

Exhibit No.:
Issue: Risk from Off-System Sales
Witness: Michael M. Schnitzer
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2007-0291
Date Testimony Prepared: September 20, 2007

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0291

SURREBUTTAL TESTIMONY

OF

MICHAEL M. SCHNITZER

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

Kansas City, Missouri
September 2007

*** [REDACTED] *** Designates "Highly Confidential" Information
Has Been Removed.
Certain Schedules Attached To This Testimony Designated
("HC") Have Been Removed
Pursuant to 4 CSR 240-2.135.

Exhibit No. 23- NP
Case No(s). ER-2007-0291
Date 10/1/07 Rptr MV

SURREBUTTAL TESTIMONY

OF

MICHAEL M. SCHNITZER

Case No. ER-2007-0291

1 **Q: Please state your name and business address.**

2 A: My name is Michael M. Schnitzer. My business address is 30 Monument Square,
3 Concord, Massachusetts 01742.

4 **Q: By whom and in what capacity are you employed?**

5 A: I am a Director of the NorthBridge Group, Inc. ("NorthBridge"). NorthBridge is a
6 consulting firm specializing in providing economic and strategic advice to the electric
7 and natural gas industries.

8 **Q: Are you the same Michael M. Schnitzer who provided Direct Testimony in support**
9 **of Kansas City Power & Light Company in this Case No. ER-2007-0291?**

10 A: Yes, I am.

11 **I. PURPOSE OF TESTIMONY AND CONCLUSIONS**

12 **Q: What is the purpose of your Surrebuttal Testimony?**

13 A: The purpose of my Surrebuttal Testimony is first to briefly update the prospective
14 calculations of the KCPL's 2008 Off-System Contribution Margin contained in my
15 Direct Testimony and second to briefly comment on the Staff's support, as set out in the
16 Rebuttal Testimony of Steve M. Traxler, of the use of the 25th percentile methodology
17 approved by the Commission in KCPL's last rate case, Case. No. ER-2006-0314.

1 Q: Could you please summarize your conclusions?

2 A: Yes, there are two. First, the updated distribution of potential 2008 Off-System
3 Contribution Margin (or "Margin") outcomes as of September 11, 2007 has a median
4 value of **[REDACTED]**, with a 25th percentile value of **[REDACTED]**. Second, the
5 volatility in Margin that underpinned the Commission's concern in the last rate case
6 regarding KCPL's available cash flow and earnings during the construction of Iatan 2,
7 continues to be a concern looking ahead to 2008 and would support a decision by the
8 Commission to continue the use of the 25th percentile methodology.

9 II. SEPTEMBER 11, 2007 UPDATE TO OFF-SYSTEM MARGIN

10 CALCULATIONS

11 Q: What update do you have to the probabilistic analysis contained in your Direct
12 Testimony?

13 A: KCPL committed at p. 15 of my Direct Testimony to provide updates to my probabilistic
14 analysis of Margin during the course of this rate case. The prospective analysis of 2008
15 Margin contained in my Direct Testimony was based on inputs from the Company
16 provided as of December 5, 2006. KCPL has provided additional inputs to NorthBridge
17 as of September 11, 2007, which were then used to update my probabilistic analysis. A
18 comparison of the probability distribution from the updated analysis and the original
19 analysis is shown in Schedule MMS-6. The probability distribution of the updated
20 analysis has a median value of [REDACTED]**, compared to the original median value
21 of **[REDACTED]** in my Direct Testimony. Similarly, as shown in Schedule MMS-7
22 the 25th percentile value has declined from **[REDACTED]** to **[REDACTED]**. A
23 further update to the Margin analysis as of September 30, 2007 will be filed as part of my
24 Direct True-Up Testimony on November 2, 2007.

1 Q: What are the key drivers of the leftward shift of the probability distribution of 2008
2 Margin between your Direct Testimony and this update?

3 A: The median value of the distribution of 2008 Margin has decreased from **[REDACTED]**
4 to **[REDACTED]** primarily because of updated KCPL forecasts reflecting lower energy
5 prices, decreased unit availability (due to planned and forced outages) and increased
6 spinning reserves (making less energy available for sale off-system). These negative
7 factors together reduce the median Margin by approximately **[REDACTED]**. Partially
8 offsetting this decrease is a lower KCPL forecast of native load (making more energy
9 available for sale off-system), which along with other less significant drivers increases
10 margin by approximately **[REDACTED]**. The net effect of all of these updates is a
11 reduction in the median Margin value of approximately **[REDACTED]**. Also, since
12 volatility increases with time, we would expect that the updated probability distribution
13 of outcomes (having been calculated at a point closer in time to 2008) would be more
14 centered or "concentrated" about the median value than the January distribution. The
15 25th percentile value of the distribution has declined from **[REDACTED]** to
16 **[REDACTED]** for the same reasons.

17 **III. VOLATILITY OF OFF-SYSTEM CONTRIBUTION MARGIN**

18 Q: What comments do you have regarding continued volatility of Off-System
19 Contribution Margin for 2008?

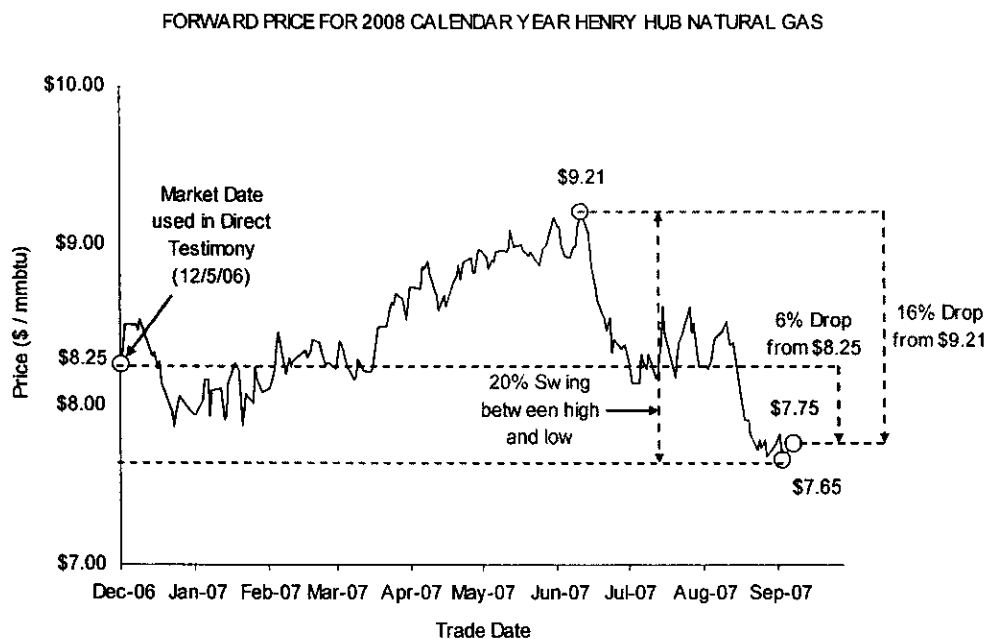
20 A: The update to my probability distribution for 2008 Margin shows that prospectively
21 Margin will continue to be volatile, for the same reasons discussed in my Direct
22 Testimony. This volatility in Margin during 2008 is potentially a risk to KCPL's cash
23 flow and earnings. The forward market in SPP-North is currently a bilateral market in
24 which equivalent forward strip prices for 2008 are not directly observable. However, as

1 noted in my Direct Testimony, natural gas price volatility for 2008 can be observed in the
2 Henry Hub forward strip, and electric price volatility for 2008 can be directly observed at
3 other regional trading hubs for electricity, such as the Northern Illinois Hub ("NI-Hub")
4 and the PJM Western Hub ("PJMW-Hub").

5 **Q: What can be observed about natural gas price volatility for 2008?**

6 **A:** Figure 1 below shows the forward prices for the 2008 Henry Hub strip, which traded at
7 \$8.25/mmBtu on December 5, 2006, the market date on which the probabilistic analysis
8 in my Direct Testimony is based. The 2008 strip traded as high as \$9.21/mmBtu and as
9 low as \$7.65/mmBtu in calendar year 2007, a swing of 20 percent between the high and
10 low settlement price. The 2008 strip settled at \$7.75/mmBtu on September 11, 2007.

11 **Figure 1 – Henry Hub 2008 Strip December 5, 2006 to September 11, 2007**



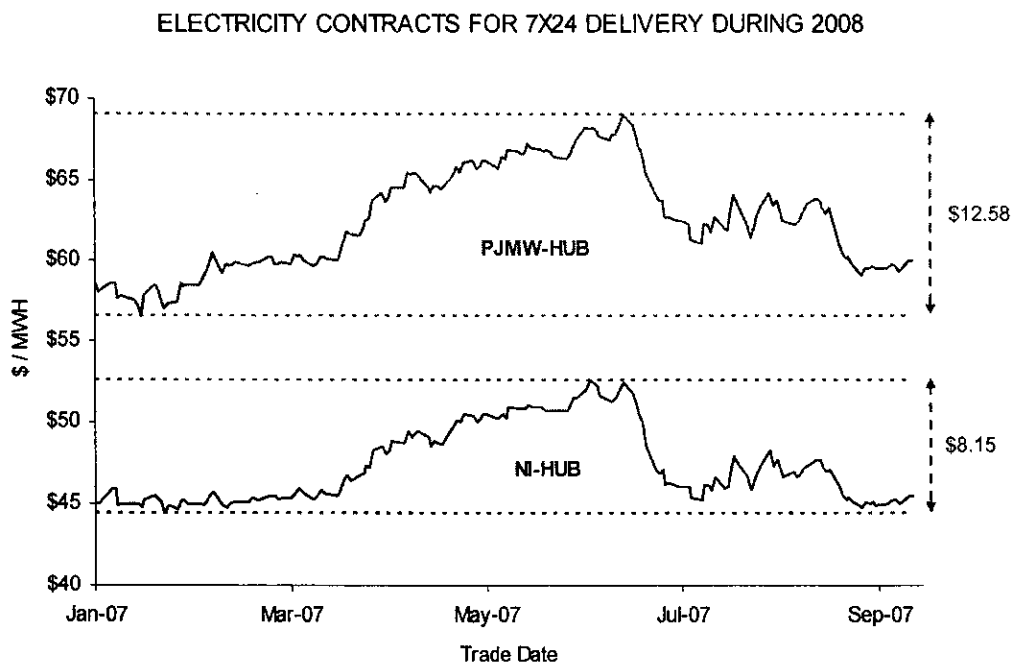
1 **Q: Have the visible forward markets for electricity shown similar volatility?**

2 **A:** Yes. Figure 2 below shows similar price volatility at regional trading hubs such as the
3 NI-Hub and the PJMW-Hub. The price for forward around-the-clock 2008 delivery in
4 both markets rose from lows established early in the year to peak in June (corresponding
5 with the peak in the price of natural gas) and to approach the yearly lows again in late
6 August.

7 **Q: What do you conclude from this data?**

8 **A:** The historical volatility in the underlying drivers of Off-System Contribution Margin has
9 continued in 2007, as evidenced by the 2008 strip for natural gas and forward contracts in
10 other observable electricity markets. Volatility in Margin continues to be a concern
11 looking ahead to 2008.

12 **Figure 2 – PJMW-Hub and NI-Hub 2008 7x24 Contracts**



1 **Q: What is the connection between the volatility of Off-System Contribution Margin**
2 **for 2008 and the use of the 25th percentile methodology?**

3 A: As noted by Mr. Traxler at pp. 2-3 of his Rebuttal Testimony, the Commission's adoption
4 of the 25th percentile methodology in the last rate case was based on its concern about
5 KCPL's available cash flow and earnings during the construction of Iatan 2 and other
6 infrastructure projects. As this risk to cash flow and earnings will continue through 2010,
7 Mr. Traxler and Staff support the adoption of the same 25th percentile methodology in
8 this rate case.

9 **Q: Are you the KCPL witness who is primarily responsible for supporting the use of**
10 **Margin as an offset to revenue requirements at the 25th percentile in this rate case?**

11 A: No, Chris B. Giles is the KCPL witness who has argued the Company's position in
12 support of the 25th percentile methodology in his Direct and Rebuttal Testimony. My
13 role is to provide the analytical support and probabilistic framework that allows Mr. Giles
14 to advocate for use of the 25th percentile in this case, and for the Commission to make a
15 policy judgment on its appropriateness, as the Commission did previously in Case. No.
16 ER-2006-0314. As the Commission stated at p. 36 of its December 21, 2006 Report and
17 Order, "In contrast, the potential importance of not achieving that level during a time
18 when KCPL will be issuing equity and investing hundreds of millions of dollars in
19 infrastructure construction and upgrades could be disastrous to KCPL. In short, in
20 balancing the interests of shareholders and ratepayers, straying from KCPL's
21 recommended 25th percentile might benefit ratepayers some, but might also damage
22 KCPL much, much more than any benefit that might accrue to ratepayers." In my view,
23 the Commission in KCPL's last rate case rightly based the offset for 2007 Margin on a
24 forward-looking estimate for 2007 rather than historic test-year Margins. In addition, the

1 Commission went further and appropriately exercised its policy judgment in balancing
2 risks and assessing the volatility in Margin in order to establish the offset at the 25th
3 percentile of my probability distribution and to couple the offset with a regulatory
4 liability mechanism to protect ratepayers. As noted in my Direct Testimony in this case,
5 realized Margin will again vary from a single point forecast estimate of Margin made
6 prospectively due to the volatility of Margin. The Commission can again choose to act to
7 address that volatility through adoption of Mr. Giles' 25th percentile proposal.

8 **Q: Does that conclude your testimony?**

9 **A:** Yes, it does.

In the Matter of the Application of Kansas City)
Power & Light Company to Modify Its Tariff to) Case No. ER-2007-0291
Continue the Implementation of Its Regulatory Plan)

COMMONWEALTH OF MASSACHUSETTS)
) ss
COUNTY OF MIDDLESEX)

1. My name is Michael M. Schnitzer. I work in Concord, Massachusetts, and I am employed by The NorthBridge Group, Inc., as a Director.

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


Michael M. Schnitzer

Subscribed and sworn before me this 14th day of September 2007.

Notary Public

My commission expires: June 21, 2013

SCHEDULES MMS-6 AND MMS-7

**THESE DOCUMENTS CONTAIN
HIGHLY CONFIDENTIAL
INFORMATION NOT AVAILABLE
TO THE PUBLIC**