Exhibit No.:
Issue: IEC, 2011 Missouri River Flood
AAO, Fuel Prices
Witness: Wm Edward Blunk
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2012-0174
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2012-0174

REBUTTAL TESTIMONY

OF

WM. EDWARD BLUNK

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

Kansas City, Missouri
September 2012

"[redacted]**" Designates "Highly Confidential" Information Has Been Removed.**

REBUTTAL TESTIMONY

OF

WM. EDWARD BLUNK

Case No. ER-2012-0174

Q: Please state your name and business address.

A: My name is Wm. Edward Blunk. My business address is 1200 Main Street, Kansas City, Missouri 64105.

Q: Are you the same Wm. Edward Blunk who pre-filed Direct and Supplemental Direct Testimony in this matter?

A: Yes, I am.

Q: What is the purpose of your Rebuttal Testimony?

A: I will respond to the Direct Testimony of Dwight D. Etheridge, on behalf of the United States Department of Energy and the Federal Executive Agencies, and Greg R. Meyer, on behalf of the Missouri Industrial Energy Consumers and Midwest Energy Consumers Group, regarding Kansas City Power & Light Company's ("KCP&L" or the "Company") requested Interim Energy Charge ("IEC"). I will respond to Mr. Etheridge and Mr. Meyer regarding the Company's requested accounting authority order related to lost off-system sales ("OSS") margin related to the Missouri River flood of 2011. Finally, I will respond to Staff's proposed fuel prices.

I. Interim Energy Charge

Q: Please recap that part of Mr. Etheridge's Direct Testimony regarding the IEC that you are addressing.

A: At page 4, Mr. Etheridge recommended that KCP&L's OSS margins be addressed separate and independent of KCP&L's IEC proposal.

Q: What are your issues with Mr. Etheridge's idea?

A: When the OSS margin credit to retail mechanism was created in Case No. ER-2006-0314 ("2006 Case") it increased the Company's cost risk by breaking the natural hedge between fuel cost and OSS margin. As discussed in Mr. Schnitzer's Direct Testimony at pages 12-15, Off-System Contribution Margin is a function of natural gas prices, market implied heat rate, and quantity sold. Because OSS margin is positively correlated with the price of natural gas it helps mitigate some of the fuel cost risk from changes in the market price of natural gas, and thus provides a hedge against such cost increases.

The Report and Order in the 2006 Case, which initiated the use of the 25th percentile OSS margin credit mechanism, discussed on pages 31-32 the Company's reasoning on why its return on equity ("ROE") should be increased if the Missouri Public Service Commission ("MPSC" or the "Commission") set rates using an OSS margin greater than the 25th percentile. When rates were established using the 40th percentile for OSS margin in Case No. ER-2010-0355 ("2010 Case"), KCP&L's ROE was not increased by any additional basis points as discussed in the 2006 Case. The Company disagreed with including the 40th percentile OSS margin in the 2010 Case because of the increased risk it placed on the Company. In this case, the Company is supporting the 40th percentile but only in combination with its proposed IEC, because only then would the Company be able to restore the natural hedge that OSS margin provided for part of fuel expense.

Q: When the Commission adopted the 40th percentile for OSS margin in the 2010 Case did it compensate the Company for that increased risk to its ROE?

A: No. The 2006 Case was the genesis of the OSS margin mechanism and the 25th percentile, and in its Report and Order in the 2006 Case the Commission noted the link between ROE and OSS. Based on its discussion of risk on pages 32-36, the Commission should have increased KCP&L's ROE when the OSS margin requirement was changed from the 25th percentile to the 40th percentile. However, that did not occur even though the shift from the 25th to the 40th percentile represented a significant change in risk that the 2006 Rate Case Report and Order appeared to suggest would warrant an increase in ROE.

Q: Has this Commission recognized in another context the need to consider changes in the risk to a utility resulting from changes in rate adjustment mechanisms?

A: Yes. The Commission's regulation at 4 CSR 240-20.090 (2)(B) states:

> (B) The commission may take into account any change in business risk to the utility resulting from establishment, continuation or modification of the RAM in setting the electric utility's allowed return in any rate proceeding, in addition to any other changes in business risk experienced by the electric utility.

Q: Will the Company's proposed IEC sufficiently mitigate the risk of using the 40th percentile to eliminate the need for extra ROE like that discussed in the Report and Order in the 2006 Case?

A: It will reduce but not eliminate the increased risk created by imputing the 40th percentile of OSS margin into KCP&L's cost of service ("COS").

Q: What is Mr. Meyer's recommendation regarding the IEC?

A: At pages 3, lines 27-32 through 4 of his Direct Testimony Mr. Meyer simply recommended that the Commission deny KCP&L's request for an IEC proposal.

Q: What are your issues with Mr. Meyer's recommendation to deny KCP&L's request?

A: In the 2010 Case, the Commission adopted Mr. Meyer's recommendation to move away from using the 25^{th} percentile to using the 40^{th} percentile threshold for OSS margins. Moreover, in his True-up Rebuttal with a then current market perspective in hand, Mr. Meyer argued that a stale out-of-date market perspective from the Direct filing was more relevant than current information from the True-up filing. In essence Mr. Meyer was arguing against the value of a True-up. He did not mention the fact that from the time the Company's Direct Testimony had been filed until True-up the forward price of natural gas had dropped 16-17% and that was the reason why the **[redacted]** off-system sales margin number he was recommending was about **[redacted]** greater than the True-up 40^{th} percentile. If he had told the Commission what percentile his **[redacted]** recommendation represented given the market conditions known at True-Up, it may not have viewed his recommendation as "conservative and easily achievable in that it represents a point where KCP&L has a better than equal probability of meeting or exceeding expectations."[1] It appears that in this pending case, Mr. Meyer is again recommending that timely market information be ignored and the Company be denied the opportunity to true-up fuel cost and OSS margins.

[1] Report and Order at p. 136, ¶ 397, Case No. ER-2010-0355 (Apr. 27, 2011).

Q: Is an IEC the best mechanism for minimizing costs to ratepayers and incenting the Company to maximize OSS margins, thereby reducing the COS?

A: No.

Q: What kind of mechanism would minimize costs to ratepayers and incent the Company to maximize OSS margins in order to reduce COS?

A: It would take a mechanism that is more comprehensive than is currently permitted under Missouri's Rate Adjustment Mechanism regulations. Such a mechanism would need to recognize that in an integrated market place like the one Southwest Power Pool plans to implement in March 2014, utilities will be making decisions that are affected by ever changing fuel, power, and transmission costs. The interplay between those costs and the derivatives to manage those costs should be fully recognized. When fuel, power, and transmission costs are managed separately it can create incentives or disincentives that lead to undesired consequences.

Q: The Commission is contemplating opening a docket to discuss hedging for electric utilities. Would it be appropriate for the Commission to analyze rate adjustment mechanisms or modifications to the current RAMs that may be necessary to mitigate risks to ratepayers and utilities caused by changes in the market place?

A: Yes. The purpose of hedging is to mitigate risk. Therefore, the Commission should consider mechanisms or modifications to existing mechanisms that can reduce costs to ratepayers while effectively mitigating risk to both the ratepayer and the utility.

II. 2011 Missouri River Flood AAO

Q: Please recap Mr. Etheridge's Direct Testimony regarding the Company's request for an accounting authority order ("AAO") to amortize the costs of the 2011 Missouri River flood.

A: Mr. Etheridge questions the reasonableness of the Company's request to be compensated for OSS margins that did not materialize because of the flood. He argues at page 5, lines 11-12 of his Direct Testimony that the Commission should reject KCP&L's request based on "the balance struck in the Regulatory Plan between customers and shareholders regarding OSS margins…."

Q: When the Regulatory Plan was implemented in the 2006 Case, how did it balance OSS margins between customers and shareholders?

A: The Report and Order in the 2006 Case states at page 33:

> The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of the alternative KCPL sponsored in which it would agree to book any amount over the 25th percentile as a regulatory liability, and would flow that money back to ratepayers in the next rate case, with a corresponding regulatory asset account for KCPL to book any amount below the 25th percentile to be recovered in the next rate case.

The methodology established by that finding credited customers with a reasonable portion of anticipated OSS margins and kept the Company whole should those margins not come to fruition. That Order went on to say on page 36:

> In short, in balancing the interests of shareholders and ratepayers, straying from KCPL's recommended 25th percentile might benefit ratepayers some, but might also damage KCPL much, much more than any benefit that might accrue to ratepayers.

Q: Didn't the Commission reverse that part of its Order which created the regulatory asset for KCPL to utilize for OSS margins that fell below the 25th percentile?

A: Yes. In its January 18, 2007, Order Regarding Motions For Rehearing, the Commission reconsidered its OSS margin decision and decided to not allow KCP&L to use the regulatory asset mechanism.

Q: When the Commission eliminated the regulatory asset for recovery of OSS margin deficits from the 25th percentile did it maintain the balance between customer and shareholders regarding OSS margins as discussed by Mr. Etheridge?

A: No. On page 36 of the December 21, 2006 Report and Order the Commission was referring to the combination of a regulatory asset account for recovery of any deficit and a regulatory liability account for return of any surplus in OSS margins when it said it was "...balancing the interests of shareholders and ratepayers...." When the January 18, 2007, Order eliminated the regulatory asset mechanism but required KCP&L to continue booking amounts above the 25th percentile as a regulatory liability[2], it also eliminated that balance.

Q: Given that history, what is your disagreement with Mr. Etheridge's testimony regarding the request for an AAO to amortize the costs of the 2011 Missouri River flood?

A: As I noted, Mr. Etheridge claims that there is "balance ... between customers and shareholders regarding OSS margins." However, as I discussed above there is no balance in the OSS mechanism. In the 2010 Rate Case the Commission ordered that rates be based on what it believed was the 40th percentile OSS margin. Under that assumption, the Company faced a 40% chance of loss and a 0% chance of gain. The customer faced

0% chance of loss and a 60% chance of gain. As I discussed earlier, there is no extra ROE to offset that risk. Likewise there is no extra ROE to offset the risk of a natural disaster like the 2011 Missouri River flood. An alternative to the extra ROE would be to use a mechanism like the one initially adopted in the 2006 Rate Case that created a regulatory asset account for KCP&L to book any amount below the threshold percentile to a regulatory asset account to be recovered later.

It should also be recognized that the issue of natural disasters affecting KCP&L's OSS margins was never raised in a prior case, and that KCP&L's right to seek an AAO under the circumstances presented in this case was not limited by the Regulatory Plan or any Commission order.

Q: What was Mr. Meyer's Direct Testimony regarding the request for an AAO to amortize the costs of the 2011 Missouri River flood?

A: Mr. Meyer argues at pages 26-27 that the lost OSS margins are comparable to The Empire District Electric Company's ("Empire") lost revenues and profits attributable to the Joplin tornado.

Q: Are KCP&L's lost OSS margins comparable to Empire's lost revenues and profits attributable to the Joplin tornado?

A: No. Empire's lost revenues and profits were lost from retail sales. Empire's lost sales were due to the number of retail customers impacted by the tornado. Approximately 8,000 of Empire's retail customers had damaged or destroyed structures that no longer took service. Empire requested recovery for the loss of the "fixed cost components" of its rates due to the lost retail sales. It defined those "fixed cost components" as the difference between its filed tariff rates less the variable cost components of fuel and

[2] Order Regarding Motions for Rehearing at p. 3, Case No. ER-2006-0314 (Jan. 18, 2007).

purchased power.[3] Those components would have included the return on its capital investment. KCP&L has not requested recovery for its lost return on capital. KCP&L has not requested recovery for lost revenues and profits from retail sales. KCP&L is requesting recovery of an imputed cost not based on historical data but on future expectations and those expectations did not include a major flood on the Missouri River.

III. Fuel Prices

Q: Do you have any issues with the fuel or fuel additive prices Staff used in its filing?

A: Staff's filing was based on its March 31, 2012 cut-off date in this case. The fuel and fuel additive prices Staff recognized contained certain significant price changes that were effective April 1, 2012. I do not disagree with Staff's use of the April 1 prices for its historical filing however the Company expects both the Company and Staff to update all of those prices to prices known on August 31, 2012 at the True-up portion of this case.

Q: Does that conclude your testimony?

A: Yes, it does.

[3] The Empire District Electric Company Application for Accounting Authority Order at p. 4, Case No. EU-2011-0387 (Jun. 6, 2011).

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	)))	Case No. ER-2012-0174

AFFIDAVIT OF WILLIAM EDWARD BLUNK

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

William Edward Blunk, appearing before me, affirms and states:

1. My name is William Edward Blunk. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Supply Planning Manager.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Kansas City Power & Light Company consisting of nine (9) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

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

William Edward Blunk

Subscribed and affirmed before me this 5th day of September, 2012.

Notary Public

My commission expires: Feb. 4, 2015

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