

Exhibit No.:  
Issues: Interchange Sales  
Ice Storm  
Amortization  
Witness: James R. Dittmer  
Type of Exhibit: Direct Testimony  
Sponsoring party: DOE-NSSA  
Case No.: ER-2006-314  
Direct Testimony Date: August 8, 2006

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. ER-2006-0314**

**PUBLIC VERSION**

**DIRECT TESTIMONY**

**OF**

**JAMES R. DITTMER**

**ON BEHALF OF**

**THE DEPARTMENT OF ENERGY – NATIONAL  
NUCLEAR SECURITY ADMINISTRATION**

**Kansas City, Missouri  
August 2006**

“\*\* [REDACTED] \*\*” Designates that “Highly Confidential” or “Proprietary”  
information has been removed pursuant to the Standard Protective Order

1 Power and Light Company's ("KCPL" or "Company") application to the  
2 Missouri Public Service Commission ("MPSC" or "Commission") to increase  
3 Missouri electric retail rates. Thus, the testimony I am presenting is offered on  
4 behalf of the United States Department of Energy that is representing the  
5 interest of the National Nuclear Security Administration ("DOE-NNSA") and  
6 other affected Federal Executive Agencies.  
7

8 **Q. ARE THERE OTHER WITNESSES APPEARING ON BEHALF OF**  
9 **DOE-NNSA?**

10 A. Yes. Dr. J. Randall Woolridge is also appearing in this proceeding on behalf of  
11 DOE-NNSA. Dr. Woolridge will be addressing KCPL's capital structure,  
12 return on equity as well as the overall rate of return. Additionally, Mr. Luis  
13 Bernal will be filing testimony on behalf of DOE-NNSA addressing class cost  
14 of service issues later in this proceeding.  
15

16 **Q. WILL DOE-NNSA BE ADDRESSING A BROAD NUMBER OF ISSUE**  
17 **AREAS?**

18 A. No. I will be addressing only two issues in direct testimony and Dr Woolridge,  
19 as just noted, will only be addressing cost of capital issues. In addition, we will  
20 be reviewing testimony of other parties and may support positions being  
21 recommended by such other parties.  
22

1     **Q.     PLEASE BRIEFLY STATE THE TWO ISSUES OR TOPICS YOU WILL**  
2     **BE ADDRESSING WITHIN YOUR DIRECT TESTIMONY?**

3     A.     First, I address and respond to KCPL witnesses Messrs. Chris Giles and  
4     Michael Schnitzer's proposal to reflect an unreasonably low estimate of non-  
5     firm off-system sales margins as a revenue credit within the Company's  
6     adjusted retail cost of service. Second, I am proposing an adjustment to  
7     eliminate test year amortization expense related to repairs stemming from a  
8     2002 ice storm.

9  
10    **I.     QUALIFICATIONS**

11   **Q.     BEFORE DISCUSSING IN GREATER DETAIL THE ISSUES YOU**  
12   **BRIEFLY DESCRIBED ABOVE, PLEASE STATE YOUR**  
13   **EDUCATIONAL BACKGROUND?**

14    A.     I graduated from the University of Missouri - Columbia, with a Bachelor of  
15    Science Degree in Business Administration, with an Accounting Major, in 1975.  
16    I hold a Certified Public Accountant Certificate in the State of Missouri. I am a  
17    member of the American Institute of Certified Public Accountants.

18  
19   **Q.     PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

20    A.     Subsequent to graduation from the University of Missouri, I accepted a position  
21    as auditor for the Missouri Public Service Commission. In 1978, I was  
22    promoted to Accounting Manager of the Kansas City Office of the Commission  
23    Staff. In that position, I was responsible for all utility audits performed in the

1 western third of the State of Missouri. During my service with the Missouri  
2 Public Service Commission, I was involved in the audits of numerous electric,  
3 gas, water and sewer utility companies. Additionally, I was involved in  
4 numerous fuel adjustment clause audits, and played an active part in the  
5 formulation and implementation of accounting staff policies with regard to rate  
6 case audits and accounting issue presentations in Missouri. In 1979, I left the  
7 Missouri Public Service Commission to start my own consulting business.  
8 From 1979 through 1985 I practiced as an independent regulatory utility  
9 consultant. In 1985, Dittmer, Brosch and Associates was organized. Dittmer,  
10 Brosch and Associates, Inc. changed its name to Utilitech, Inc in 1992.

11  
12 My professional experience since leaving the Missouri Public Service  
13 Commission has consisted primarily of issues associated with utility rate,  
14 contract and acquisition matters. For the past twenty-seven years, I have  
15 appeared on behalf of clients in utility rate proceedings before various federal  
16 and state regulatory agencies. In representing those clients, I performed revenue  
17 requirement studies for electric, gas, water and sewer utilities and testified as an  
18 expert witness on a variety of rate matters. As a consultant, I have filed  
19 testimony on behalf of industrial consumers, consumer groups, the Missouri  
20 Office of the Public Counsel, the Missouri Public Service Commission Staff, the  
21 Indiana Utility Consumer Counselor, the Mississippi Public Service  
22 Commission Staff, the Arizona Corporation Commission Staff, the Arizona  
23 Residential Utility Consumer Office, the Nevada Office of the Consumer

1 Advocate, the Washington Attorney General's Office, the Hawaii Consumer  
2 Advocate's Staff, the Oklahoma Attorney General's Office, the West Virginia  
3 Public Service Commission Consumer Advocate's Staff, municipalities and the  
4 Federal government before regulatory agencies in the states of Arizona,  
5 Michigan, Missouri, Ohio, Florida, Colorado, Hawaii, Kansas, Mississippi,  
6 New Mexico, Nevada, New York, West Virginia, Washington and Indiana, as  
7 well as the Federal Energy Regulatory Commission.  
8

9 **II. NON-FIRM OFF-SYSTEM SALES MARGINS**

10 **Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF KCPL'S**  
11 **PROPOSAL FOR REFLECTING NON-FIRM OFF-SYSTEM SALES**  
12 **MARGINS AS A REVENUE CREDIT TO KCPL'S RETAIL COST OF**  
13 **SERVICE.**

14 A. First, by way of background, like other generating utilities, KCPL routinely  
15 engages in making off-system sales to neighboring utilities from its generating  
16 fleet when such units are not needed to economically meet the energy demands  
17 of its firm retail and wholesale customers. Any revenues from off-system sales  
18 in addition to recovering fuel and other variable costs result in margins that are  
19 available to offset or defray the fixed cost of production that in most instances  
20 would otherwise be charged to firm retail and wholesale requirements  
21 customers. Sometimes such sales are firm in nature and extend for longer  
22 periods of time with stated maximum demands within given time periods. Such  
23 firm sales are most commonly referred to as "capacity" sales.  
24

In addition to making limited firm capacity sales, KCPL engages in non-firm energy sales – commonly referred to as “interchange” sales. Unlike the capacity sales, interchange sales typically have no long term commitment and are not “firm” in nature. In other words, such energy sales contracted for any where from an hour to several months ahead of the expected delivery time could be cancelled or withdrawn without penalty for failure to deliver.

In recent years the margins obtained from engaging in interchanges sales have been volatile, but overall, increasing significantly. Specifically, KCPL has achieved the following margins from interchange sales in recent years:

<u>Year/Period</u>	<u>Margins Before Deducting SO<sub>2</sub> Allowances and Variable Non- Fuel O&amp;M (000,000s)</u>	<u>Margins After Deducting SO<sub>2</sub> Allowances and Variable Non- Fuel O&amp;M (000,000s)</u>
2002	** [REDACTED] **	** [REDACTED] **
2003	** [REDACTED] **	** [REDACTED] **
2004	** [REDACTED] **	** [REDACTED] **
2005	** [REDACTED] **	** [REDACTED] **
12 Months Ended 5/06	** [REDACTED] **	** [REDACTED] **

**Q. COULD YOU PLEASE EXPLAIN WHY YOU SHOW INTERCHANGE MARGINS “BEFORE” AND “AFTER” DEDUCTING SO<sub>2</sub>**

1       **ALLOWANCES AND VARIABLE NON-FUEL OPERATIONS AND**  
2       **MAINTENANCE EXPENSE?**

3       A.    Yes.  Much of the data provided by KCPL in discovery reflected interchange  
4       margins *after* deducting SO<sub>2</sub> allowances and non-fuel variable operations and  
5       maintenance expense.  It was observed that the margins reported in response to  
6       various parties' data requests did not tie to amounts discussed and shown within  
7       the testimonies of Mr. Chris Giles and Mr. Michael Schnitzer.  As discussed  
8       within the Company's response to MPSC Staff Data Request No. 0233, \*\*

9       [REDACTED]  
10      [REDACTED]  
11      [REDACTED]  
12      [REDACTED]  
13      [REDACTED]  
14      [REDACTED]  
15      [REDACTED]  
16      [REDACTED]  
17      [REDACTED]  
18      [REDACTED]  
19      [REDACTED]  
20      [REDACTED]  
21      [REDACTED]  
22      [REDACTED]  
23      [REDACTED] \*\*

1 Q. PLEASE CONTINUE WITH YOUR DISCUSSION OF KCPL'S  
2 ANALYSIS, FORECAST AND ULTIMATE RATE  
3 RECOMMENDATION.

4 A. KCPL Vice President Regulatory Affairs Chris Giles, as well as Mr. Michael  
5 Schnitzer of NorthBridge Group, Inc., discuss, describe and quantify the  
6 volatility of interchange sales margins over recent years. Further, Mr. Schnitzer  
7 created a sophisticated forecast model to prepare estimates of possible  
8 interchange sales margin outcomes in 2007 under 200 purportedly equally-  
9 likely-to-occur scenarios. The results of such modeling efforts indicated that  
10 margins from off-system sales could range from \*\* [REDACTED] \*\* with a  
11 90% confidence interval (i.e., there is a 5% chance that margins could be less  
12 than \*\* [REDACTED] \*\* and a 5% chance the margins could exceed \*\* [REDACTED]  
13 [REDACTED] \*\*). Mr. Schnitzer's modeling efforts indicate that the projected median  
14 value for 2007 interchange sales is \*\* [REDACTED] \*\*. The projected median  
15 forecast by Mr. Schnitzer's modeling efforts is essentially identical to the  
16 forecast prepared by KCPL utilizing its "MIDAS" model that has been reflected  
17 within KCPL's 2006 budget and its longer term 2007 forecast.

18  
19 Notwithstanding the fact that both Mr. Schnitzer's and KCPL's budget models  
20 predict that the most likely short term forecasts for interchange sales margins  
21 will be approximately \*\* [REDACTED] \*\*, KCPL proposes to reflect on a total  
22 company basis only \*\* [REDACTED] \*\* as a revenue credit to the total company  
23 cost of service.



1     **Q.     WHY DOES KCPL PROPOSE TO REFLECT ONLY \*\* [REDACTED] \*\***  
2     **OF INTERCHANGE SALES MARGINS AS A CREDIT TO THE COST**  
3     **OF SERVICE IF KCPL'S OWN BUDGET MODEL, AS WELL AS**  
4     **NORTHBRIDGE GROUP'S INDEPENDENT MODEL, PREDICT THAT**  
5     **INTERCHANGE MARGINS OF APPROXIMATELY \*\* [REDACTED]**  
6     **[REDACTED] \*\* ARE MORE LIKELY TO BE REALIZED?**

7     A.   Mr. Giles states in direct testimony that off-system sales are much more volatile  
8     than retail revenues – which are typically the predominant contributor to a  
9     utility company's return on equity. However, Mr. Giles notes that in KCPL's  
10    situation off-system sales represent a much-larger-than typical proportion of  
11    total revenues. Ultimately Mr. Giles concludes in direct testimony that "KCPL  
12    selected the 75/25 point on the probability curve as a risk the Company would  
13    be able to accept given the return on equity, amortization, and other factors in  
14    the regulatory plan, *e.g.*, potential annual rate filings." (Giles Direct, page 25).

15  
16    In response to OPC Data Request No. 20060428 KCPL elaborated further upon  
17    its selection of an interchange margin level that has a 75% chance of being  
18    achieved:

19           A 50 percent probability exists that KCPL's off-system sales  
20           margin in 2007 would be below the median value and a 50  
21           percent probability exists that it would be above the median.  
22           During the period KCPL is completing its comprehensive energy  
23           plan it is critical that sufficient cash flow is achieved to maintain  
24           its investment grade credit rating. In addition, it is critical that  
25           KCPL meet its authorized rate of return to maintain its stock  
26           price as it issues equity and debt to finance its construction  
27           program. Including off-system sales margins at the median level  
28           means KCPL has only a 50/50 chance of earning its authorized

1 rate of return and only a 50/50 chance of meeting its cash flow  
2 requirements. KCPL needs better than a 50/50 chance of  
3 meeting its off-system sales margins if these margins are going  
4 to be included in computing the revenue required from retail  
5 customers. Off-system sales margins are not the same as retail  
6 revenue and cannot be attributed the same probability of  
7 achieving those level of sales. Thus, it is imperative that off-  
8 system sales margins, to the extent they are included in  
9 determining revenue required from retail customers, are set at a  
10 probability level that gives more assurance to investors and  
11 creditors that KCPL has better than a 50/50 chance of success.  
12 Thus KCPL selected 25% as a more reasonable probability for  
13 off-system sales margins. (Set OPC\_20060428; Question No.  
14 5005)  
15  
16

17 **Q. DO YOU AGREE WITH KCPL'S PROPOSAL TO INCLUDE WITHIN**  
18 **THE DEVELOPMENT OF THE COST OF SERVICE A LEVEL OF**  
19 **OFF-SYSTEM SALES MARGINS THAT IS SIGNIFICANTLY BELOW**  
20 **THE MOST LIKELY "50/50" CHANCE OF OCCURRENCE?**

21 A. No. The Company's proposal only recognizes and emphasizes the downside  
22 risk that KCPL is exposed to regarding off-system sales. On its face, it is  
23 simply asymmetrical and unfair to ratepayers. If rates are established at the 75<sup>th</sup>  
24 percentile of probability of achievement and the Company actually achieves the  
25 more likely 50<sup>th</sup> percentile forecasted amount, *and* no other accounting  
26 safeguards are imposed, KCPL's shareholders will achieve a totally  
27 unwarranted windfall of approximately \*\* [REDACTED] \*\* before-tax and an after-  
28 tax windfall of approximately \*\* [REDACTED] \*\*  
29

30 **Q. IN YOUR EXPERIENCE, WHEN ESTABLISHING BASE RATES DO**  
31 **REGULATORS TYPICALLY DELIBERATELY SKEW THE INPUTS**

1           **TO THE RETAIL COST OF SERVICE BY KNOWINGLY INCLUDING**  
2           **FEWER REVENUES AND/OR MORE EXPENSES THAN IS “MOST**  
3           **LIKELY” TO OCCUR?**

4       A.    No. Frequently there is debate and argument about what level of “normal” or  
5           “ongoing” revenues or expense can be expected. For instance, a utility may  
6           argue that normalized off-system sales to be credited to the cost of service is  
7           “X” while the regulatory Staff or various intervenors may argue that an ongoing  
8           level of normalized off-system sales should be “X plus 10%.” In the typical  
9           situation described, each party is arguing that its proposal represents the “most  
10          likely” outcome of revenues to be experienced during the rate effective period,  
11          but from experience neither party is promoting that the cost of service input  
12          should be intentionally skewed to favor stockholder or ratepayer interests.

13  
14          However, that is not the situation regarding KCPL’s request in the current case.  
15          Rather, KCPL is simply requesting that rates be established considering a low –  
16          and I would add an unreasonably low – level of interchange sales margins  
17          within the retail cost of service development.

18  
19       **Q.    DO KCPL WITNESSES RECOGNIZE THE SIGNIFICANT UPSIDE TO**  
20       **FUTURE EARNINGS UNDER ITS OFF-SYSTEM SALES PROPOSAL?**

21       A.    Yes. Mr. Giles states at page 28 of his direct testimony that:

22                   KCPL intends to account for this potential earnings increase in  
23                   some manner in this proceeding, given the Company’s proposed  
24                   risk sharing of off-system sales. This case will be updated to the  
25                   twelve months ended June 2006, and trued up to September 30,

1 2006. As time gets closer to the effective date of new rates,  
2 KCPL anticipates additional information will be valuable in  
3 determining different approaches to this issue. A number of  
4 alternatives exist in this proceeding to account for the potential  
5 upside to the Company of increased off-system sales margins.  
6 These alternatives may include, but are not limited to; return on  
7 equity sharing mechanisms, earmarking of additional earnings  
8 for future amortization requirements, adjustments to the risk  
9 sharing for off-system sales, and potential refunds to customers.  
10

11 **Q. GIVEN WHAT YOU HAVE STATED REGARDING RECENT**  
12 **HISTORICAL EXPERIENCE, AND THE VOLATILITY OF**  
13 **INTERCHANGE SALES MARGINS IN RECENT YEARS, WHAT IS**  
14 **YOUR SPECIFIC RECOMMENDATION AT THIS TIME?**

15 A. NorthBridge Group has updated its forecast based upon data available as of the  
16 end of June 2006. This forecast considers recent actual historical experience as  
17 well as latest-available forecasts of natural gas price for ensuing months. The  
18 latest projection of interchange sales margins for 2007 made by NorthBridge  
19 continue to include an estimate of margins at the 50<sup>th</sup> percentile to be \*\*  
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1 Accordingly, I am recommending that total Company off-system sales margins  
2 in the amount of \*\* [REDACTED] \*\*, exclusive of deductions for SO<sub>2</sub> allowances  
3 and variable non-fuel operation and maintenance expense, be included within  
4 the development of the “total Company” cost of service. The noted \*\* [REDACTED]  
5 [REDACTED] \*\* of total Company margin that I am proposing would be comparable to  
6 the Giles/Schnitzer total company margin proposal of \*\* [REDACTED] \*\*. The  
7 total Company margin that I am recommending would, of course, need to be  
8 allocated to Missouri jurisdictional retail operations based upon the appropriate  
9 energy allocation factor. Thus, the impact of increasing the total company  
10 margin from the Company-proposed level of \*\* [REDACTED] \*\* to the latest-  
11 provided NorthBridge estimate of the 50<sup>th</sup> percentile of interchange margins of  
12 \*\* [REDACTED] \*\* would be to reduce the Missouri jurisdictional revenue  
13 requirement proposed by KCPL by approximately \*\* [REDACTED]  
14 [REDACTED]  
15 [REDACTED] \*\*

16  
17 **Q. YOU STATED THAT THE RECENTLY-PROVIDED UPDATED**  
18 **NORTHBRIDGE ESTIMATE OF THE 50<sup>TH</sup> PERCENTILE OF**  
19 **INTERCHANGE SALES MARGINS APPEARED REASONABLE**  
20 **BASED UPON A NUMBER OF FACTORS. WILL YOU PLEASE**  
21 **EXPLAIN THAT OBSERVATION?**

22 A. Yes. First, as noted on the table shown above wherein I reflected interchange  
23 sales margins for the years 2002 through 2005, as well as for the twelve months

1 ending May 2006, the trend in off-system sales margins has been upward, with  
2 the margins for the twelve months ending May 2006 being very close to the  
3 recently updated NorthBridge forecast of the 50<sup>th</sup> percentile on off-system sales.  
4 Further, as explained by Mr. Schnitzer, margins from off-system sales are  
5 significantly impacted by the market price of electric energy in the region. The  
6 market price of electric energy is, in turn, heavily influenced by, and correlated  
7 to a significant degree with, natural gas prices. \*\* [REDACTED]

8 [REDACTED]  
9 [REDACTED].\*\* Finally, 100 MWs  
10 of wind capacity is being added to KCPL's generation fleet in 2006. This  
11 additional capacity, with virtually no variable costs, should tend to make  
12 additional coal-fired generation available for sale on the interchange market for  
13 more hours of the year than has occurred in recent history. In recognition of all  
14 these observations and events, I believe NorthBridge's 50<sup>th</sup> percentile projection  
15 of interchange margins is a reasonable estimate of interchange margins that can  
16 be expected to be achieved in 2007. Again, my recommendation should not be  
17 construed as my full endorsement of, the NorthBridge forecast modeling efforts.  
18 Rather, I am simply stating that at this time, NorthBridge's sophisticated  
19 modeling efforts are producing results that are in line with what one would  
20 expect simply by reviewing recent actual experience of off-system sales and the  
21 forecast of major drivers that would be expected to influence modeling results.  
22

1     **Q.     BASED ON YOUR PROPOSAL TO REFLECT THE “MOST LIKELY”**  
2     **LEVEL OF INTERCHANGE SALES MARGINS WITHIN THE COST**  
3     **OF SERVICE, ARE YOU THEREFORE SPECIFICALLY REJECTING**  
4     **MR. GILES’ PROPOSAL TO ESTABLISH RATES UTILIZING A**  
5     **CONSERVATIVELY LOW ESTIMATE OF INTERCHANGE SALES**  
6     **MARGINS, BUT THEN CONSIDER CREDITING RATEPAYERS WITH**  
7     **EITHER ADDITIONAL “AMORTIZATION EXPENSE” OR FUTURE**  
8     **REFUNDS?**

9     A.    At this point in the proceeding it is premature to suggest that any unique  
10    accounting provisions or “skewing” of the inputs in the development of a  
11    traditional Missouri jurisdictional revenue requirement study may be  
12    appropriate. In August 2005 the MPSC approved a Comprehensive Energy  
13    Plan that was embodied within a Stipulation and Agreement (“S&A”) entered  
14    into between KCPL, the MPSC Staff, the OPC and a number of other  
15    intervenors<sup>1</sup>. In relevant part, the noted Stipulation and Agreement states:

16           The non-KCPL Signatory Parties commit to work with KCPL to  
17           ensure that based on prudent and reasonable actions, KCPL has a  
18           reasonable opportunity to maintain its bonds at an investment  
19           grade rating during the construction period ending June 1, 2010.  
20           As part of this commitment, the non-KCPL Signatory Parties  
21           agree to support the “Additional Amortizations to Maintain  
22           Financial Ratios”, as defined in this section and related  
23           appendices, in KCPL general rate cases filed prior to June 1,  
24           2010. The “Additional Amortization to Maintain Financial  
25           Ratios” will only be an element in any KCPL rate case when the  
26           Missouri jurisdictional revenue requirement in that case fails to  
27           satisfy the financial ratios shown in Appendix E through the  
28           application of the process illustrated in Appendix F. (Stipulation  
29           and Agreement filed in MPSC Case No. EO-2005-0329, page  
30           19)

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<sup>1</sup> DOE-NNSA did not oppose the S&A although it was not a signatory to the agreement.

1  
2 Pursuant to the quoted S&A, the option exists to increase rates above that  
3 generated employing a traditional Missouri retail jurisdictional cost of service is  
4 available through consideration of “Additional Amortizations to Maintain  
5 Financial Ratios.” However, the first step in such process should be to establish  
6 an estimate of the traditional Missouri jurisdictional revenue requirement. To  
7 that end, I believe a *traditional* Missouri jurisdictional revenue requirement  
8 should begin with reflection of normal, ongoing and “most likely” to occur  
9 revenue and expense levels.

10  
11 As noted at the beginning of this testimony, DOE-NNSA is presenting only  
12 limited direct testimony regarding KCPL’s Missouri jurisdictional revenue  
13 requirement, but fully expects the Staff and other parties will address numerous  
14 other revenue, expense and rate base proposals included within KCPL’s cost of  
15 service. After reviewing the *totality* of revenue requirement issues presented by  
16 Staff and other parties, it *may* be appropriate to consider “Additional  
17 Amortizations to Maintain Financial Ratios” or other unique rate/accounting  
18 proposals. However, in my opinion, I believe that a traditional Missouri  
19 jurisdictional revenue requirement needs to be established first so that one can  
20 begin to measure the *possible* need to consider “Additional Amortizations to  
21 Maintain Financial Ratios.” Further, such traditional Missouri jurisdictional  
22 revenue requirement needs to be established by considering “most likely”  
23 estimates of revenue and expense levels.



1  
2 The noted S&A has elements that are very beneficial to KCPL and its  
3 shareholders – namely, the significant provision to collect in rates revenues for  
4 “amortization expense” that would be above and beyond that generated by a  
5 traditional cost of service revenue requirement determination. As noted, some  
6 consideration to shoring up cash flow and interest coverages through an  
7 allowance for recovery of amortization expense or other accounting authority  
8 orders *may* be justified in light of the volatility of margins from off-system  
9 sales. However, given the overall benefits afforded KCPL within the S&A, it  
10 *may* also be justified to conclude that some rate payer participation in, or  
11 sharing of, margins above that considered by including off-system sales margins  
12 at the 50<sup>th</sup> percentile of probability of occurrence within the traditional cost of  
13 service is warranted.  
14

15 **Q. IS THE COMPANY’S PROPOSAL TO ONLY INCLUDE**  
16 **INTERCHANGE SALES MARGINS THAT ARE ESTIMATED TO**  
17 **OCCUR WITH A 75 PERCENT PROBABILITY IN COMPLIANCE**  
18 **WITH OTHER TERMS OF THE NOTED S&A?**

19 A. The S&A from Case No. EO-2005-0329 also states that:

20 KCPL agrees that off-system energy and capacity sales revenues  
21 and related costs will continue to be treated above the line for  
22 ratemaking purposes. KCPL specifically agrees not to propose  
23 *any adjustment* that would remove *any portion* of its off-system  
24 sales from its revenue requirement determination in any rate  
25 case, and KCPL agrees that it will not argue that these revenues  
26 and associated expenses should be excluded from the ratemaking

1 process. (Stipulation and Agreement from Case No. EO-2005-  
2 0329, page 22, *emphasis added*).  
3

4 I believe KCPL's proposal in its direct case is certainly contrary to the intent, as  
5 well as the letter, of such S&A language. As noted earlier, parties frequently  
6 argue about the "most likely" level of revenues or expenses expected to be  
7 experienced, but I do not recall parties recommending a higher or lower level of  
8 revenues/expense with the intent of knowingly creating a bias for either  
9 shareholders or ratepayers. The Company's proposal of promoting inclusion of  
10 an admittedly conservatively low estimate of off-system sales margins has the  
11 same impact as *removing a portion of its off-system sales from its revenue*  
12 *requirement determination* in this case, and accordingly, I believe KCPL's  
13 position on the issue of reflecting an ongoing level of interchange margins is  
14 contrary to the requirements of Case No. EO-2005-0329 Stipulation and  
15 Agreement.  
16

17 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING**  
18 **INTERCHANGE SALES MARGINS TO BE REFLECTED WITHIN**  
19 **THE DEVELOPMENT OF KCPL'S COST OF SERVICE**  
20 **DETERMINATION.**

21 A. The first step in establishing KCPL's rates in this proceeding should be to  
22 determine a traditional Missouri jurisdictional revenue requirement utilizing  
23 "most likely" revenue and expense estimates. I accept NorthBridge's most  
24 recently prepared estimate of the 50<sup>th</sup> percentile of interchange sales margins as

1 a proper or “most likely” level of margins to be achieved during the year that  
2 rates being established in this proceeding will be in effect. Accordingly, I  
3 recommend that such level of projected interchange margins be reflected within  
4 the traditional revenue requirement being established in this case.

5  
6 After the filing of all direct testimony, the parties can begin to evaluate the  
7 extent to which, if any, “Additional Amortizations to Maintain Financial  
8 Ratios” maybe necessary<sup>2</sup>. At that time the parties can also evaluate whether  
9 any other unique rate or accounting authority might be warranted in light of  
10 KCPL’s exposure to shortfalls in cash flow stemming specifically from the  
11 significance and volatility KCPL interchange sales.

### 12 13 14 **III. AMORTIZATION OF STORM DAMAGE EXPENSE**

#### 15 **Q. DOES KCPL’S ADJUSTED TEST YEAR COST OF SERVICE INCLUDE** 16 **A LEVEL OF STORM DAMAGE AMORTIZATION EXPENSE?**

17 A. Yes. On a total Company basis, KCPL’s adjusted test year cost of service  
18 includes \$8,294,549 of amortization expense related to repair costs incurred and  
19 initially deferred resulting from a January 2002 ice storm. The Missouri  
20 jurisdictional portion of this total Company amortization is \$4,562,002.

21  

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<sup>2</sup> Perhaps Staff and more active other intervenors may be in a position to assess the possible need for additional “amortization” expense concurrent with their direct filings inasmuch as they will be comprehensively addressing all elements of the traditional cost of service. However, absent a comprehensive assessment of all traditional cost of service components it is not possible to begin to assess the need for additional “amortization” expense at the time of direct testimony filing.

1     **Q.     DID KCPL OBTAIN AUTHORITY TO DEFER THE REPAIR COSTS**  
2     **ASSOCIATED WITH THE JANUARY 2002 ICE STORM?**

3     A.     Yes. In April 2002 KCPL filed an application with the MPSC seeking to defer  
4     costs incurred in an ice storm that occurred on January 30 and 31, 2002.  
5     Following the filing of recommendations by the Office of the Public Counsel  
6     (“OPC”) and the MPSC Staff, a prehearing conference was held with KCPL,  
7     Staff and OPC wherein the noted parties agreed upon a set of conditions that  
8     they jointly recommended that the MPSC adopt in conjunction with the issuance  
9     of an order approving the Company’s requested accounting authority. On July  
10    30, 2002 the MPSC issued an accounting order in Case No. EU-2002-1048  
11    wherein it authorized KCPL to defer the January 2002 ice storm costs subject to  
12    the terms and conditions as had been included within the joint recommendation  
13    of the noted parties.

14  
15    **Q.     OVER WHAT PERIOD IS KCPL AMORTIZING THE JANUARY 2002**  
16    **DEFERRED ICE STORM COSTS?**

17    A.     The Commission adopted the joint recommendation of the noted parties that  
18    provided for KCPL to amortize deferred ice storm costs ratably over the period  
19    September 2002 through January 2007.

20  
21    **Q.     DID KCPL ALSO RECEIVE AUTHORITY FROM THE KANSAS**  
22    **CORPORATION COMMISSION TO DEFER AND AMORTIZE THE**  
23    **2002 ICE STORM COSTS?**

1 A. No. According the Company's response to DOE-NNSA Data Request No. 2-  
2 29, the regulatory treatment for the 2002 ice storm costs was included as part of  
3 a broader Stipulation and Agreement approved by the Kansas Corporation  
4 Commission ("KCC") in Docket No. 02-KCPE-840-RTS. Pursuant to the noted  
5 KCC Stipulation and Agreement, KCPL agreed to *not* seek recovery of non-  
6 capital expenditures related to the January 2002 ice storm.

7  
8 **Q. GIVEN THAT KCPL DID NOT HAVE AUTHORITY TO DEFER 2002**  
9 **ICE STORM COSTS IN KANSAS, DID KCPL ONLY DEFER THE**  
10 **MISSOURI JURISDICTIONAL ALLOCATED PORTION OF TOTAL**  
11 **INCREMENTAL 2002 ICE STORM COSTS?**

12 A. That is my understanding. Accordingly, the test year "recorded" amortization  
13 of deferred 2002 ice storm cost reflects only the Missouri jurisdictional portion  
14 of total ice storm costs incurred. The Kansas portion would have been written  
15 off immediately to expense in 2002. On this latter point, I note that KCPL posts  
16 total Company Adjustment No. 2 to effectively gross up the Missouri  
17 jurisdictional amortization of 2002 ice storm costs recorded during the historic  
18 test year to a "total Company" level that would have been recognized had  
19 Kansas issued an identical accounting authority order to that which the MPSC  
20 issued in Case No. EU-2002-1048. This total company "gross up" adjustment  
21 was necessary in preparation of the Company's case inasmuch as KCPL elected  
22 to prepare a "total company" cost of service that it, in turn, allocated to the  
23 Missouri jurisdiction using a state jurisdictional allocation factor.

1  
2 **Q. SHOULD RATES BEING ESTABLISHED IN THIS PROCEEDING**  
3 **REFLECT ANY AMORTIZATION EXPENSE RELATED TO THE 2002**  
4 **ICE STORM?**

5 A. No.

6  
7 **Q. PLEASE EXPLAIN WHY NOT.**

8 A I believe these so-called “extraordinary” costs have already been recovered  
9 from Missouri jurisdictional ratepayers under existing rates. Specifically, and  
10 more to the point, for the years 2002 through 2005 KCPL’s Missouri  
11 jurisdictional earnings have been robust, if not excessive, when viewed relative  
12 to MPSC returns authorized for other Missouri energy utilities as well as other  
13 returns authorized by other state regulatory commission during the relevant time  
14 period. Pursuant to a settlement among KCPL, the MPSC Staff and certain long  
15 time intervenors in KCPL rate proceedings, KCPL annually prepares an  
16 earnings surveillance report that calculates total Company and Missouri  
17 jurisdictional earnings generally consistent with previous precedents established  
18 in KCPL Missouri jurisdictional rate cases. According to those annual reports,  
19 KCPL earned the following returns on equity in recent years for its Missouri  
20 jurisdictional operations:

<u>Year</u>	<u>Return on Equity</u>
2002	** [REDACTED] **
2003	** [REDACTED] **

2004

\*\* [REDACTED] \*\*

2005

\*\* [REDACTED] \*\*

I think it should be emphasized that the reported returns are after recognition of the deferral and amortization of 2002 ice storm costs authorized by the MPSC in Case No. EU-2002-1048. Admittedly, these calculated returns are largely “unaudited” and have not been “normalized.” Nonetheless, I believe they overwhelmingly demonstrate that KCPL was experiencing robust Missouri jurisdictional earnings – particularly in years 2002 through 2004 – even after deducting approximately \$4.5 million of amortization expense related to the 2002 ice storm.

**Q. WHAT RETURNS ON EQUITY WERE GRANTED OTHER ELECTRIC UTILITIES BY THE MPSC DURING THIS TIME FRAME?**

A. Some returns on equity authorized by the MPSC for energy utilities during the noted time frame that I am aware of include:

<u>Company</u>	<u>Case No.</u>	<u>ROE</u>
Laclede Gas	GR-2002-356	10.5%
Empire District	ER-2004-0570	11.0%
Missouri Gas Energy	GR-2004-0209	10.5%

Given the returns being authorized by the MPSC and other state regulatory jurisdictions during the relevant 2002 through 2005 time period, I believe it is reasonable to conclude that KCPL may have earned in excess of a return on equity that would have been authorized by the MPSC had a KCPL rate case

1           been undertaken during this time frame. To allow additional recovery of the  
2           2002 deferred ice storm costs in this case by reflection of a full annual  
3           amortization level will result in an unwarranted over recovery of such costs.

4  
5       **Q.   DID THE COMMISSION'S ORDER IN CASE NO. EU-2002-1048**  
6       **GUARANTEE OR OTHERWISE PROMISE THAT SUCH**  
7       **AMORTIZATION COSTS ORIGINALLY BEING ESTABLISHED**  
8       **WOULD BE CONSIDERED IN FUTURE RATE CASES?**

9       A.   No. To the contrary, the noted order specifically found:

10               That in granting the requested AAO, the Commission makes no  
11               findings as to whether deferred expenses are reasonable, whether  
12               other factors contributed to the damage to the system and the  
13               resulting repair/replacement costs incurred, or whether KCPL  
14               would have suffered financial harm (*i.e.* earnings during the  
15               period were inadequate to compensate KCPL for the costs  
16               incurred) absent deferral. The Commission reserves the right to  
17               consider in a future rate case the ratemaking treatment of the  
18               costs deferred, as well as any assertions, including the  
19               appropriate amortization period, made by parties thereto. (Order  
20               Granting Authority Order, page 3, from Case No. EU-2002-  
21               1048)  
22

23           The 2002 ice storm deferral request and authorization was occurring outside the  
24           scrutiny of a complete earnings investigation. Thus, no party could fully assess  
25           KCPL's ability to absorb such extra costs without an unacceptable hit to  
26           earnings. The Commission's order obviously recognized this limitation, and  
27           accordingly, clearly reserved the right to revisit the whole issue of the amount  
28           of, the need for, and the appropriate amortization period for the ice storm costs  
29           it was initially allowing to be deferred.



1  
2 **Q. WOULD A “DISALLOWANCE” OF THE MISSOURI**  
3 **JURISDICTIONAL ICE STORM AMORTIZATION BY THE MPSC IN**  
4 **A RATE ORDER ISSUED IN THIS PROCEEDING CREATE A WRITE-**  
5 **OFF AND HIT TO EARNINGS?**

6 A. Rates resulting from this proceeding should go into effect around January 1,  
7 2007. As previously noted, the Missouri jurisdictional ice storm amortization is  
8 scheduled to expire at the end of January 2007. Thus, at the end of December  
9 2006, the total unamortized balance – representing one more month of  
10 amortization expense – will only be \$380,167. Thus, the maximum “write  
11 down” or hit to earnings, that arguably might have to be written off in  
12 December 2006 when the order from this proceeding would become “known”  
13 would only be \$380,167. Given the relatively di minimus amount at stake, and  
14 the fact that the amount would have been written off in the following month of  
15 January 2007, I am not certain that specific financial disclosure would be  
16 required.

17  
18 **Q. ARE YOU STATING THAT EVEN THOUGH ONLY ONE MONTH OF**  
19 **AMORTIZATION EXPENSE WILL REMAIN WHEN RATES**  
20 **ESTABLISHED IN THIS PROCEEDING GO INTO EFFECT, THAT**  
21 **THE COMPANY’S REVENUE REQUIREMENT RECOMMENDATION**  
22 **REFLECTS A FULL ANNUAL AMORTIZATION ALLOWANCE.?**

1     A.     Yes. As noted previously, the annual Missouri jurisdictional amortization  
2           expense included within the KCPL cost of service study is \$4,562,002.  
3           However, at the end of December, 2006 the unamortized balance of the 2002 ice  
4           storm costs will only be \$380,167. Thus, if *any* ice storm costs were to be  
5           included in the Missouri jurisdictional cost of service stemming from this  
6           proceeding, *at most* it would only be equitable to include \$380,167 and  
7           concurrently authorize the Company to slow down the amortization of such  
8           balance from its original one-month schedule ending January 2007 to a twelve  
9           month period ending December 2007 – the approximate period that rates  
10          established in this proceeding will likely remain in effect. That stated, and as  
11          emphasized earlier, I do not believe inclusion of *any* amount of ice storm  
12          amortization expense in rate development or any “rescheduling” of ice storm  
13          amortization expense is necessary or equitable given that a review of historic  
14          earnings during the period that ice storm costs have been amortized to date  
15          demonstrate that these costs have already been fully recovered from retail  
16          ratepayers.

17  
18     **Q.     PLEASE SUMMARIZE YOUR POSITION REGARDING 2002 ICE**  
19           **STORM COSTS INCLUDED AS AMORTIZATION EXPENSE WITHIN**  
20           **KCPL’S MISSOURI JURISDICTION COST OF SERVICE**  
21           **DEVELOPMENT.**

22     A.     The entire \$4,562,002 of Missouri jurisdictional ice storm costs included within  
23           KCPL’s proposed Missouri jurisdictional cost of service study should be

1 removed. Given the returns that KCPL's Missouri jurisdictional operations  
2 achieved during the years 2002 through 2005 it is clear that these so-called  
3 "extraordinary" costs have already been fully recovered within rates. Further, it  
4 would be extremely unfair to ratepayers who have already paid rates that  
5 allowed KCPL to earn robust, if not excessive, returns on equity for the last  
6 three years, to design rates that would allow for recovery of \$4.5 million of  
7 additional ice storm costs in 2007 when only \$380,167 will remain  
8 "unamortized" at the beginning of 2007.

9  
10 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

11 **A.** Yes, it does.

My Commission Expires: 10-7-2010