
Exhibit No.:

**Issue: Energy Cost Recovery, Fuel and
Purchased Power Expense, Off-System
Sales Margin**

Witness: Ralph C. Smith

Type of Exhibit: Surrebuttal Testimony

Sponsoring Party: Office of Public Counsel

Case No. ER-2006-0314

Date Testimony Prepared: October 2006

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

**SURREBUTTAL TESTIMONY OF
RALPH C. SMITH**

**ON BEHALF OF
THE OFFICE OF PUBLIC COUNSEL**

“NP” Version

**** KCPL-DESIGNATED
“HIGHLY CONFIDENTIAL” INFORMATION
HAS BEEN REDACTED****

October 2006

NP

In the Matter of the Kansas City Power & Light Company for Authority to Modify Its Tariffs to Begin the Implementation of Its Regulatory Plan

My commission expires _____.

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. DISCUSSION OF ISSUES.....	1
A. Off-System Sales Margin.....	2
B. Jurisdictional Allocation Of Off-System Sales Margin	5
C. Surface Transportation Board Claim	7
III. SUMMARY OF RECOMMENDATIONS	9

1

2 **I. INTRODUCTION**

3 Q. Please state your name and business address.

4 A. Ralph C. Smith. My business address is: Larkin & Associates, PLLC, 15728
5 Farmington Road, Livonia, Michigan 48154.

6

7 Q. Are you the same Ralph C. Smith who filed direct and rebuttal testimony on behalf of the
8 Missouri Office of the Public Counsel (“OPC”) concerning issues affecting the revenue
9 requirement of Kansas City Power & Light Company (“KCPL” or “Company”) in this case?

10 A. Yes.

11

12

13 **II. DISCUSSION OF ISSUES**

14 Q. What issues are addressed in your surrebuttal testimony?

15 A. I address the following issues:

16 1) The amount of off-system sales margin that should be reflected in the determination of
17 KCPL’s base rate revenue requirement in this case;

18 2) The proposed use by KCPL of an “Unused Energy” factor for allocating off-system sales
19 margins to the Missouri retail jurisdiction; and

20 3) The ratemaking treatment of KCPL’s costs for a Surface Transportation Board (“STB”)
21 rail road complaint case.

1

2 **A. Off-System Sales Margin**

3 Q. Have you reviewed the rebuttal testimony of Michael M. Schnitzer and Chris B. Giles on
4 behalf of KCPL?

5 A. Yes. Mr. Schnitzer's rebuttal testimony updates KCPL's distribution of potential
6 total company off-system sales margins. His updated outcomes have a median value of
7 ** ** which is virtually identical to the comparable value in his direct
8 testimony. His 25th percentile value for off-system sales margin contribution has increased
9 from ** ** in his direct testimony to ** ** in his rebuttal. At page 6,
10 lines 3-9, of his rebuttal testimony, Mr. Schnitzer mentions a criticism of the Company's
11 proposal to use the 25th percentile in establishing the revenue requirement in this
12 proceeding. Mr. Schnitzer does not respond to that criticism himself but instead refers
13 KCPL's response to such criticism to Mr. Giles.

14 At page 7, lines 18-22, of his rebuttal testimony Mr. Giles states that:

15 "As a number of witnesses in this case have noted, KCPL has agreed in its
16 testimony in this case, and in the Stipulation and Agreement approved in
17 2005 by the Commission, that it has no inherent right to earnings from the
18 off-system sales market as long as the costs of the assets generating those
19 wholesale earnings are in retail prices."
20

21 However, despite this acknowledgement, Mr. Giles' rebuttal attempts to produce a contrary
22 result under which KCPL would retain for itself a substantial portion of the off-system sales
23 margin, either by using an amount for off-system sales margin that is substantially below the
24 median expectation of the Company, or by retaining for the Company a return on equity

1 substantially above the 11.5% that KCPL has requested. For the determination of its
2 revenue requirement, KCPL proposes including an amount for off-system sales margins that
3 is at only the 25th percentile of the Company's own expectations. KCPL proposes to include
4 an amount of ** (the total company amount, prior to jurisdictional
5 allocations) which is far below the Company's median expectation for 2007 total Company
6 wholesale margins of **. Reflecting only ** in the
7 determination of KCPL's rates would result in KCPL earning an excessive rate of return if
8 KCPL then receives more than ** of off system sales margins in 2007. Since
9 75% of the potential values for 2007 off-system sales margin exceed KCPL's proposed
10 amount, which is based on the 25th percentile, KCPL's proposal essentially results in a 75%
11 probability of the Company earning an excessive return. Moreover, as pointed out above,
12 this would violate KCPL's commitment contained in the Stipulation and Agreement.

13 Starting at page 6, line 20, and continuing on to page 7, line 3, of his rebuttal, Mr.

14 Giles makes the following statement:

15 "As an illustration, if the Commission includes ** of wholesale
16 margins in KCPL's revenue requirement, ** of which is
17 jurisdictional to Missouri, and KCPL actually achieves total Company
18 wholesale margins of ** in 2007, or **
19 margin on a Missouri jurisdictional basis, this will result in a ** basis
20 point increase in return on equity, all other things being equal. If the
21 Commission had authorized a return on equity in this case of 11.5 percent,
22 KCPL's actual return on equity, in this example, would be ** percent,
23 all other things equal."¹

24 Allowing KCPL to retain substantial amounts of off-system sales margin contribution for

¹ The Missouri jurisdictional amounts mentioned in Mr. Giles' rebuttal testimony appear to reflect KCPL's proposed application of a new "Unused Energy" factor to allocate off-system sales margin. As explained in my rebuttal testimony

1 shareholders in the manner described by Mr. Giles in the above-quoted portion of his
2 rebuttal testimony is contrary to the agreement that KCPL made in the Stipulation and
3 Agreement approved in 2005 by the Commission. KCPL has stated that it has no inherent
4 right to earnings from the off-system sales market as long as the costs of the assets
5 generating those wholesale earnings are in retail prices. Yet, KCPL's proposed treatment
6 would have a 75% likelihood of retaining for shareholders large amounts of off-system sales
7 margins.

8
9 Q. What do you recommend?

10 A. KCPL's proposal to utilize only the 25% percentile of expected 2007 off-system
11 sales margin is contrary to the agreement that KCPL made in the Stipulation and Agreement
12 approved in 2005 by the Commission and should be rejected. The ** _**
13 median value for off-system sales margin should be reflected in setting KCPL's revenue
14 requirement in this proceeding.

15
16 Q. Why is it necessary to reflect the best estimate of off-system sales margin in the
17 determination of KCPL's revenue requirement in this proceeding, as opposed to some lower
18 amount?

19 A. It is necessary to reflect the most accurate estimate of off-system sales margin for
20 purposes of determining KCPL's jurisdictional revenue requirement in this proceeding

1 because, if some lower amount of off-system sales margin were to be reflected in the
2 determination of KCPL's revenue requirement, and then KCPL achieves a higher amount of
3 such sales margin (such as its projected median estimate), the result would be that KCPL
4 shareholders would receive a windfall at the expense of ratepayers. The extra off-system
5 sales margin would increase KCPL's return for shareholders above the level that the
6 Commission determines is reasonable. The new rates resulting from this case will not be
7 just and reasonable if they are set at a level (i.e. reflecting the 25th percentile for off-system
8 sales instead of the 50th percentile) that is expected to provide a return on equity in excess of
9 the return on equity determined by the Commission to be appropriate in this case.

10
11 Q. Is OPC willing to consider an alternative treatment of off-system sales margins that would
12 provide specific consideration for the potential for a large variation in the level of off-
13 system sales margin that KCPL could realize during the rate effective period?

14 A. Public Counsel discussed a sharing proposal in my direct testimony. KCPL never
15 followed up, preferring to stick with its novel 25th percentile proposal.

16
17 **B. Jurisdictional Allocation Of Off-System Sales Margin**

18 Q. Has KCPL included in its rebuttal testimony a "correction" to the calculation of its proposed
19 "Unused Energy Allocator"?

20 A. Yes. As described on pages 1-2 of KCPL witness Don A. Frerking's rebuttal
21 testimony, the Company has corrected the megawatts ("MW") of "Available Energy" based

1 on the total “Available Capacity” as allocated using the jurisdictional Demand allocation
2 factors. Mr. Frerking states that, in its June 2006 update filing, KCPL incorrectly calculated
3 the “Available Energy” component of the calculation by using the average coincident peak
4 (“CP”) loads. This KCPL correction produced an “Unused Energy Allocator” of 51.55%
5 for Missouri, in comparison with the 46.97% factor that KCPL used in its June 2006 update
6 filing. KCPL used the “Unused Energy Allocator” to allocate off-system sales margins to
7 the Missouri retail jurisdiction.

8
9 Q. Do you agree with KCPL’s proposal to allocate off-system sales margins to the Missouri
10 retail jurisdiction using an “Unused Energy Allocator”?

11 A. No. The Company’s response to Staff DR 0502(1) indicates that the Unused Energy
12 allocation methodology for non-firm energy sales “margin” has not previously been
13 proposed or adopted in any KCPL rate proceedings in Missouri or Kansas. KCPL is
14 proposing such an allocation method for the first time in its current rate case filing in
15 Missouri, and in its current rate case filing in Kansas. In KCPL’s previous rate case filings
16 and KCPL’s annual surveillance reporting, KCPL dealt with the gross level of off-system
17 revenues without a breakout of margin and cost components embedded in those gross
18 revenues, and KCPL jurisdictionally allocated the gross level of non-firm energy revenues
19 using an Energy allocator. The change proposed by KCPL in the jurisdictional allocation of
20 off-system sales revenues results in an unreasonable and substantially lower amount of off-
21 system sales margin (now 51.55% with KCPL’s correction) being allocated to the Missouri

1 retail jurisdiction than would result from the continued use of an Energy allocator. Using an
2 Energy factor would allocate 57.12% to the Missouri retail jurisdiction. Other concerns, as
3 described in my rebuttal testimony, include the fact that KCPL's proposed use of a new
4 factor creates a potential inconsistency in the allocation of off-system sales margin between
5 the jurisdictions and that KCPL's proposed "Unused Energy Allocator" is both arbitrary and
6 flawed as a measure of available energy and as an allocator of off-system sales margin.
7

8 **C. Surface Transportation Board Claim**

9 Q. Have you reviewed the rebuttal testimony of KCPL witness Wm. Edward Blunk concerning
10 STB case costs?

11 A. Yes.
12

13 Q. At page 1, lines 16-17, of his rebuttal, Mr. Blunk states: "OPC recommended that KCPL not
14 be permitted to recover any of the expense associated with the STB rail case complaint
15 case." Is that a complete and accurate portrayal of OPC's position on this matter?

16 A. No, it is not. KCPL's costs associated with the STB rail case complaint should not
17 be charged to customers in the current KCPL rate case because such costs are not known
18 and measurable and there are no benefits reflected in the current case. This does not mean
19 that there can be no recovery of such costs during a future period when such costs can be
20 appropriately matched with the benefits that KCPL indicates its STB rail case complaint
21 could produce.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21

Q. Please explain why it would be inappropriate to allow KCPL's estimate of STB rail case complaint costs to be charged to customers in the current KCPL base rate case.

A. For the reasons described in my direct testimony, KCPL's adjustment no. 58 does not meet the standard of a "known and measurable" adjustment. Moreover, KCPL's proposed inclusion of such costs does not appropriately match costs and benefits. KCPL has identified no benefits from its STB complaint in the test year, only costs. Consequently, I have recommended that rate recognition of such costs should be coordinated with the period benefited. Schedule RCS-2, which was attached to my direct testimony, shows the calculation of my recommended adjustment to remove these expenses.

Q. Does it appear that KCPL has changed its position concerning STB cost recovery?

A. Yes, it does. At page 3, lines 15-21, of his rebuttal testimony, Mr. Blunk recommends that the costs related to the STB case be treated as a regulatory asset and amortized to expense over five years beginning in January 2007, the month when electric rates for this proceeding will go into effect. If the STB case results in a refund, Mr. Blunk proposes that any refund received by KCPL would first offset any existing balance of STB case costs in the regulatory asset, with the remainder of the refund offsetting fuel costs as determined in a future proceeding.

Apparently, this proposal by Mr. Blunk for a prospective amortization of STB rail case costs would replace Adjustment 58 from KCPL's original filing.

1

2 Q. Do you agree with KCPL's revised recommendation concerning the STB costs?

3 A. No. While it is a marginal improvement over KCPL's original position, it does not
4 result in matching costs with benefits. KCPL has not shown that it would begin to receive
5 benefits from the STB claim beginning in January 2007. Mr. Blunk's rebuttal at page 3,
6 lines 7-8, indicates that KCPL expected the refunds and savings it estimated would be "fully
7 unencumbered at the conclusion of the railroad's probable appeal or sometime in the first
8 quarter of 2009." However, by suspending KCPL's case, the STB's rulemaking will delay
9 an order in the Company's case and delay receipt of any refunds. Consequently, any
10 amortization of KCPL's deferred STB costs should not begin until KCPL's total costs for
11 the STB complaint case are known and certain, the outcome of the claim is clear, and
12 benefits are being realized and provided to ratepayers. In this manner, the recognition of
13 costs for ratemaking purposes could be matched to the period when benefits are recognized.

14 **III. SUMMARY OF RECOMMENDATIONS**

15 Q. Please summarize the recommendations you are making in your surrebuttal testimony.

16 A. My surrebuttal testimony contains the following recommendations:

- 17 • The ** ** median value for off-system sales margin should be reflected
18 in setting KCPL's revenue requirement in this proceeding.
- 19 • KCPL's proposed use of an "Unused Energy Allocator" is arbitrary and flawed, and
20 should be rejected for the purposes of allocating off-system sales margin to the Missouri
21 retail jurisdiction.

1 • KCPL's STB complaint cost incurred during the test year and its adjustment no. 58
2 for costs related to a STB proceeding against UP railroad should be rejected. The
3 procedural schedule in this STB proceeding has been suspended. Cost levels related to this
4 STB complaint previously estimated by KCPL to occur were not incurred by June 30, 2006,
5 the date specified by the Commission for updates, at KCPL's estimated levels. Moreover,
6 rate recognition of such costs should be coordinated with the period benefited, and there
7 have been no benefits, only costs, identified in the test year.

8 • If, despite OPC's recommendations to the contrary, the Commission decides to
9 permit KCPL to recover some STB-related cost in the determination of the revenue
10 requirement in the current case (where there has been no benefit to ratepayers
11 demonstrated), at minimum only the actual, verifiable costs of the STB complaint incurred
12 through the June 30, 2006 update period should be spread over a representative period, such
13 as five years or longer, that reflects the relative infrequency of such cases and the future
14 period benefited from the expenditure.

15
16 Q. Does this complete your surrebuttal testimony at this time?

17 A. Yes, it does.