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Issue: Rates  
Witness: Huttzell  
Type of Exhibit: Surrebuttal Testimony  
Sponsoring Party: Missouri Public  
Service Commission  
Company: Kansas City Power & Light  
Case No.: HO-86-139

MISSOURI PUBLIC SERVICE COMMISSION  
UTILITY DIVISION

KANSAS CITY POWER & LIGHT COMPANY  
CASE NO. HO-86-139

SURREBUTTAL TESTIMONY  
OF  
DR. CURT HUTTSELL

Jefferson City, Missouri

April, 1987

OFFICIAL CASE FILE  
MISSOURI PUBLIC SERVICE COMMISSION

- Exhibit No. 56  
Date 4-10-87 Case No. HO-86-139  
By Byrne

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

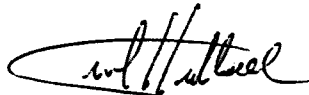
In the matter of the investigation )  
of steam service rendered by Kansas )  
City Power & Light Company )

CASE NO. HO-86-139

AFFIDAVIT OF DR. CURT HUTTSELL

STATE OF MISSOURI )  
 ) ss  
COUNTY OF COLE )

Dr. Curt Huttshell, of lawful age, on his oath states: that he has participated in the preparation of the attached written surrebuttal testimony in question and answer form, consisting of 7 pages, to be presented in the above case; that the answers in the attached written surrebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.



Dr. Curt Huttshell

Subscribed and sworn to before me this 9th day of April, 1987.

MISSOURI PUBLIC SERVICE COMMISSION  
NOTARY PUBLIC

  
Notary Public

My commission expires 9/4/87



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Curt Huttzell

1 Truck Lines, American Freight Systems, Next Day Motor Freight, Hyman  
2 Freightways and Graves Truck Lines.

3 After accepting my present position, I participated in the  
4 Staff's audits of Southwestern Bell Telephone Company in Case No. TR-86-84  
5 and General Telephone Company of the Midwest in Case No. TC-87-57. My  
6 designated tasks in both cases primarily involved evaluating economic  
7 studies of each company's central office replacements. Southwestern  
8 Bell's rate case ended with a negotiated settlement before the Staff's  
9 filing deadline, and I did not submit written testimony. My written  
10 testimony in General's rate case was filed under seal.

11 Before joining the Commission's Staff, I was a member of the  
12 faculties of Briar Cliff College in Sioux City, Iowa, and Saint Ambrose  
13 College in Davenport, Iowa. Since joining the Staff, I have served  
14 occasionally as a member of the adjunct faculty of Lincoln University of  
15 Missouri, Jefferson City, Missouri. While teaching at Briar Cliff and  
16 Saint Ambrose, I was responsible for courses in both economics and busi-  
17 ness statistics. At Lincoln University, I have taught graduate courses in  
18 managerial economics, operations research, and the social control of  
19 industry.

20 Q. What is the purpose of your surrebuttal testimony?

21 A. The purpose of my surrebuttal testimony is to respond to Mr.  
22 Beaudoin's proposal found at page seven (7) of his rebuttal testimony.  
23 Mr. Beaudoin recommends that Kansas City Power and Light Company (KCP&L or  
24 Company) be permitted to raise its central station steam rates in order to  
25 correct a revenue deficiency of \$3.2 million. This recommendation is  
26 predicated upon the eventuality that KCP&L will be required to operate its  
27 steam system while searching for a buyer and will not be allowed to offer  
28 free boilers to its existing steam customers. The proposed rate increase

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1 would take effect immediately; that is, there would be no phase-in of  
2 higher rates. Mr. Beaudoin contends that there is no basis to deny this  
3 rate increase to KCP&L. I believe that such a recommendation is  
4 inconsistent with the facts as portrayed in his direct testimony and  
5 elsewhere in his rebuttal testimony.

6 Q. What are the facts which you believe are inconsistent with  
7 Mr. Beaudoin's proposal?

8 A. Mr. Beaudoin acknowledges at page three (3) of his rebuttal  
9 testimony that the price of steam service is the principal determinant of  
10 customers' decisions to stay on the existing system or adopt alternative  
11 methods of meeting their heating requirements and other energy needs.  
12 Moreover, he predicts at page four (4) that rising steam prices likely  
13 will lead to still further increases as the company's customer base  
14 declines and fixed costs must be recovered from successively fewer users.

15 Factual support for the foregoing prediction is contained in Mr.  
16 Beaudoin's direct testimony. At pages six (6) and seven (7), Mr. Beaudoin  
17 explains the company's reasons for seeking approval to discontinue its  
18 central station steam operations. According to the explanation, customers  
19 have been leaving the system even at the substantially lower current and  
20 past steam rates and those who remain are taking less steam. As a result,  
21 the unit costs of steam have risen sharply. This historical upward trend  
22 in unit costs has been reinforced by two additional factors. First, the  
23 deteriorating condition of the steam plant has caused operating and  
24 maintenance expenses per unit to increase. Second, the retirement of  
25 KCP&L's electric generating facilities at Grand Avenue station has meant  
26 that certain common and joint costs once shared with electric customers  
27 must be borne entirely by steam users.  
28

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1 Additional support for the prediction may be found at pages  
2 fourteen (14) and fifteen (15) of Mr. Beaudoin's direct testimony. There  
3 he asserts that present steam rates do not yield sufficient revenue to  
4 cover current operating costs, much less provide for a return on existing  
5 investment. He argues further that doubling current steam rates would  
6 accelerate the pace at which the company expects customers to exit the  
7 system. The implication of this line of argument is that doubling rates  
8 would widen the gap between revenue and costs. It seems reasonable to  
9 conclude that a near-doubling of rates would have much the same effect.

10 Q. Should the Commission adhere to traditional ratemaking  
11 methods if the expectation is that rates so determined will not yield  
12 required revenue?

13 A. No, traditional ratemaking procedures should not be applied  
14 under such circumstances. Cost-of-service ratemaking works tolerably well  
15 provided demand is strong relative to unit costs or is growing. Where a  
16 large portion of costs are overhead and demand is weak or declining,  
17 test-year volumes as a guide to fixing rates may be ambiguous or even  
18 meaningless. High rates which choke off volume will always pull variable  
19 costs per unit of output up toward demand -- or even surpassing it --  
20 leaving little or nothing to contribute to the burden of overhead. The  
21 problem is that total variable costs at given levels of output often fall  
22 far less than in proportion to sales and overhead costs do not decline at  
23 all. In other words, neither average variable nor average total costs  
24 stay put. A price so high as to be far above average variable cost at  
25 current levels of output, thereby contributing greatly to overhead, may be  
26 below average total costs at future levels of output brought about by  
27 price increases.

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1 Q. What do you mean by the term "variable costs"?

2 A. Variable costs are those costs which vary with usage, that  
3 is, with the rate of output. Time plays an important role in identifying  
4 which costs are variable and which are invariant with respect to output.  
5 If there is insufficient time to alter plant size, output can be varied by  
6 varying plant utilization. In this case, the usual examples of variable  
7 costs are wages, fuel and raw materials. The more distant the time  
8 horizon under consideration, the greater the proportion of costs that  
9 become variable. In situations where the discontinuance of an entire  
10 service is under review, the relevant costs are those which can be avoided  
11 by curtailing operations. In other words, the relevant costs are  
12 escapable costs rather than sunk costs. Sunk costs are costs which have  
13 been irreversibly incurred and cannot be avoided or minimized by  
14 restricting output. Sunk costs would include embedded investment in plant  
15 and equipment.

16 Q. Are the terms "variable costs" and "out-of-pocket costs"  
17 synonymous?

18 A. No, not as the terms are usually employed. Out-of-pocket  
19 costs customarily refer to additional cash outlays required by the produc-  
20 tion of additional output. When the withdrawal of an entire service from  
21 some specific block of customers is being appraised, additional output  
22 clearly means the entire service in question, and the relevant  
23 out-of-pocket costs are the cash outlays needed to engage in production  
24 instead of not engaging in production at any particular time period. In  
25 contrast, variable costs include any decline in the future value of assets  
26 or any higher costs incurred in the future as a direct result of current  
27 production. Such future sacrifices are called user costs. The difference  
28 is that certain monetary payments for maintenance, repairs and

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1 replacements may be deferred and not constitute a cash outlay in the  
2 current period, although they may be necessary to provide service in the  
3 future.

4           However, when appraising whether the continuation of a whole  
5 block of service is worthwhile, it is especially important to keep the  
6 economic concept of demand firmly out in the forefront of analysis. Cost  
7 must be the cost of something, and this cost must be worth undertaking.  
8 The principal test of whether anything is worth having or worth doing is  
9 the price existing and prospective customers are willing to pay for it.  
10 Absent special kinds of costs and benefits which take special forms,  
11 failure of a service to satisfy this primary test in the future implies  
12 that user costs are zero. There is no current loss in the net value of  
13 the firm's assets causally attributable to operating instead of not  
14 operating. Hence the notions of variable and out-of-pocket costs become  
15 equivalent except for any reduction in whatever salvage value the firm's  
16 assets might have.

17           Q. Should the Commission adhere to traditional ratemaking  
18 standards of reasonableness if an entire utility operation is to be  
19 abandoned in the near future?

20           A. No, traditional standards of reasonableness should not be  
21 applied if a utility operation is to be completely discontinued. Specif-  
22 ically, rate levels established to recover past capital expenditures  
23 through an annual allowance for depreciation and provide for an annual  
24 return on the unamortized portion of such investments are inappropriate.  
25 Capital investments undertaken in the past represent fixed, historically  
26 sunk costs. Sunk costs are irrelevant to the pricing decisions of sellers  
27 doing business in competitive marketplaces. Their decisions to increase  
28 or decrease output, or shut down altogether, are governed by costs still



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1 under their control. Competitively determined prices demonstrate no  
2 persistent tendency to rise or decline in such a fashion that historically  
3 incurred costs are always recovered. Insofar as regulation should emulate  
4 the outcomes in competitive endeavors, sunk costs are inapposite for  
5 ratemaking.

6 Q. What are reasonable cost-of-service standards when an entire  
7 utility operation is being gradually discontinued?

8 A. Once a decision has been made to terminate a complete  
9 utility service within the next few years, the relevant costs for purposes  
10 of establishing reasonable rate levels are the costs which could be saved  
11 or avoided by shutting down the operation immediately; that is, avoidable  
12 or escapable costs. Avoidable costs are the variable costs of usage when  
13 usage means extending versus withdrawing a complete block of service to a  
14 specific customer group. Obviously, avoidable costs would include the  
15 additional costs imposed until the process of abandonment is concluded.

16 To the extent that maintenance, depreciation, cost of capital  
17 and various other overhead expenses cannot be escaped by shutting down  
18 altogether, they do not belong in rates. On the other hand, certain  
19 repairs and replacements might have to be made to ensure safe and reliable  
20 operations while service is being withdrawn. To the extent that addition-  
21 al repair and replacements costs are likely to be incurred, they should be  
22 reflected in rates, provided it is also likely that customers are willing  
23 to pay these costs.

24 Q. Does this conclude your surrebuttal testimony?

25 A. Yes.  
26  
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28