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| EXHIBIT NO. | |
| WITNESS: | DENNIS W. GOINS |
| TYPE OF EXHIBIT | SURREBUTTAL TESTIMONY |
| ISSUES: | COST OF SERVICE, REVENUE SPREAD |
| SPONSORING PARTY: | U.S. DEPT. OF ENERGY |
| CASE NO. | ER-2010-0355 |

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. ER-2010-0355**

**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 CONTINUE THE IMPLEMENTATION OF THE REGULATORY PLAN**

# SURREBUTTAL TESTIMONY OF DR. DENNIS W. GOINS ON BEHALF OF THE U.S. DEPARTMENT OF ENERGY

**January 5, 2011**

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## INTRODUCTION

**Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.**

**A.** My name is Dennis W. Goins. I operate Potomac Management Group, an economics and management consulting firm. My business address is 5801 Westchester Street, Alexandria, Virginia 22310.

**Q. DID YOU PREVIOUSLY FILE TESTIMONY IN THIS CASE?**

**A.** Yes. I filed direct testimony on November 24, 2010, and rebuttal testimony on December 10, 2010, on behalf of the U.S. Department of Energy (DOE) representing the Federal Executive Agencies (FEA), including the National Nuclear Security Administration (NNSA) facility in Kansas City that is served by Kansas City Power & Light Company (KCPL).

**Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

**A.** The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of KCPL witness Paul M. Normand, Staff witness Michael S. Scheperle, and Office of Public Counsel (OPC) witness Barbara A. Meisenheimer regarding cost-of-service and revenue spread issues. Witness Normand sponsors KCPL's class cost-of-service study (COSS) that is based on the Base-Intermediate-Peak (BIP) production cost allocation method. Witness Scheperle sponsors the Staff's class COSS—which is based on a variant of KCPL's BIP Method—and *Rate Design and Cost-of-Service Report* (COS Report), and also presents Staff's proposed revenue spread. Witness Meisenheimer did not conduct a class COSS, but submitted rebuttal testimony reiterating her support for a revenue spread that reflects results from KCPL witness Normand's BIP class COSS.

**Q. ON THE BASIS OF YOUR REVIEW OF THE REBUTTAL TESTIMONY OF WITNESSES NORMAND, SCHEPERLE, AND MEISENHEIMER, HAVE YOU CHANGED ANY OF THE CONCLUSIONS AND RECOMMENDATIONS DELINEATED IN YOUR DIRECT TESTIMONY?**

**A.** No. I continue to recommend that the Commission:

1. Reject KCPL's BIP Method for allocating fixed production costs to rate classes. Instead, KCPL should be required to use the four coincident peak method (4CP Method).
2. Reject KCPL's proposed allocation of off-system sales margins, and continue to allocate such margins using loss-adjusted kWh (energy) for each class.
3. Approve an across-the-board revenue spread of any rate increase granted to KCPL.

## KCPL WITNESS NORMAND

**Q. DO YOU HAVE ANY GENERAL COMMENT REGARDING WITNESS NORMAND'S REBUTTAL TESTIMONY?**

**A.** Yes. In his rebuttal testimony, witness Normand provided no meaningful critique of my recommended 4CP production cost allocation method.[1] Instead, he merely repeated many of the reasons he cited in his direct testimony for supporting the BIP Method. However, he did not address my fundamental criticisms of his BIP Method. Specifically, the BIP Method:

- Ignores peak demand as a principal factor driving KCPL's need for production resources.
- Unreasonably allocates more than 80 percent of KCPL's fixed production costs—and 100 percent of its fixed baseload costs—on the basis of energy.

**Q. IS THE BIP METHOD "WELL RECOGNIZED IN THE INDUSTRY" AS WITNESS NORMAND CLAIMS?**

**A.** No. Contrary to witness Normand's assertion,[2] the BIP Method is an arcane production cost allocation method that has never gained a strong following among cost analysts or regulators. In fact, witness Normand cited no regulatory commission other than Kansas that had adopted the BIP Method in a recent case.

[1] Witness Normand mistakenly claims that Maurice E. Brubaker, witness for various industrial intervenors, has recommended the 4CP Method to allocate the cost of production and transmission facilities. See Normand rebuttal at 6:12-21. Although witness Brubaker considers both the coincident peak and average and excess cost allocation methodologies superior to the BIP Method, he relies on the average and excess method—not the 4CP Method—for his recommended production cost allocation and rate design. *See* Brubaker direct at 20:14 and rebuttal at 2:23-26.

[2] *See* Normand rebuttal at 4:13.

**Q. DOES THE KANSAS CORPORATION COMMISSION'S RECENT DECISION TO ADOPT THE BIP METHOD IN DOCKET NO. 10-KCPE-415-RTS CHANGE YOUR OPINION THAT THE BIP METHOD IS OUT OF THE MAINSTREAM OF PRODUCTION COST ALLOCATION METHODOLOGIES?**

**A.** No. I simply note that the Kansas decision is an anomaly—it represents one of the few cases in the past 30 years in which a regulatory body has adopted the BIP Method. Witness Normand's claim that the BIP Method is a well-recognized cost allocation technique is disputed by a simple fact—most regulatory commissions have never adopted it.

**Q. IN HIS REBUTTAL TESTIMONY, DID WITNESS NORMAND ADDRESS THE BIP METHOD'S NUMEROUS DEFICIENCIES DISCUSSED IN YOUR DIRECT TESTIMONY?**

**A.** No. For example, he simply ignored the failure of his BIP Method to match the allocation of production plant and fuel costs—resulting in a gross over-allocation of production costs to higher load factor rate classes. He also did not address the BIP Method's failure to recognize the capacity value of baseload power plants. I discussed both of these deficiencies of the BIP Method in my direct and rebuttal testimony.

**Q. CAN RESULTS FROM YOUR 4CP COSS BE USED TO GUIDE DECISIONS REGARDING THE DESIGN OF KCPL'S RATES?**

**A.** Yes. Witness Normand claims that because my 4CP COSS did not "break down costs by season or by any other detail than Class level,"[3] it provides little insight regarding how KCPL's rates should be designed. I strongly disagree. A properly conducted, non-time-differentiated 4CP class COSS is a far superior guide for efficient rate design than a time-differentiated BIP Method that rests on implausible assumptions and incorrect analyses

that I detailed in my direct and rebuttal testimony. In my opinion, basing KCPL's rate design on results from witness Normand's fatally flawed BIP class COSS would provide consumers with incorrect price signals that encourage customers to make inefficient investment (purchases of equipment and appliances) and consumption decisions.

**Q. IS THE ALLOCATION OF FIXED BASELOAD CAPACITY COSTS UNDER THE BIP METHOD CONSISTENT WITH HIGHER SUMMER PRICES IN KCPL'S TIME-DIFFERENTIATED RATES?**

**A.** No. In general, KCPL's summer rates are significantly higher than its winter rates—reflecting KCPL's higher cost of serving summer peak loads. These higher summer rates send price signals that encourage customers to reduce both maximum *demands and energy* use in summer months, as well as invest in energy-efficient equipment and appliances. However, in allocating fixed baseload production costs—the bulk of KCPL's total fixed production costs—to rate classes, witness Normand used an energy allocation factor derived from energy consumption by class during a minimum-use, non-summer-peak month. In other words, witness Normand allocated the vast bulk of KCPL's fixed production costs on the basis of each class' energy use in an off-peak month that is totally unrelated to demand factors driving KCPL's need for production resources to meet its summer peak demands. In my opinion, KCPL's BIP Method provides no rational basis for developing time-differentiated seasonal rates.

[3] *See* Normand rebuttal at 6:15-17.

## STAFF WITNESS SCHEPERLE

**Q. WHAT DOES WITNESS SCHEPERLE CITE AS HIS BIGGEST CONCERN ABOUT YOUR RECOMMENDED 4CP PRODUCTION COST ALLOCATION METHOD?**

**A.** According to witness Scheperle, "Staff is concerned that a study involving CP information could result in free ridership when service rendered (sic) completely, or mostly, off-peak."[4] He then cites the Lighting class as the potential free-rider culprit.

**Q. IS WITNESS SCHEPERLE'S FREE-RIDER CONCERN VALID OR REASONABLE?**

**A.** No. First, fundamental economic principles support allocating little if any demand-related production costs to customers whose loads occur primarily in off-peak periods. Off-peak loads simply utilize production capacity that was built to serve peak demands. Second, the Lighting class cited by witness Scheperle as a potential free-rider represents a miniscule portion (I estimate less than 1.25 percent) of total retail revenue. Even if witness Scheperle is correct about the free-rider issue (which he is not), rejecting a mainstream 4CP allocation method for the arcane BIP Method that assumes no capacity value for baseload production plant is akin to treating an infected fingernail by cutting off the patient's hand. There are far simpler and more reasonable ways of addressing Staff's free-rider concern in a 4CP class COSS—notwithstanding the fact that the Lighting class' demands do not drive KCPL's need for production capacity. For example, one could simply assume a specified fraction of the Lighting class' maximum off-peak demands (say, 25 percent) should be included as CP demands in a 4CP class COSS. This approach is far more reasonable than moving to an unsupportable and illogical BIP Method.

[4] *See* Scheperle rebuttal at 8:11-12.

**Q. IS WITNESS SCHEPERLE'S ENDORSEMENT OF THE BIP METHOD FOR ALLOCATING DEMAND-RELATED PRODUCTION COSTS CONSISTENT WITH THE STAFF'S RECOMMENDED JURISDICTIONAL ALLOCATION METHOD?**

**A.** No. Staff witness Cary G. Featherstone recommends the 4CP Method for allocating KCPL's fixed production plant costs between jurisdictions.[5] In contrast, witness Scheperle rejects the 4CP Method for allocating these costs to KCPL's various Missouri retail rate classes, and instead recommends the BIP Method. This jurisdictional/retail allocation dichotomy is not merely inconsistent—it reflects two vastly different views regarding how and why KCPL incurs fixed production plant costs. Both Staff witnesses cannot be right.

Witness Featherstone correctly points out that KCPL needs production plant (which includes baseload capacity) to meet peak demands. As a result, he recommends allocating fixed production costs (including baseload costs) to the Missouri retail jurisdiction on the basis of 4CP demands. Concerning the allocation of fixed production costs, witness Featherstone says:

> Demand factors are used to allocate fixed costs because a utility incurs those fixed costs to meet its maximum loads—the coincident peaks—for which utilities must design and construct their electric systems to meet.[6]

In contrast, witness Scheperle argues that jurisdictional baseload costs allocated to the Missouri retail jurisdiction on the basis of KCPL's coincident peaks should be allocated solely on the basis of energy to Missouri retail rate classes using the BIP Method. He simply ignores this gross inconsistency in jurisdictional and class allocations of baseload

[5] *See* Featherstone rebuttal at 11:11-15.
[6] *Id*. at 23:15-17.

capacity costs in his class COSS. The most reasonable, cost-based way to address and eliminate this inconsistency is to reject Staff's recommended BIP-based class COSS, and instead use my recommended 4CP Method or witness Brubaker's recommended average and excess allocation methodology to allocate KCPL's fixed production costs to Missouri retail rate classes.

**Q. DOES WITNESS SCHEPERLE ACKNOWLEDGE THAT THE BIP METHOD ALLOCATES ALMOST ALL OF KCPL'S FIXED PRODUCTION COSTS ON THE BASIS OF ENERGY?**

**A.** No. He claims the "BIP methodology gives weight to both capacity and energy considerations."[7] This statement is misleading at best, since his BIP Method allocates all baseload plant costs—which comprise the bulk of KCPL's total fixed production costs—on the basis of energy, with ***no*** weighting for the capacity value of baseload resources.[8]

**Q. IS THE REVENUE SPREAD PROPOSED BY WITNESS SCHEPERLE REASONABLE?**

**A.** No. In his rebuttal testimony, witness Scheperle urges the Commission to reject my proposed across-the-board revenue spread.[9] However, witness Scheperle's proposed revenue spread is based on results from Staff's flawed BIP class cost study that inaccurately identifies KCPL's cost of serving each retail rate class. Relying on Staff's BIP class COSS as a rate design guide would result in rates that improperly reflect costs—thereby promoting inefficient investment and consumption decisions by KCPL's retail customers.

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[7] *See* Scheperle rebuttal at 4:6.

[8] As shown in my rebuttal testimony at Table 1 (page 5), witness Scheperle assigned 2,791 MW (62 percent) of KCPL's production plant to the Base category. For a discussion of why witness Scheperle's BIP Method implies that baseload capacity has no capacity value, see my rebuttal testimony at 6:6-23.

[9] *Id*. at 16:1-3.

## OPC WITNESS MEISENHEIMER

**Q. DO YOU AGREE WITH WITNESS MEISENHEIMER THAT CLASS MAXIMUM DEMANDS USED IN AN AVERAGE AND EXCESS CLASS COSS SHOULD NOT BE LIMITED TO JUNE-SEPTEMBER AS RECOMMENDED BY WITNESS MAURICE E. BRUBAKER?**

**A.** No. Witness Meisenheimer's argument ignores the fact that summer peaks drive KCPL's need for production resources. As a result, and contrary to witness Meisenheimer, limiting class noncoincident peak demands to the summer months as recommended by witness Brubaker in his average and excess class COSS is a proper costing approach taken by an experienced cost analyst. The NARUC cost manual provides only broad and fairly general descriptions of various cost allocation methodologies. The methodologies have to be applied in a manner that fits the specific circumstances of the utility being analyzed. In contrast to witness Brubaker, witness Meisenheimer seems to argue for form over substance.

**Q. IS WITNESS MEISENHEIMER CORRECT THAT OFF-SYSTEM SALES MARGINS SHOULD NOT BE ALLOCATED ON THE BASIS OF ENERGY?**

**A.** No. Witness Meisenheimer contends that allocating "off system sales revenue on energy alone…would ignore that plant investment is a component of generating off system sales volumes."[10] Her argument:

- Ignores this Commission's precedent for allocating off-system sales margins on the basis of energy.
- Provides no meaningful explanation or rationale for rejecting the Commission's precedent.

[10] *See* Meisenheimer rebuttal at 4:5-7.

**Q. SHOULD OFF-SYSTEM SALES MARGINS BE ALLOCATED ON THE BASIS OF ENERGY?**

**A.** Yes. As I discussed in my direct testimony,[11] the Commission has properly determined that off-system sales margins should be allocated on the basis of energy. This policy should be affirmed in this case because no witness has provided a rational justification for rejecting it.

**Q. DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?**

**A.** Yes.

[11] *See* Goins direct at 13-15.

**AFFIDAVIT**

Commonwealth of Virginia )
County of Fairfax ) SS

Before me this day appeared DENNIS W. GOINS of Potomac Management Group, who stated under oath that the foregoing testimony was prepared by him or under his direct supervision and control; that he has knowledge of the matters set forth in said testimony; and that such matters are true and correct to the best of his knowledge, information, and belief.

Subscribed and sworn to me this 4th day of January 2011.

Dennis W. Goins

Notary Public

REYNA MARIBEL VANEGAS
Notary Public
Commonwealth of Virginia
320413
My Commission Expires Jan 31, 2014

My Commission Expires: _____