EXHIBIT

Exhibit No.:	
Issue(s):	Off-System Sales Position
Witness:	Ryan Kind
Type of Exhibit:	Surrebuttal
Sponsoring Party:	Public Counsel
Case Number:	ER-2006-00314
Date Testimony Prepared:	October 6, 2006

SURREBUTTAL TESTIMONY

OF

RYAN KIND

FILED

NOV 1 3 2006

Missouri Public Service Commission

Submitted on Behalf of
the Office of the Public Counsel

KANSAS CITY POWER & LIGHT COMPANY

Case No. ER-2006-0314

HIGHLY CONFIDENTIAL INFORMATION
HAS BEEN REMOVED

OPC Exhibit No. 205
Case No(s). ER-2006-0314
Date 10-16-06 Rptr KF

October 6, 2006

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

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of Its Regulatory Plan	)))))	**<u>Case No. ER-2006-0314</u>**

AFFIDAVIT OF RYAN KIND

AFFIDAVIT OF RYAN KIND

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ryan Kind, of lawful age and being first duly sworn, deposes and states:

1. My name is Ryan Kind. I am Chief Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony consisting of pages 1 through 11.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Ryan Kind

Subscribed and sworn to me this 6th day of October 2006.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 10, 2009
Cole County
Commission #05754036

Jerene A. Buckman
Notary Public

My commission expires August 10, 2009.

SURREBUTTAL TESTIMONY

OF

RYAN KIND

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2006-0314

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. Ryan Kind, Chief Public Utility Economist, Office of the Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. This testimony will address the response of Kansas City Power & Light Company (KCPL or Company) witness Chris Giles in his rebuttal testimony to the direct testimony on behalf of several parties that criticized the Company's position that its rates should be set based on the 25 percent point on the off-system sales probability distribution instead of the median (50 percent point) of this distribution. I am referring here to the off-system sales margin probability distribution that is presented in the rebuttal testimony of KCPL witness Michael Schnitzer.

Q. DOES MR. GILES COMMENT IN HIS REBUTTAL TESTIMONY ON HOW OFF-SYSTEM SALES ARE GENERALLY TREATED IN THE DETERMINATION OF THE RETAIL REVENUE REQUIREMENT FOR A REGULATED UTILTY COMPANY LIKE KCPL?

A. Yes. At line 4 on page 4 of his testimony, Mr. Giles states that "[off-system] sales benefit retail customers because the margin from these sales is a reduction to KCPL's retail revenue requirement."

Q. IS THE KCPL POSITON REGARDING THE APPROPRIATE RATE MAKING TREATMENT FOR OFF-SYSTEM SALES IN THIS CASE CONSISTENT WITH THE ABOVE QUOTED STATEMENT FROM THE REBUTTAL TESTIMONY OF MR. GILES?

A. Certainly not. After Mr. Giles acknowledges that the margins from off-system sales should be used to reduce KCPL's revenue requirement, he proceeds to persist in his recommendation that KCPL's revenue requirement should include the low level (** [redacted] **) of off-system sales margins associated with the 25 percent point on the probability distribution for off-system sales margin distribution rather than the much larger value (** [redacted] **) associated with the median (50 percent point) of this distribution.

Q. HOW DOES MR. GILES EXPLAIN THE DISCREPENCY BETWEEN HIS ACKNOWLEDGEMENT THAT RATEPAYERS ARE ENTITLED TO HAVE OFF-SYSTEM SALES REFLECTED IN THEIR RATES AS AN OFFSET TO COSTS AND KCPL'S POSITION THAT THIS OFFSET TO COSTS SHOULD BE ADJUSTED DOWNWARD FROM THE MEDIAN VALUE ON THE PROBABILITY DISTRIBUTION FOR OFF-SYSTEM SALES MARGIN DISTRIBUTION TO THE MUCH LOWER 25 PERCENT VALUE ON THIS PROBABLIITY DISTRIBUTION?

A. He does not even attempt to explain this discrepancy.

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Q. AT LINE 21 ON PAGE 5 OF HIS REBUTTAL TESTIMONY, MR. GILES ASSERTS THAT "SEVERAL REASONS JUSTIFY SETTING THE OFF-SYSTEM SALES LEVEL AT [THE 25 PERCENT VALUE ON THE PROBABILITY DISTRIBUTION FOR OFF-SYSTEM SALES MARGIN DISTRIBUTION]." WHICH REASONS DOES HE IDENTIFY IN HIS TESTIMONY?

A. I have only been able to identify two reasons in Mr. Giles testimony that he cites to support his assertion that that "several reasons justify setting the off-system sales level at [the 25 percent value on the probability distribution for off-system sales margin distribution]." The first reason begins on the last line of page 5 where he states that "the off-system sales market has additional risk compared to retail sales." The second reason that he cites appears at line 20 on page 8 where he states "cash flow and the ability to maintain both the Company's stock price and credit rating is critical during the year these rates go into effect (2007)."

Q. YOU STATED THAT THE FIRST REASON CITED BY MR. GILES WHICH PURPORTEDLY JUSTIFIES "SETTING THE OFF-SYSTEM SALES LEVEL AT [THE 25 PERCENT VALUE ON THE PROBABILITY DISTRIBUTION FOR OFF-SYSTEM SALES MARGIN DISTRIBUTION]" IS HIS ASSERTION THAT "THE OFF-SYSTEM SALES MARKET HAS ADDITIONAL RISK COMPARED TO RETAIL SALES." WHAT FACTS OR ANALYSIS DOES MR. GILES PROVIDE IN HIS TESTIMONY AS SUPPORT FOR THIS CONCLUSION?

A. At the bottom of page 7, Mr. Giles claims that "wholesale revenue and earnings have different financial characteristics than retail revenues and earnings." He attempts to support this claim by citing two examples at the top of page 8 in his rebuttal testimony. The first example is "if a major generating unit is out of service, retail revenue continues, but off-system sales revenue declines or ceases altogether." The second example is "if

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gas prices fall, profit margins from retail customers are not significantly impacted, but off-system sales decline."

Q. DO YOU AGREE WITH THE FIRST EXAMPLE CITED BY MR. GILES TO SUPPORT HIS CONTENTION THAT "WHOLESALE REVENUE AND EARNINGS HAVE DIFFERENT FINANCIAL CHARACTERISTICS THAN RETAIL REVENUES AND EARNINGS?"

A. No. The first example that Mr. Giles cited was that "if a major generating unit is out of service, retail revenue continues, but off-system sales revenue declines or ceases altogether." While it is true that retail rate revenue will continue to flow in the event of an extended outage of a major generating unit (assuming KCPL had sufficient power reserves or could obtain replacement power from external sources that allowed customers to have uninterrupted service), it is quite likely that the power that KCPL uses to replace the output from the major generating unit would be more expensive than the unit that went down. This more expensive power that KCPL uses to continue to serve customers would cause KCPL's earnings to decline and could also have negative impacts on its cash flows if the Company was required to make cash payments to an outside company in order to purchase power in the wholesale market. Therefore, KCPL has the risk of negative financial impacts on both its retail and wholesale operations if it experiences an extended outage at one of its major units.

Q. DO YOU AGREE WITH THE SECOND EXAMPLE CITED BY MR. GILES TO SUPPORT HIS CONTENTION THAT "WHOLESALE REVENUE AND EARNINGS HAVE DIFFERENT FINANCIAL CHARACTERISTICS THAN RETAIL REVENUES AND EARNINGS?"

A. Yes, but Mr. Giles failed to note that these impacts will tend to offset each other to some extent and lower the enterprise-wide risk that KCPL faces from fluctuations in natural gas prices. The second example that Mr. Giles cited was that "if gas prices fall, profit margins from retail customers are not significantly impacted, but off-system sales decline." If gas prices fall, profit margins from retail customers will increase unless the utility has a fuel adjustment clause (FAC) in place. KCPL's profit margins for serving retail customers would increase as gas prices fall since KCPL does not have a FAC and the Company uses gas-fired generating units to serve part of its load. Therefore, a decrease in the cost of spot market gas that is purchased as fuel for these units would result in an increase in KCPL's retail profit margins, assuming all other factors impacting the profit margin remain unchanged. Since changes in gas prices are likely to have opposite impacts on KCPL's retail and wholesale profit margins they will offset each other to some extent. Because of these opposing impacts, it is more appropriate to evaluate the enterprise-wide risks that fluctuations in natural gas prices have on KCPL's regulated operations rather than evaluating the risk that gas price fluctuations have on a single aspect of KCPL's business.

Q. DID MR. GILES CITE ANY RISKS FACED BY THE RETAIL SIDE OF KCPL'S BUSINESS THAT ARE NOT THERE ON THE WHOLESALE SIDE?

A. No. It would be easy to find such risks but Mr. Giles may not have chosen to identify them since doing so would not help him buttress his contention that the wholesale side of the business has greater financial risks than the retail side. Risks that would probably be greater on the retail side include: labor issues, increases in coal prices, asbestos litigation,

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and major disallowances of construction costs for distribution, transmission and generation plant.

Q. WHAT IS YOUR UNDERSTANDING OF THE PURPOSE OF KCPL'S RECOMMENDATION TO INCLUDE THE LOW LEVEL OF OFF-SYSTEM SALES MARGINS ASSOCIATED WITH THE 25 PERCENT POINT ON THE PROBABILITY DISTRIBUTION FOR OFF-SYSTEM SALES MARGIN DISTRIBUTION RATHER THAN THE MUCH LARGER VALUE ASSOCIATED WITH THE MEDIAN (50 PERCENT POINT) OF THIS DISTRIBUTION?

A. This appears to be a means by which KCPL can bump up its requested return on equity (ROE) from 11.5% to the ** [redacted] ** figure specified at line 3 on page 7 of Mr. Giles' rebuttal testimony. For some reason, KCPL is unwilling to permit the public to see the actual ** [redacted] ** ROE that Mr. Giles implies the Company is seeking in this case.

Q. HAS MR. GILES EXPLAINED WHY THE 11.5% RETURN SUPPORTED BY KCPL'S RATE OF RETURN WITNESS, SAM HADAWAY, WOULD NOT BE AN APPROPRIATE RETURN FOR KCPL?

A. His only attempt to do so is his rather absurd assertion at line 9 on page 9 of his testimony that "other companies" don't participate in the off-system sales market.

Q. ARE YOU AWARE OF ANY REGULATED MISSOURI ELECTRIC UTILITIES THAT DO NOT PARTICIPATE IN THE OFF-SYSTEM SALES MARKET?

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A. No. In fact, I am certain that all regulated Missouri electric utilities participate in the off-system sales market. KCPL is in the middle of the pack for Missouri utilities in terms of the amount of participation that it does in the off-system sales market.

Q. IS KCPL SEEKING TO HAVE THE COMMISSION GIVE IT AN INCREASED RETURN TO REFLECT WHAT THE COMPANY CONTENDS IS ITS INCREASED RISK DUE TO PARTICIPATING IN THE OFF-SYSTEM SALES MARKET OR IS KCPL SEEKING TO HAVE THE COMMISSION ELIMIINATE MUCH OF THE RISK THAT IT FACES FROM PARTICIPATING IN THE OFF-SYSTEM SALES MARKET?

A. The answer to that question depends on which part of Mr. Giles rebuttal testimony you are reading. As I mentioned before, KCPL's proposal to include only the low level of off-system sales margins associated with the 25 percent point on the probability distribution for off-system sales margin appears to be a way for the Company to bump up its requested ROE from 11.5% to the ** [redacted] ** figure specified at line 3 on page 7 of Mr. Giles rebuttal testimony. However at line 8 on page 9 of his testimony, Mr. Giles states that KCPL "is simply requesting that the Commission eliminate 25 percent of the risk of an off-system sales market..."

Q. DO YOU BELIVE IT APPROPRIATE FOR MR. GILES TO CHARACTERIZE THE COMPANY'S PROPOSAL TO INCLUDE ONLY THE LOW LEVEL OF OFF-SYSTEM SALES MARGINS ASSOCIATED WITH THE 25 PERCENT POINT ON THE PROBABILITY DISTRIBUTION FOR OFF-SYSTEM SALES MARGIN DISTRIBUTION AS SIMPLY A MEANS TO ELIMINATE 25 PERCENT OF THE RISK OF AN OFF-SYSTEM SALES MARKET?

A. No. This is a huge understatement of the impact that KCPL's proposal would have. First, this proposal would actually eliminate 50 percent of the risk of adverse outcomes from participating in off-system sales market. Second, on top of eliminating 50% of the risk, this proposal could also lead to huge windfalls being captured by the company for any level of off-system margins that are substantially above the level of margin associated with the 25 percent point on the probability distribution.

Q. PLEASE EXPLAIN YOUR FIRST POINT.

A. If this Commission were to set the level of KCPL's off-system margins at the median value, or the 50 percent point in the probability distribution for off-system sales margins, then based on the probability distribution analysis, there would be a 50% risk that KCPL's participation in the off-system sales market could lead to outcomes for KCPL that are better than the amount of off-system sales margins associated with the median point and a 50% risk that KCPL's participation in the off-system sales market could lead to outcomes for KCPL that are worse than the amount of off-system sales margins associated with the median point.

It seems reasonable to assume that KCPL's proposal is intended to mitigate the Company's **risk of adverse consequences** from participating in the off-system sales market. Based on this assumption, it is clear that KCPL's proposal to include only the low level of off-system sales margins associated with the 25 percent point on the probability distribution for off-system sales margin distribution would eliminate 50% of the risk of adverse consequences from participating in the off-system sales market that would be present if KCPL's revenue requirement reflected the off-system margin value associated with the median of the probability distribution.

Q. PLEASE EXPLAIN THE SECOND POINT THAT YOU MADE ABOVE.

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A. If KCPL was only interested in lowering the amount of downside risk that it faced from participating in the off-system sales market, it would either have (1) a sharing mechanism or (2) some other method of passing through to ratepayers the positive or negative fluctuations in off-system sales margins from the level of margins reflected in its revenue requirement. For example, KCPL could have requested that the Commission include only the low level of off-system sales margins associated with the 25 percent point on the probability distribution for off-system sales margins **in conjunction with** proposing some method to credit ratepayers with the amount of off-system sales margins that exceed this level. Since KCPL did not propose any method to credit ratepayers for the amount of margins that exceed the low level that it proposes to reflect in the revenue requirement, the Company is seeking to decrease its downside risk by 50% **while also** setting up a situation where it will likely reap a huge windfall for its shareholders since there is a 75% probability that the actual level of off-system sales would exceed the 25 percent level that was reflected in revenue requirement.

Q. DIDN'T MR. GILES' DIRECT TESTIMONY ADDRESS THIS POSSIBLE WINDFALL ASSOCIATED WITH INCLUDING ONLY THE LOW LEVEL OF OFF-SYSTEM SALES MARGINS ASSOCIATED WITH THE 25 PERCENT POINT ON THE PROBABILITY DISTRIBUTION FOR OFF-SYSTEM SALES MARGIN?

A. Yes. In his direct testimony, Mr. Giles stated at line 7 on page 28 that "KCPL intends to account for this potential earnings increase in some manner in this proceeding, given the Company's proposed risk sharing of off-system sales." He also stated on page 28 that "a number of alternatives exist in this proceeding to account for the potential upside to the

Company of increased off-system sales margins" and he even listed a number of alternatives.

Q. HAS KCPL EVER FOLLOWED UP ON ITS COMMITMENT TO "ACCOUNT FOR THIS POTENTIAL EARNINGS INCREASE IN SOME MANNER IN THIS PROCEEDING, GIVEN THE COMPANY'S PROPOSED RISK SHARING OF OFF-SYSTEM SALES?"

A. No. Mr. Giles and other KCPL witness have made no further mention of: (1) their previous proposal to share the risk of potential off-system sales volatility with customers or (2) their previously stated intention "to account for this potential earnings increase in some manner in this proceeding." At this point it would be too late for KCPL to make such a proposal with less than two weeks remaining prior to the hearing. Public Counsel recommends that the KCPL proposal to set the off-system sales margins at an artificially low level should not be given serious consideration since the Company never followed up with a concrete proposal to account for the potential earnings windfall created by its artificially low off-system sales level proposal.

Q. AT LINE 6 ON PAGE 8 OF HIS TESTIMONY, MR. GILES EMPHASIZES THAT KCPL'S OFF-SYSTEM SALES PROPOSAL IS NOT A SHARING MECHANISM. DO YOU AGREE WITH MR. GILES ON THIS POINT?

A. Yes, I agree that it would not be accurate to characterize the KCPL off-system sales proposal as a "sharing mechanism." I believe **the KCPL proposal can be summed up as a means to: (1) remove risk** (which the Company would presumably have been compensated for in its allowed ROE unless the ROE was specifically adjusted downward

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to reflect a major reduction in the risk of participating in off-system sales markets) **and (2) facilitate an earnings windfall in between rate cases.**

Q. PLEASE SUMMARIZE PUBLIC COUNSEL'S VIEW ON THE LEVEL OF OFF-SYSTEM SALES MARGINS THAT SHOULD BE REFLECTED IN KCPL'S REVENUE REQUIREMENT IN THIS CASE.

A. As recommended by OPC witness Ralph Smith in his direct, rebuttal and surrebuttal testimony in this case, the Commission should determine that the ** [redacted] ** median value of the off-system sales probability distribution is the correct total system (prior to jurisdictional allocations) amount to reflect in KCPL's revenue requirement. The Commission should reject KCPL's proposal to use the ** [redacted] ** 25 percent value of the off-system sales probability distribution because this value: (1) will remove 50% of KCPL's downside risk of participating in the off-system sales market (without making the appropriate corresponding downward adjustment to ROE), (2) will likely lead to an earnings windfall for KCPL in between rate cases, and (3) would violate the terms of Commission approved the Stipulation and Agreement in Case No. EO-2005-0329 for the reasons cited in my rebuttal testimony in this case.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

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