

Exhibit No.:
Issue: Off-System Sales Margin Calculation
Witness: Michael M. Schnitzer
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2006-0314
Date Testimony Prepared: September 8, 2006

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2006-0314

REBUTTAL TESTIMONY

OF

MICHAEL M. SCHNITZER

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

**Kansas City, Missouri
September 8, 2006**

***** [REDACTED] *** Designates that "Highly Confidential"
Information has been Removed.
"Highly Confidential" Information has been Removed from Certain Schedules
Attached to this Testimony Designated ("HC")
Pursuant To The Standard Protective Order.**

REBUTTAL TESTIMONY

OF

MICHAEL M. SCHNITZER

Case No. ER-2006-0314

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

2 A: My name is Michael M. Schnitzer. My business address is 55 Old Bedford Road,
3 Lincoln, Massachusetts 01773.

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-2006-0314?**

10 A: Yes, I am.

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

12 **Q: Please describe the purpose of your Rebuttal Testimony.**

13 A: My Rebuttal Testimony has two main purposes. First, I provide an update (as of June 30,
14 2006) to the prospective calculation of Off-System Contribution Margin for KCPL in
15 2007 provided in the second part of my Direct Testimony. Second, I respond to issues
16 regarding the calculation of Off-System Contribution Margin raised in the testimony of
17 certain intervenor witnesses.

1 **Q: Could you please summarize your conclusions?**

2 A: Yes, there are two. First, the updated distribution of potential Off-System Contribution
3 Margin outcomes has a median value of **[REDACTED]**, with a 25th percentile value
4 of **[REDACTED]**. These estimates are similar in magnitude to the values originally
5 filed in my Direct Testimony in January – the distribution of Off-System Contribution
6 Margin outcomes in January had a median value of **[REDACTED]** and a 25th
7 percentile of **[REDACTED]**. However, the new calculations do not include the 2007
8 margin from the 50 MW firm sale that KCPL has recently entered into with MJMEUC,
9 the margin from which is netted against test year revenue requirements separately from
10 Off-System Contribution Margin.

11 Second, none of the intervener witnesses takes issue with the probabilistic
12 methodology I used to calculate Off-System Contribution Margin, as described in my
13 Direct Testimony, and certain of these witnesses support 2007 estimates of Off-System
14 Contribution Margin derived from my analysis. However, the witnesses do take issue
15 with the Company's proposal to offset less than the median value identified in my
16 analysis. This criticism is responded to in the Rebuttal Testimony of KCPL witness
17 Mr. Chris Giles. As in its direct case, KCPL continues to propose a mechanism that
18 establishes the offset to test year revenue requirements below the median value of the
19 probability distribution shown in Schedule MMS-8. In rebuttal, Mr. Giles proposes to
20 establish the offset at the 25th percentile of this distribution as shown in Schedule MMS-
21 9.

22 **II. JUNE 30, 2006 UPDATE TO OFF-SYSTEM MARGIN CALCULATIONS**

23 **Q: Please describe the update to your Direct Testimony.**

1 A: The prospective analysis of 2007 Off-System Contribution Margin contained in my
2 Direct Testimony was based on inputs from the Company's November 22, 2005 budget.
3 In July, KCPL provided inputs to NorthBridge as of June 30, 2006, which were then used
4 to update my probabilistic analysis. A comparison of the probability distribution from
5 the updated analysis and the original analysis is shown in Schedule MMS-8. Both
6 distributions have a median value of **[REDACTED]**.

7 **Q: Does that mean that no changes have taken place since January?**

8 A: No, it does not. There are three significant sources of difference from the January
9 analysis. The net effect of all three sources of difference is to produce an updated
10 probability distribution with the same median, although the distributions are not the same.
11 The first source of difference is simply the passage of time. The January analysis looked
12 forward between 12 and 24 months to 2007, while the updated analysis looks forward
13 only 6 to 18 months. Since volatility increases with time, we would expect that, other
14 things being equal, the July probability distribution of outcomes would be more centered
15 or "concentrated" about the median value than the January distribution.

16 The second source of difference is the change in individual inputs from KCPL,
17 which could have either a negative or a positive effect. For example, as of June 30, 2006,
18 KCPL is forecasting lower around-the-clock energy prices in SPP-North which would
19 tend to decrease Off-System Contribution Margin. But, KCPL is also forecasting
20 favorable changes to heat rates and outage rates for its generating units, which would
21 tend to increase Off-System Contribution Margin.

22 The third and most significant source of difference is the 50 MW MJMEUC
23 wholesale contract, which has reduced the number of MWHs that are available for

1 off-system sale and accounted for as part of the Off-System Contribution Margin. As
2 described at pp. 13-14 of my Direct Testimony: *"If the Native Load and 'Firm'*
3 *wholesale sales volumes increase, then all other things equal, there will be a smaller*
4 *amount of economic output available for off-system sale at market prices."* The January
5 analysis contained a "Firm" wholesale sales estimate for 2007 of 350,400 MWH. As of
6 June 30, 2006 the "Firm" wholesale sales estimate has increased to 788,400 MWH. The
7 effect of the MJMEUC sale is to decrease the number of MWHs available for sale
8 off-system, and hence to decrease the projected Off-System Contribution Margin.
9 However, this is partially offset by an approximately 300,000 MWH reduction in forecast
10 native load obligations.

11 In addition to these substantive changes, the July update also incorporates the
12 effect of increasing the number of modeled scenarios from the 200 scenarios used in the
13 January analysis, to 1,000 scenarios. This change does not shift the probability
14 distribution in any direction, but does allow for greater precision in identifying particular
15 percentile values in the probability distribution.

16 **Q: What is the net effect on the 25th percentile calculation?**

17 A: The 25th percentile of the July probability distribution of Off-System Contribution
18 Margin is ****[REDACTED]****, as compared to ****[REDACTED]**** in January as shown in
19 Schedule MMS-9.

20 III. RESPONSE TO INTERVENER WITNESSES

21 **Q: Have you prepared responses to the intervener witnesses?**

1 A. Yes. My Rebuttal Testimony responds to the Direct Testimony of: James R. Dittmer on
2 behalf of the Department of Energy; Ralph C. Smith on behalf of the Office of Public
3 Counsel; and Maurice Brubaker on behalf of Praxair, Inc. and the Missouri Industrial
4 Energy Consumers. The Direct Testimony of Steve M. Traxler of the Commission Staff
5 addresses only the historic calculation of Off-System Contribution Margin and not my
6 estimates for 2007, so I have not responded to Mr. Traxler.

7 **Q: What response do you have to Mr. Dittmer's testimony on use of the MIDAS**
8 **model?**

9 A: At p. 7 of his Direct Testimony he refers to "*Mr. Schnitzer's MIDAS model forecast*" and
10 states: "*Thus, I believe that all margins shown on Mr. Schnitzer's Table 1 are all, by*
11 *design, understated to be consistent with the forecast results he discusses in his direct*
12 *testimony.*" To clarify, I do use some of the outputs of KCPL's MIDAS modeling as
13 inputs to my probabilistic analysis, but I do not do any independent MIDAS modeling.
14 Also, the analysis in my Direct Testimony consistently states both historic and projected
15 Off-System Contribution Margins for KCPL on a gross basis (i.e., without deducting SO₂
16 allowances or non-fuel costs from the margin). However, Mr. Dittmer's use of the word
17 "understated" is a somewhat of a misnomer, as the 'gross' margins used in my analysis
18 are greater than the 'net' margins that would be calculated by deducting these items, as
19 can be seen by the table on p. 6 of Mr. Dittmer's testimony.

20 **Q: Other than these clarifications, does Mr. Dittmer take issue with your analysis?**

21 A: No. In fact, at pp. 12-14 he supports my median estimate as a reasonable estimate of the
22 most likely outcome for 2007, and generally praises the NorthBridge modeling effort,
23 although he stops short of a full endorsement of our methodology. As discussed above,

1 Mr. Dittmer does, however, take issue with the use that the Company makes of my
2 probabilistic modeling. Mr. Giles responds to Mr. Dittmer on this point.

3 **Q: Does Mr. Smith criticize your methodology?**

4 A: As with Mr. Dittmer, Mr. Smith does not criticize my probabilistic methodology. At p. 8
5 of his Direct Testimony, he supports the median value of my analysis as the best estimate
6 of 2007 Off-System Contribution Margin. However, at pp. 8-10 he criticizes the
7 Company's proposal to use the 25th percentile in establishing 2007 revenue requirements
8 and at pp. 12-14 proposes an alternative mechanism. Mr. Giles responds to his criticism
9 and proposal.

10 **Q: What response do you have to Mr. Brubaker's comments?**

11 A: Mr. Brubaker also agrees at p. 8 of his Direct Testimony that the best estimate for 2007
12 Off-System Contribution Margin would be either my median estimate, or, alternatively,
13 an historic test year actual result. And, like the other intervener witnesses, at p. 10 Mr.
14 Brubaker criticizes the Company's proposal to use the 25th percentile, characterizing it as
15 "stacking the deck." However, Mr. Brubaker goes one step further and states that if a
16 probabilistic analysis is to be pursued, the Commission should establish the offset at the
17 75th percentile. As noted in the Rebuttal Testimony of Mr. Giles, this stands the
18 Company's proposal on its head and increases the risk to the Company's financial
19 viability during the time it is constructing the Iatan Unit 2 generating plant. In its direct
20 case, KCPL had proposed establishing the offset at the 25th percentile and stated its
21 intention to account for the potential earnings above this offset amount (see Mr. Giles
22 Direct Testimony at p. 28). By setting the revenue requirement offset for Off-System
23 Contribution Margin above the median value of the probability distribution,

1 Mr. Brubaker's proposal simply makes it more likely that the Company will fall short of
2 its cash needs in 2007.

3 **Q. Does that conclude your testimony?**

4 **A. Yes, it does.**

SCHEDULES MMS-8 & MMS-9

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

In the Matter of the Application of Kansas City)
Power & Light Company to Modify Its Tariff to) Case No. ER-2006-0314
Begin the Implementation of Its Regulatory Plan)

COMMONWEALTH OF MASSACHUSETTS)
) ss
COUNTY OF MIDDLESEX)

1. My name is Michael M. Schnitzer. I work in Lincoln, 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

Patricia Ann S. Bost
Notary Public

My commission expires: June 21, 2013