO was imprudent to use natural gas futures to hedge electricity price risk, and because the company recorded those hedge costs in a natural gas account, they should be disallowed, too.

Now, as I understand it, their revised recommendation is for disallowance of $14.8 million based on an analysis after our filing of our testimony. Staff says it knows of no formalized -- excuse me -- no formal organized market that allows for spot purchased power to be hedged which would aid GMO in mitigating the risk associated with buying spot purchased power.

Consequently, GMO employed a common practice that we've been talking about, cross hedging, to protect customers from the risk of skyrocketing prices. When Staff concludes that purchasing natural gas futures to mitigate risk associated with purchase of spot purchased power is somehow imprudent, what they're really saying is that GMO was imprudent for trying to protect its customers from the risk of skyrocketing power prices.

Staff witness Eaves claims that the crux of his position is that GMO was imprudent in this case because of his analysis of the correlation between electricity prices and natural gas prices are essentially zero. That contradicts the findings of the company's experts and other respected agencies like the Southwest Power Pool, the New York Independent System Operator, the Electricity Reliability Council of Texas, the Midwest Independent Transmission System Operator, which is called MISO, the ISO in New England, the California Independent System Operator, Staff's own testimony in prior cases, and industry's common knowledge.

Now, in an effort to deny GMO's recovery of prudently incurred costs, Staff has also constructed an accounting theory which contradicts the company's long-established accounting practice, its understanding of the FERC and the FASB accounting standards, and expression of intent in multiple Stipulations & Agreements. Staff argues that GMO should be penalized $14.8 million or .9 million because it disagrees with how the company accounted for its hedging costs.

My last slide. This is an important slide, Judge. Staff has failed to demonstrate any ratepayer harm. This is Figure 1 from Mr. Blunk's direct, and it clearly shows that GMO's hedging program was successful in containing GMO's fuel and purchased power costs and protecting GMO's customers from power spikes. This table includes the cost of fuel, the cost of purchased power and the hedge costs. Clearly if you look at that graph during the review period, the total cost was actually declining. Now, it's difficult to conclude that these costs were in any way unreasonable or imprudent.

I've gone on a long time. I appreciate your patience very much. It's a technical topic, and I hope you'll ask my technical experts your questions, but I'd be happy to answer your questions as well. Thank you very much.

JUDGE STEARLEY: Thank you, Mr. Fischer. Commissioner Stoll, did you have any questions for Mr. Fischer before he sits down?

COMMISSIONER STOLL: Not at this time. Thank you.

JUDGE STEARLEY: All right. Opening statement from Staff, Mr. Thompson.

MR. THOMPSON: Thank you, Judge. May it please the Commission?

On behalf of Staff, I'd like to welcome Commissioner Stoll back to the Bench. We're happy to see you there. We hope you'll enjoy this hearing and many to follow.

COMMISSIONER STOLL: Thank you.

MR. THOMPSON: Like Mr. Fischer, I'll do my best to make this topic as accessible as I can. Mr. Fischer talked for a long time and he had a lot to say, and it's always a difficult thing consequently to follow Mr. Fischer in giving an opening statement because, frankly, one wonders if the audience's patience has been completely exhausted by that time.

This case is about hedging. To be more specific, this case is the third prudence review of the fuel adjustment clause of KCP&L Greater Missouri Operations Company, an entity that we will refer to as GMO. It is the company once known as Aquila, and before that known as UtiliCorp United, and acquired by Great Plains Energy in a transaction approved by this Commission. That transaction closed just about four years ago in July of 2008.

We would not be here had Staff not recommended that a portion of GMO's hedging costs be disallowed as imprudent and refunded to the ratepayers. That portion amounts to nearly $15 million. I think Mr. Fischer said 14.9 million.

As I said, this case is about hedging. Hedging is a risk reduction strategy. It is similar to buying insurance. The hedger, like the purchaser of insurance, accepts a small loss to avoid or mitigate the possibility of a larger loss. You pay your home insurance, as Mr. Fischer pointed out, your fire insurance, accepting the cost of the premium, a loss, to mitigate the possibility of a larger loss if your house should catch on fire.

We all understand that. We all understand that that's a reasonable thing to do. But do you pay $14.9 million for your fire insurance?

In this case, GMO purchased natural gas futures and options as a hedge against upwards volatility in on-peak spot market purchased power prices. Staff's position is that GMO's conduct was imprudent and that the costs of the hedging, which have already been flowed through the fuel adjustment clause and onto bills of GMO's customers, must be refunded to those customers.

GMO, of course, is an investor-owned electric utility headquartered in Kansas City, Missouri, regulated by this Commission. GMO has some 300,000 customers, including 273,000 residential customers, 38,000 commercial customers, and some 500 industrial, municipal and other customers.

To serve them, GMO owns 2,000 megawatts, somewhat over 2,000 megawatts of generating capacity, of which something over 1,000 megawatts is coal-fired capacity, close to 1,100 megawatts is natural gas fired combustion turbine capacity, and 63 megawatts is oil-fired combustion turbine capacity. In a recent year, GMO used its capacity to produce over 6 million megawatt hours of electricity to serve its customers.

However, this large amount of power was insufficient to meet the requirements of GMO's customers. Using the figures that we heard from Mr. Fischer in his opening, GMO purchased 3.5 million to 3.9 million megawatt hours of power at a cost of 120 to 135 million. That is in addition to the power that it made itself with its own generation capacity. As Mr. Fischer said, this constituted 40 percent of GMO's energy requirements to serve its customers. We must agree that spot market purchased power consequently is a big item for GMO.

This case, as Mr. Fischer pointed out, is a prudence case. Prudence reviews at an interval no greater than 18 months are required by the statute that legalized fuel adjustment clauses in Missouri. We've heard it referred to already as, I think, Senate Bill 1979, as I recall. Is that the right number? 179. Excuse me.

Our Supreme Court held in 1979 -- that's where that number came from -- that fuel adjustment clauses were not lawful in Missouri. And, in fact, GMO's fuel adjustment clause was the very first one to be approved by this Commission after the law was changed.

A prudence review is the quid pro quo for access to that fuel adjustment clause mechanism. It is required by law. It is part of the structure put in place by the Missouri Legislature. And the fact of regular prudence reviews was accepted by GMO when it asked the Commission to put a fuel adjustment clause in place for it.

What is a fuel adjustment clause? Well, it's a mechanism by which changing fuel costs are passed on to a utility's customers quickly outside of a general rate case. A general rate case is an 11-month-long proceeding that involves a lot of people and costs a lot of money, and it is a slow way of getting changes in the operating and financial conditions of a utility into rates.

That slowness is referred to as regulatory lag. Regulatory lag is the interval that passes between a change in the utility's revenue requirement and the reflection of that change in the customers' bills. If a price goes up for a utility, it needs more money, and yet it's going to take 11 months of a general rate case before that price that has gone up for the utility, that rising cost, is then reflected in higher rates for customers.

The utility is still required to provide services to those customers through that 11-month lag period, and that money will never be recovered because rates, of course, are always prospective. Always prospective. They don't look backwards.

So a fuel adjustment clause is an important thing for a utility company because mitigation of regulatory lag is an important thing for a utility company. And so in order to get this lag mitigating device, this fuel adjustment clause, GMO accepted the requirement of regular prudence reviews. We're here for the third of those prudence reviews.

What is prudence? The dictionary tells us that it is shrewdness in the management of one's affairs, that it is caution and circumspection in the face of risk or danger.

In this case, the decisions made by GMO's management are scrutinized in the context of what was known or what should have been known at the time those decisions were made. The Commission will determine whether GMO's management was appropriately cautious in the face of risk and danger and was appropriately shrewd in the management of its affairs.

I think an important point to remember here is that the money that GMO spent on hedging was not GMO's money. It was the customers' money. Sure, it came out of

GMO's bank account, but then it flowed back in through the fuel adjustment clause. As I said a moment ago, the costs of this hedging program for this review period have already been recovered from the customers. The customers have already paid that $15 million. That's why we're talking about a refund. The money has already gone from the customers' pockets and back in GMO's bank account. So this prudence review is pretty much after the fact you might say.

In a recent case that also involved GMO, as an example, this Commission determined that the company was not prudent, that it did not shrewdly manage its affairs because it overhedged natural gas that it used to generate steam, thereby increasing rather than reducing price volatility. That case is AG Processing versus GMO, Case No. HC-2010-0235, Report and Order issued on September 28, 2011, a recent case.

Prudence cases are difficult from Staff's point of view because Staff bears the initial burden of making a showing of imprudence or improvidence. The Commission accords the utility a presumption of prudence that the challenger must overcome by making a threshold showing sufficient to raise an implication that the company has not acted prudently. Only if Staff makes that initial showing successfully does the burden of proof shift to the company to show that its conduct was, in fact, prudent.

In the steam complaint case that I referred to a moment ago, for example, AG Processing overcame that presumption of prudence by showing that for the years under consideration GMO had forecast natural gas usage far in excess of the actual amounts it used to produce steam, with the result that GMO hedged a great deal more gas than it needed.

The leading Commission case in this area of prudence is reported at 27 Public Service Commission New Service 183. That case is in the matter of the Union Electric Company. Issued on March 29, 1985, it concerned the construction of the Callaway nuclear plant by Union Electric Company, now known to us as Ameren Missouri.

At page 193 of that decision the Commission stated, quote, the existence of $2 billion in cost overruns raises doubts as to prudence in this case. The very magnitude of the cost overruns was sufficient to rebut the presumption of prudence.

In the present case, it is Staff's position that the existence of $14.9 million of hedging losses over an 18-month period raises doubts as to prudence. The magnitude of the hedging costs, like the magnitude of the cost overruns at Callaway, raises the initial showing of improvidence sufficient to rebut the presumption or prudence.

In this case, Staff points to a number of areas where Staff believes GMO has never managed its affairs shrewdly, where Staff believes GMO has not been cautious in the face of risk. These are GMO's lack of sufficient efficient generation capacity of its own and its resulting over-reliance on spot market purchased power, the misleading accounting practices that you've heard from Mr. Fischer, its use of cross hedging with financial instruments based on natural gas to mitigate purchased power price risk, and passing hedging costs to ratepayers through its fuel adjustment clause contrary to the controlling tariff language.

Staff has long taken the position that GMO lacks sufficient capacity of its own to serve its native load, and that it is consequently overly reliant on purchased power. Staff witness Lena Mantle says as much in her testimony in this case.

In responding to Staff's DR 58, Mr. W. Edward Blunk, a GMO witness, stated, quote, GMO is heavily reliant on purchased power to serve its load. In 2010 GMO purchased more power than KCP&L and Union Electric combined, about twice as many megawatt hours as Empire District Electric Company, end quote.

It is noteworthy in this respect that GMO did not add any capacity at all to its fleet between 1981 and 2005, a period of nearly 25 years. Now, it is true, GMO does own capacity that it does not generally operate, and that's because the capacity in question is inefficient and it costs too much to run in the current market, and GMO can obtain power more cheaply on the spot market, which is what it has, in fact, been doing. That unused capacity amounts to about 95 megawatts.

However, it is Staff's position that GMO needs not just more capacity but more efficient capacity, efficient capacity that can produce power at a low cost per kilowatt hour.

Because GMO is overly reliant on purchased power, GMO is particularly exposed to on-peak spot market purchased power price volatility. In response to Staff DR 58, GMO's witness Edward Blunk again states, quote, GMO has a significant exposure to the volatility of the power market, close quote.

In that same response, Mr. Blunk notes that KCP&L, Union Electric and Empire combined supply only about 7 percent of their total energy requirements with purchased power. We've heard Mr. Fischer tell us that for GMO the figure is 40 percent, 40 percent compared to 7 percent.

GMO's overexposure to spot market purchased power price volatility constitutes Staff's first charge of imprudence in this case. That exposure would not exist but for GMO's lack of adequate efficient generation resources of its own.

GMO hedges not only its purchased power price risk but also the natural gas that it uses to fuel a portion of its generation fleet. I note that Staff has not raised any question whatsoever about the cost of the hedging for the natural gas fuel, which is a modest amount by comparison to the amount spent to hedge the on-peak spot market purchased power price volatility.

But GMO accounts for both types of hedging in the same account, an account intended for fuel costs, not purchased power costs. You heard Mr. Fischer explain that. Why is Staff concerned with that? Why does Staff care? Because it misrepresents the cost of purchased power. The cost of purchased power includes the money spent to hedge price risk for purchased power. Consequently, those costs need to be booked to the purchased power account, FERC Account 555, not the fuel account, 547.

GMO cross hedges its purchased power price risk. A cross hedge, as you've heard from Mr. Fischer, is a risk mitigation device in which the risk in one sort of investment is hedged by a position in another. In this case, GMO hedges on-peak spot market purchased power risk by investments in natural gas. The theory is that if purchased power prices rise on the spot market, natural gas prices will rise, too, so that when GMO liquidates its natural gas position, the gain realized from that transaction will mitigate the increased cost paid for the purchased power.

The effectiveness of this hedging strategy is totally dependent on the degree of correlation between natural gas prices and the on-peak spot market purchased power price. And you heard Mr. Fischer pay a great deal of attention to exactly that point.

It is Staff's position that there are many factors that influence the spot market price of electricity and that this sort of hedging is inappropriate when viewed in the context of Staff's long, ongoing concern about GMO's lack of efficient capacity and overexposure to spot market price volatility.

We might change our insurance example a little bit away from the fire insurance, you pay an amount every year for fire insurance. Your house doesn't burn down. You've lost the money you paid on the premium, but you've mitigated the possibility of a catastrophic financial disaster, the burning down of your house, right?

Okay. But what GMO is doing is slightly different. It says if GMO has a house with no roof, and what they've done is they've paid somebody to come out whenever it looks like it's going to rain to throw a tarpaulin over the house. Staff believes that, instead of that, GMO needs to put a new roof on the house. GMO needs to build or buy efficient generating capacity. Instead of playing games and running risks, unnecessary risks on the spot market, GMO needs to put a new roof on its house by building adequate efficient generating capacity. That has been Staff's position with respect to this company, whatever you might call it, for many years.

It is important to note that Staff is not opposed to hedging. A well-designed and thoughtfully implemented hedging program is a good and prudent thing, just like that fire insurance on your house. Such a hedging program certainly does not always result in positive gains. In fact, it cannot. It cannot.

But remember, with fire insurance you're paying a small premium to mitigate a much larger loss. In this case, GMO has spent $15 million over 18 months to mitigate a risk that it has itself equated at about $40 million. That's a lot to pay. It's Staff's opinion that this insurance is too costly by far.

In 2005 GMO implemented a hedging program referred to as the one-third program. You've heard Mr. Fischer mention that. Under that program, one-third of GMO's expected power requirement was hedged with natural gas futures contracts to lock in a price. Another third was hedged with options to cap the price, and the remaining third was not hedged at all but floated with the market. GMO's purchased power requirements were forecast annually, July of every year I believe, and an equal portion of the requirement then was hedged every month.

The program was purposefully market insensitive. It was not a gamble in the sense of playing the market to find financial returns. It was implemented regardless and without any concern with respect to what the market was doing at any given time.

Staff criticized that program as being overly rigid, and as a result, in 2007 a Stipulation & Agreement was executed in which GMO agreed to forego recovery of 11 and a half million dollars it had lost in its hedging program in 2006 in exchange for immunity from prudence review of all hedge positions that existed as of Mary 27, 2007.

Some of those hedge positions were liquidated in the review period in this case, and that accounts for the movement of Staff's recommendation from the original 18 million to the 14.9 million that staff agrees is at issue now. What was removed and thereby reduced that amount by 3 million was the costs of hedges that Staff had agreed would not be subject to prudence review in that Stipulation & Agreement.

In 2007, GMO turned to Kase & Company to design a new hedging strategy. And I might point out that we've heard Mr. Fischer talk about what did Staff know and when did Staff know it. And certainly before 2007 Staff was very well aware that GMO was engaging in cross hedging of its on-peak spot purchased power risk. Staff knew about it and Staff didn't like it.

When the Kase & Company hedging program was brought in in 2007, Staff was not aware that the hedging of the on-peak purchased power risk continued under that program. Staff was not aware that the purchased power hedging continued when the new hedging program was put into place.

The Kase hedging strategy was implemented in October of 2007. It relies upon proprietary software, Easy Hedge and Hedgemaster. As much as two-thirds of GMO's forecast requirements may be hedged under the two programs.

Hedgemaster is a statistical program that places defensive hedges when prices move into a high zone and takes advantages of opportunities when prices move into a low zone and does nothing at all when prices remain in a neutral zone in between.

Easy Hedge, on the other hand, places hedges based on business cycles, analysis of business cycles, and Easy Hedge tends to hedge whatever amount has been committed to it. I gather that the proportion of requirements that are hedged under the two programs changes from time to time. It's not one-third Hedgemaster, one-third Easy Hedge, but it changes from time to time.

Easy Hedge, like Hedgemaster, also acts to take advantage of opportunities offered by low prices. That's an important consideration because natural gas prices collapsed after mid 2008, from nearly $13.66 per MMBtu in I believe July of 2008 to $2.50 by August of 2009, a precipitous and rapid price decrease.

The hedge positions that resulted from the losses under review in this case, as far as I know, as far as I can tell, were all taken after March 27, 2007, and they were all driven, as far as I can tell, by the Kase & Company hedging program, not by the old one-third program.

That program, I believe, responded to the collapse of natural gas prices by taking advantage of what appeared to be opportunities presented by precipitously falling prices, but these were not opportunities because the prices never went back up. They haven't gone back up yet. They were not opportunities. They were instead an opportunity to lose a lot of money, which is what happened.

Once again, GMO's hedging program even under the Kase & Company strategy has turned out to be overly rigid and unthoughtfully implemented. The program did not protect ratepayers from upward price volatility but, in fact, significantly increased the price paid for spot market purchased power. We believe the only conclusion you can reach is that the program was imprudent.

Finally, Staff points out that GMO's fuel adjustment clause tariff nowhere states that hedging costs for on-peak spot market purchased power shall be flowed back through the fuel adjustment clause to the ratepayers. Under the filed tariff doctrine, the tariff language is the law. It is binding on the company. It is binding ratepayers. It is binding on the Commission. It is the law.

Let me say that in the process of preparing this case and conducting discovery and getting this case ready to bring to you today, there has been only cooperation between the Staff and the company. We took depositions about two weeks ago in Kansas City and were afforded every courtesy by the company and its employees, for which we are very grateful. And they took depositions here sometime before that, and we made every effort to provide every courtesy as well.

I want to make it clear that there is no animus, there is no secret agenda, there is no reason that this case is here other than the fact that it is a statutorily required prudence review and Staff believes that the amount of the hedging costs in and of themselves show that there has been imprudence, and upon inquiring further, more closely, Staff has found several areas of concern which I have just outlined to you.

I can tell you that both the Staff and the company eagerly await the Commission's decision and guidance. We want to know what you think about these issues, both for the Staff and for the company for future behavior. The company wants to know if it should continue to engage in these hedges or if it should change its activities in some respect. The Staff wants to know what you think about these areas of concern that we've pointed out, are they okay, should we forget about them, or are they something that need to be addressed?

Thank you very much for your attention.

JUDGE STEARLEY: Thank you, Mr. Thompson. Before you sit down, Commissioner Stoll, do you have any questions for Mr. Thompson?

COMMISSIONER STOLL: No, not at this time.

JUDGE STEARLEY: All right.

MR. THOMPSON: Thank you.

JUDGE STEARLEY: It appears we have no other party to give an opening. We've been going for not quite two hours yet, but why don't we go ahead and take about a ten-minute intermission. We'll come back and begin with witness testimony.

(A BREAK WAS TAKEN.)

(GMO EXHIBIT NOS. 8, 9 AND 10 WERE MARKED FOR IDENTIFICATION.)

JUDGE STEARLEY: We are back on the record.

MR. FISCHER: Judge, over the break I was able to obtain an order -- or a certified copy of the Order Clarifying Report and Order in the Aquila case, Case No. ER-2007-0004, and I've given a copy to the court reporter, and I'd ask that it be admitted into the record.

JUDGE STEARLEY: Okay. Are there any objections to the admission of that exhibit?

MR. THOMPSON: No objection, your Honor.

JUDGE STEARLEY: It shall be admitted and received into the record.

(GMO EXHIBIT NO. 10 WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: Mr. Fischer, you may call your first witness.

MR. FISCHER: Yes. GMO would call Dr. C.K. Woo, please, to the witness stand.

(Witness sworn.)

JUDGE STEARLEY: Thank you. Please be seated. And you may proceed, Mr. Fischer.

C.K. WOO testified as follows:

DIRECT EXAMINATION BY MR. FISCHER:

Q. Please state your name and business address for the record.

A. My name is C.K. Woo, W-o-o. The address is 101 Montgomery Street, M-o-n-t-g-o-m-e-r-y, Suite 1600, San Francisco, California. The zip code is 94104.

Q. Are you the same C.K. Woo that caused to be filed in this particular proceeding direct testimony that has been for your information marked as Exhibit No. 8 and surrebuttal testimony which has been marked as Exhibit No. 9?

A. Yes, I am.

Q. Do you have any corrections or changes that you need to make to that testimony?

A. No, I do not.

Q. If I were to ask you the questions that are contained in those written documents today, would your

answers be the same?

A. Yes.

Q. And are they truthful and accurate to the best of your knowledge and belief?

A. Yes, they are.

MR. FISCHER: Judge, at this time I would move for the admission of GMO Exhibit No. 8 and GMO Exhibit No. 9, and tender the witness for cross-examination.

JUDGE STEARLEY: Any objection to the admissions of Exhibits 8 and 9?

MR. THOMPSON: No objection, your Honor.

JUDGE STEARLEY: They shall be received Aden admitted into the record.

(GMO EXHIBIT NOS. 8 AND 9 WERE RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: And cross-examination.

MR. THOMPSON: No questions from Staff.

JUDGE STEARLEY: No questions. Any questions from the Bench? Commissioner Stoll, any questions for this witness?

COMMISSIONER STOLL: No.

JUDGE STEARLEY: Well, Mr. Woo, you've made record time on your testimony. I appreciate your coming. There are no cross-examination questions for you.

Consequently, Mr. Fischer, there will be no redirect.

MR. FISCHER: Unfortunately, Judge.

JUDGE STEARLEY: Mr. Woo, you may step down.

THE WITNESS: Am I excused?

JUDGE STEARLEY: You are excused as a witness.

THE WITNESS: That's got to be record time for me. I did not know that I can be that fast.

MR. FISCHER: Judge, he can be excused if he needs to be; is that correct?

JUDGE STEARLEY: He can be finally excused.

MR. FISCHER: Okay. Thank you.

THE WITNESS: Thank you.

JUDGE STEARLEY: Thank you, Mr. Woo.

THE WITNESS: Thank you very much.

JUDGE STEARLEY: All right. Mr. Fischer, you may call your second witness.

MR. FISCHER: Judge, at this time we'd call to the stand William Edward Blunk.

(Witness sworn.)

JUDGE STEARLEY: Thank you, you may be seated. And, Mr. Fischer, you may proceed.

(GMO EXHIBIT NOS. 1NP AND HC, AND 2NP AND HC WERE MARKED FOR IDENTIFICATION.)

WILLIAM EDWARD BLUNK testified as follows:
DIRECT EXAMINATION BY MR. FISCHER:
Q. Please state your name and address for the record.
A. My name is William Edward Blunk, and my business address is 1200 Main Street, Kansas City, Missouri.
Q. And who are you employed by?
A. Kansas City Power & Light Company.
Q. Are you the same Edward Blunk that caused to be filed in this proceeding certain direct and surrebuttal testimony?
A. Yes.
Q. I believe for your information the testimony on your direct has been marked as Exhibit No. 1NP, and your surrebuttal testimony has been marked as Exhibit No. 2, highly confidential and NP versions. Do you have any -- I'm sorry. You also have an HC version on the Exhibit 1, the direct.
Do you have any corrections that need to be made or changes that need to be made that haven't already been included in those documents?
A. I have a couple of corrections to my direct testimony.
Q. Okay. Would you go through those at this

time?

A. On page 9, line 2 should read, power risk been included in GMO's cost of service, question. Line 3 should read, answer: In Case No. ER hyphen. And line 4, I would strike the word as.

And on page 18, at line 25, the open paren, No. 1, close paren, should be replaced with the word thousand, and the word hours should be plural.

Q. Any other changes you need to make?

A. No. That's it.

Q. If I were to ask you the questions that are contained in Exhibits 1 and 2, would your answers be the same today?

A. Yes.

Q. And are they accurate and, to the best of your knowledge and belief, correct?

A. Yes.

MR. FISCHER: Judge, then I would move for the admission of Exhibits 1 and 2, the NP and the HC versions, and tender the witness for cross.

JUDGE STEARLEY: Any objections to the admission of Exhibit 1 and 2 for GMO?

MR. THOMPSON: No objections.

JUDGE STEARLEY: They shall be admitted and received into evidence.

(GMO EXHIBIT NOS. 1 AND 2 WERE RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: And, Mr. Thompson, cross-examination?

MR. THOMPSON: Thank you, Judge. With your leave, I'll cross from here --

JUDGE STEARLEY: That's quite fine.

MR. THOMPSON: -- rather than from the podium. Thank you.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Nice to see you again, Mr. Blunk.

A. Mr. Thompson.

MR. THOMPSON: I have an exhibit I'd like to have marked. And this is Schedule TMR-3 from the testimony of Tim Rush, I think the surrebuttal.

(STAFF EXHIBIT NO. 4 WAS MARKED FOR IDENTIFICATION.)

BY MR. THOMPSON:

Q. Okay. Mr. Blunk, have you ever seen this document before?

A. Briefly, yes.

Q. Briefly. Okay. Do you have any reason to doubt whether or not it's accurate or truthful?

A. No.

Q. Okay. If you would take a look at page 1

of 2, in the very first column there are dates. Do you see that?

A. Yes.

Q. And if you look down, oh, a little bit below the middle of the page there's one cell that has the date October of '07. Do you see that?

A. Yes.

Q. I wonder if you could read the entry in the second column opposite the date October '07.

A. Implemented Kase hedging program.

Q. Now, do you have any reason to doubt that the Kase hedging program was implemented in October of 2007?

A. It would have been in that time period. The program was developed in June/July '07. I don't remember the date of the first hedge.

Q. Okay. So you don't remember the date of the first hedge, so you have no reason to question the date here; is that correct?

A. Correct.

MR. THOMPSON: Okay. Another exhibit, if I may approach.

(STAFF'S EXHIBIT NO. 5 WAS MARKED FOR IDENTIFICATION.)

MR. THOMPSON: And this is Schedule WEB-5 which is out of Mr. Blunk's testimony.

BY MR. THOMPSON:

Q. Mr. Blunk, have you seen this document before?

A. Yes, I have.

Q. Now, was this attached to your direct or your surrebuttal?

A. This was attached to my direct.

Q. Okay. And as far as you know, it's accurate and correct?

A. There was a version -- my original filing had an error, and we filed a correction.

Q. What was that error?

A. I don't remember exactly. There were a couple of numbers that didn't tie up.

Q. I don't mean to put you on the spot. It's just this is the version I plan to use, and I want to know what part of it should not be relied on. Well, there's several columns on this page; isn't that correct?

A. Yes.

Q. And would you agree with me that the column headed F is a compilation month by month of those hedge transactions which are excluded from consideration by virtue of the immunity afforded by the Stipulation & Agreement?

A. Yes.

Q. Okay. And so the transactions which are at issue here would then appear in column G; isn't that correct?

A. Yes.

Q. And if you know, are any of those numbers inaccurate or wrong?

A. No. To the best of my knowledge, those are correct.

Q. Okay. So am I correct in understanding that all of those transactions were placed under the Kase hedging strategy?

A. Yes.

Q. Okay. None of them were placed under the one-third strategy?

A. That's correct.

Q. In fact, the ones that were removed by virtue of the stipulation, those are the last remaining hedge transactions placed by the one-third strategy; isn't that correct?

A. That is correct.

MR. THOMPSON: Okay. I'd like to offer Staff Exhibits 4 and 5 at this time.

JUDGE STEARLEY: Any objections to the offering of Staff Exhibits No. 4 and 5?

MR. FISCHER: Judge, I would just note that is a highly confidential document, and I would request that it be maintained that. I don't have -- I don't have an objection. I think we did update it with a correct version that was attached in the testimony, but I think for purposes of cross, it's fine.

JUDGE STEARLEY: It will remain highly confidential, and these two exhibits will be received and are admitted into the record.

(STAFF'S EXHIBIT NOS. 4 AND 5 WERE RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: And I'm going to count on the parties to inform me if the testimony starts getting into highly confidential matters so that we can go in-camera, and it will also be the parties' responsibility to clear members out of the gallery if they should not be hearing highly confidential information.

MR. FISCHER: Judge, on that topic, I would just note that in the original Staff Report, the original disallowance of 18.8 million or .9 million was declared -- was marked as highly confidential. The company does not consider that to be highly confidential at this time, nor does it consider the current Staff disallowance of 14.9 million to be a confidential number.

JUDGE STEARLEY: All right. Very good.

Thank you. You may proceed, Mr. Thompson.

MR. THOMPSON: Thank you.

BY MR. THOMPSON:

Q. Now, Mr. Blunk, you have testified in the past on the volatility of the natural gas market; isn't that correct?

A. Yes.

Q. And, in fact, you've testified as to the volatility of the natural gas market in Case No. HC-2010-0235, did you not?

A. Yes.

MR. THOMPSON: Okay. If I may approach?

JUDGE STEARLEY: You may.

BY MR. THOMPSON:

Q. Let me show you a document, Mr. Blunk, that I printed out from the Commission's EFIS system last night. Do you recognize that document?

A. It appears to be my direct testimony from Case HC-2010-0235.

Q. And is that, in fact, the Ag Processing versus GMO complaint that I referred to in my opening statement?

A. Yes.

Q. And what was the date of that testimony, if you see that date anywhere?

A. October 22, 2010.

Q. Now, if you look at the document I handed you, there's a flag on one page. I think it's page 24. Do you see that?

A. Yes.

Q. And there's a paragraph that starts at line 7. I think it's marked with ink. Do you see that?

A. Yes.

Q. Could I ask you to read that paragraph, please?

A. Natural gas in December 2004 was about $6.83 per MMBtu. In December 2005 it reached a peak of $15 and 300 -- 378 per MMBtu. Then it dropped to $4.12 per MMBtu in September 2006. These moves represented a price spike of 125 percent followed by a decline of 73 percent. By July 2008, natural gas had returned to $13.58, but then dropped 82 percent to $2.508, a price level that the markets had not seen since March 2002. In the first nine months of 2010, the price for natural gas has ranged from $3.651 to 6.009.

Q. Thank you very much.

JUDGE STEARLEY: Mr. Thompson, when you're at the table, if you could please use your microphone.

MR. THOMPSON: I will. Pardon me, Judge.

JUDGE STEARLEY: That's all right.

MR. THOMPSON: If I could recapture that from you. Thank you, sir.

(STAFF EXHIBIT NO. 6 WAS MARKED FOR IDENTIFICATION.)

BY MR. THOMPSON:

Q. Now, Mr. Blunk, this is another schedule from your testimony. Perhaps you recognize it.

A. Yes.

Q. And this is your Schedule WEB-12?

A. Yes.

Q. And do you recall, was this attached to your direct testimony or to your surrebuttal?

A. This is attached to my surrebuttal.

Q. Okay. And am I correct in understanding this graph to show the trend of natural gas prices between January of 2007 -- or excuse me. Well, is that January of 2007?

A. That is January 2007.

Q. And going until April of 2012?

A. Yes.

Q. Okay. So that would encompass the review period that we're here to talk about, would it not?

A. Yes, it would.

Q. And it would also encompass the period when those transactions were placed, would it not?

A. Yes, it would.

Q. Okay. I have yet another version of this for you.

(STAFF EXHIBIT NO. 7 WAS MARKED FOR IDENTIFICATION.)

BY MR. THOMPSON:

Q. Now, Mr. Blunk, this is your Schedule WEB-12 that I've taken the liberty of drawing on to show the recovery period. Do you see that?

A. Yes.

Q. Or what purports to be the recovery period. And I've also drawn a line that purports to show the date March 27, 2007. Do you see that?

A. Yes.

Q. So assuming for purposes of cross-examination, if you would, that I've managed to put those lines at the correct spots --

A. Yes.

Q. -- would you agree with me that we have, therefore, designated the volatility of the natural gas market during first the period when the transactions at issue in this case were placed, the hedges, and also the review period itself?

A. Volatility is typically measured using daily prices, and the Schedule WEB-12 represents monthly settlement prices.

Q. Okay.

A. That would be a difference between this and the testimony you had me read out of HC-2010-0235.

Q. Okay. But this chart minus the additions I've put on it is, in fact, your chart, is it not?

A. Oh, that's true.

Q. Is it inaccurate in some way?

A. No, it's not inaccurate.

Q. Okay. And monthly settlement prices, do they have some relationship to daily settlement prices?

A. These would represent as a monthly settlement price, it is the average of the last 30 minutes of trading on the closing date for each contract. So it represents 30 minutes of trading each month.

Q. Okay. Now, in the excerpt that I had you read, you described a precipitous decline in natural gas prices starting in 2008; is that not correct?

A. That's what I recall, yes.

Q. Okay. And this figure, as well as Staff Exhibit 6, which it's based on, also shows that; isn't that correct?

A. Staff Exhibit 6 is?

Q. Is your chart without my drawing on it.

A. Oh, yes.

Q. You agree that they show that decline?

A. Yes. They both show a decline from mid '08 through about mid '09.

Q. Okay. And that was during the period when the hedges that we're concerned with here were being placed; isn't that correct?

A. Yes.

Q. And isn't it true that the Hedgemaster software is designed to take advantage of opportunities indicated by falling prices?

A. Yes. Actually, the correct reference to the program is Hedge Model.

Q. Hedge Model. I'm sorry.

A. But yes, it does take advantage of falling prices.

Q. Okay. And isn't it true that Easy Hedge does as well?

A. They both do, yes.

Q. Okay. Now, in your direct testimony on page 26, you indicate that under the Kase hedging strategy, one-third of the volume is not hedged at all?

A. That is true.

Q. And that's similar, is it not, to the prior one-third program?

A. Yes. That third is left unhedged because, in addition to price risk, we have volume risk, and that is the primary means we deal with volume risk is by leaving that one-third unhedged.

Q. And so the volume, how is that determined?

A. Volume?

Q. In other words, the volume that you require, your predicted requirements, how is that determined?

A. We project the requirement using the company's Midas model to look at how much we're expecting load to be, and based on our projection for fuel requirements and then also our projection for on-peak purchased power requirements, we use the market implied heat rate on the on-peak purchased power requirements, convert that to MMBtu equivalent and sum those two numbers and it creates a total volume, natural gas volume that we will hedge.

Q. Okay. And that's revisited regularly, is it not?

A. Yes.

Q. In fact, is that revisited on a daily basis?

A. Not daily, but we do revise those projections monthly.

Q. Okay. Now, up to two-thirds of the

projected volume is hedged using either Easy Hedge or Hedge Model or a combination of the two; isn't that correct?

A. Yes, up to two-thirds.

Q. But it's not always two-thirds?

A. Correct.

Q. And how is that determined?

A. Both Hedge Model and Easy Hedge are market sensitive, and they will only trigger based on how the market is moving. So I'll use Hedge Model because it's a little easier to describe. Hedge Model essentially defines three different pricing zones, when prices are high, when prices are normal, and prices are very low. And as you move through those pricing zones, it will trigger various actions.

For example, in this part where there is a decline as we're looking at the prices are trending down, it will take a very small bite. It will take just a few percentages of the requirements are purchased on a day. You'll wait. Then it will take another bite. You'll wait. You take another little bite, and then you wait another month, because if prices are trending down, you want to let them go down as long as they can.

And once it reaches a point where it looks like the market has kind of found a new normal on the low, it might not place any hedges for a while because it's just basically waiting. In fact, on the way down, the most you would place of that two-thirds, the most you'd place would be maybe half, maybe. It depends how long it takes it to get down.

Q. Okay. And does the percentage that is hedged under Hedge Model and the percentage hedged under Easy Hedge, does that change from time to time?

A. The split between Hedge Model and Easy Hedge is an 80/20 split. The two models will trigger differently. So if you look at the total volume that's actually hedged under the programs, that might vary. But we have decided as just a matter of strategy that of the projected volume, 80 percent is committed to Hedge Model and 20 percent is committed to Easy Hedge.

Q. And those two softwares are proprietary to Kase & Company; is that correct?

A. Yes.

Q. Now, on page 27 of your direct testimony, you talk about the merger of the GMO and KCP&L hedging programs. Do you see that?

A. Yes.

Q. And you indicate that volume drivers particular to each company or peculiar to each company were maintained. What are those volume drivers?

A. The main difference is that KCPL does not have the purchased power price risk that GMO does, so KCPL does not hedge purchased power. It does not take the purchased power that it -- it does not convert it into natural gas. GMO on the other hand does, and so the purchased power risk is included in GMO hedge volume.

Q. Take a look at page 17 of your direct. Now, you were present for the opening statements by Mr. Fischer and myself; is that correct?

A. Yes.

Q. And Mr. Fischer stated that the cross hedging of on-peak spot market purchased power price risk is done entirely to protect ratepayers; isn't that correct?

A. Yes.

Q. If you would, read the question that starts on line 13 of page 17 of your direct testimony.

A. Why does GMO cross hedge spot electricity price risk with natural gas futures and options?

Q. And the answer that starts on line 15, just the first sentence.

A. The simple answer is liquidity.

Q. Okay.

A. Now, this is referring to a case --

Q. That's sufficient. Thank you.

MR. FISCHER: Counsel, what page was that reference to?

MR. THOMPSON: Page 17 of direct testimony.

MR. THOMPSON: Thank you.

(STAFF EXHIBIT NO. 8 WAS MARKED FOR IDENTIFICATION.)

BY MR. THOMPSON:

Q. Mr. Blunk, this is also out of your testimony. Your testimony has been a useful companion.

A. Thank you.

Q. This is your Schedule WEB-18. Do you see that?

A. Yes.

Q. But it is, in fact -- or it is also, I should say, Staff's DR 0058; isn't that correct?

A. Yes.

Q. And this was a DR propounded to you by Staff that you responded to; is that correct?

A. Yes.

Q. Okay. I wonder if you'd take a look at question No. 1 and the response thereto, the very last sentence of that response, I wonder if you could read that.

A. If yes, please describe GMO's knowledge of these activities.

Q. Okay. Maybe I'm not making myself -- do you see your response, there's a paragraph labeled 1?

A. Yes.

Q. Okay. And under the bold paragraph there's a paragraph in normal typeface and a sentence that begins with the phrase "in other words".

A. You're referring to the last sentence of the answer?

Q. That's the one.

A. In addition to --

MR. THOMPSON: Well, if I may approach?

JUDGE STEARLEY: You may.

BY MR. THOMPSON:

Q. I can point it. I apologize. That one right there (indicating).

A. Okay.

Q. I wonder if you can read that sentence.

A. In other words, while GMO lost $1.80 per megawatt hour power purchase in 2008, AIC lost $18.15 per megawatt hour.

Q. Am I correct in understanding that hedge costs added $1.80 to the price of every megawatt of power that GMO purchased in 2010? Is that what that sentence means?

A. That I think is correct.

Q. Okay. If you look down at the very bottom of that first page, there's an answer headed three. Do you see that?

A. Yes.

Q. Why does GMO hedge its purchased power?

A. Yes.

Q. I wonder if you could read the first sentence or the first two sentences of the response on the following page?

A. GMO purchases 3.5 million to 3.9 million megawatt hours of power to serve its load at a cost of 120 to $135 million per year.

Q. Okay. And the next sentence?

A. Those purchases represent about 40 percent of GMO's energy requirements.

Q. Would you agree with me that that represents a significant exposure to the volatility of the power market?

A. Yes, it does.

MR. THOMPSON: At this time I'd like to move the admission of Staff Exhibits 6, 7 and 8.

JUDGE STEARLEY: Any objections to the admission of Staff Exhibits 6, 7 and 8?

MR. FISCHER: No objection.

JUDGE STEARLEY: Hearing none, they are

admitted and received into the record.

(STAFF EXHIBIT NOS. 6, 7 AND 8 WERE RECEIVED INTO EVIDENCE.)

(STAFF EXHIBIT NO. 9HC WAS MARKED FOR IDENTIFICATION.)

BY MR. THOMPSON:

Q. Now, this is a highly confidential exhibit that did not come from your testimony, but rather was prepared by Lena Mantle of the Staff. I wonder if you've seen that document before?

A. Is this the same as the schedule in Ms. Mantle's testimony?

Q. Yes, it is.

A. I have seen it.

Q. Okay. And do you have any reason to doubt the accuracy of the figures depicted on that schedule?

A. No.

MR. THOMPSON: I would move the admission of Staff Exhibit 9.

JUDGE STEARLEY: Any objections to the admission of Staff Exhibit No. 9?

MR. FISCHER: No objection.

JUDGE STEARLEY: Hearing none, it shall be admitted and received into the record.

(STAFF EXHIBIT NO. 9 WAS RECEIVED INTO

EVIDENCE.)

MR. THOMPSON: And I have no further questions for Mr. Blunk. Thank you.

JUDGE STEARLEY: Any questions from the Bench for this witness, Commissioner Stoll?

COMMISSIONER STOLL: No.

JUDGE STEARLEY: Mr. Blunk, I have a couple.

QUESTIONS BY JUDGE STEARLEY:

Q. If you could explain a little bit more for all of us non-accountants, with regard to the hedge settlements, if I'm understanding correctly, GMO is linking a futures derivative transaction with a physical transaction?

A. Yes. That is basically how you construct a hedge.

Q. That's how you construct a hedge. And how often do these settle then?

A. The hedges themselves would settle -- well, the futures contract is going to settle monthly. You buy into it. So, for example, for August of 2009, we had 39 -- or 32 different purchases, but it had one day of settlement. So that one day of settlement is when we close out the positions.

Q. And when you close it out, are there

different ways it can be closed out?

A. Yes. You can close out at any time you want basically after you made the purchase, you can liquidate the position any time after that. When we have a change in volume, we will close out early. In fact, you see some of that showing up in some of my schedules where I refer to positions that were closed early. That's what I'm referring to is that we were adjusting for our volume changes, so we closed those early.

But typically since we are a hedger, our intent is to protect that future price. So, for example, again referring to August 2009, if we placed a hedge in July 2008, we would hold that hedge until we get right up against August, and then we would get out of the position with the idea we're trying to protect August 2009.

Q. How does that protect the August 2009 price?

A. The way it would work is, again using the example that I was just working on, you would buy a futures contract in this example in July 2008, and right at the end of July 2009, the August 2009 futures contract -- I know that sounds a little confusing, but the August delivery month is what it's referring to. So it's saying for gas that would be delivered in August 2009, that contract would expire three business days before you have to start shipping gas under it.

So we would buy in July 2008. We would sell out of that futures position right at the end of August. In essence, at that time we would have a gain or a loss, basically a bucket of money, and that bucket of money then would protect us for whatever happened in the cash market, be it the price went up or down. They would offset each other.

Q. So how is the bucket of money used in the settlement?

A. When you settle the hedge?

Q. Uh-huh.

A. When you settle the hedge, that's where you accumulate what I'm referring to as a bucket of the money. So the settlement is, you have purchased the futures and you sell it, and the sale price you get, that difference between the two is your settlement.

Q. So that could be potential gain or loss?

A. Yes.

Q. Okay. Are there times when you execute the futures contract and buy gas at that price that you mentioned?

A. You could. We do not because futures gas is delivered in Erath, Louisiana, Henry Hub, and for us to transport gas from Henry Hub to the Kansas City areas, it can be done. It's just it's a lot easier to buy gas locally. And so we don't take physical delivery.

Q. Okay. So hedge is used solely to protect the natural gas price of where you're buying it here locally, the local distributor?

A. Yes.

JUDGE STEARLEY: Okay. Thank you. Any other questions from the Bench?

(No response.)

JUDGE STEARLEY: All right. Any recross based on questions from the Bench?

MR. FISCHER: Yes, Judge. Oh, I'm sorry.

JUDGE STEARLEY: We'll get to redirect in just a few minutes.

MR. THOMPSON: No recross.

JUDGE STEARLEY: Now you may redirect.

MR. FISCHER: Okay. Thank you, Judge. I jumped ahead here.

REDIRECT EXAMINATION BY MR. FISCHER:

Q. Let's go to Judge Stearley's questions there at the end and make sure I understand what you're saying. He was asking how often you settle. Do you recall that?

A. Yes.

Q. Would you explain whether you wait 'til the

monthly settlement date to deal with these natural gas futures contracts?

A. Generally we do.

Q. Okay. Would you explain that -- how that process works and how that -- because you're dealing with an hourly electric price, how that would be important?

A. Well, generally the settlement is the sale price of the contract. The purchase price varies continuously throughout the day and across the whole time that the contract's been traded. So the purchase price of August 2009 gas has been varying for almost seven years continuously. So the purchase price is whenever you bought it at -- whatever price you bought it at. It varies.

The settlement price is the point at which the NYMEX brings to a close that futures contract, and if you will, it's essentially a touch point of where the futures market and the cash market come together. They essentially have to converge at some point for the whole thing to work. And that settlement price is that point of convergence where futures and cash come together, and that's why it is a single price.

It's used a lot of times in analysis, but it is the average of the last 30 minutes of trading on the exchange for that contract.

Q. But the electric prices vary hourly throughout the month; is that right?

A. Yes, they do.

Q. Well, how does a monthly natural gas settlement help you hedge the hourly prices?

A. Well, it comes back to, one, you've got multiple pieces happening. One as I was referring to, on the purchase side your price is moving on gas just like the electricity price is moving. It's moving all the time.

The settlement, what you're looking for when you make a hedge is you've bought a futures, you've sold a futures, and the gain or loss from that is what I'm referring to as this bucket of money. That bucket of money is then used to offset whatever was happening in the cash or the physical market.

So if I can go to my Schedule WEB-9, I think it's a little easier to talk from a picture. On Schedule WEB-9, which is part of my surrebuttal, I illustrate how this works with real numbers. And what you see in essentially the cell that I call B1, which is under the column labeled physical market, you see where it's showing that GMO needed 982,000 megawatt hours. It needed that for August. Well, that's what it needs on average. And then to offset that need, it went out to the futures market and bought 793 contracts of natural gas. So those two volumes are essentially equivalent, 982,000 megawatt hours versus 793 contracts. We had a need. We bought a futures contract.

Then it comes time when we actually really do need that electricity, so we go out and first we would sell the futures contract. That happens right at the end of the month before. And you can see on the column that I labeled C under futures market, it says sell. That's saying we sold 793 contracts at a value of $4.34, and we have a loss of $14 million, which this is roughly equivalent to the 14.8 that everybody's been referring to.

On the physical market side, you see that we come in, we buy electricity, but we're buying at a price much lower than what we thought we were going to have to pay. So we experienced a real gain of $12.8 million. That's how they work. They sync up with each other.

Q. So is that a real world example of what I was talking about in the opening where the gains and losses offset each other?

A. Yes. These are real GMO numbers. They don't exactly sync to the 14.8 because I took out some of the more complicated hedges, but this is what we're looking at. It's showing how the offset and how you buy one, sell the other, and then you reverse it.

Q. Would that roughly equate to the $1.80 that Mr. Thompson was referring to per megawatt hour or not?

A. Well, if you only looked at the futures side, you get to the $1.80 or something like that, but if you recognize both sides of the hedge, there is really no adjustment.

Q. Well, did you do an analysis of that $1.80 effectively and whether that was a reasonable cost for the insurance that you were buying to cover the risk of the electric price spikes?

A. I did. But if you'd like to go back to the one schedule that Mr. Thompson gave me from Ms. Mantle's testimony, that would be an easy place just to even eyeball it without even going into my own testimony of schedule where it's --

Q. That's Schedule 9, I believe.

A. This one (indicating).

Q. Yes.

A. In the lower right-hand corner you'll see it refers to total purchases and it says total purchases, the dollar cost was on average $26.86. Well, $1.80 of $26 is less than 10 percent. And where I live, sales tax is almost 9 percent. So what's a reasonable amount to pay for this insurance? Industry rule of thumb, as long as you're less than 30 percent, you've done well. We've done very well.

Q. At the time of settlement, has the company decided whether it will purchase power in the following month or whether it will generate electricity?

A. No.

Q. Okay. I'd like to go to Exhibit No. 7 that the Staff put in front of you that had the NYMEX natural gas contract settlement price chart or graph. Do you have that?

A. Yes. Is that the one labeled Schedule WEB-12?

Q. Yes. Mr. Blunk, where on that chart did Katrina happen?

A. Katrina was in '05, wasn't she? I don't remember exactly.

Q. What happened in August of 2008 where the spike began, if you know?

A. I'm sorry. I'm not remembering the event.

Q. Okay. Do you recall if the Commission's natural gas price volatility mitigation rule was adopted after the Katrina event?

A. Well, the Commission issued a joint report that was following, I believe it was Katrina and Rita, and that was -- the report came out in 2006 because they have a picture of it on the front cover.

Q. Do such events affect electricity or natural gas prices?

A. Yes.

Q. In what way?

A. Well, for example, the hurricanes, they led to a spike in the price of natural gas, and since natural gas is the primary on the margin fuel, if your primary on the margin fuel is going up, then the market price for electricity is going to follow it. And natural gas is always the cause, a primary cause for what's driving the price of electricity in Southwest Power Pool.

Q. Would you expect that if Katrina hit the natural gas fields in New Orleans, that that would affect your margin on electricity cost?

A. Oh, it definitely would. It definitely would, because it would so impact the price for natural gas that it's going to in turn, since that is primary -- the fuel for the on-peak power in Southwest Power Pool, it's going to drive up the price for electricity.

Q. Did you expect Katrina to hit New Orleans?

A. Well, not before 2005.

Q. Do you expect the hurricane to hit New Orleans this year?

A. I don't personally, no.

Q. Do you think it's wise to have some insurance in case electricity prices would spike for some reason?

A. Yes.

Q. You were asked a question about your direct testimony on page 17, and you were asked to read into the record, I think, the first sentence regarding simply to liquidate or liquidity?

A. Yes.

Q. Would you explain what that reference relates to?

A. Putting it in context, this is testimony from Case No. ER-2007-0004, and it is testimony referring to why GMO would choose to use cross hedges as opposed to trying to use an electric forward contract to hedge price risk. It's also worth noting that that testimony was in a case that first introduced GMO's fuel clause.

But liquidity is the reason why you would choose to cross hedge instead of just signing a contract with another electricity provider. If you just sign a contract with another electricity provider, you'd still get price insurance, but getting out of that contract should your volume change, you're going to have to sell, shall we say, at a loss because that other person, they don't -- it's not a good secondary market. So you have to pay a consequence to get out of the contract.

Q. Would you turn to the next page of your testimony that continues to discuss that topic.

A. Yes.

Q. Are there other reasons listed there that would suggest that using natural gas futures contracts rather than these other financial tools makes good sense?

A. Yes, there are. I mean, liquidity is a very big one. The natural gas market, it trades a factor of, I don't know for sure, like 30 times the actual volume of gas. It's very liquid. You can easily get in. You can get out. Basically no penalty for doing that. There is credit party risk. If I signed or if the company signed a bilateral contract with another counter party, we'd have to worry about their credit risk.

The futures exchange, when you purchase a futures contract, your counter party is technically the exchange itself or the NYMEX. The NYMEX is guaranteed by the clearing members, and the clearing members include a large number of very financially strong institutions, large banks, large players in the industry. They have and have maintained very high credit ratings.

Another value is simply the volume you can deal in. If I use NYMEX futures, we can take a very small bite. For example, one contract is the equivalent of nearly 1,000 hours of electricity. And if we did a bilateral contract, I probably couldn't fine tune it.

Maybe take a larger quantity or lesser quantity. Again, if we had to adjust the volumes, which we do have to adjust volumes from time to time, making that adjustment if it's a contract, a bilateral contract, as the buyer, I'm essentially going to pay a price to make the change. On the futures exchange, I mean, the broker fee in this stuff is insignificant, so there's no penalty.

Q. If you're going to use financial instruments to hedge your electricity price risk, do you know of any better financial instrument than the natural gas futures NYMEX?

A. No, not for what we're dealing with.

Q. Does any of this discussion that you have here on page 17 or 18 suggest that the company isn't hedging to protect customers?

A. The purpose of our hedging program really is to protect customers. The fuel clause, the customer is the one that bears the energy market risk. So all the hedging is for the benefit of the customer. There is no benefit to the company of any of this hedging. There is no benefit to the company.

Q. So you're indifferent whether you -- if the Commission says don't cross hedge anymore, what would be

the company's response?

A. We would probably stop hedging, hedging altogether. There's no -- the company has no benefit from employing this hedging program. It is strictly for the benefit of the customer.

Q. Does the company -- does Kansas City Power & Light Company, to your knowledge, hedge in Kansas?

A. No. We do not hedge in Kansas because in Kansas KCPL has a fuel clause. Again, when there's a fuel clause in place, the hedging is for the benefit of the customer. There is no benefit to the company for a hedge program. There's no motive, no benefit, no reason to do it.

Q. But again, do yo know if Katrina's going to hit again this year?

A. No, I do not if Katrina or Rita's going to hit.

Q. Mr. Thompson asked you a number of questions about the Kase program and the Hedge Model and Easy Hedge. Do you recall those?

A. Yes.

Q. Would you explain to Commissioner Stoll and Judge Stearley just how this Kase program works, in layman's terms?

A. Yes. Probably the easiest thing to do is talk from a picture again. I guess this is Schedule 9, my graph. It's a little easier to see from the picture. In general, what the Kase hedge program is doing is it is creating a moving average. Is there a way I can draw, draw a picture?

JUDGE STEARLEY: Well, we could use the ELMO. Have you got some paper perhaps he could draw on and display it up there?

MR. FISCHER: Mr. Blunk, if you'd go to the machine over here, we'll give you a piece of paper, and I believe the Judge in his magic can project it onto the wall.

JUDGE STEARLEY: We'll see about that.

MR. FISCHER: Or if you want to put that on there and draw on that, that will work, too.

THE WITNESS: Okay.

MR. FISCHER: Judge, can you see this from your vantage point?

JUDGE STEARLEY: I can. It's a little gray, but we can see it.

BY MR. FISCHER:

Q. Go ahead, Mr. Blunk. Please explain your answer.

A. You've seen this chart. You've seen the line which it was essentially the market price for gas, and while these are monthly prices, we assume these are daily because we track this daily.

What I've drawn, if you will, I've drawn kind of a thick line that kind of follows more like the moving average. So the middle line, which kind of goes through the middle, from the Kase hedge program we would consider something about where the prices are more or less at as a normal price.

If it's just moving a little bit today or tomorrow, you might not do anything. But if a price gets outside of a range, so, for example, it would cross this line, we'd say prices are running away. We need to have done something to protect ourself. Under the Kase hedge program, it would say you probably should buy a few caps, unless you don't need gas in that period. It's really looking out and saying prices that spike like that, that spike is only going to last six, maybe nine months. And if it's not going to come in and affect you, don't do anything. Just ride it out.

On the other hand, we would come in and this is saying, oh, well, that's probably a very opportunistic price. We want to buy into that. We want to take a little bite, buy into it, take another bite, buy into it and see if prices go down and continue to ride them down.

So if you think of it as a high price zone, a low price zone and a middle zone, in the middle zone where it's just kind of like normal day-to-day stuff, you might not place any hedges because it does cost money to place a hedge. But it it's going high, you're going to do things to protect yourself. If it's going low, you're going to take advantage of that opportunity and you're going to ride it down.

Q. Mr. Blunk, is the Kase program then market insensitive?

A. No. It's very market sensitive. It is giving a lot of consideration to the market. In fact, the Kase program -- well, going back to the joint report of -- you might not have a copy of it, but in 2006 there was a report done by -- it's called the Joint Report on Natural Gas Market Conditions, PGA Rates, Customer Bills and Hedging Efforts of Missouri's Natural Gas Local Distribution Companies.

I referred to it in my testimony. That report identified things that it thought were important in a hedging program. One of them was that it needed to give consideration and have flexibility to react to markets, and the Kase hedge program does that. In fact, of the various bullets that that report identifies, the Kase program lines up best of any program that I know of.

Q. Do you still exercise professional judgment even though you have Kase?

A. Yes, we do. Those lines that I drew, those are based on statistics, and they tell us this might be a good time to trigger. Just because we have a trigger doesn't mean we'll go out and place a hedge.

We are in constant consultation with Kase, who is the provider of the program, and every time we have a trigger, we talk to them, because that -- the triggers are statistical. I mean, it's kind of like any kind of test, you might get a false reading. So we discuss with them their interpretation and is that consistent with what we know about the market based on things we read in the marketplace and what we're knowing about the market.

Q. Are you trying to outguess the market?

A. If I could truly outguess the market, I might not have to be in this seat.

Q. When prices for natural gas plummet like they did during this period, what do you typically expect would happen with electricity spot prices?

A. It will follow the gas prices down.

Q. Is that a bad thing for consumers?

A. Oh, no. Oh, no. In fact, that's what we saw and I showed in my Schedule WEB-9 was that the price of gas came down on the futures side, the price of electricity came down on the cash or physical market side.

Q. If Katrina or Rita or something like that had hit during this period, would you have expected natural gas prices to have fallen?

A. Oh, no. No. If a major hurricane had gone through -- gone through the gas-producing region of the Gulf like Katrina and Rita did, it would have driven gas prices up.

Q. From the shareholder perspective, assuming that you have an FAC in place, do you care if a Katrina hits?

A. As a share -- well, from the company's perspective, its risk goes through the fuel clause, so no. As a ratepayer, I'm a GMO ratepayer, I do care.

Q. You care very much?

A. I do.

Q. Okay. Talking about the Kase program, how does Kase differ from a cost averaging program perhaps like a one-third program?

A. Under the one-third program, and that's probably -- the market neutrality portion of the one-third program versus Kase, under that market neutrality piece, what Aquila was doing was -- and I'll exaggerate to illustrate the point. I don't know the exact pieces of it. But it's like as if on the second Tuesday of every month they bought 1/12 of whatever the requirement was, and whatever the market was, they triggered on that, which is why Mr. Hyneman referred to it as a very rigid program, and it was. The way that was implemented, if it was the second Tuesday of the month, you did what you had to buy.

Under the Kase program, it doesn't give consideration to that. It's looking at what's happening in the marketplace? Are prices trending up or are they trending down? And depending which way they're going affects what acts you will take. It will affect the level of action you will take.

So the two are very different in that the, what we've referred to as the one-third program being market neutral is very rigid, very, very locked in, but Kase is not.

Q. Would you explain under the Kase program when you would typically make decisions on when to hedge or whether to hedge and how that would work?

A. The Kase hedge program as we're employing it looks out up to three years, which again is consistent with what the recommendations in the joint report said. The joint report said you should look out three years or more. We're looking out three years.

Most of our hedges are not placed three years in advance. Only if -- you remember I showed when the prices are low, it's in the low price zone, and when they are really low prices, then we'll look out three years and we'll place them. If they're high prices, we don't want to lock into those for a long time.

So on average, it looks like that Kase triggers -- and this is simple average over what's happened. It's not a way to read the rules, but just on average, based on what's happened, we tend to place hedges about 11 to 12 months out. That's an average.

Q. Could you build a power plant in 11 or 12 years, a coal plant like Iatan 2?

A. 11 or 12 years?

Q. I mean 11 or 12 months?

A. No. No, we could not build a coal-fired power plant in 11 months.

Q. Are you likely to be able to secure significant amounts of capacity for 11 months out?

A. You couldn't construct it that quick, no.

Q. If the company had built generation, natural gas or otherwise as suggested by Mr. Thompson, would the company continue to hedge as it does today?

A. Yes, and I discussed that in my prefiled testimony. If the company had built gas-fired generation or, as Ms. Mantle kind of implies, purchased Aries, which is now known as Dogwood, we would have employed the same hedges. We probably would have had the exact same hedge volume. We would have used Kase. We would have had exactly the same hedge adjustment. It would look just exactly the same to the ratepayer, except for the cost of capital, which cost of capital does not go through the fuel clause.

Q. And that's because that's a natural gas fired plant?

A. Yes.

Q. Okay. When you make the decision to hedge your expected purchased power, do you know at that point what your generation fleet is and do you have any control about what that generation fleet, how that's going to change in 12 months?

A. No. I don't have control over as I make the hedge program, no.

Q. So as a decision-maker, under the circumstances that you know at the time, you know what the generation is, what your capabilities are?

A. Yes.

Q. And what your spot purchased power requirements are likely to be?

A. Yes. We have projections of those things. We know what our capacity is, our fleet is, and we projected what we think are fuel requirement is and what we think we will then supplement it with out-of-the-market purchases are.

Q. Going back to your Schedule WEB-9 that you referred to earlier, the real life example of what the physical market gain was and what the futures market loss was.

A. Yes.

Q. There is under that table a dollar offset ratio of 109.6 percent?

A. Yes.

Q. What does that show?

A. That 109.6 percent is dividing the 14 million by the 12.8 million. And what that is showing is how well did the actual hedges that were placed in the futures market, how well did they project the risk that we had in the physical market. And at 109.6 percent, that suggests this is a very good hedge. The guidelines established consistent with a variety of parties, and we've referenced several of them, implement -- well, not implementation, but accounting firms and applying FASB's rules, commodity futures trade exchange, they are all suggesting that anything between an 80 percent and either 120 or 125 percent represents a good hedge, and that fits very nicely inside that bound.

Q. But isn't that a hindsight review? You

knew what happened now?

A. Oh, yes, this is hindsight. We know exactly what happened at this point.

Q. When you put in these hedges, did you know what was going to happen?

A. No, we did not know. We had to rely on historical correlation analysis.

Q. That's what you relied on, correct?

A. Yes.

Q. When natural gas prices are falling like they did in this case, would you expect to have some losses in the hedging program or not?

A. If you're only looking at the derivative side, yes.

Q. Is that necessarily a bad thing from your perspective?

A. No. It just simply could be indicating the hedge worked as designed, because when you put a hedge in place, you are essentially saying I'm going to lock into a price, and the way you lock into a market that you cannot control or you can't get a contract for is you go to the futures market, and the two are moving in parallel. So all the gains I have on one side will offset the losses on the other or all the losses on the other will offset the gains. The issue is, at the end of the day, you're coming to essentially a net zero.

Q. Well, if natural gas prices are going the other way, would you expect -- and they're skyrocketing, like apparently they did in October of '08 and then again in October of 2010 --

A. Yes.

Q. -- what would you expect electric prices to be doing?

A. They also would skyrocket.

Q. Now, on the derivative side, what would you expect in your hedging program?

A. The natural gas futures contracts would have a significant gain. In other words, we'd make a lot of money there. That would fill my little bucket of money that I keep referring to, and I can then use that bucket of money to offset what's happened on the cash or the physical market for electricity. I've got all this, if you will, this insurance proceeds to help pay for this now higher price electricity.

Q. Well, since you had all those gains, is that a good thing?

A. I don't know if you'd say it's good or bad. It's -- you need to take the two, and the two of them wash each other out.

Q. So the company's indifferent, is that what

you're saying?

A. Yes. Doesn't matter to the company.

Q. The Staff seems to suggest -- well, strike that.

Gas prices that are the low level today, the $2, $3 range, would you still recommend the Commission continue to hedge or not?

A. Oh, yes. Yeah. The Kase program is going to help us exercise how we do that, but we're looking at historically low gas prices, and as a buyer, I'm looking if I want to lock something in, I want to lock in low prices. So this is really an optimal time to be hedging. I would want to continue the program that would allow us to lock in these lower prices, and how far we can carry them in the future remains to be seen, but this is -- this is a good time to be hedging, good time to be placing hedges, which is consistent with how our program works. Identifies these low prices and we'd be placing hedges.

MR. FISCHER: Judge, I think that's all I have. Thank you very much.

JUDGE STEARLEY: All right. That concludes redirect. You may step down, and thank you for your testimony, Mr. Blunk.

We are at about 11:35. Do the parties wish to start the next witness testimony or do you want to break for lunch at this time?

MR. FISCHER: We can do it either way. Whatever your preference, Judge.

JUDGE STEARLEY: Do you know how much cross you might have for Mr. Heidtbrink?

MR. THOMPSON: Very little.

JUDGE STEARLEY: Let's go ahead and call him, then.

(GMO EXHIBIT NO. 5 WAS MARKED FOR IDENTIFICATION.)

SCOTT H. HEIDTBRINK testified as follows:

DIRECT EXAMINATION BY MR. STEINER:

Q. Please state your name for the record.

A. Scott Heidtbrink.

Q. Where are you employed?

A. Kansas City Power & Light.

Q. Did you cause to be filed direct testimony which I believe has been marked, premarked as Exhibit 5, GMO Exhibit 5 in this case?

A. I did.

Q. Do you have any corrections to that testimony?

A. Just a couple. At the time my position was senior vice president of supply, and as of June 1st it's the company's executive vice president and chief operating officer.

And then on page 3, line 4, where it says, it has been part of GMO's retail cost of service, instead I would say, it has been recorded above the line since 2005.

Q. If I were to ask you the questions that are contained in Exhibit 5, would your answers be the same today?

A. Yes.

MR. STEINER: I would move for the admission of GMO Exhibit 5 and tender the witness for cross-examination.

JUDGE STEARLEY: Any objections to the admission of Exhibit No. 5 for GMO?

MR. THOMPSON: No objections.

JUDGE STEARLEY: All right. It shall be admitted and received into the record.

(GMO EXHIBIT NO. 5 WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: You may conduct your cross-examination.

MR. THOMPSON: No questions. Thank you.

MR. THOMPSON: That was very quick. Questions from the Bench, Commissioner Stoll?

COMMISSIONER STOLL: No questions.

JUDGE STEARLEY: I have no questions. There will be no recross. And I'm presuming, Mr. Fischer, no redirect.

MR. FISCHER: No.

MR. STEINER: That's correct.

JUDGE STEARLEY: You may step down, Mr. Heidtbrink.

THE WITNESS: Thank you.

JUDGE STEARLEY: I appreciate your testimony.

Mr. Thompson, I would ask the same question regarding Mr. Clemens, do you anticipate a lengthy cross-examination of him?

MS. McLOWRY: It isn't lengthy. We can go ahead.

JUDGE STEARLEY: Let's go ahead and call Mr. Clemens to the stand.

(Witness sworn.)

(GMO EXHIBIT NO. 4 WAS MARKED FOR IDENTIFICATION.)

JUDGE STEARLEY: You may be seated. And you may proceed, Mr. Fischer.

GARY L. CLEMENS testified as follows:

DIRECT EXAMINATION BY MR. STEINER:

Q. Please state your name for the record.

A. Gary L. Clemens.

Q. And by whom are you employed?

A. I'm self employed, utility consultant.

Q. Did you cause to be filed what's been premarked as GMO Exhibit 4 in this proceeding?

A. Yes.

Q. Which is your surrebuttal testimony?

A. Yes.

Q. Mr. Clemens, do you have any corrections to that surrebuttal testimony?

A. Yes, one correction. On page 3, line 16, says in the middle of the sentence $2.55 per kilowatt hour. That should say $2.55 per MCF. That's the only correction.

Q. If I were to ask you the same questions that are contained in GMO Exhibit No. 4, would your answers be the same today?

A. Yes.

MR. STEINER: I would like to move for admission of GMO Exhibit No. 4 and tender the witness for cross.

JUDGE STEARLEY: All right. Any objections to the admission of GMO Exhibit No. 4?

MS. McLOWRY: No objection.

JUDGE STEARLEY: Hearing none, it shall be

received and admitted into the record.

(GMO EXHIBIT NO. 4 WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: Cross-examination by Staff.

CROSS-EXAMINATION BY MS. McLOWRY:

Q. Good morning, Mr. Clemens.

A. Good morning.

Q. In 2004 when Aquila was developing its hedging program, it looked at different alternatives; that's true?

A. Yes.

Q. And you were working at Aquila at the time?

A. Yes.

Q. What was your position at Aquila?

A. I was director of staff -- of regulatory services.

Q. And you were involved in looking at different hedging alternatives at that time?

A. I was not involved in looking at those alternatives.

Q. Do you know whether your superiors when they were looking at those alternatives, whether they looked at different types of commodities?

A. No, I do not.

Q. Mr. Clemens, you gave a deposition in this case last month, didn't you?

A. Yes.

Q. Do you have a copy of that deposition with you?

A. Yes.

Q. Can you please turn to page 9 of that deposition? Prior to that deposition being taken, you were sworn in by the court reporter; that's true?

A. Yes.

Q. Okay. And you took that same oath today?

A. Yes.

Q. And you had an opportunity to review this deposition?

A. Yes.

Q. Okay. I'm going to read from your deposition. Starting at line 9 I asked, did you consider hedging with any other commodities? You said, answer: I was involved in those decision -- in those decision-making, what they decided to use, but there are other alternatives, but that was the one that was chosen.

Question: Do you know who would have been in charge of deciding this?

Answer: Most likely it was Andy Fortee out of -- that would have been one of the decision-makers on

that. He was in the risk fuels department.

Question: Okay. Do you know if at that time Aquila considered building generation as a hedge for purchased power?

Answer: They looked at all alternatives.

Okay. Did I read that correctly?

A. Correct. There was -- I did provide an errata sheet to the Commission. On page 9, 11, it said I was not involved in that decision. The word not was left out. That was in my errata sheet.

Q. Okay. Would you agree that from 1981 through the time South Harper was built in 2005, Aquila did not build any generation?

A. Correct.

Q. Did at that time, between 1981 and 2005, Aquila have a philosophy not to build regulated generation?

A. Aquila chose to go purchased power contracts. We had an opportunity to go into a long-term contract with NPPD, Nebraska Power, which provided very low capacity cost for Aquila in place of building a power plant.

Q. So there was a philosophy not to build regulated generation?

A. That was the decision made.

Q. Do you have a copy of the 2005 Stipulation & Agreement in Case No. ER-2005-0436?
A. No.
MS. McLOWRY: May I approach the witness?
JUDGE STEARLEY: You may.
MS. McLOWRY: Here's a copy of the Order and the Stipulation & Agreement's attached.
MR. STEINER: Do you have an extra copy?
MS. McLOWRY: I actually don't.
BY MS. McLOWRY:
Q. On that Order it states the effective date is March 1st, 2006; is that correct?
A. Yes.
Q. Were you involved in drafting the Stipulation & Agreement?
A. Yes.
Q. I want to point your attention to paragraph 17 on page 10. That paragraph's entitled Accounting Authority Order; is that correct?
A. Correct.
Q. And that paragraph reads, the signatory parties agree, for accounting and ratemaking purposes, that hedge settlements, both positive and negative, and related costs, e.g., option premiums, interest on margin accounts and carrying costs on option premiums, directly

related to natural gas generation and on-peak purchased power transactions under a formal Aquila Networks-MPS hedging plan will be considered part of the fuel cost and purchased power costs recorded in FERC Account 547 or Account 555 when the hedge arrangement is settled. These hedging costs will continue to be recorded on a mark to market basis, as required by Financial Accounting Standard No. 133, with an offsetting regulatory asset FERC Account 182.3 or regulatory liability FERC Account 245 entry that recognizes the change in the timing of value recognition under Financial Accounting Standard No. 71. Aquila agrees there will be no rate base treatment afforded to hedging expenditures recorded on the mark to market basis. Aquila agrees to maintain separate accounting in Accounts 547 and 555 to track the hedging transaction expenditures recorded under this agreement. I

Did I read that correctly?

A. Yes.

Q. Did Aquila draft this language?

A. We did.

Q. And FERC Account 547 is the account representing fuel; is that true?

A. One of the accounts that's required for fuel. 501 is also for fuel, but it's coal.

Q. And FERC Account 555 represents purchased

power?

A. Correct.

Q. So you agree that hedge settlement for hedges designed to mitigate price exposure for natural gas generation by GMO would be recorded in Account 547?

A. Could be, yes.

Q. Mr. Clemens, would you agree with me that Aquila did not engage in purchased power hedging in any other regulated jurisdiction from 2004 until the merger?

MR. STEINER: Objection. Lack of foundation.

JUDGE STEARLEY: Counsel?

MS. McLOWRY: I'll just go ahead and lay a foundation.

BY MS. McLOWRY:

Q. Mr. Clemens, in your position at Aquila, would you be aware of purchased power hedging in other regulated jurisdictions that Aquila did?

A. I was in charge of the Missouri operations only. We had other people in charge of our Kansas and Colorado operations, and I don't know the details of those other jurisdictions.

MS. McLOWRY: I have no further questions.

JUDGE STEARLEY: All right. Any questions from the Bench for this witness? Commissioner Stoll? I have no questions, so there will be no recross. Redirect, Mr. Steiner?

MR. STEINER: Briefly.

REDIRECT EXAMINATION BY MR. STEINER:

Q. Mr. Clemens, you were asked by counsel whether purchased power costs should be booked to Account 555, and I believe your answer was it could be; is that correct?

A. I thought she said 547.

Q. Okay. And that was your answer, it could be?

A. 547 -- fuel costs would always go to 547. Any gas costs go to 547, and coal would go to 501.

Q. I believe her question was related to hedges for purchased power costs, could those be booked in either 547 or 555?

A. They would be booked in 547 because it's a cost of natural gas. That's the gas that's purchased. There is a time when you would actually maybe purchase a -- I think there's instance where you may go out and purchase electricity, like if you could go out in the market and get electricity and actually buy kilowatt hours, you would charge it to 555.

But in all of our cases, we've always bought natural gas as a cross hedge. That would always go to, in our case, 547.

MR. STEINER: Thank you.

JUDGE STEARLEY: All right. You may be excused. Thank you very much for your testimony.

All right. Are you anticipating a lot of cross for Mr. Bresette?

MS. McLOWRY: Yes. It will be more lengthy.

JUDGE STEARLEY: All right. Why don't we go ahead and break at this juncture for lunch, and we will return and go back on the record about 1:20.

(A BREAK WAS TAKEN.)

(GMO EXHIBIT NO. 3 WAS MARKED FOR IDENTIFICATION.)

JUDGE STEARLEY: We are back on the record and continuing with witness examination. Mr. Fischer, Mr. Steiner, if you'd please call your next witness.

MR. FISCHER: The company would call Ryan Bresette to the stand.

(Witness sworn.)

JUDGE STEARLEY: Please be seated. And you may proceed.

RYAN BRESETTE testified as follows:

DIRECT EXAMINATION BY MR. FISCHER:

Q. Please state your name and address for the

record.

A. Ryan Bresette, 1200 Main Street, Kansas City, Missouri.

Q. Are you the same Ryan Bresette that caused to be filed in this case certain surrebuttal testimony that's been marked as Exhibit 3, an HC version and an NP version?

A. Yes.

Q. Do you have any changes or corrections that you need to make in that testimony?

A. No, I do not.

Q. If I were to ask you the questions contained in that document, would your answers today be the same?

A. Yes.

Q. And are they accurate and correct to the best of your knowledge and belief?

A. Yes, they are.

MR. FISCHER: Judge, then I would move for the admission of Exhibit 3HC and 3NP and tender the witness for cross.

JUDGE STEARLEY: All right. Are there any objections to the admission of Exhibit No. 3 from GMO?

MS. McLOWRY: No objections.

JUDGE STEARLEY: Hearing none, it shall be

received and admitted into the record.

(GMO EXHIBIT NO. 3NP AND HC WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: And you may proceed with cross-examination, Mr. Thompson, or Ms. McLowry.

CROSS-EXAMINATION BY MS. McLOWRY:

Q. Mr. Bresette, you're the assistant controller for KCP&L; that's correct?

A. Yes.

Q. And in your position as the assistant controller, you're responsible for corporate accounting, forecasting and budgeting and margin accounting which includes hedging the company's transaction derivative; is that correct?

A. Yes, it is.

Q. In your position as assistant controller, are you familiar with financial reports of KCP&L?

A. Yes, I am.

Q. How about financial reports of its holding company, GPE?

A. Yes, I am.

Q. Are you familiar with GPE's 10Q quarterly report that was filed on May 3rd, 2012?

A. Yes, I am.

JUDGE STEARLEY: Counsel, I don't mean to interrupt. We have had an issue raised with regard to Mr. Conrad trying to enter an appearance today by phone, and I just received a message from him with a phone number. If I were to pass our phone out, if you could place it somewhere out there and perhaps call this number and we can bring him into the proceeding.

Mr. Conrad, can you hear me?

MR. CONRAD: I can. Thank you, Judge.

JUDGE STEARLEY: All right. Sorry if there was some confusion earlier.

MR. CONRAD: Well, it's probably all engendered on my side because I guess I brought probably what was an old number. Obviously I got the music.

JUDGE STEARLEY: We actually didn't have a call-in number for the evidentiary hearing today. And I'm assuming you're wanting to enter an appearance.

MR. CONRAD: I would like to if that's still possible. I know you've gotten past perhaps the third or fourth witness.

JUDGE STEARLEY: We've gotten -- right. We have gotten through four of GMO's witnesses at this point, and we are starting testimony with Mr. Bresette.

MR. CONRAD: And, Judge, we did not have questions, so that probably makes it easy.

JUDGE STEARLEY: It certainly does. And

let's go ahead and take your entry, and I'm assuming you're entering your appearance for SIEUA and Ag Processing?

MR. CONRAD: That is correct, sir, and that would just be Stew Conrad at Finnegan, Conrad & Peterson, 3100 Broadway, Suite 1209, K.C., Missouri 64111. And obviously either at a later time or something else I can give a sheet to the reporter.

JUDGE STEARLEY: That would be fine. I had one clarifying question for you, Mr. Conrad.

MR. CONRAD: Please.

JUDGE STEARLEY: SIEUA was made party to this case by virtue of the Commission's rules making it an automatic party?

MR. CONRAD: Yes, sir.

JUDGE STEARLEY: That association was composed of a number of entities back in the ER-2007-0004 case, and I just wanted to confirm, I'm assuming it's the same membership today as it was back --

MR. CONRAD: Judge, as far as I know, that is correct. I would have to -- to be honest with you, I would have to go back and look at the 0004 case and see who we had. I think I did that at one earlier time and it looked like it was essentially the same. At least one of the parties has changed the name, and that is

Hayes-Lemmerz is now Maxom, M-a-x-o-m, Wheel. As far as I know, it's the same company.

JUDGE STEARLEY: Okay. At a point of your convenience, if you'd just file something for the record --

MR. CONRAD: I will certainly do that, sir.

JUDGE STEARLEY: -- we'll have that clarified. And with that, you have entered your appearance, and you've stated you didn't have any questions for the prior four witnesses?

MR. CONRAD: Did not.

JUDGE STEARLEY: All right. And we will continue. There's been one question asked by Staff in cross-examination of Mr. Bresette, and we'll continue with cross-examination then at this time.

BY MS. McLOWRY:

Q. I believe we finished with establishing that you know what a 10Q report is and you're familiar with it?

A. Yes.

Q. Okay. I'm going to show you that 10Q.

MS. McLOWRY: May I approach the witness?

JUDGE STEARLEY: You may.

BY MS. McLOWRY:

Q. I'd like to direct your attention to

page 37.

A. Okay.

Q. And that's entitled No. 13, derivative instruments; is that correct?

A. Yes.

Q. I want to direct your attention to the last sentence in the first paragraph that reads, changes in the fair value of derivative instruments are recognized currently in net income unless specific hedge accounting criteria are met, except GMO utility operations hedges that are recorded to a regulatory asset or liability consistent with MPSC regulatory orders as discussed below. Did I read that correctly?

A. Yes, you did.

Q. Is that statement referencing the 2005 Stipulation & Agreement that's been discussed today?

A. Yes. It's referenced on that same page in the last paragraph. It says in, I think it's the third to last sentence, in connection with GMO's 2005 Missouri electric rate case.

Q. Is that the same Stipulation & Agreement that you discussed in your deposition as not being pointblank clear?

A. That is the same Stipulation & Agreement.

MS. McLOWRY: And I apologize, but I have no further questions.

JUDGE STEARLEY: All right. Mr. Conrad, would you have any cross-examination for this witness? Is Mr. Conrad still present?

MR. CONRAD: No, sir. I had to cut off mute. I'm sorry.

JUDGE STEARLEY: That's quite all right. I wanted to make sure we hadn't lost you after we finally got you in here.

Questions from the Bench. Commissioner Stoll? There's no questions from the Bench, so there will be no recross. Redirect.

REDIRECT EXAMINATION BY MR. FISCHER:

Q. Mr. Bresette, counsel for the Staff asked about the 10Q statement and the statement that you had regarding derivative instruments and accounting there?

A. Yes.

Q. Why would you put something like that in the 10Q?

A. The purpose of the statement that's in the 10Q is to show transparency to our -- in the SEC document, to show exactly how GMO hedges and records those financial instruments.

Q. Has that always been the practice of GMO since you've been at the company, to be transparent in

that regard?

A. Yes, since 2008 with the merger, it is.

Q. And counsel asked you about the 2005 Stipulation & Agreement. Do you recall that?

A. Yes, I do.

Q. She referenced that perhaps you made a statement that it wasn't pointblank clear. What would you mean by that?

A. The context of that discussion during the deposition was in regards to the company's interpretation of Staff's recommendation on how to account for the hedging gains and losses, and our interpretation of Staff's recommendation is that we would split the hedge between FERC Account 447 and 555. And the comment I made at the time was that the Order was not pointblank clear on how to account for futures contracts in the Order, and so the company would look to the US of A in that regard on how to account for those.

Q. Based on the US of A and that stipulation, you believe your accounting is reasonable?

A. Absolutely.

MR. FISCHER: I have no further questions.

JUDGE STEARLEY: I did have one question of clarification, I guess.

QUESTIONS BY JUDGE STEARLEY:

Q. You had made reference, Mr. Bresette, in a number of places in your testimony to Account 447, and I just wanted to make sure, because I'm not an accountant, that those were all correct and you weren't referring to 547 which has been a matter of dispute in this case?

A. Yes. The references I make to 447 are in regards to when we sell the derivative back, and that's where the revenue for that transaction would go under Staff's recommendation.

Q. I just wanted to be -- make sure I was clear on that.

JUDGE STEARLEY: Any other questions from any of the parties based on my question of clarification?

MS. McLOWRY: I have one.

RECROSS-EXAMINATION BY MS. McLOWRY:

Q. 447 is known as the sale for resale account; is that right?

A. Subject to check, I believe the FERC description is wholesale revenue.

MS. McLOWRY: Okay. No further questions.

JUDGE STEARLEY: Any redirect on that, Mr. Fischer?

MR. FISCHER: No.

JUDGE STEARLEY: Okay. Thank very much for your testimony.

THE WITNESS: Thank you very much.

JUDGE STEARLEY: You are excused.

THE WITNESS: Thank you.

JUDGE STEARLEY: GMO may call its next witness.

MR. FISCHER: GMO calls Tim Rush to the stand.

(GMO EXHIBIT NOS. 6, 7NP AND 7HC WERE MARKED FOR IDENTIFICATION BY THE REPORTER.)

(Witness sworn.)

JUDGE STEARLEY: Thank you very much. You may be seated, and you may proceed.

TIM RUSH testified as follows:

DIRECT EXAMINATION BY MR. FISCHER:

Q. Please state your name and address for the record.

A. Tim Rush, 1200 Main Street, Kansas City, Missouri.

Q. Are you the same Tim Rush that caused to be filed in this case certain direct testimony and surrebuttal testimony that have been marked as GMO Exhibit 6, direct, and GMO Exhibit 7HC and NP, the surrebuttal?

A. Yes.

Q. Do you have any changes or corrections you

need to make to those pieces of testimony?

A. I do have one change. On page 5, on line 10, I use the statement Account 430.17, and that should read 417.1.

Q. Is that in your direct or your surrebuttal?

A. I'm sorry. It is in my direct. My direct testimony, on page 5, line 10, 430.17 should read 417.1.

Q. Any other changes or corrections?

A. No.

Q. If I were to ask you the questions contained in those pieces of testimony today, would your answers be the same?

A. They would.

Q. And are they true and accurate to the best of your knowledge and belief?

A. Yes, they are.

MR. FISCHER: Judge, with that I would move for the admission of GMO Exhibit 6 and GMO Exhibit 7HC and NP and tender the witness for cross.

JUDGE STEARLEY: All right. Any objections to the admission of GMO's Exhibits 6 and 7?

MS. McLOWRY: No objection.

JUDGE STEARLEY: All right. They shall be received and admitted into the record.

(GMO EXHIBIT NOS. 6, 7HC AND 7NP WERE

RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: Cross-examination. Mr. Conrad, do you have any cross-examination for this witness? Give Mr. Conrad just a moment to unmute.

All right. Staff, you may proceed with your cross-examination.

MR. THOMPSON: No questions. Thank you, Judge.

JUDGE STEARLEY: Mr. Rush, I've got maybe one or two for you.

THE WITNESS: All righty.

QUESTIONS BY JUDGE STEARLEY:

Q. I believe there's been reference to GMO's FACs having gone through four different accounting periods at this point and two prudence reviews; is that correct?

A. We've had two prudence reviews, and previously we've had four six-month periods that are included in that review. We've also had four rate cases during that period of time that would cover this period.

Q. Okay. In those prior adjustment periods, because if I understand correctly we're looking at accumulation periods 5, 6 and 7 --

A. That's correct.

Q. -- for this?

But in accumulation periods 1 through 4,

did the cross hedging produce gains or losses?

A. It had both in those situations. I believe in the first period we had an accumulation of approximately 7 million of losses, which included both cross hedging and hedging associated with the fuel burnt in the generation units. And then in the periods 3 and 4, I believe we showed a slight gain. That would have been in the combination of those two areas.

Q. In those four periods, would you have experienced a net loss or net gain?

A. As I was saying, we would have a net loss in the first two review periods and a net gain in the second two review periods.

Q. Would you know the numbers of those off the top of your head?

A. The split between what was in the purchased power versus what was in the generation side or the total?

Q. The total.

A. I believe it's in the stipulation of the facts that were provided to you, and I believe it was $7 million in the first two periods of loss, and it may have been 2 million gain. I don't remember that.

Q. I believe that's correct, and I appreciate you directing me to that.

A. Okay.

JUDGE STEARLEY: That's all I have. Any questions, Commissioner Stoll?

COMMISSIONER STOLL: No.

JUDGE STEARLEY: All right. Recross based on questions from the Bench?

MR. THOMPSON: None from Staff. Thank you.

JUDGE STEARLEY: Any redirect, Mr. Fischer?

MR. FISCHER: Yes.

REDIRECT EXAMINATION BY MR. FISCHER:

Q. Mr. Rush, you mentioned in answer to Judge Stearley's questions that there have been two prudence reviews and that you had losses in one and gains in the other. Is that what you were saying?

A. I did say that, yes.

Q. In any of those prudence reviews, did the Staff allege that cross hedging using natural gas futures was on its face imprudent?

A. No, they did not.

Q. In any of those cases, did Staff suggest to you informally that they thought it was imprudent?

A. No, they did not.

Q. And you mentioned there were four rate cases?

A. That's correct.

Q. Did Staff in any of those four rate cases

suggest to the company that they believed it was imprudent to cross hedge on its face?

A. No, they did not. Let me clarify. I was not involved with the first two rate cases. They were when it was Aquila, and it had not been acquired by GPE at that point. But in the two I was personally involved with, they did not.

Q. In answer to the Judge's questions, you mentioned that there were some gains and there were some losses. Would that be expected in a hedging program over time?

A. Yes, it would.

MR. FISCHER: I have no other questions.

JUDGE STEARLEY: All right. Thank you very much, Mr. Rush. You may be excused. I believe that concludes all of GMO's witnesses. Staff, you may call your first witness.

MR. THOMPSON: Staff calls Charles R Hyneman.

(Witness sworn.)

JUDGE STEARLEY: You may be seated. And you may proceed.

MR. THOMPSON: Thank you, Judge.

CHARLES R. HYNEMAN testified as follows:

DIRECT EXAMINATION BY MR. THOMPSON:

Q. State your name, please.

A. Charles R. Hyneman.

Q. And how are you employed, Mr. Hyneman?

A. I am a regulatory auditor with the Missouri Public Service Commission.

Q. Mr. Hyneman, did you prepare or cause to be prepared the testimony that has been marked as Staff Exhibit 3?

A. Yes.

Q. And do you have any corrections or changes to that testimony?

A. No.

Q. If I asked you those questions today, would your answers be the same?

A. Yes, they would.

Q. And those answers are true and correct to the best of your knowledge and belief?

A. Yes, they are.

MR. THOMPSON: At this time I would move for the admission of Staff Exhibit 3, and I tender Mr. Hyneman for cross-examination.

JUDGE STEARLEY: Any objections to the admission of Staff Exhibit No. 3?

MR. FISCHER: No objection.

JUDGE STEARLEY: Hearing none, it shall be

received and admitted into the record.

(STAFF EXHIBIT NO. 3 WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: And we have cross-examination.

MR. FISCHER: No questions.

JUDGE STEARLEY: No questions, Mr. Fischer?

MR. FISCHER: No questions.

JUDGE STEARLEY: All right. Is Mr. Conrad still on the line?

(No response.)

JUDGE STEARLEY: Okay. Very well. Mr. Hyneman, I have a couple questions.

QUESTIONS BY JUDGE STEARLEY:

Q. I believe in your testimony you've testified you were one of the auditors working on the 2005 Aquila rate case --

A. Yes.

Q. -- is that correct?

A. I was the Staff's primary auditor for Aquila's hedging program in that case.

Q. For the hedging programs in specific?

A. Yes.

Q. And that is the case ER-2005-0436?

A. Yes.

Q. And that is the case that resulted with that Nonunanimous Stipulation & Agreement containing paragraph 17, which was the Accounting Authority Order?

A. Right. It was Aquila request for an accounting authority order to record its hedging costs was included in the Stipulation & Agreement to that case.

Q. And there's apparently a dispute amongst the parties as to what that language allows in terms of accounting between Accounts 547 and 555; is that correct?

A. Yes.

Q. And I believe in your testimony you've alleged it's your belief that GMO is violating the language of that Accounting Authority Order in the manner in which they've done their accounting; is that correct?

A. That's correct. The language in the Accounting Authority Order is clear, that there's two types of hedging they do, one for on-system generation. They buy the natural gas and they burn it in their plants, and that's fuel, and that's to be recorded to 547. The other hedging they do for purchased power, which is Account 55, should be charged to Account 55, and that's exactly spelled out in this stipulation language.

Q. You believe it's expressly in there?

A. It's clear. And in my testimony at page 23, I underlined the exact statements that makes it very clear that they're required to charge purchased power hedges to Account 555.

Q. All right. As us non-accountants try to wrap our heads around these accounting measures, let me try to summarize a statement and you tell me if this is Staff's position or the company's position.

A. Okay.

Q. Did the signatories to this Nonunanimous Stipulation & Agreement agree that Aquila, which is now GMO, should be permitted to match its natural gas and purchased power hedging transaction settlements and associated hedging costs with the cost of fuel for accounting and ratemaking purposes?

A. Yes, and if I can give the background to that to explain that.

Q. Is that -- my question is, is that Staff's position or is that the company's position?

A. Well, this language allowed them to bring the recording of their hedging transactions. They used to record it below the line because it was designed for their shareholders. So they brought it above the line, but they needed language from the Commission on how to do that. In this case, this is the language that was proposed and ordered by the Commission.

Q. I understand. But did that -- did the

parties agree that Aquila, which is now GMO, should be permitted to match the natural gas and purchased power hedging transaction settlements and associated hedging costs with the cost of fuel for accounting and ratemaking purposes?

A. That statement on its face is not correct. It requires additional language. To match it with the fuel and the purchased power, that would make it a correct statement.

Q. Okay. And I guess I don't see anything in the Accounting Authority Order expressly stating that there's a split between purchased power hedging costs and just natural gas cost for fuel --

A. Right.

Q. -- hedging costs.

A. If I may, and I'll pick up right after the parenthesis premium says, directly related to natural gas generation and on-peak purchased power transactions, and then you drop below a few lines it says, FERC Account 547, which is fuel, which matches with the natural gas generation, then Account 555, which is purchased power, which matches with the purchased power transactions. They sync up there respectively with the language.

And then if you look at the last sentence, it says, Aquila agreed to maintain separate accounting in

547 and 555 and track the hedge settlements. It didn't do any tracking or record any hedge settlements in 555. So that was a clear violation of that sentence, that requirement.

Q. Are you saying that the stipulation doesn't allow them to record the hedging settlement transactions and costs from purchased power as fuel costs?

A. Absolutely not. Purchased power is not a fuel cost. It's separate and distinct. To put hedging for purchased power in a fuel cost account would be to distort the amount that they charge to fuel. It would understate purchased power and overstate fuel. It's bad accounting.

JUDGE STEARLEY: Mr. Thompson, if you'd help me out here. Come forward. I am going to give you a document where I got that language, which is Staff's Suggestions in Support of the Nonunanimous Stipulation & Agreement from ER-2005-0436, and I'd like you to get a certified copy of that document from that filing from that case and file it in this matter as an exhibit.

MR. THOMPSON: Okay. Is this a Commission's exhibit?

JUDGE STEARLEY: You can call it what you will.

MR. THOMPSON: All right, Judge. Thank

you. I asked Mr. Hyneman to explain the statement which has been included in the Staff's suggestions in support of this. If you'd rather Mr. Fischer offer it as a GMO exhibit, I can have him do that as well.

MR. FISCHER: I'd be happy to help the Judge on that. We'd offer that at this time.

JUDGE STEARLEY: If you would get a certified copy of that from the Commission's data center. We'll label that GMO's Exhibit No. 11.

MR. FISCHER: Judge, could you clarify what the number was or the date of the document?

MR. THOMPSON: I'll let you have it.

MR. FISCHER: Thank you, sir.

JUDGE STEARLEY: Mr. Fischer, I believe I don't have -- maybe I wrote it on there. I thought I had the EFIS docket entry number on there, but I may be wrong. But I'll trust you can find that.

MR. FISCHER: We can find it. Judge, the data center can help as well.

JUDGE STEARLEY: Mr. Thompson, I would require your assistance again. I'm going to have you hand Mr. Hyneman this document.

BY JUDGE STEARLEY:

Q. And again, we're trying to get to the clarity of what the language in that AAO was supposed to

mean. Mr. Hyneman, there was the Stipulation or the Nonunanimous Stipulation & Agreement in ER-2005-0436, and that was filed. The Commission held an on-the-record preparation in that case. Did you recall providing testimony in that on-the-record presentation?

A. I do not recall.

Q. If you'd please identify the document that I gave you.

A. Yes. It's a transcript of proceedings, on-the-record presentation, February 9, 2006, for Case No. ER-2005-0436, and that's the Aquila 2005 rate case.

Q. And who were the other auditors that worked on that case, do you recall?

A. I'm aware that Mr. Cary Featherstone worked on the case, but I don't recall any others.

Q. And from what I have read in here, you did not provide testimony?

A. In that case?

Q. At this hearing, at the hearing of the --

A. I do not recall.

Q. And I do not see where you had in here. If you look through and see your name, you can tell me. But I'll direct your attention to page 48 of the transcript, and on line 14 through 18, tell me which witness was called.

A. I believe that's Mr. Schallenberg.

Q. And was he sworn?

A. Yes.

Q. All right. And if you will now jump ahead to page 126, and if you'll glance over lines 1 through 15, the Commission recalled Mr. Schallenberg; is that correct?

A. Yes, it is.

Q. Okay. And they reminded him he was under oath; is that correct?

A. Correct.

Q. I know there's a lot of questioning and junk in here, so I'm trying to get to the page in question and make sure we have the proper witness identified. If you will please turn to page 148, and at the top of that page you'll see questions are being asked by Commissioner Gaw; is that correct?

A. That's correct.

Q. And the first question you can see that he's questioning Mr. Schallenberg still; is that correct? I think you'll see that in lines 2 and 3.

A. Yes, that's correct.

Q. Okay. I just wanted to make sure we're identifying the proper person because it just gives Q and A for questions and answers.

So if you will please flip over to

page 149, starting at line 3, if you will please start reading beginning with that question and then the answer that follow.

A. Question: And I'm going to have to apologize that I have to cut this short here. One other thing. Please explain to me what the Accounting Authority Order does in this case.

Is this the mark to market piece?

Q. And please identify if that's an answer or question.

A. The answer was: Is this the mark to market piece?

Then the question: Yes, I think it is. It's in section 17 of the stip, page 10. It is the mark to market.

Answer: What that does there is an -- in accounting terms it's called FASB 133. If you buy a financial instrument related to a commodity, between the time you buy it and the time it closes or settles you are required to adjust it on your books as to its market value unless it is tied to a physical transaction. In fact, we call FASB 133, it's related to speculation. You're buying financial instruments without having physical transaction, just hoping that the thing will settle in the money or you sell it will while it's in the money. So you're just speculating on a financial transaction without any physical control.

Our utilities, and that would include not only electric utilities but natural gas, under risk management that I'm aware of they tie the financial transaction to the physical transaction. So that if they've agreed to buy a certain amount of gas at a certain time, they have gone and gotten the financial traction to hedge, to hedge that to a price certain. Not that the physical price will fluctuate, but when you look at that and combine it with the financial transaction, it will result in a price that's fixed.

By making that connection, and that's what this portion of the stipulation is, they do not have to adjust their books based on the market value fluctuations of that financial instrument. And so it was designed to, one, allow Aquila to use what's called FASB 171, which is a regulatory one, so they no longer have to do mark to market, and it also makes the connection between the physical transaction and the financial transaction for fuel expense more definite. So it can actually be booked as fuel expense.

Q. Stop right there. Now, is that consistent with Staff's position as to whether or not these hedging costs can be booked as fuel expense?

A. I believe Mr. Schallenberg gave example. Part of it is fuel expense. I don't think he said all-inclusive. I mean, I don't think he addressed the purchased power piece. I don't know if he was aware that Aquila included the purchased power hedges.

Q. Okay. Now, if you will drop to line 25 on the bottom there of page 150, and please start reading again.

A. Now, the practice that's reflected in this agreement is consistent with the practice that's taking place in our other utilities. It's just that their external auditors have not insisted on language in a Commission order to the same extent that Aquila has a requirement.

Q. Please continue.

A. Question: Is that because of the -- that the external auditor has that particular requirement of all the utilities it serves, if you know, or is it because we're dealing with Aquila itself? Is it attributable to Aquila or attributable to the external auditor that this is being made?

Q. Please continue.

A. Answer: It's attributable to the external auditor. Now, whether the external auditor would have a different opinion if it's a different company --

Question: Yes.

Answer: I don't know that.

Question: That's what I'm asking.

Answer: But I will tell you we get different issues from the same external auditor for the same company case after case -- I mean, from different cases. So I can't tell you whether it's an Aquila financial condition issue or it's just the individual auditor.

Question: Okay.

Answer: But I also want to point out, though, this agreement has the benefit of tying the financial instrument as fuel expense so -- and without that, they would actually book the financial instrument in another account, and you would be susceptible to the argument that the financial instrument and the gain will be separated from fuel expense.

Q. And that's the end of the questioning there, isn't it?

A. Yes.

Q. The next statement is, thank you, Mr. Fischer, from Commissioner Gaw. I had you read that because I'm trying to and the Commission's trying to figure out the language in that AAO and the difference in interpretations from the parties, and that's why I asked

you if the language is consistent with Staff's position.

A. Well --

Q. Mr. Schallenberg at the end there seemed to be talking if you didn't tie the expenses of the hedging together with fuel costs, then you could not flow the gains through as fuel costs. Is that a correct summation of what he's saying?

A. Yes, and he's saying a lot of times auditors tie fuel and purchased power together in an audit area. No other utility in Missouri does hedging like this, derivative hedging for purchased power. I believe no other utility in Missouri has ever done hedge accounting for purchased power the way Aquila does. So I'm sure Mr. Schallenberg was saying that most utilities engage in hedging transactions with natural gas for natural gas generation as KCPL does. So whether he specifically did include purchase power, the stipulation did and it's clear. I don't know why Mr. Schallenberg didn't.

JUDGE STEARLEY: All right. Very wood. Any other questions from the Bench?

QUESTIONS BY COMMISSIONER STOLL:

Q. So when you say that they -- I forget exactly how you said it -- but they buy that for the gas to be used by the company rather than using it to be sold

at some point in the future?

A. Yes. Most utilities when they do a hedging transaction for natural gas, they buy a financial instrument, like a NYMEX contract, to protect the volatility of the prices. So if prices go up, they'll have a hedging gain in the financial market, which they can take that cash to offset the increase in price. And they charge that, when they hedge for natural gas, they charge it to the fuel account to reduce the fuel account. And that's what utilities do.

Q. Because they're actually using that to produce the electricity?

A. Yes. Yeah. They're using fuel to produce electricity to generate for their customers and potentially for some off-system sales.

COMMISSIONER STOLL: Okay. Thank you.

JUDGE STEARLEY: Thank you, Mr. Hyneman. Recross based on questions from the Bench?

RECROSS-EXAMINATION BY MR. FISCHER:

Q. Mr. Hyneman, have you ever audited Ameren?

A. No.

Q. The Judge asked you regarding your view about violations of the stip on accounting. Even if GMO recorded the purchased power hedging gains and losses in a different account than what the Staff thought it should be

recorded in, does that make the hedging program itself necessarily imprudent?

A. It's not related to the hedging program itself.

Q. Is it necessarily imprudent, the hedging program, just because it's recorded in a different account?

A. No.

Q. Would you agree that all prudently incurred hedging costs should be recovered by the company?

A. Again, you -- and I think we went through this in the deposition.

Q. We did.

A. Okay. Aquila initiated the hedging the program below the line.

MR. FISCHER: Judge, I'm just asking a simple question. The question is, would you agree that all prudently incurred hedging costs should be recovered by the company.

JUDGE STEARLEY: That's a yes or no answer.

THE WITNESS: I'm sorry. I was tying to be consistent with my deposition. Assuming it -- yes, above the line, it is.

BY MR. FISCHER:

Q. And in addition to the Stipulation &

Agreement that the judge asked you about, the company would also be required to file -- or to follow Generally Accepted Accounting Standards and various accounting standard codifications; is that right?

A. Yes. This Accounting Authority Order is Generally Accepted Accounting Principles.

Q. Prior to March 21st of 2012, the date I think you filed your rebuttal testimony, had you recently reviewed the accounting standards codification topic 815 on derivatives in hedging?

A. I reviewed FAS 133, which I believe has been translated into the new ASC number.

Q. And that accounting standard codification addresses how the preparers of financial statements are required to record the changes in fair value in the financial instruments on their financial statements; is that your understanding?

A. Yeah, for KCPL. For GMO, they would have the Accounting Authority Order under FAS 171, which would guide how they would record it on their financial records.

Q. When was the first time that you reviewed ACS topic 815 on derivatives in hedging?

A. I think it was promulgated in 1998. I may have looked at it over the years.

Q. When was the last time you remember

reviewing it?
A. Probably today.
Q. So prior to the time you filed your rebuttal testimony, you had not recently reviewed that topic?
A. I think Mr. Bresette brought the FAS 133 issue into this case. I think upon reading his testimony is when I reviewed it again, because FAS 133 really doesn't apply to this case.
Q. Is that the first time you reviewed ACS topic 815, after you read Mr. Bresette's testimony?
A. Again, I reviewed FAS 133, which I believe is the same document as the ASC 815 you referred to, but I'm not sure.
Q. You don't remember reviewing that particular document, topic 815?
A. No. I remember reviewing FAS 133.
Q. Is it correct that you did not consider ACS topic 815 when you made your recommendation in this case since you hadn't reviewed that particular standard prior to Mr. Bresette's testimony?
A. That standard does not apply to this case. Aquila's requirement for accounting purposes under FAS 171, which is GAAP, is spelled out in the Stipulation & Agreement, the Accounting Authority Order, not under

FAS 133, and that is --

Q. My question to you, Mr. Hyneman, is is it correct that you did not consider ACS topic 815 when you made your recommendation in this case?

MR. THOMPSON: Objection. Asked and answered.

MR. FISCHER: Judge, he never answered the question.

JUDGE STEARLEY: I didn't hear it.

MR. THOMPSON: He stated that it was not applicable.

MR. FISCHER: That's not the question, Judge.

JUDGE STEARLEY: It's a yes or no question, counsel. I believe Mr. Hyneman can answer with a yes or no.

THE WITNESS: Could you repeat the question?

BY MR. FISCHER:

Q. Yes, sir. Is it correct that you did not consider ACS topic 815 when you made your recommendation in this case since you had not reviewed that accounting standard prior to the filing of Mr. Bresette's testimony?

A. Yes.

MR. FISCHER: That's all I have, Judge.

JUDGE STEARLEY: All right. And, Mr. Fischer, if you would also please get a certified copy of the transcript from the on-the-record February 9th, 2006 in ER-2005-0436, and offer that as an exhibit.

MR. FISCHER: Okay.

JUDGE STEARLEY: This will be Exhibit No. 12 for GMO.

MR. FISCHER: What page numbers was that, Judge?

JUDGE STEARLEY: You can just file the entire copy, but the language I was reading from I believe came from pages -- or that I had Mr. Hyneman read from, pages 148 through 152, and I believe that is EFIS docket entry 264 in that case.

MR. FISCHER: Could we late file that?

JUDGE STEARLEY: Yes, you may, by next Friday.

MR. FISCHER: That's February the 9th, is that the date?

JUDGE STEARLEY: That's correct.

MR. FISCHER: Yes, we can do that.

THE WITNESS: That would be the date of the transcript. I believe the date of filing was February 27th.

MR. FISCHER: That's the 2007 Aquila rate case?

JUDGE STEARLEY: That's the 2005.

MR. FISCHER: 2005.

JUDGE STEARLEY: ER-2005-0436.

MR. FISCHER: Thank you.

JUDGE STEARLEY: All right. Recross is finished. Redirect?

MR. THOMPSON: For the record, Judge, Staff's going to object to those two exhibits as violative of the parol evidence rule.

JUDGE STEARLEY: And, counselor, if you will flush out your objection a little bit for me.

MR. THOMPSON: Certainly. The Commission is faced with interpreting a Stipulation & Agreement, which is of the nature of a contract, and parol evidence is not admissible to go to the intention of the parties of a contract. You must base the interpretation upon the language within the four corners of the instrument.

JUDGE STEARLEY: Well, Mr. Thompson, I believe to me the language in the AAO was made in dispute by the parties here, and it also appears that this is the relevant case in which the AAO was ordered. So you're telling me the documents which are relevant to that are not admissible because they're not within the four corners of the stipulation, that's your objection?

MR. THOMPSON: That is the objection.

JUDGE STEARLEY: All right. Your response, Mr. Fischer?

MR. FISCHER: Judge, I think you can take into account the admissions of the Staff that will be contrary to their position in this case in previous sworn testimony before this Commission that is on record here at the Commission. I would certainly urge you to do that. I would suggest that it's admissible, if nothing else, to the weight of the evidence, not the admissibility.

JUDGE STEARLEY: Is the rule of parol evidence a technical rule of evidence or fundamental rule of evidence, Mr. Thompson?

MR. THOMPSON: Frankly, I don't know.

JUDGE STEARLEY: Well, the Commission's not bound by the technical rules of evidence. When Mr. Fischer late files these exhibits, you can file a written objection at that time, and you can try and find some case law for me as to why that would fall under the technical rules of evidence or the fundamental rules of evidence versus the technical rules of evidence. Technical rules do not apply here. And, Mr. Fischer, GMO will be allowed to respond to that, of course.

MR. FISCHER: Thank you, Judge.

JUDGE STEARLEY: Any other objections?

MR. THOMPSON: No other objections for me.

JUDGE STEARLEY: I'll reserve a ruling on those exhibits until they're filed and I see the written objections as briefed by counsel. Any redirect, Mr. Thompson?

MR. THOMPSON: No redirect. Thank you.

JUDGE STEARLEY: All right. Mr. Hyneman, thank you very much for your testimony, and you are excused. And you may call your next witness.

MR. THOMPSON: Staff calls Lena M. Mantle.

MR. FISCHER: Judge, can we take about a five-minute break just before I start cross here to get myself organized a little bit?

JUDGE STEARLEY: Certainly. You want to go ahead and take it now? We'll go ahead and take a five-minute or ten-minute break at this time.

(A BREAK WAS TAKEN.)

JUDGE STEARLEY: All right. Ms. Mantle, I need to swear you in.

(Witness sworn.)

JUDGE STEARLEY: Thank you. You may proceed.

MR. THOMPSON: Thank you.

LENA M. MANTLE testified as follows:

DIRECT EXAMINATION BY MR. THOMPSON:

Q. State your name, please.
A. Lena M. Mantle.
Q. And how are you employed?
A. I'm employed by the Missouri Public Service Commission.
Q. And are you the same Lena Mantle that prepared or caused to be prepared the documents marked as Staff Exhibit 2HC and NP?
A. Yes.
Q. And do you have any changes or corrections to those documents?
A. Yes, I do. And it is to the first page of my Schedule LMM-1. I had not updated my credentials for the changes in the energy department's name to energy unit and the fact that operations division then became a department and there's a new division. So I have prepared a new LMM-1-1 that gives the correct unit, department and division.
While I was updating it, what is filed in my testimony says that I'm actively involved in updating the Chapter 22 rules. Since those have been revised, I removed that sentence since I was updating the credentials anyway. That would be the only change.
MR. THOMPSON: Your Honor, I don't know if you want to mark this as a separate exhibit, and if so, I

don't know what number we're up to.

JUDGE STEARLEY: I believe we can substitute this as long as the parties have no objections.

MR. FISCHER: No objection.

MR. THOMPSON: Thank you.

BY MR. THOMPSON:

Q. With that correction in mind, if I asked you the same questions today, would your answers be the same?

A. Yes.

Q. And as far as you know, would those answers be true and correct to the best of your knowledge and belief?

A. Yes.

MR. THOMPSON: At this time I would offer Staff Exhibit 2HC and NP with the new schedule LMM-1, and tender Ms. Mantle for cross-examination.

JUDGE STEARLEY: All right. Any objections to the admission of Staff Exhibit 2?

MR. FISCHER: No objection.

JUDGE STEARLEY: Hearing none, it shall be received and admitted to the record.

(STAFF EXHIBIT NO. 2 WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: Cross-examination. Is

Mr. Conrad still on the phone? Did we lose him at some point?

MR. THOMPSON: Mr. Conrad, are you there? I don't know, your Honor. No response.

JUDGE STEARLEY: He has not e-mailed me back. He may just have his phone muted. GMO, you can proceed with cross-examination.

MR. FISCHER: Thank you, Judge.

CROSS-EXAMINATION BY MR. FISCHER:

Q. Good afternoon, Ms. Mantle.

A. Good afternoon.

Q. Do you happen to have a copy of your rebuttal testimony and the deposition that we took in this case?

A. Yes, I do.

Q. Okay. I'd like to begin on your rebuttal testimony at page 1, line 17 through 18, and I believe you may have just updated this, but you're the -- you're currently the manager of the energy unit of the tariff safety and economics analysis department of the regulatory review division, right?

A. Yes.

Q. Okay. And that -- that energy resource analysis group is a part of your department, right?

A. It is a section within the energy unit.

Q. Okay. And I believe it was the persons in that particular unit that completed the GMO FAC review in this case and filed the Staff Report?

A. That is correct.

Q. Okay. So those persons would be Dana Ives -- Eaves. I'm sorry. I have Darren Ives over here. Dana Eaves, Leon Bender, Matthew Barnes and David Roos, correct?

A. I believe that's who did the report, yes.

Q. Would you describe for the Commissioner and the Judge your role in this FAC case, just briefly?

A. The gentlemen that you listed did a review, a prudence review of information provided to them through data requests, monthly submissions, quarterly submissions, FAC submissions, their own data responses and information from rate cases. Together they compiled a prudence review. They took the results of that prudence review to management, which included me and Natelle Dietrich, Cherlyn Voss. I believe there was an attorney there. I don't know if it was Mr. Thompson or Nathan Williams, and most likely Bob Schallenberg. And we reviewed that prudence review and okayed it, that it could be Staff's prudence review in that case or in this case.

Once it became evident that we were likely to have testimony filed, because of my background, my history in resource planning with the Commission and reviewing the resource plans of not only Aquila but Empire, Ameren Missouri and Kansas City Power & Light Company, and also the background that I have with the FAC having written the rules and been a part of every FAC tariff written and every FAC tariff filing made, it was determined that I should write testimony that you find in my rebuttal testimony.

Q. Okay. Very good.

A. I remember that in your deposition you told me that your role was an oversight of the work, it wasn't to get into the details?

A. That is correct.

Q. Okay. And in this case there's one disallowance being proposed by the Staff related to GMO's cross hedging program where GMO has for several years been cross hedging using natural gas futures. Is that your understanding?

A. There's a disallowance of the cross hedging for purchased power in this prudence review. How long that's been going on really is irrelevant to this prudence review because we looked at this time period and whether or not that was prudent for this time period.

Q. Okay. And as I understand it, Mr. Eaves is the sponsoring witness for the disallowance. You're not

the sponsoring witness, right?

A. Yes, he is the witness for the disallowance.

Q. And as I recall from your testimony in the deposition, the adjustment was initially recommended and developed by Mr. Eaves; is that right?

A. With help from Mr. Hyneman, Mr. Featherstone and the other gentlemen that contributed to the report. I don't know how much influence they had or not, but he was the lead for that.

Q. Didn't you tell me in the deposition that this adjustment was initially Mr. Eaves' idea?

A. I believe it was, yes.

Q. And did you rely on Mr. Eaves' professional judgment when you approved the recommended disallowance associated with the cross hedging program?

A. Yes.

Q. Now, did you personally evaluate GMO's hedging program or specifically review the hedges that were placed by GMO in this case?

A. No.

Q. Did you make any independent judgment about the issue of whether it was prudent or not to use natural gas hedges associated with spot purchased power in this case?

A. I did go back and review the tariff to see what was in the tariff as far as what was allowed to flow through the FAC. That I did do in detail, but otherwise, no, I did not.

Q. Okay. And I believe you told me you've never testified regarding an electric company's hedging program in any other proceeding; is that right?

A. That's correct.

Q. And I believe you said you hadn't attended the PGS Energy webinar entitled How to Financially Hedge Natural Gas or Electricity Price Risk either, right?

A. No, I did not attend that.

Q. Now, would you just describe for the Commissioner and for the Judge how you view the role of the Staff in an FAC audit?

A. In an FAC audit, we task our employees to look at the costs and revenues that are to flow through the FAC for prudence. Basically, you can think of it as a grid divided up into four sections. If it's prudent and it's prudence on one axis and cost on the other, if it's prudent but it still costs a lot, that's still allowed. If it is imprudent and it doesn't harm the customers, then we don't bring that up either. That's not what the purpose is.

But it's when it causes harm, it's the

quadrant where it's imprudent and causes harm to the customers, that's how we find -- that's what we find to be imprudent.

Q. Would you agree that the Staff is supposed to be a neutral party in a case to provide a fair and equitable solution for inclusion of costs in the FAC cause?

A. Yes.

Q. And from your perspective, is the role of the Commission Staff to be fair, objective and un biased in an FAC audit?

A. As it is in all of our work.

Q. Is the role of the Commission to be a strong and aggressive protector of the ratepayer interests?

A. No, it is not.

Q. From your perspective, is the role of the Commission Staff to present a case that's intended to keep the rates as low as possible for the consumers?

A. No, it is not.

Q. From your perspective, is it the role of the Commission Staff to make recommendations in an FAC audit that are designed to keep the public utility financially whole, or just financially healthy? Let's just -- let's leave it there, financially healthy.

A. I think in a prudence audit we are to find whether something is prudent or not. Now, sometimes we may find something that's imprudent that cause -- could cause financial harm, but I believe our task is the imprudence or the prudence, not keeping the utility from any financial harm.

Q. Your role is to balance the interests, just like it is in other cases, right?

A. Yes.

Q. In balancing the interests of the consumers and the public utility shareholders, do you try to follow the policies of the Commission through the Commission's previous orders?

A. Yes.

Q. Let's look at the Staff Report if you've got that in front of you.

A. I don't have it.

Q. You don't have that. Okay. Let me just ask you some questions. I think you'll be able to answer them based on your deposition.

We talked about the prudence standard a little bit, remember the discussion in the deposition, and it's addressed in the Staff Report?

A. I believe I tried to give a summary of that just a few minutes ago, if that's what you're talking

about, yes.
Q. **Is this the standard that Staff believes should be applied to the Commission or by the Commission in this proceeding to determine if GMO's actions were imprudent in this case?**
A. I'm sorry. Could you ask that again?
Q. **The prudence standard that's mentioned in the Staff Report, is that the standard that the Commission should apply to GMO in this case?**
A. Yes.
Q. **From your perspective, and not as a lawyer but as the head of the energy unit, would you agree that GMO's costs are presumed to be prudent?**
A. I believe I heard that earlier from my attorneys, so I will have to agree.
Q. **All right. That sounds good. And the company's conduct should be judged by asking whether the conduct was reasonable at the time under all the circumstances considering the company had to solve the problem prospectively rather than in reliance on hindsight?**
A. Yes, based on the information that we can gather.
Q. **And under that prudence standard, the Commission must determine how a reasonable person would**

have performed the tasks that confronted the company under the circumstances that confronted them at the time the decision was being made?

A. Yes.

Q. Now, do you believe that a reasonable person at GMO under the circumstances of this case would not have attempted to hedge the company's risks related to volatile spot purchased power costs?

A. I don't know what a reasonable -- I don't know a reasonable person at GMO different from a reasonable person anywhere else, I don't know what that distinction is.

Q. Well, let me ask it this way. Do you believe that a reasonable person at GMO, under the circumstances of this case, would have attempted to play the market and not hedge the company's risk associated with spot purchased power?

A. The question is, do I believe that a reasonable person would not have cross hedged purchased power with natural gas?

Q. And just played the market, played the spot market.

A. Yes, that's correct. I believe that.

Q. You believe that -- okay. Let me ask it again. You believe that a reasonable person, under the

circumstances of this case, would not have cross hedged and would have instead played the spot -- played the market, right?

A. I believe a reasonable person in the position that they were in would have said what is the least expensive resource to meet our customers' need? If that was the spot market, it's the spot market. If it's generation, it's generation. I don't believe a reasonable person would have said let's add some additional loss or gain according to financial hedges in the natural gas market.

Q. So you believe that a reasonable person at GMO, under the circumstances of this case, would have chosen to play the market?

A. No. They would not have chosen to buy natural gas futures in an effort to offset purchased power spot market prices.

Q. What alternative would you recommend other than generation and purchased power agreements?

A. I don't know that any other's needed.

Q. Is there any one available that you're aware of?

A. Not that I can think of right here and now, no.

Q. Okay. So the alternative is really to

either -- you're suggesting we shouldn't hedge, so the alternative is to basically buy spot purchased power and flow it through the FAC?

A. That's what all you -- the other utilities do. Now, I mean, GMO does buy more spot market than the other utilities, but that's because of the position of their generation, that the other utilities aren't in a position where they need so much spot. They don't off -- they don't hedge their spot market purchases with natural gas futures or derivatives.

Q. Is it correct to conclude that Staff is not making a recommendation that the Commission find that a reasonable person at GMO would have refrained from attempting to hedge the risk associated with purchased power using natural gas futures?

A. That's another confusing question.

Q. It is.

A. Can we try to break that down?

Q. Is Staff recommending that the Commission find that a reasonable person wouldn't have used cross hedging?

A. Yes.

Q. That's the ultimate recommendation of Staff?

A. Yes. Not in these circumstances. There's circumstances cross hedging may be -- well, may be useful for. We're not saying cross hedging is bad as a total idea.

Q. That's what I'm asking. Is it bad as a total idea?

A. It's a tool that can be used and should be used appropriately, just as you would not use a hammer to break apart a board if you wanted a straight cut. You'd use a saw. It's the appropriate tool in the appropriate place. We do not believe this was the appropriate tool in this place.

Q. Is it correct that you believe a reasonable person could have attempted to mitigate the risk of a volatile spot purchased power if he had a reasonable method of doing so?

A. He could have, yes.

Q. And as I understand your testimony, you personally do not believe that it's imprudent on its face for GMO to have attempted to mitigate the risk of a volatile spot purchased power price, right?

A. I do not believe that it was imprudent for Aquila to attempt to mitigate the volatility, no.

Q. Well, assuming it was reasonable to attempt to mitigate the risk of a volatile spot purchased power price using some reasonable method to do that, what should

GMO have done instead of using natural gas futures as a method of cross hedging that risk?

A. I don't know that there is. They could have built generation back when they needed generation. That would have been the hedge that the other utilities use.

Q. I believe you told me in the deposition that that's not the basis for the Staff's recommendation in this case, right?

A. That's correct.

Q. Do you personally believe that the company in the future should stop its efforts to hedge the price of spot purchased power?

A. Personally, yes.

Q. Is Staff recommending to the Commission that it order the company to refrain from using cross hedging as a method of mitigating its risk associated with purchased power prices?

A. Staff is recommending that the Commission find what GMO did during this time period imprudent, and GMO can make the management decisions as to whether or not it continues or stops.

Q. If the Commission does adopt the Staff's recommendation in this case and disallows, what is it, $14.9 million now, would you expect the company would be

inclined to stop its cross hedging program?

A. Yes.

Q. If we assume for purposes of this question that the natural gas prices are strongly positively associated with spot electricity prices, do you believe that it would be possible to cross hedge the risk associated with spot purchased power by using natural gas futures?

A. It is possible.

Q. Now, as I understand again your role, you're not holding yourself out as an expert in cross hedging in this case, right?

A. That's correct.

Q. That's being left entirely to Mr. Eaves?

A. Yes.

Q. Who on Staff would you consider to be the most knowledgeable person about electricity price hedging?

A. At this time I believe it would be Mr. Eaves.

Q. Okay. Let's turn to your rebuttal testimony in the current case, page 1, lines 22 through 25. You state there, on pages 5, 7 and 11 of his direct testimony, KCP&L Greater Missouri Operations Company witness Dr. C.K. Woo states that procurement risk may be mitigated via generation ownership; is that right?

A. Yes.

Q. And then you go on to state, Staff agrees with Dr. Woo that generation ownership mitigates procurement cost risks. Staff has consistently urged all the Missouri investor-owned utilities, including GMO, formerly Aquila, to acquire more generation rather than purchasing energy either through purchased power contracts or the spot market for electricity. Is that generally right?

A. Yes.

Q. Is another way of saying that that the Staff has urged companies to put steel in the ground rather than relying on purchased power contracts or spot purchase --

A. Yes.

Q. -- for electricity?

A. Yes.

Q. Now, then on page 2 of your rebuttal, you state at lines 1 and 2, my testimony explains why GMO relies so heavily on spot market electricity; is that right?

A. Yes.

Q. And you agree that GMO does rely more heavily on spot market electricity than other electric companies in Missouri, right?

A. Yes.

Q. And that means, doesn't it, that customers are more at risk depending on what the prices of electricity do in the spot market?

A. Since there is an FAC, yes, they are.

Q. And is the fact that GMO relies on spot market electricity the reason Staff is proposing to disallow its hedging costs associated with the spot purchased power in this case?

A. No, it is not.

Q. Is the fact that GMO relies so heavily from Staff's perspective on spot market electricity the reason that Staff is proposing to disallow the hedging costs in this case?

A. No, it is not.

Q. Is Staff's prudence adjustment based upon Staff's concern that GMO has relied too heavily on spot market electricity?

A. I don't -- I don't believe Staff has ever said that they relied too heavily on. The Staff position is, if it is the least cost and reliable source of energy is a spot market, then GMO or Ameren Missouri or Empire District or Kansas City Power & Light should purchase the energy either on the spot market or through purchased power agreements. That's the Staff's position.

Q. I doubt anyone in the industry would you disagree with you. Wouldn't you think that's true.

A. I hope they wouldn't.

Q. But for purposes of this case, your disallowance is not based upon the fact that GMO relies more heavily on spot purchased power, right?

A. No, it is not.

Q. Does the Staff believe that it's imprudent for GMO to rely upon spot purchased power during the FAC audit period?

A. No. It was the most prudent method for them to meet their customers' need, the least expensive way, because their own generation was much more expensive.

Q. And Staff hasn't made any disallowance because they didn't use the least expensive option, right?

A. If we did, it would increase the fuel cost to the customers, increasing what they would have had to pay through the FAC.

Q. Does the Staff believe that it was imprudent for GMO to rely on spot purchased power rather than putting additional steel in the ground today?

A. It is Staff's position that they should have put steel in the ground back in 2000 when the Aries plant was built.

Q. But that's not the basis for the

disallowance, correct?

A. No, it is not.

Q. Okay. Is Staff proposing to disallow the hedging costs related to its spot purchased power in this case because they didn't buy the Aries plant in the year 2000?

A. No.

Q. And you don't believe that the company is relying too much on spot purchased power and the company needs to penalize the company for that, right?

A. That is not the reason for the adjustment. Given the resources that GMO has, that's what we deal with during this time period.

Q. Now, I believe you say that basically on page 6, don't you, on your rebuttal testimony, beginning on line 14, where you're -- you're not suggesting that GMO should have met its power needs by using generating plants it owned instead of buying so much spot market electricity; is that right?

A. Yes.

Q. And then on page 6, line 17, you say -- you state, absent some offsetting consideration, GMO should use the least cost electricity to serve its customers. If it had not, it's very likely Staff would have alleged that GMO was imprudent. Is that right?

A. That is correct.

Q. So to get to the bottom line, the Staff's view is not that we -- that the company's done anything imprudently by purchasing power under the circumstances of this case?

A. That's correct.

Q. And the Staff is not suggesting that it's always imprudent to try to cross hedge that electric power risk, right?

A. Staff believes cross hedging is a tool that should be used prudently, and in this case it was not used prudently.

Q. Now, in the Staff Report, I believe the Staff recommended the Commission order the company to refund $18.8 million or so; is that right?

A. It was 18 million. I don't know what after the decimal point.

Q. And Staff -- has Staff modified based on, as I understand the opening statement, your position on the amount of the disallowance and refund after you reviewed the company's testimony in this case?

A. Yes.

Q. Is it correct that the number you're recommending now is 14.9 million?

A. Yes.

Q. Did Staff make a mistake in your original position when you recommended an $18.8 million disallowance?

A. Staff was not fully aware of the Stipulation & Agreement in the prior rate case, I think it was the 2005 rate case. Mr. Eaves had not worked in that rate case, but he did get together with the auditors in that rate case and agree that now the number should be $14.9 million.

Q. Okay. That was after you looked at what the company had suggested and made an evaluation about that, right?

A. I don't know the exact sequence, but we did look at, you know, what was told to us, and we did talk with Mr. Hyneman and the other auditors to make sure that we got the right amount.

Q. In the Staff's position statement, under the first two issues, the Staff states, GMO was imprudent in that it relied on an overly rigid market insensitive cross hedging strategy resulting in the loss of $14.9 million during the review period. Is that your understanding?

A. That's how I remember.

Q. Does your prefiled testimony in this case assert that GMO's hedging strategy was overly rigid?

A. No.

Q. Does your prefiled testimony in this case assert that GMO's hedging strategy was market insensitive?

A. No.

Q. Do you know of any prefiled Staff testimony that includes an assertion that GMO's current hedging program is overly rigid or market insensitive?

A. I don't recall any, but Mr. Hyneman and Mr. Eaves had quite a few pages of testimony. I really can't say.

Q. Would you have reviewed that testimony?

A. Yes. I don't -- I don't remember specifically that, but that doesn't mean that there couldn't be something in there that would support that.

Q. But you're not aware of it?

A. I'm not aware of it.

Q. Ms. Mantle, is it correct that you personally know of no formalized organized market that allows for the purchase of electric futures in the SPP market area?

A. That's correct.

Q. And by that statement do you mean that Staff knows of no formalized market that allows spot purchased power to be hedged using on-peak purchased power futures contracts?

A. That is correct.

Q. Well, from your perspective, since there is no organized market for electric futures contracts, are there alternative methods of hedging electric price risk other than building generation or entering into PPAs?

A. No.

Q. So is it correct to conclude that there's no financial instruments from your perspective that can be used to hedge this risk, right?

A. That is correct.

Q. Even though I know you haven't attended the seminars on how you hedge -- how you can use natural gas hedges to do that, right?

A. I believe that can be one. Whether that's the prudent thing to do or not is another question.

Q. Well, that's what I'm trying to get to. If you don't think it's prudent to use natural gas futures contracts to hedge and there's no other financial instrument that you can do it with but you still want the company to consider hedging, I'm asking what should they have done in this circumstance? Should they have built another power plant?

A. The time to build the power plant was before these accumulation periods occurred. That is -- that is their hedge. That is the other utility's hedges in the state of Missouri, either that or purchased power, long-term purchased power agreements, which GMO does have.

Q. And so when Mr. Blunk made his decision about whether to hedge or not, he knew what his generation fleet was. He knew how long it would take to build a generation plant. At that point in time, what should he have done?

A. He should not have crossed hedged with natural gas futures. He should have -- if it was cheaper to purchase spot market energy than it was to generate, then he should have purchased spot market energy.

Q. He should have just played the spot market and passed it through under the fuel adjustment clause, right?

A. Yes.

Q. Do you know of any Missouri Public Service Commission decision where the Commission has found that it's imprudent on its face to use natural gas futures to hedge this electric risk?

A. I'm not aware that it's ever come up before.

Q. Okay. Would you agree that if the Commission adopts the Staff's position in this case, it will be the first time that the Commission has disallowed an electric company's cross hedging costs associated with

on-peak spot purchases?

A. Because it's never been brought before them before, yes, it would be the first time.

Q. Do you know of any other Public Service Commission decision anywhere else where they've done that?

A. Where they've done?

Q. Where they have found that it was imprudent on its face to use natural gas futures to hedge the risk associated with spot purchased power costs?

A. No.

Q. Do you believe that GMO should have as a goal the hedging of the risk of volatile spot purchased power costs using financial instruments at all?

A. No, not -- it's the ratepayers' money that they're using now. It's not their shareholders back when they didn't have an FAC. Now it's the ratepayers' money that they are doing this with.

Q. So again, to get to the bottom line, it's your perspective that GMO would be better off not to hedge but instead just play the spot market if that's the cheapest way to go as far as buying from other utilities --

A. Yes.

Q. -- right?

A. Yes.

Q. I'd like to show you the Nonunanimous Stipulation & Agreement in Case No. ER-2009-0090, which was the last GMO rate case.

A. It wasn't the last GMO. It was the one before that.

Q. You're right. You're right.

MR. FISCHER: May I approach the witness?

JUDGE STEARLEY: You may.

BY MR. FISCHER:

Q. Would you turn to page 10 of the stipulation where it indicates in paragraph 18C, to aid in FAC tariff prudence and true-up reviews, GMO shall submit to Staff the following, and then I believe it lists 11 bullet points containing information to be submitted to Staff. Do you see that?

A. Yes.

Q. If you turn to page 11, the fourth bullet point on the page indicates that GMO is to provide Staff a copy of each and every GMO hedging policy that is in effect for Staff to retain; is that right?

A. Yes.

Q. And then the next bullet says, within 30 days of any change in a GMO hedging policy, a copy of the changed hedging policy.

A. Yes.

Q. Okay. These provisions were intended to keep Staff apprised of changes of the GMO hedging plans; is that right?

A. Yes.

Q. And are you aware that the company invited members of the Staff to participate in discussions with a firm known as Kase & Company that was revising the company's hedging plans back in 2007?

A. I've been made aware of that by Mr. Hyneman, yes.

Q. Okay. And prior to that case, has Staff ever recommended a disallowance based upon the fact that Aquila or GMO was using natural gas futures to hedge the risk associated with electric purchased power costs?

A. Not to my knowledge.

Q. To your knowledge, prior to this case, has Staff ever expressed to the company that it opposed the use of natural gas futures to hedge the price of electricity?

A. It's my understanding we weren't aware of the magnitude of it, and that partly goes to Mr. Hyneman's testimony in that it was all in Account 547. We didn't have a split out between what was hedged for fuel and what was hedged for purchased power agreements. So we were aware that it might happen. We weren't aware of the --

that GMO was actually doing it.

Q. Okay. Well, the answer to the question then is that you're not aware that -- of any case where the Staff had particularly expressed its opposition --

A. That's --

Q. -- to the company, right?

A. That's correct.

Q. No one on your staff has ever told you that Staff was opposed to the use of natural gas futures to hedge the price of electricity prior to this case; is that right?

A. That's correct.

Q. But you're aware of the testimony in this case that indicates that Aquila and GMO have been using the hedging technique since 2004, right?

A. That is your testimony, yes.

Q. And you're also aware of the testimony that in some years the company's been in the money and in other years it's been out of the money in this hedging program, right?

A. That was the testimony, yes.

Q. Now, if you had known whenever the hedging program was in the money that GMO was using this technique, do you think Staff would have raised a concern at that point that it was imprudent to use this technique

to hedge the electric price risk?

A. I don't know.

Q. I think in the deposition you may have indicated "I hope we would have."

A. That's correct. I hope we would be consistent, whether it would be a gain or a loss.

Q. And I think Mr. Hyneman in this case has testified that he was aware since 2005, the Aquila rate case, that this practice was going on. Is that your recollection?

A. I'm --

Q. I can point you to his testimony, but do you recall that he said that?

A. I know at different points he was aware of cross hedging going on.

Q. Well, why didn't Staff inform the company of their concerns regarding this hedging policy in the last seven years?

A. Staff was not aware of the mag-- or aware of how much off-system sales was being hedged by -- and we still don't -- I still don't know prior to this prudence period how much was actually hedged. The hedging policy, I went back and looked into EFIS, that you supplied in response to this Stip & Agreement, I believe it was in January of 2011, I -- I did a search on it for spot market energy, and it said nothing about hedging for spot market energy. All of the hedges were put into Account 547. There was no way for us to tell whether or not it was for natural gas, the plants that were actually being used.

What brought it to our attention was when Dana was doing his prudence audit, he saw that there were $22 million in hedging losses, and with a number that big, he decided that he needed to look into it. Now, that gets to our four quadrant thing, and if it's -- if it does no harm to the customers and it's imprudent, then that's different.

So the magnitude of it, the fact that Staff was -- like I say, even the hedging policy that you provided in response to that bullet point didn't say anything about hedging for spot market energy.

Q. I believe in your deposition you testified that you understood that Mr. Hyneman and Mr. Featherstone were aware of the company's cross hedging; is that right?

A. I believe they were aware that there was some going on. The magnitude or amount, I don't know.

Q. Okay. And you've indicated it's not the losses themselves that are the concern, right?

A. That gets to our four quadrants again. If it's imprudent and it does no harm to the customer, then hopefully Staff would say it was imprudent but we're not going to -- we're just going to tell you it's imprudent so you don't continue to do it.

Q. And you understand there's another side to that hedge transaction where there was an offsetting gain, right?

A. No, I do not understand that.

Q. And that may be a fundamental difference.

A. Is that what you -- are you referring to Mr. Blunk's surrebuttal testimony where he showed the gain and the loss?

Q. I'm referring to that among other things, but yes.

A. When I looked at that, the gain that was shown was because GMO forecasted the price in August to be 50, but it was actually 40. So the gain was 10, but the gain was never realized. The customers never saw a gain of $10.

Q. Did you pass through the $50 through the fuel adjustment clause even though it was only 40?

A. No.

Q. Okay. So they did see a gain, right?

A. No.

Q. They did see the $40?

A. They saw the $40, but it was not a gain. You could have made that number 65. You could have made that number 100. If you made that number 100, your gain would have been $60. Boy, you're doing a real good job.

Q. I believe you also indicated that you didn't believe anybody in your group that reviews the FAC prudence was aware of this practice?

A. That's my understanding, yes.

Q. Did you ask the group that performs the FAC prudence audit if they were aware of the company's practice in past cases?

A. I talked with Dana Eaves, and he said they weren't. I took him at his word.

Q. Okay. Did you ask Matt Barnes, who was a member of the team on this case, whether he was aware of that?

A. No, I did not.

Q. Is it possible that Mr. Barnes would have been aware of the longstanding cross hedging program?

A. I did not talk to him. So assuming, yes, he could have known that.

MR. FISCHER: Judge, I'd like to have an exhibit marked.

JUDGE STEARLEY: No. 13.

(GMO EXHIBIT NO. 13 WAS MARKED FOR IDENTIFICATION.)

BY MR. FISCHER:

Q. Ms. Mantle, does this DR appear to be a DR from this case, DR No. 29?

A. Yes.

Q. Does this DR appear to be requesting information by month by unit for the past 18 months ending November 21st, 2010 relating to natural gas commodity prices, the cost of hedges and other information related to natural gas volumes?

A. Yes.

Q. Would you flip to the second page of the exhibit and take a look at the table. In the third column there's a series of highly confidential numbers that appear to have the total for generation and purchased power hedges, including the hedge plan and the Kase plan; is that right?

A. Yes.

Q. Would that third column indicate to you that it includes the hedge costs for both generation and for purchased power hedges?

A. Yes.

Q. Does staff sometimes --

MR. FISCHER: Judge, I'd ask for the admission of Exhibit -- whatever the number was.

JUDGE STEARLEY: GMO No. 13.

MR. FISCHER: 13.

JUDGE STEARLEY: Any objections to the admission of GMO's Exhibit No. 13?

MR. THOMPSON: No objection, your Honor.

JUDGE STEARLEY: Hearing none, it shall be received and admitted into the record.

(GMO EXHIBIT NO. 13 WAS RECEIVED INTO EVIDENCE.)

MR. FISCHER: I'd like have another exhibit marked.

(GMO EXHIBIT NO. 14 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. FISCHER:

Q. Does this exhibit, Ms. Mantle, appear to be DR No. 29 in Case No. EO-2010-0167?

A. Yes.

Q. Was that GMO's last FAC review period case?

A. Probably. I don't know for sure.

Q. Does this DR appear to be requesting similar information for that audit period as the DR 29 that we just talked about in the current case?

A. Yes.

Q. Would you flip over to the second page of the exhibit and review the column entitled total for generation and purchased power. Does this column appear to include hedging costs for both generation and purchased

power hedges?

A. Yes.

Q. Now, would you flip back to the question itself and take a look at the sentence, the next to the last sentence in the question. All of GMO's natural gas hedges include the hedges that GMO would allocate to purchased power. Do you see that?

A. Yes.

Q. Would that indicate perhaps that the drafter of this data request was aware that some of the natural gas hedges would be allocated to GMO for purchased power hedging?

A. Yes.

MR. FISCHER: Judge, I'd move for admission of DR 29 in this case, No. 14.

JUDGE STEARLEY: Yes. Any objections to the admission of GMO Exhibit No. 14?

MR. THOMPSON: No objection, your Honor.

JUDGE STEARLEY: Hearing none, it shall be received and admitted into the record.

(GMO EXHIBIT NO. 14 WAS RECEIVED INTO EVIDENCE.)

MR. FISCHER: I'd like to have another exhibit marked.

(GMO EXHIBIT NO. 15 WAS MARKED FOR

IDENTIFICATION BY THE REPORTER.)

BY MR. FISCHER:

Q. Ms. Mantle, does this appear to be DR No. 30 in Case No. EO-2009-0115?

A. Yes.

Q. And does that -- do you think that's GMO's first prudence review case?

A. The timing seems about right, yes.

Q. All right. Does this DR appear to be requesting similar information for that audit period as the two 29s that we just looked at in this case and the previous prudence review case?

A. Yes.

Q. Would you please flip over to the second page of the exhibit and look at the column entitled total for generation and purchased power. Does this column appear to include the hedging costs for both generation and purchased power hedges?

A. Yes.

Q. And then if you flip back to the question itself, isn't there a sentence that's next to the last sentence on the question that states, all of GMO's natural gas hedges include the hedges that GMO would allocate to purchased power. Do you see that?

A. Where's that again?

Q. That's again the next to the last sentence on the question. Same place it was on the other exhibit.

A. All of the --

Q. All of Aquila's natural gas hedges include the hedges that Aquila would allocate to purchased power.

A. Yes.

Q. Now, at the top of the page it indicates that this is a response to Barnes, Matthew interrogatories. Do you see that reference?

A. Yes.

Q. Would that indicate to you that Matt Barnes had requested this information?

A. Yes.

Q. Since Mr. Barnes is asking for GMO's natural gas hedges that are allocated to purchased power, would that suggest to you that at least Mr. Barnes would have been aware at some level that GMO uses natural gas hedges for hedging its purchased power?

A. Yes.

MR. FISCHER: Judge, I'd move for the admission of Exhibit 15.

JUDGE STEARLEY: Any objections to the admission of GMO Exhibit No. 15?

(No response.)

JUDGE STEARLEY: Hearing none, it shall be

received and admitted into the record.

(GMO EXHIBIT NO. 15 WAS RECEIVED INTO EVIDENCE.)

BY MR. FISCHER:

Q. Let's change gears, Ms. Mantle. Let's talk about the Commission's natural gas price volatility rule.

A. Okay.

Q. Better leave that alone. I'd like to hand you a copy of that joint report that came out of that effort just for purposes of the cross. I don't need to make it an exhibit. It's too many pages.

MR. FISCHER: I'd also like to, though, make an exhibit of the actual rule itself, Judge. I'd like to have another exhibit marked.

JUDGE STEARLEY: Be No. 16.

(GMO EXHIBIT NO. 16 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. FISCHER:

Q. Let's talk about the natural gas price volatility rule itself first. Would you explain for Commissioner Stoll the purpose of that rule? He probably doesn't know about it.

A. Back in, I believe it was around 2000 when natural gas prices started spiking, we had a lot of our natural gas heating utilities who were coming in for large adjustments to the purchased gas adjustment. The Commission asked Staff to look into the practices for -- of the natural gas companies, and I believe that's what this joint report was from. I did not work in the natural gas area when that was done. I believe Warren Wood led that effort on the Staff's behalf. And I believe this rule was part of what came out of that.

It's my understanding the Commission did not want to specifically tell the utilities how to hedge or how to make its natural gas prices less volatile, but it wanted to provide some guidelines for the utilities to follow.

Q. Would you agree, though, they wanted to encourage the LDCs to do some hedging?

A. They wanted the utilities to find ways to mitigate volatility.

Q. Let's look at the purpose clause itself of the rule where it says purpose. This rule represents a statement of Commission policy that natural gas local distribution companies should undertake diversified natural gas purchasing activities as a part of a prudent effort to mitigate upward natural gas price volatility and secure adequate natural gas supplies to their customers. Is that right?

A. That is what it says.

Q. Then if we go to subsection A there of the rule, as a part of a prudent planning effort to secure adequate natural gas supplies for their customers, natural gas utilities should structure their portfolios of contracts with various supply and pricing provisions in an effort to mitigate upward natural gas price spikes and provide a level of stability of delivered natural gas prices. Is that right?

A. That is 1A.

Q. That's 1A, yes. Do you see that? Did I get that right?

A. Yes.

Q. Do you agree with the Commission's statement of policy in that section?

A. Yes.

Q. Do you believe that as a part of a prudent planning process by -- to secure adequate supplies of electricity, electricity companies like GMO should structure their portfolios of purchased power contracts with various supply and pricing provisions in an effort to mitigate upward electricity price spikes and provide a level of stability to -- of delivered electricity prices?

A. Can you ask that question again?

Q. I can. I was just trying to substitute basically electric for gas. Do you believe that as a part

of a prudent planning effort to secure adequate supplies of electricity, electric companies like GMO should structure their portfolios of purchased power contracts with various supply and pricing provisions in an effort to mitigate upward electricity price spikes and provide a level of stability of delivered electricity prices?

A. I believe the electric utilities should take efforts to mitigate price spikes through purchased power, long-term PPAs, generation as the other three investor-owned utilities have done. GMO is in a unique spot because it does purchase so much on spot. I don't think the Commission is making a statement here as to what an electric utility should do that has to purchase -- that purchases much of its energy requirements on the spot market.

Q. Well, I guess I'm asking you, do you think that the same kind of policy that applies to LDCs should also apply to electric companies?

A. LDCs are different than electric companies.

Q. So your answer is no?

A. Give me the question again. I'll make sure I get the answer right.

Q. Shouldn't there be a policy or shouldn't there -- from your perspective, isn't it reasonable for -- if the LDCs are expected and encouraged to hedge their

risk, isn't it also reasonable that electric companies would be looking at that option?

A. Yes, they should prudently hedge their risk.

Q. And hedging for natural gas LDCs can sometimes result in consumers paying more for natural gas than if the LDC hadn't hedged, right?

A. Yes.

Q. Even though those hedging techniques resulted in a higher cost to the consumer, the higher costs are not necessarily considered imprudent on their face; is that right?

A. That's correct.

Q. And just because a natural gas company's hedging program results in being out of the money, that doesn't mean the company was imprudent for trying to hedge those costs, right?

A. Any more than dis-- we don't disallow the hedging costs for natural gas plants, the supply to electric natural gas plants or oil plants or even I think there's a little bit of coal hedging done. The Staff does not -- even in this case, we allowed hedging for the natural gas that was used by the natural gas plants. So Staff is not against hedging for electric utilities.

Q. But you are against it for purchased power,

right?

A. We're against using cross hedging using natural gas futures for spot market -- to offset spot market pricing.

Q. As I understand your testimony in the deposition, it was the magnitude of the losses and what -- what brought Staff's attention to this issue?

A. Yes.

Q. But you only know those losses after the fact, right?

A. We only do, yes.

Q. Staff doesn't have any evidence that at the time GMO decided to continue their hedging program by using natural gas futures, that the company expected to incur losses, right?

A. I believe if you look at the responses to some of these DRs, especially the one from this case, you can see that the hedging losses just kept increasing and increasing, always negative. I do believe somebody at GMO should have been looking at that and making a decision whether or not to continue, whether at the beginning of these accumulation periods. I don't know if they stopped in the middle, whether we'd be making this imprudence adjustment.

Q. Would you turn to page 62 of your

deposition?

A. Sure.

Q. 63, line 13. I asked you the question, Staff doesn't have any evidence, do they, that at the time they decided to continue their program of using natural gas futures to hedge electricity prices, that the company expected to have between 18 and $20 million in losses? And what was your answer?

A. No.

Q. Is that still your answer?

A. Yes.

Q. The company expected that the hedging program would produce results that were within a reasonable range; is that right?

A. I don't know what they expected.

Q. Okay. Would you look at page 63, line 18. You were asked, they expected that this would be a good program and would -- well, a reasonable person would enter into a program that they thought would produce results that were within a reasonable range, right?

A. Yes, a reasonable person would.

Q. And your answer was yes?

A. Yes.

Q. So that doesn't -- it doesn't matter what the losses are under the Staff's theory, it's the method

that's unreasonable as I understand your testimony, right?

A. The method is unreasonable. We did not -- it came to our attention through the magnitude of the losses. I don't know if we would be having this discussion if the losses were a lot smaller. I don't know.

Q. Or if there were gains?

A. Or if there were gains. I don't know whether we would or not. Obviously from prior prudence reviews, we didn't.

Q. You've never in the past disallowed hedging losses for any company in the state, right?

A. This is the only company that I know that has hedging losses for spot market.

Q. Has the Staff, to your knowledge, ever disallowed hedging losses for any company?

A. Not that I'm aware of, no. Well, I will say, there is, what was it, ER-2005-0436. Is that the case where we came to a stip and agreement where there would be $11 million disallowed and --

Q. There was a stipulation in that case, right?

A. Yeah.

Q. Not a Commission decision?

A. Not a Commission -- well, the Commission approved the Stip & Agreement.

Q. But as far as cross hedging goes, there's never been a case where the Commission Staff has recommended for GMO or anybody else that those cross hedging costs be disallowed, even if there were -- even if there were losses, right?

A. That's correct.

Q. Now, looking at the B section of the rule, 1B, in making this planning effort, natural gas utilities should consider the use of a broad array of pricing structures, mechanisms and instruments, including but not limited to those items described in 2A through 2GH. If you go down to 2A and 2H, there are a number of things, including fixed price contracts, call options, collars, outsourcing agency agreements, futures contracts, financial swaps and options from over-the-counter markets. It also mentions other tools utilized in the market for cost-effective management, price and/or usage volatility, right?

A. Yes.

Q. Would you agree that the Commission's natural gas price volatility rule is intended at least in part to encourage natural gas LDCs to hedge their risk to mitigate spikes in their natural gas costs?

A. It's intended to encourage them to mitigate spikes, whether that's through hedging or any of those things listed in A through H.

Q. And many of those things are related to hedging, right?

A. Yes.

Q. Do you agree with the Commission that natural gas LDCs should consider the use of futures contracts to mitigate price volatility?

A. I don't have enough information. I don't feel qualified to say that.

Q. So you just don't have an opinion about that?

A. When you're talking about futures contracts, are you talking about contracting for future provision of natural gas to the utility?

Q. No. I'm really talking about NYMEX futures contracts like what we're talking about in this case.

A. Okay. Then now what was the question again?

Q. Do you agree with the Commission that the natural gas LDCs should consider the use of futures contracts to mitigate price volatility?

A. If it's done prudently, yes.

Q. Do you also agree with the Commission that natural gas LDCs should consider the use of other tools

utilized in the market for cost-effective management of price volatility?

A. Prudent use of those tools, yes.

Q. Now, hedging is really principally designed to mitigate the adverse impacts on customers, right?

A. Yes. Well, for GMO, yes, because they absorb very little of the fuel cost.

Q. To your knowledge, has the Staff ever suggested the Commission should repeal the natural gas price volatility rule?

A. No.

Q. Would the Staff be concerned if a natural gas LDC decided not to hedge its natural gas costs and simply played the spot market?

A. We do have small gas utilities that do that, that do not hedge.

Q. Is that of concern to the Staff?

A. Looking at the size of the utility or the LDC and the size of the contracts that they would have to purchase, it would be imprudent for them to enter into a contract where they would have to take more gas than they could use. So again, prudent use of these instruments.

Q. For a larger LDC, do you have a concern if they don't hedge?

A. I have a concern if they don't look at hedging and determine whether or not it's the appropriate thing to do at that time, the prudent thing to do at the time.

Q. Do you believe that electric companies should consider the use of tools utilized in the market to mitigate price volatility in its spot purchased power costs?

A. Prudent use of tools, yes.

Q. From your perspective, is there a reason why natural gas companies should be encourage to hedge natural gas costs but electric companies should be discouraged from using tools available in the marketplace to mitigate price volatility in the purchased power cost market?

A. There are a couple differences. So I guess my answer is, you know --

Q. The answer is yes?

A. The LDC delivers the commodity that the customer wants. An electric utility does not deliver coal or natural gas to the customer. The customer gets electricity.

Q. And it produces that electricity?

A. Yes, it does, and it makes choices between the time the fuel's bought to the electricity's delivered on how to get it there and get it there most cost effectively.

And the other difference is there are these -- there's a natural gas market. There's all these natural gas financial instruments. There are not those same financial instruments available for the electric spot market.

Q. I guess I'm asking, do you believe that electric companies should be encouraged to use whatever hedging tools are available win the marketplace to try to control those price spikes for consumers?

A. If it's prudent to use those, yes.

Q. Okay. Well, what do you mean by that, if it's prudent? You add that on a lot of things. What -- if you don't -- if we're not talking about building power plants and we're not talking about purchased power agreements, we set those two aside, what is it that the company should be doing that is prudent to try to manage that price risk?

A. With the electric utilities, I don't know that there is anything.

Q. Well, wouldn't you agree that hedging insurance, if you want to call it that, costs money, but there can be offsetting benefits to the consumer for hedging the price risk?

A. There could be, yes.

Q. And one of those benefits would be the reduction in the volatility of the cost of the product, natural gas or electricity, right?

A. That is, yes.

Q. And just because you're out of the money doesn't mean the company was imprudent in trying to hedge those costs, right?

A. Now, you went from asking me if they could to whether or not it was prudent; is that correct?

Q. I don't know if I did or not.

MR. FISCHER: Kellene, could you read the question back?

THE REPORTER: "Question: And just because you're out of the money doesn't mean the company was imprudent in trying to hedge those costs, right?"

THE WITNESS: Not necessarily, no.

BY MR. FISCHER:

Q. On page 7 of your rebuttal testimony, you discuss that joint report that I had in front of you on the natural gas market conditions, PGA rates, customer bills and hedging effects of the Missouri natural gas local distribution companies. Do you see that?

A. Yes.

Q. I believe the Staff was a party to that investigation and supported that joint report; is that

right?
A. Yes.
Q. And I believe at the time you filed your testimony, you said you hadn't completed your review of that report. Have you had a chance to look at it a little more carefully?
A. No.
Q. No. Okay. I'd like to ask you whether you agree with a statement on page 3 of the joint report, and it's down in the last paragraph. It's the third sentence where it says, hedging strategies that obtain price certainty in lieu of price variability may not result in the lowest costs. Do you agree with that statement?
A. Yes.
Q. Do you agree with the next statement? If a utility sets an objective to achieve the lowest delivered cost to its consumers, and if market prices stay at or increase from current levels, then the lower the percentage of market price exposure the better. If market prices drop significantly, the opposite will be true. Do you agree with that?
A. I don't know.
Q. Okay. Then do you agree with the next sentence? If a utility has targeted its hedging strategy at limiting exposure to market price spikes, the

appropriate level of hedging for that utility will depend on its perception of forecasted market price trends and the benefits, costs and risks of relative hedging mechanisms.

A. Yes.

Q. You agree with that?

A. Yes.

Q. Would you flip over to page 5 of that joint report. In the first bullet point under that recommendation No. 1, the joint report indicates that the parties were recommending that the Commission consider modifying the natural gas price volatility mitigation rule to clarify that the provisions of this rule are mandatory unless a waiver or variance has been granted. Do you see that?

A. Yes.

Q. Would you conclude that the parties to this docket were recommending the Commission clarify the natural gas hedging program should be considered a requirement or even mandatory?

A. At that time, yes.

Q. Does Staff have a different view of that now?

A. I don't think Staff has really thought about or come together to try and make a decision on that now.

Q. So at that time, that's what your view was and you don't know that it's changed?

A. I don't know that it's changed. I don't know that it's stayed the same.

Q. Who makes that decision?

A. That would be Cherlyn Voss, Natelle Dietrich, Bob Schallenberg, Kevin Thompson.

Q. Well, would you -- maybe I asked you this, but would you conclude that at least at that time the parties were recommending that that policy be considered a requirement or mandatory?

A. Yes.

Q. And, in fact, if you go to the third bullet point on page 5, it indicates that the parties were suggesting that there should be, as I quoted here, minimum boundaries for hedging programs unless good cause is shown for any deviation from these minimums, parentheses open, e.g., no less than 65 percent of the upcoming normal winter supply shall be hedged against market exposure by no later than October 1st each year, parentheses closed. Do you see that?

A. Yes.

Q. Why do you believe that the joint report so strongly advocated hedging for natural gas LDCs?

A. I don't know.

Q. Who benefits from the LDCs hedging?

A. The LDC and the customer.

Q. How does the LDC benefit?

A. If the customers are happy, it's better off for the LDC.

Q. Okay. That's fair. That's fair. So you want happy customers. They doesn't like volatility in their prices for their utility service, right?

A. That's right.

Q. But the company's shareholders, since they have a PGA, don't benefit by their hedging programs; is that right?

A. That's right.

Q. So it's really LDCs are hedging to benefit their customers and to have happy customers, right? They benefit by that?

A. Yes.

Q. Do you believe that LDCs should be required to hedge their natural gas costs but electric companies like GMO should be discharged or prohibited from hedging their risk associated with purchased power costs?

A. I don't believe electric -- or LDCs are required to hedge.

Q. Okay. So it's their choice?

A. It's their choice. And I would say the same for the electric utilities, and then a prudence determination can be made as to whether that was a prudent decision or not.

Q. But the Commission has clearly encouraged natural gas utilities to hedge their natural gas prices, right?

A. Well, they backed off from what was in this joint recommendation because they didn't go as far as what is in this report. So the Commission obviously felt that it did not want to establish these guidelines for the requirements for the LDCs.

Q. Do you believe there are policy reasons why it is not appropriate for the Commissioners to encourage electric companies to hedge their electric costs using financial instruments?

A. It is a management decision at the utility, and the Commission or the Staff is not to manage the utilities.

Q. I'll really asking about the commissioners. Is the Commission -- do you believe there are policy reasons why the Commission itself shouldn't be pronouncing some policy guidance to companies on whether they should hedge or not?

A. Yes.

Q. There are policy reasons why they shouldn't provide that guidance?

A. Why they shouldn't provide guidance or requirements?

Q. Let's go with guidance to start with.

A. In my almost 29 years here at the Commission, I've seen a reluctance of the Commissioners to make some definite statements. It varies with the Commissioners themselves and the other Commissioners, you know, and there's a lot of legal determinations in there. I'm not an attorney. So all that blends together. I'm -- I don't know that I really can say what the policy decision of the Commissioners should be.

Q. Well, from the Staff's perspective, is it better to Monday morning quarterback rather than give some input to the utilities up front on what their hedging program should be?

A. I know there's quite a few staff that would like to give the utilities up-front information, tell them how to do things, but that is not our role.

Q. On the LDC side, though, don't you invite the LDCs to come in every year, or at least they perhaps want to, to get that kind of guidance from the Commission Staff?

A. They come in and provide to us what their current strategy is, what it looks like, their PGA is going to look like for the upcoming year, and they do invite comments. As to what they do with those comments, that's their -- that's up to those utilities, those LDCs.

Q. And doesn't the Staff file a staff recommendation in those PGA cases where it's not uncommon at all for them to make suggestions about their hedging programs?

A. I would believe that's probably the ACA cases, not the PGA cases. Basically, PGA, we just look at it and see did they do the calculations right, because we have to turn those around within ten days.

Q. I stand corrected. I think they are the ACA filings. That's when you do your prudence review of LDCs, right?

A. That's correct.

Q. And in those cases you do provide guidance or at least suggestions or criticisms, whatever you'd like to call it, raise concerns about LDCs' hedging programs?

A. I haven't looked at those in great detail. They're not under my -- they're not in the energy department. They're in a -- or the energy unit or even the department that I'm in. It's a different group, and so I've got enough on my hands. I haven't taken that on, too. So my answer to the question is, I don't know.

Q. Is Staff opposed to recovery of any prudently incurred hedging costs associated with purchased power?

A. Any prudently recovered? No, we are not.

Q. Is Staff opposed to recovery of any prudently incurred hedging costs associated with purchased power through GMO's FAC?

A. No, we would not.

Q. Ms. Mantle, if you were in the shoes of GMO under the circumstances of this case, you're trying to make a decision about cross hedging, do we do it, do we not do it, we know what our generation fleet is and we know what the purchased power options are out there, PPAs, at that point in time, is it Staff's position that they should not have used financial instruments but said just play the spot purchased power market and passed whatever those costs are on to consumers?

A. If GMO believes that it's done a good job of resource planning, that is the least cost way to meet it's customers' needs. So the cross hedging is not necessary because it's least cost without the cross hedging, so I don't know they should be doing the cross hedging.

Q. But the hedging's not designed to bring the lowest cost to the consumer, right? It's designed to

reduce volatility.

A. The resource planning is to bring the least cost resources to the utility -- or to the customers.

Q. And I don't disagree with you, but I'm asking about the hedging program. Isn't that designed to reduce volatility? It doesn't mean that you're going to get the cheapest price.

A. No, it does not. But in this case, we believe that the amount that was done and the cross hedging was imprudent.

Q. The amount that was done was because the losses were high, right?

A. I don't know if it's the -- what exactly caused the losses to be high, whether it was the amount done or the difference between the price, when they had to -- you know, the margin difference. I don't know exactly what caused that amount to be so high.

Q. But we don't know what those losses are until after the fact, right?

A. No, but you do have an idea of where the market's going and where natural gas prices are going.

Q. Is that the -- is that the issue, that you saw falling natural gas prices so, therefore, you think Mr. Blunk shouldn't have tried to hedge? Is that what it's all about?

A. I don't know if that's what it's all about, but that's part of what Staff is saying is that, well, for one thing, we couldn't find an analysis of the pol-- of why you were hedging, of why you chose this. Dana, I believe, asked in DRs for reasons. We didn't see any kind of analysis that showed us that it was a good thing to do.

Q. But if the prices had been going up, then Staff's view would have been different?

A. It very possibly could have been.

Q. And you only know whether prices are going up or going down after the fact, don't you?

A. You have some idea of whether they're going to go up or they're going to go down. I think you guys currently use the Midas model to try to figure out what's going to happen to purchased power prices. You model those.

Q. They work very hard to try to figure it out to make sure that they have the best policies in place.

A. As Mr. Blunk said, if his crystal ball was right, he wouldn't be here today.

Q. Well, in the next FAC case, if the prices are going up or if we have another Katrina or if we have an unusual spike in natural gas prices, are the company -- is the company going to face the opposite position if they quit hedging that, well, they should have hedged, gee

whiz, they knew the price was going up?

A. Not if they're under -- not if it's my decision.

Q. What is the standard?

A. What is the standard?

Q. What is the standard for prudence here?

A. The standard for prudence is --

MR. THOMPSON: I think that was asked, Judge, earlier in the cross-examination. So I would object, asked and answered. As I recall, you went through the standard in the report, Mr. Fischer, and asked her if that was the standard applicable.

MR. FISCHER: I did go through the prudence standard. I'm asking really how you implement that, I guess is a better way to put it. What should the company do, is the question.

JUDGE STEARLEY: Since he's rephrased --

MR. THOMPSON: Thank you.

THE WITNESS: What should the company do? The company should take into consideration the results of this case and decide how it goes forward, or even now, until that time, because we know the Commission sometimes takes a little while to make decisions, they can make their decisions based on what they know now.

BY MR. FISCHER:

Q. So Staff will be okay if the company decides, based upon this case, that it should no longer cross hedge and no longer try to protect consumers from price volatility risk, right?

A. Again, cross hedging is an appropriate tool for some things, but we do not believe it was appropriate here. So I cannot say forever and ever that cross hedging should not ever be used, but as it was used during this time period, that is correct.

Q. When should cross hedging be used?

A. I don't know. I would be with Mr. Blunk if his crystal ball worked well. If I knew that, then I probably wouldn't be working at the Commission either.

Q. Okay. So it was imprudent for them to hedge in this case, even though they've been doing it for seven years, and the fact that there were losses, that's how you determined what the cost is of that imprudent decision; is that what you're saying?

A. We can't ask for more than the losses. So, I mean, and it was the magnitude of the losses that brought it to our attention.

Q. And you're not considering the fact that natural gas prices and electricity prices were plummeting on the other side and there was a benefit to consumers of having those lower costs on that side of the market,

right?

A. But the customers did not receive all the benefit because of the hedging losses.

Q. They got lower prices for purchased power. That's what they got, right?

A. They got lower prices than if the hedging had remained the -- hedging losses had remained the same and the purchased power prices were higher, yes.

Q. So what you're saying is if the company had known that prices were going to be falling, it would have been better for the consumer not to have had the hedging insurance because we knew the prices were going to come down and there wouldn't be a need, the house wasn't going to burn down, and if we knew that, we wouldn't buy the insurance, right?

A. That's right. If your house -- you know your house isn't going to burn, you wouldn't buy home insurance.

Q. Is there going to be a hurricane this fall?

A. Most likely, yes, somewhere.

MR. FISCHER: I appreciate your patience, I appreciate your candid answers, and I think I'm done.

JUDGE STEARLEY: All right. Questions from the Bench. Any questions, Commissioner Stoll?

COMMISSIONER STOLL: No. I believe

Mr. Fischer got to my questions towards the end of his questioning.

JUDGE STEARLEY: All right. There will be no recross based on questions from the Bench. Redirect.

MR. THOMPSON: We would request a short recess.

JUDGE STEARLEY: Very good. Let's take a ten-minute recess.

(A BREAK WAS TAKEN.)

MR. FISCHER: Judge, I think I failed to move for the admission of the exhibits that I had marked. There might have been a couple I missed. I would move for the admission of 13, 14, 15 and 16 if they haven't been admitted.

JUDGE STEARLEY: We've already taken up a couple of those, but I lost track myself. Are there any objections to GMO's Exhibits 13 through 16?

MR. THOMPSON: No objection.

JUDGE STEARLEY: Hearing none, they shall be received and admitted into the record.

(GMO EXHIBIT NOS. 13 THROUGH 16 WERE RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: We'll pick up again with redirect on Ms. Mantle, and Ms. Mantle, I will remind you that you're still under oath.

MR. THOMPSON: Thank you, Judge.

REDIRECT EXAMINATION BY MR. THOMPSON:

Q. Ms. Mantle, you were asked some questions about the people that you supervised. Do you recall that?

A. Yes.

Q. And you indicated that you supervise a unit that includes Dana Eaves, Leon Bender, Matt Barnes and David Roos; is that correct?

A. Yes.

Q. To your knowledge, are these the people who worked on the Staff Report in this case?

A. Yes.

Q. And do you -- do you know everything that Leon Bender knows?

A. No.

Q. Do you know everything that David Roos knows?

A. No.

Q. Matt Barnes?

A. No.

Q. So is it possible that Matt Barnes knew about the cross hedging of purchased power but that that information was not generally known within the group of employees with which he worked?

A. Yes.

Q. In fact, it wasn't known to you, was it?

A. No, it was not.

Q. Now, you were asked some questions about what a reasonable person at GMO would do. Do you recall those questions?

A. Yes.

Q. Would a reasonable person have GMO's level of exposure to spot market price volatility?

A. No.

Q. Now, you indicated that Staff's expert on electricity price hedging is Mr. Eaves; is that correct?

A. Yes.

Q. And I think you testified that you relied on Mr. Eaves' professional judgment with respect to the recommended disallowance in this case?

A. Yes.

Q. Have you heard anything here that would cause you to change your mind about that?

A. No.

Q. Now, there was -- a lot has been heard today about the number of prudence reviews that have occurred on GMO's FAC; isn't that correct?

A. Yes.

Q. In fact, this is the third one?

A. Yes.

Q. And there have been several intervening rate cases, too; isn't that correct?

A. That is correct.

Q. Now, would you agree with me that a utility company such as GMO makes a great many decisions every day that it operates?

A. Yes, a multiple of decisions.

Q. Is it possible for Staff to review every single one of those decisions?

A. No.

Q. In fact, would you agree with me that it's only in a case where something brings a decision to Staff's attention that review occurs?

A. Yes.

Q. In this case, that was the magnitude of the hedging losses; isn't that right?

A. That is correct.

Q. Now, there has been talk today about a webinar where cross hedging evidently was taught. Did you hear that?

A. Yes.

Q. And you said you did not attend, right?

A. That is correct.

Q. But some of your employees may have?

A. Yes.

Q. Including Mr. Eaves?
A. I believe Mr. Eaves did, yes.
Q. Does the fact that such a webinar exists, does that make cross hedging a prudent activity by an electric company with respect to its on-peak spot market purchased power price risk?
A. No.
Q. Now, there was talk about Staff's role. Do you recall that?
A. Yes.
Q. And you agreed that Staff's role is to be fair and neutral; is that correct?
A. Yes.
Q. Do you believe Staff has been fair and neutral in this case?
A. Yes.
Q. If, in fact, GMO has been cross hedging purchased power spot market price risk for the past seven years or more, as seems to be the case, do you believe that that means that Staff should be precluded from bringing it up now?
A. No, I do not.
Q. Do you believe that Staff's role in a prudence review of this sort is to bring those things that Staff has concerns about to the attention of the

Commission?

A. When it finds them, yes.

Q. And is that what Staff is doing now?

A. Yes, it is.

Q. Should the Commission decide that GMO's activities have been prudent, will Staff be, as far as you know, content with that result?

A. Unless we find something that was not presented to the Commission that would maybe perhaps change their mind, that is the position that Staff will stick with.

Q. So Staff would be guided by the Commission's decision?

A. Yes.

Q. Unless further information came to light?

A. Yes.

Q. If you have an opinion on this question, why does no other Missouri utility hedge purchased power price risk?

MR. FISCHER: Objection. Calls for speculation, facts not in evidence, I believe.

JUDGE STEARLEY: Mr. Thompson?

MR. THOMPSON: I'll withdraw the question.

JUDGE STEARLEY: All right.

BY MR. THOMPSON:

Q. If you know, has Staff ever taken the position before the Commission that GMO is imprudent for not building or acquiring more efficient regulated generation capacity in Missouri?

A. Yes, they have.

Q. If you know, did Staff recommend in 2005 that all of GMO's hedging losses be disallowed? And I'm referring to the 2005 rate case.

A. I believe that was the rate case where, like, 11.3 million was dis-- or was agreed to not be passed through.

Q. How about 2007, do you know if Staff made any recommendation or took a position with respect to hedging losses?

A. No, I don't know.

Q. Does GMO's hedging method actually fix a spot market purchased power price?

A. No, it does not. If it loses money, it actually increases by an increment that amount. It doesn't fix the price, the spot market price. It may offset a portion of it, but it's not ever fixed.

Q. Do you agree that it's a management decision as to whether or not to hedge?

A. Yes.

Q. Do you believe that management decisions of

that nature should be subject to prudence review, reviews of prudence?

A. Yes.

MR. THOMPSON: I have no further questions. Thank you, Judge.

JUDGE STEARLEY: Ms. Mantle, thank you for your testimony. You are excused.

Staff, you may call your last witness.

MR. THOMPSON: Staff calls Dana Eaves.

(Witness sworn.)

JUDGE STEARLEY: You may be seated.

DANA EAVES testified as follows:

DIRECT EXAMINATION BY MR. THOMPSON:

Q. Good afternoon, Mr. Eaves. Would you state your name, please.

A. My name is Dana Eaves.

Q. And how are you employed?

A. I'm employed with the Missouri Public Service Commission as a utility regulatory auditor.

Q. Are you the same Dana Eaves that prepared or caused to be prepared the documents that have been marked as Staff's Exhibit 1HC and NP?

A. Yes.

Q. Do you have any corrections or changes to that testimony?

A. I have one correction to the Staff's report on page 10. It's not line numbered by line, but it's the first line, second to the last word where it says option, I'd like to change that to future.

Q. Do you have any other changes or corrections?

A. No.

Q. With that correction in mind, if I asked you those questions today, would your answers be the same?

A. Yes, they would.

Q. And would -- are they true and correct to the best of your knowledge and belief?

A. Yes.

MR. THOMPSON: At this time I'd offer Staff's Exhibit 1HC and NP and I tender the witness for cross-examination.

JUDGE STEARLEY: Do I have any objection to the admission of Staff Exhibit No. 1?

MR. CONRAD: None.

JUDGE STEARLEY: Hearing none, it shall be received and admitted into the record.

(STAFF EXHIBIT NO. 1HC AND NP WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: Mr. Thompson, for clarity, I would like -- I know it's attached to Mr. Eaves' testimony. I would like you to offer a copy of Staff's report as a separate exhibit.

MR. THOMPSON: Will do, Judge.

JUDGE STEARLEY: And that will be Exhibit No. 10 for Staff.

MR. THOMPSON: I only have one copy. Can I offer it now or would you prefer me to late file?

JUDGE STEARLEY: You can offer it now if you wish. Any objections to Staff Exhibit No. 10?

MR. CONRAD: No.

JUDGE STEARLEY: It shall be received and entered into evidence.

(STAFF EXHIBIT NO. 10 WAS RECEIVED INTO EVIDENCE.)

JUDGE STEARLEY: Mr. Conrad, do you have any cross-examination for this witness?

MR. CONRAD: I do not, sir. Thank you.

JUDGE STEARLEY: Mr. Fischer, cross-examination?

CROSS-EXAMINATION BY MR. FISCHER:

Q. Good evening, Mr. Eaves.

A. Good evening.

Q. Do you happen to have a copy of your direct rebuttal testimony and also a copy of your deposition in this case?

A. I don't have a copy of my deposition with me.

Q. Okay. I'll give you a copy. We may need it. We may not.

As I understand the Staff's prudence review, the report, on page 2, Staff has found GMO was imprudent in its use of natural gas hedges to mitigate the risk associated with its future purchases in the spot market, right?

A. That's correct.

Q. And in the next sentence I believe you indicate originally that Staff recommends the Commission order GMO to refund an amount of $18,755,865, plus interest at the company's short-term borrowing rate through the time the refund is made in the context of the cost adjustment factor filing No. 8; is that right?

A. Yes.

Q. Now, I do also understand that you modified your position on the number; is that right?

A. Yes.

Q. And for the record, what is the disallowance and refund that Staff's supporting in this case?

A. Approximately 14.9 million.

Q. And this is the only disallowance that

you're recommending in this case, right?

A. That's correct.

Q. And you're the sponsoring witness of that disallowance?

A. That's correct.

Q. Okay. Just for the record, I think Ms. Mantle explained the difference between the original position and the 14.9, but could you briefly for the record explain why you changed your position on that?

A. Sure. Be happy to. When I initially proposed this adjustment amount, I was working off Mr. Blunk's, I believe it was at that time WEB-5, the spreadsheet, and that spreadsheet summarized the various transactions that was associated with the natural gas portion of the hedging as well as the purchased power portion of the hedging, and it made no mention of contracts that were under a Stipulation & Agreement that should not have been looked at, or I've heard some different terms used, but couldn't be considered for a prudency review.

Q. There was an agreement back in the previous rate case where, after a certain date, those hedges wouldn't be considered for a prudence review in consideration for the fact that they settled the case, right?

A. That's correct. And I just didn't connect the dots.

Q. Okay.

A. It wasn't clear and evident right before me that that had happened.

Q. Now, on page 13 of the Staff Report, near the bottom of the page, under No. 5 there, the conclusion section.

A. I'm sorry. What page again?

Q. Page 13.

A. Okay.

Q. There's a paragraph 5, conclusion. There you state, Staff found GMO's hedging activities related to natural gas used for electric generation to be in compliance with GMO's natural gas price hedge plan; is that correct?

A. I'm not seeing it. I'm sorry. My page 13 may be different than yours. You said this was the Staff Report, page 13?

Q. I may be --

MR. THOMPSON: It's Schedule DEE-2-15.

MR. FISCHER: Yeah. That's right. It's Schedule DEE-1-15, which I believe is the Staff Report.

MR. THOMPSON: 1 is the NP. 2 is the HC. Just in case that makes a difference.

MR. FISCHER: All right. I appreciate that.

BY MR. FISCHER:

Q. I'm really just looking at the last paragraph. Do you see that? It's page 13 of the report, but it's Schedule DEE-1-15.

A. Yes, I've got it.

Q. Okay.

A. No. 5, conclusion?

Q. Yes.

A. Yes, I'm there.

Q. There it says, the Staff found GMO's hedging activities related to natural gas used for electric generation to be in compliance with GMO's natural gas price hedge, right?

A. That's what it says, yes.

Q. Is it correct to conclude that you found that GMO's hedging activities related to using natural gas prices for the purpose of hedging electric generation, that was consistent with and in compliance with the GMO hedging plan, right?

A. That's a very traditional method, hedging method. I don't have any problems with that particular plan, and I don't feel that GMO has stepped outside the bounds of their policy.

Q. And you found that it was in compliance with the plan that it had when it started the process, right? Isn't that what it says?

A. And I think what I was -- what I'm referring to when I talk about the hedge plan, and that's really the risk management plan that they have. They have a document entitled, I think it's KCP&L GMO's risk management plan. Sometimes it's referred to RMP.

Q. That was -- that's in Empire, isn't it, RMP?

A. Possibly. But whatever the title, it's a risk management plan.

Q. That plan was the one that I think Mr. Hyneman may have attached to his testimony in 2005 and 2007, right?

A. Possibly, and there's -- there's other filings of it. It's the risk management plan.

Q. And it refers to both natural gas hedging for purposes of generation and also for purposes of hedging purchased power risk, right?

A. I believe that particular section, and I don't have the plan in front of me, but it does make the statement that they will use natural gas to hedge purchased power, no more, no less than that statement, as far as I recall. That's it.

Q. And as far as you know, GMO filed its hedging plan, right, both on natural gas for generation and for purchased power?

A. If their plan was to hedge natural gas futures contracts with purchased power, I think they've followed that plan, if that's a plan. It's a statement. If the statement's a plan, then they followed it.

Q. Okay. Now, I think probably the record is clear what cross hedging is by now, but you do define cross hedging, and I guess in your answer to one of the DRs, you define cross hedging as the act of hedging one's position by taking an offsetting position in another good with similar price movements; is that right?

A. Yes.

Q. And I believe your answer cited an online source, Investopedia.com, right?

A. Yes.

Q. And then if you look at that source, there was also an example of cross hedging, and it said that although the goods are not identical, they're correlated enough to create a hedge position as long as the prices move in the same direction. A good example is cross hedging a crude oil futures contract with a short position in natural gas. Even though those two -- these two products are not identical, their price movements are

similar enough to use for hedging purposes. You agree with that, right?

A. Yes.

Q. Now, does this suggest to you that it's possible to cross hedge crude oil futures contracts with a short position in natural gas even though the commodities are not identical?

A. It certainly is possible to do.

Q. And does that suggest to you that crude oil futures and natural gas commodities have similar price movements that are similar enough for hedging purposes?

A. That's what the theory tells me, yes.

Q. If you were going to cross hedge the risk of spot purchased power with another commodity using financial instruments, how would you go about doing it?

A. First I think I'd have to -- in fact, I know I would have to have a study or some type of analysis, some type of report, whether I contracted it out or did it in-house. When I say do it in-house, that would be the utility do it or they could hire a contractor to fill that obligation of that study.

Q. Somebody like Kase & Company?

A. I'm not sure what Kase & Company would do. I know for this particular case they have a hedging model that they support and they offer to the company, and it's a statistical model that helps the company.

Q. Okay. I think I interrupted you. So you'd go to somebody like -- somebody on the outside?

A. A consultant that specializes in, what am I supposed to do? I have various risks. What are the least cost options? What are some of my options? I know we've talked a lot about building. We've talked about fixed price contracts. We've talked about cross hedging, what GMO is currently doing.

I'd like to see what demand response would do. I'd like to see what energy efficiency would do. I would like to see -- I don't know. I mean, I'm not in that position to do, but I know what I would do and what I would expect to do --

Q. Okay. What --

A. -- if I was in management. I would have some type of a report, the report -- that way I would have a foundation to make some decisions on.

Q. Okay. So you have a report.

A. Uh-huh.

Q. It suggests that you should be doing some hedging using financial instruments. What's the next step? What would you do then?

A. I think the -- again, I still have to use some decision-making in that process, what I would do and based on the results of the report. Say it came back and it said, hey, look, you really -- you really have a build option here. It may take -- it may take -- what does it take to build a power plant? It may take five years to build.

Q. Let's set aside the --

A. I'm going to have to consider all my various options on that. Can I get regulatory approval? Can I get financing? You know, I think there's a lot of decisions involved, especially when you're talking about this level dollars that are at risk.

Q. And that option of building, like you say, is a five-year option, right? You can't -- you're not going to do anything to help consumers and mitigate their volatility of electric price risk during the next year if you're talking about building an Iatan 2, right?

A. No, but hopefully my horizon is more than 11 months. It may not solve this 11-month or this 12-month problem, but it may solve -- in three years it may solve. And so that would tell me, hey, now I need to do something else. Do I need to cross hedge, and when I cross hedge, should I fix the price? Should I get in with a marketer and fix the price or should I let the price float in the market and then subject myself to that risk as well? I don't know. I mean --

Q. Again, the question was, if you're going to cross hedge the risk of spot purchased power with another commodity using financial instruments, what would you do?

A. There's -- other instruments you could use would be options, which are puts and calls.

Q. Is that what Staff's recommending in this case?

A. Staff has not recommended using puts and calls. I don't know what would be -- I haven't done that analysis, so I couldn't recommend something.

Q. So you're suggesting that what they did was imprudent, but you don't have a suggestion what they should have done, right?

A. That's correct. That's my role.

Q. Well, if we assume for purposes of this question that natural gas prices are positively -- are strongly positively correlated with spot electricity prices, do you believe it would be possible to cross hedge the risks associated with the spot purchased power by using natural gas futures contracts?

A. That's the problem I have is that I don't believe that's the only -- that's the only price driver. Even though they may be highly correlated or strongly, have a strong positive correlation, whatever we want to term that, you know, I really don't care. Say they're highly correlated. I still don't feel, and I think my testimony points out, that natural gas price is not the only driver in spot prices, and we see that.

Q. I guess --

A. We've clearly demonstrated that.

Q. I'm asking you, if they're strongly positively correlated, do you believe it's possible to cross hedge the risks associated with spot purchased power using natural gas futures?

A. I do, and the best way to do that would be fixed price on the other side, not let the price float in the market.

Q. And by that you mean building a power plant --

A. No.

Q. -- or how do you fix that?

A. No. I enter into an agreement with a generator to fix a price based on natural gas. I'm going to assume the risk. Okay. Again, we've kind of got away from what we're doing here, but we're trying to mitigate the risk.

Q. Is Staff's disallowance in this case based upon the fact that they didn't go out and find a generator to fix the price with?

A. I don't know that it's solely based on that, but it's based on my feelings that there is other price drivers, okay, significant price drivers in the cost of energy prices other than natural gas, and that the tool that GMO's used, the NYMEX futures contracts, were not the best tool to use in the manner that they used it. It could be a good tool, but I think Lena said, you know, you're cutting boards with a hammer. It's not the best tool.

Q. Is Staff's disallowance based upon the fact that they didn't go out and fix a price with a generator?

A. It's not based on that. I think if you're asking me what are possible solutions, that would be a solution. If they would have done that, would the losses that GMO incurred, would they still be there? I don't know.

Q. And so you don't know what the cost to compare those options, what they did was cross hedge, you don't know what it would have been if they'd gone out and fixed the price with a generator, right?

A. No. I wish I -- I wish I had that information. I mean, it would have been -- in my position as an auditor, it would have been a wonderful document to have in the beginning, to say this is the reason GMO did what they did.

Q. So you can't quantify for the Commission

what the cost was of the decision for GMO to have cross hedged, which it did, versus going out and fixing a price with some generator?

A. No.

Q. Okay.

A. I can only tell you what the cost was.

Q. What else should they have done?

A. I don't know. I think it would be -- you're putting me in a position where you want me to make decisions for the company, and I'm not able to do that.

Q. No. I --

A. I don't have -- I don't have any supporting documents that I would be able to base my decision on.

Q. I'm asking what the Staff believes the prudent decision would have been.

A. Could have been prudent not to cross hedge at all.

Q. So that's what you think the prudent decision would have been, not to do the insurance, not to try to mitigate against skyrocketing electric prices?

A. I don't know that energy prices have skyrocketed. I don't know. I don't --

Q. With hindsight, I'd agree with you, Mr. Eaves. They haven't. They've actually gone down. The slides show that during the review period, even with

the hedging costs, they went down, which is a good thing.

A. Was that a direct effect by GMO hedging with NYMEX futures prices? And I don't believe so. I believe -- I believe what you see, the trending down of energy prices had other factors, other drivers that caused that to happen.

Q. Well, what should the company have done? In other words, what's the other option besides financial future -- financial instruments using natural gas futures contracts? The one that you mentioned was contracting with the generator. Is there a third option they should have done?

A. Could do nothing.

Q. And is that what Staff believes would be the prudent decision in this case?

A. It could have been a prudent decision.

Q. I'm asking whether it was a prudent decision from your perspective.

A. I can't give you an answer to that. I don't know.

Q. Okay. So we don't know what the cost would be comparing what the company actually did with what you believe was a prudent decision because you don't know what a prudent decision was?

A. My recommendation is, is that the decision that the company made was not prudent. I don't know. They could have made a myriad of other decisions. Some of those might have been prudent. Some of those might not have been prudent. I don't know because they didn't make them. The only decision that they made was to cross hedge energy prices with a NYMEX future contract and allowing that price on the other side, the energy price to float in the market and be subjected to market pricing.

In my -- in my analysis, my review, I've just never made the connection between how GMO's actions cross hedging has mitigated any risk at all on the energy side, the way that they've done it.

Q. If Katrina occurred during that period and prices had gone to $15 on the natural gas side and they went out of sight on electric, would that have been a prudent decision then?

A. I don't think so. I think -- because what would be the -- what would be the price driver for the increase in energy cost, it would have been Katrina. You could have had still an oversupply of gas. Maybe gas went to 15. You can still have an oversupply of energy. Energy prices didn't necessarily follow.

Q. And that goes to whether those two markets are correlated or not; isn't that the key?

A. That is a big key with -- with the decision that was made at the time that GMO made, are those markets sufficiently correlated and does it take into account all the price drivers involved in energy price and was that a prudent thing to do?

Q. Okay. Let's talk about the PGS Energy training seminar which you went to, webinar entitled How to Financially Hedge Natural Gas and Electricity Price Risk.

A. Sure.

Q. Did the PGS Energy training webinar include a discussion a how hedging electricity price risk with natural gas futures, how you do that?

A. Yeah. There's -- as I recall in reading through the handout just recently, there's really two portions of that webinar. One was working basically using NYMEX futures contracts, same on both, but then using a marketer to fix a price on a contract or letting the price of energy just float on the spot market. That was the two different, very distinct sections, as I recall, and looking through the handout, that's -- my recollection of that is correct.

Q. Do you consider PGS Energy training to be a reputable source of information about hedging electricity and natural gas?

A. They provide a lot of informational

webinars and training on various issues, whether it's transmission or hedging. They have a wide variety of programs that they offer.

Q. And I think a lot of Staff folks have gone to those over the years. I believe you gave me information there was 55 or so that attended on one of the exhibits, right?

A. That's correct. They're low cost. That's one of the reasons we're able to do it.

Q. And wouldn't you agree that that training webinar did teach someone at a very high level perhaps, as you suggested in the deposition, how to do cross hedging using natural gas futures?

A. They showed the methodology to do it. They don't -- they don't go in any depth. I'm trying to even recall if they were talking about the type of utilities that it might benefit. You know, GMO is a regulated integrated utility. There's other utilities out there that operate in different environments that this may be a better fit for. I don't know. I don't know if we've gotten -- we went into that level of discussion or not.

Q. Since your deposition, have you familiarized yourself with the CME Group?

A. No.

Q. So you didn't go back to check to see if

they own the NYMEX?

A. No.

Q. Or that they own the Chicago Mercantile Exchange and the Chicago Board of Trade?

A. No, I did not.

Q. Did you include in any of your work papers any publications or articles or treatises that address the topic of cross hedging?

A. I might have. I don't recall. I just don't remember.

Q. Would you turn to your deposition at page 22, line 19.

A. I'm there. I answered in my deposition I did not to that question that you asked.

Q. Would you list any publications, articles or treatises that you reviewed in preparation for your testimony in this case that dealt with the topic of cross hedging?

A. Did I attach?

Q. No. Did you review any? Would you list the ones you did review?

A. I did review. I don't know that I made a list of any.

Q. So none of those were attached to your work papers?

A. No.

Q. Or your testimony?

A. No.

Q. At the time of the deposition, I believe you couldn't recall any. Do you recall some today?

A. I don't recall any specific titles, and I didn't go back and try and do a review and list titles for you, no.

Q. Do you remember any textbooks or particular journals that you looked at that included those kinds of articles?

A. I just can't give you any specific. I'm really bad with names on books and things like that. I just can't do it.

Q. In your mind, can you see an article that you remember reviewing?

A. I know I reviewed some of Dr. Woo's articles and things.

Q. Some of those 16 --

A. Some of those. I mean, I reviewed some of those, but that was much, much later on in the process. I mean, that's the closest I can get to you. I've reviewed a lot. There's a couple of textbooks. One's -- some economic books and things like that, but no specific titles. It's just general information.

Q. Samuelson or what was it that you reviewed?

A. I'm not going to be able tell you. I can't tell you.

Q. So you can't really remember what you reviewed.

A. No, not specific titles.

Q. Other than some of those articles from Dr. Woo?

A. I can't even tell you which articles I reviewed from him. I re-- as a course of business, I would have reviewed the articles that he sent in a DR.

Q. Some of those 16 that we sent to you?

A. Yeah.

Q. And that would have been after you filed your recommendation in the Staff Report and after you filled the testimony recommending an $18.8 million refund, right?

A. Yeah. It would have been -- on those Dr. Woo documents, those have been after the fact, sure.

Q. And you didn't include any of those publications in your work papers?

A. No. There -- you know, there are data requests. They're available in this case. I'm not going to attach all data requests to the --

Q. And they're not in evidence?

A. That I don't know.

Q. Okay. Have you reviewed any publications of the Missouri Public Service Commission on the topic of hedging?

A. The one, the document that was referred to earlier today, I reviewed that.

Q. The joint report on natural gas hedging that encourages natural gas companies to hedge?

A. For local gas distribution companies.

Q. As a part of your undergraduate education, did you have any specific courses that taught you how to cross hedge commodities such as natural gas or electricity?

A. I don't believe so. There might have been something as just general information in some accounting class or some micro or macroeconomic class or statistics class or something.

Q. It's probably not a topic that would generally be talked about in statistics 101, right?

A. Probably not. At that as well, I don't know if cross hedging was as popular back then as it is now.

Q. It is popular now, right?

A. There's various -- there's active markets in cross hedging, yes.

Q. And a lot of different commodity markets?
A. You can almost cross hedge anything, I think.
Q. But not electricity and natural gas?
A. You can do it.
Q. I think during your deposition you also told me that you talked to Dave Sommerer on the general topic of natural gas hedging for gas companies, right?
A. Yes.
Q. With the exception of Dave Sommerer, you had not had any specific discussions about natural gas hedging, electricity price risk hedging or cross hedging or correlation hedging with any other members of the Staff; isn't that what you told me?
A. I think that's what I told you, yes.
Q. Now, that webinar that you attended, it was a four-hour webinar, and the second section was dealing with how to use natural gas futures to hedge the price of electricity, right?
A. I think both sections were around how to use that model to hedge energy price with NYMEX futures contracts. One was fixing a price on the side. The other was letting it float out in the market. That's how I recall it.
Q. But that title of that second session,

wasn't it that it was basically how to hedge electric price risk with natural gas futures?

A. Okay. I have session 2.

Q. What's the title of that? I may have incorrectly stated it.

A. The title of session 2, How to Financially Hedge Natural Gas and Electricity Price Risk. That's the title.

Q. Okay. And then go to the next -- the fifth -- the fifth slide in. Doesn't that say or isn't there one around that point that says how to hedge electricity price using NYMEX natural gas futures, something to that effect?

A. The 5 and 6 slides, No. 5, No. 6 slides, the heading on No. 5 is Hedging Basis Risk with a Basis Swap. The No. 6 title is Hedging Basis Risk with a Basis Swap.

Q. Okay. Let's go back to that a little bit later.

A. Okay.

Q. With the exception of that course, that webinar that you took, haven't you told me in the deposition that you didn't participate in any other formal seminars or webinars or undergraduate or graduate courses that dealt with the topics of natural gas hedging or

electric price hedging?

A. That's what I said in my deposition, yes.

Q. And I think I asked you if you were going to recommend a textbook to the Commission on hedging so they understood this cross hedging a little bit more, what would you recommend? Do you have anything that comes to mind today? At the time I don't think you did.

A. No. I didn't -- I didn't attempt to bring a list of titles to educate the Commissioners, no.

Q. And you haven't published any white papers or other articles on the topic of natural gas or electric price hedging, right?

A. Not yet.

Q. I hope -- I'll read it when you do.

Have you previously testified regarding cross hedging electricity using natural gas futures contracts?

A. No.

Q. I believe that Ms. Mantle indicated that Staff's proposed disallowance in this case is really your responsibility, it was your idea; is that right?

A. Correct.

Q. Do you believe you're probably the most knowledgeable person on Staff about cross hedging today?

A. I'm not sure. We have -- we have some people on Staff that are very knowledgeable. They may have -- but in my apartment, Dr. Kang, he may have a degree, he may have a doctor's degree in economics. I don't know what his specialty is, if he knows about cross hedging. He may have more knowledge. I mate to single myself out just because I haven't done analysis of who knows what.

Q. Sure.

A. But for the purposes of this case, I probably know more about the specifics in this case than any other Staff person does.

Q. Okay. You're the primary person that's responsible for reviewing the hedging activities in this case, right?

A. The buck stops here, yes.

Q. Okay. In the Empire prudency cases that we talked about in your deposition, Case No. EO-2010-255 and ER-2008-0093, those were the prudency cases on Empire that you participated in, right? Do you recall that?

A. I'm sorry. You're going to have to -- you lost me in the numbers.

Q. Let's don't talk about the numbers.

A. Okay.

Q. You were involved with two prudency reviews of Empire, right?

A. That's correct.

Q. Okay. And in those prudency reviews, didn't you find that Empire had complied with their hedging plan?

A. Yes.

Q. And in those cases you found that Empire followed its hedging plan, right?

A. Yes.

Q. It's also correct that you recommended no disallowances in those Empire cases relating to hedging activities, right?

A. Yes.

Q. Now, you also were involved in a couple of Ameren cases, right?

A. I believe one Ameren case.

Q. Okay.

A. Well, I take that back. There has been a subsequent, so yes, two.

Q. And you reviewed whether Ameren followed its hedging plan in those two cases?

A. Yes.

Q. Did you find that Ameren had followed the hedging plan in those cases?

A. Yes.

Q. Is it correct that in the Ameren prudency

cases, you did not recommend a disallowance related to the company's hedging activities?

A. There was a disallowance recommended, but not associated with hedging activities.

Q. That's the one that got recently reversed; is that right?

A. I'm not sure what it's done in the circuit court. I know it went to circuit court, but I don't know what it's done.

Q. Okay. Well, until this case, is it correct that you personally have never specifically proposed any disallowance in a prudence review related to an electric company's financial hedges or hedging activities?

A. Associated with a prudency review, I believe that's correct, yes.

Q. In any rate case?

A. I'm going to have to say no. I just can't recall. Seems that there was something about hedging, but I can't recall. I'm going to say no.

Q. Well, okay. Let me make sure the record is clear. You're saying that you can't recall that you ever specifically recommended a disallowance related to financial hedges or hedging activities?

A. I think it's getting late, and so --

Q. I agree.

A. -- yes. I think how you presented that is correct, yes.

Q. Okay. Do you know if Staff has reviewed GMO or Aquila's hedging plans in previous cases?

A. They should have. The report would tell us whether or not they did and at what level they reviewed those.

Q. I believe in your deposition I asked you about the 2005 and the 2007 Aquila rate cases, and you indicated, I believe, that Aquila's hedging programs were reviewed in those cases.

A. They were or were not?

Q. They were. Do you recall that?

A. I don't recall saying it, sitting here today without having the reports in front of me. How those reports are broken up, they're broken up by section. Different witnesses are responsible for the different sections.

Q. Would you turn to page 41 of your deposition, line No. 1. I guess you need to go back to page 40 where the question is asked, would it be likely to have been the 2005 and 2007 rate cases of Aquila? And I guess you go back another question or two where it says, on line 18, do you know if Staff has reviewed GMO's or Aquila's hedging plans in previous rate cases? And then

we go --

A. And I answer yes.

Q. Yeah.

A. And again, thinking about it today, some time has elapsed, I would assume they would have. Again, I wasn't on those cases. And I know I've reviewed the prior reports, but to get to that level of specificity sitting here today, I -- I don't know.

Q. So in your preparation for this case, you really didn't go back and review what Staff might have said about Aquila or GMO's cross -- or hedging plans in the past?

A. I would have read the reports, but being able to recite exactly what that report says, I -- my assumption is that they looked at the hedging strategies. Now, at what level they looked at, did they understand what they were looking at, I didn't go back and ask the auditors, say, hey --

Q. And that's fair. In those cases, did Staff specifically allege that GMO's cross hedging activities related to the use of natural gas futures contracts were imprudent?

A. I know that there wasn't any recommendations by Staff for disallowance, for an allowance for those, so if that answers the question.

JUDGE STEARLEY: Mr. Fischer, before you go on with another question, I'm going to interrupt here briefly. I'm not sure how much longer you have for cross and then with redirect.

MR. FISCHER: I've got a little, Judge.

JUDGE STEARLEY: And I don't mind going late and finishing up if it means we're not going to be back here tomorrow, but there may be other people who have to make arrangements for child care or something of this nature. So I wanted to stop for a moment and just check with everyone.

MR. FISCHER: I'm happy to go forward, but I think given the amount of material I need to cover, it's going to be a while.

JUDGE STEARLEY: Okay.

MR. FISCHER: And the company's certainly willing to come back tomorrow. We are scheduled anyway.

JUDGE STEARLEY: What is the parties' preference in general? Staff?

MR. THOMPSON: Staff is ready to do whatever is required. Staff will stay late tonight to complete or Staff will come back tomorrow and complete then, whatever the preference of the Commission and the majority of the people here.

JUDGE STEARLEY: In terms of your cross,

Mr. Fischer, just a ballpark time?

MR. FISCHER: Judge, I might be able to cut it down if we take a break tonight. So right now there's substantial amount of cross.

COMMISSIONER STOLL: Would it be of any advantage to reconvene tomorrow when other Commissioners would be here?

JUDGE STEARLEY: It may be. I don't want to cut down on any of the --

MR. FISCHER: We're ahead of schedule. I would recommend, I guess, if it was up to me, to take a break and let everybody clear their heads a little bit. Maybe I can cut the cross a little bit, and if we have some other Commissioners, that would be terrific, too.

JUDGE STEARLEY: A ten-minute break or are you referring to a break until tomorrow morning?

MR. FISCHER: No. I'm talking about a break 'til tomorrow.

JUDGE STEARLEY: All right. Is this a good stopping point or did you have a couple more questions you want --

MR. FISCHER: Yes, this is fine. It's five o'clock, and it's a good stopping point.

JUDGE STEARLEY: Well, let's go ahead and take a recess at this point and we'll reconvene tomorrow morning then at 8:30. All right. And when we come back, Mr. Eaves, you will still be under oath and we'll pick up where we left off.

MR. FISCHER: Judge, I note it's an agenda day tomorrow, too. If the Commission prefers to take a break for the agenda, we can stay around until the Commissioners are available, too.

JUDGE STEARLEY: And I can find out in the morning just who's going to be here, because I know at least one I believe is out traveling. We could resume, and I'm not sure how long agenda's going to go. I understand there may be a presentation up there tomorrow as well. So we may just want to go ahead and start at 8:30.

MR. FISCHER: Whatever is your preference. I just wanted to indicate we want to accommodate the Commissioners any way we can.

JUDGE STEARLEY: That's fine. And with regard to Exhibits 11 and 12, which I have reserved the ruling on and had asked for some further information from Staff, I think I will go ahead and take those up tomorrow. That was regarding two exhibits on Staff's filing and transcript in ER --

MR. THOMPSON: Right. You said you wanted Staff to give a written submission. Do you want that tomorrow?

JUDGE STEARLEY: No. I think I'll make a ruling based on what I already know regarding the parol evidence rule objection. If you have any other objections at that time to those documents, you can raise them then and take it up --

MR. THOMPSON: Thank you, Judge.

JUDGE STEARLEY: -- at the conclusion of the hearing on some other housekeeping matters.

All right. We'll stand in recess until tomorrow morning at 8:30.

(WHEREUPON, the hearing recessed at 5:00 p.m.)

INDEX

EXHIBITS INDEX

GMO'S EXHIBITS

	MARKED	RECEIVED
EXHIBIT NO. 1NP/1HC		
Direct Testimony of Wm. Edward Blunk	90	93
EXHIBIT NO. 2NP/2HC		
Surrebuttal Testimony of Wm. Edward Blunk	90	93
EXHIBIT NO. 3NP/3HC		
Surrebuttal Testimony of Ryan A. Bresette	149	151
EXHIBIT NO. 4		
Surrebuttal Testimony of Gary L. Clemens	140	142
EXHIBIT NO. 5		
Direct Testimony of Scott H. Heidtbrink	138	139
EXHIBIT NO. 6		
Direct Testimony of Tim M. Rush	159	160
EXHIBIT NO. 7NP/7HC		
Surrebuttal Testimony of Tim M. Rush	159	160
EXHIBIT NO. 8		
Direct Testimony of Dr. C.K. Woo	87	89
EXHIBIT NO. 9		
Surrebuttal Testimony of Dr. C.K. Woo	87	89
EXHIBIT NO. 10		
Order Clarifying Report and Order, Case No. ER-2007-0004	87	89
EXHIBIT NO. 11		
Staff's Suggestions in Support of the Nonunanimous Stipulation & Agreement Case ER-2005-0436	*	
EXHIBIT NO. 12		
Certified Copy of Transcript, February 9th, 2006 in ER-2005-0436	*	

C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified Shorthand Reporter with the firm of Midwest Litigation Services, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of Jefferson, County of Cole, State of Missouri.

____

Kellene K. Feddersen, RPR, CSR, CCR