

Exhibit No.: \_\_\_\_\_  
Issue: Right to Insurance  
Payments  
Witness: Michael S. Proctor  
Sponsoring Party: MoPSC  
Type of Exhibit: Rebuttal  
Case No.: EC-99-553

**MISSOURI PUBLIC SERVICE COMMISSION**  
**UTILITY OPERATIONS DIVISION**

**REBUTTAL TESTIMONY**

**OF**

**MICHAEL S. PROCTOR**

**CASE NO. EC-99-553**

**Jefferson City, Missouri**  
**February 2000**

**FILED<sup>2</sup>**

**FEB 28 2000**

*Missouri Public  
Service Commission*

**\*\*Denotes Highly Confidential Information\*\***

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**REBUTTAL TESTIMONY**  
**OF**  
**MICHAEL S. PROCTOR**  
**GST STEEL COMPLAINT RESPECTING**  
**KANSAS CITY POWER & LIGHT COMPANY**  
**CASE NO. EC-99-553**  
**February 28, 2000**

**Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?**

A. My name is Michael S. Proctor. My business address is 301 West High St.,  
P.O. Box 360, Jefferson City, Mo. 65102-0360.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am employed by the Missouri Public Service Commission (Commission) as  
Chief Regulatory Economist in the Electric Department.

**Q. WHAT IS YOUR EDUCATION BACKGROUND AND WORK EXPERIENCE?**

A. I have Bachelors and Masters of Arts Degrees in Economics from the  
University of Missouri at Columbia, and a Ph.D. degree in Economics from Texas A&M  
University. My previous work experience has been as an Assistant Professor of  
Economics at Purdue University and at the University of Missouri at Columbia. Since  
June 1, 1977, I have been on the Staff of the Commission and have presented testimony  
on various issues related to weather normalized energy usage and rate design for both  
electric and natural gas utilities. With respect to electric issues, I have worked in the

Rebuttal Testimony of  
Michael S. Proctor

1 areas of load forecasting, resource planning and transmission pricing. Recently, I served  
2 as the Staff Vice Chair of the Market Structure and Market Power working group of the  
3 Commission's Task Force on Retail Competition, Case No. EW-97-245.

4 **Q. WHAT ARE YOUR CURRENT DUTIES IN THE ELECTRIC**  
5 **DEPARTMENT AS CHIEF ECONOMIST?**

6 A. In addition to advising the Staff of the Electric Department on various issues  
7 related to weather normalization of sales and rate design, my primary focus has been on  
8 the development and structure of Regional Transmission Organizations (RTOs) for the  
9 purpose of increasing efficiency and reliability in the supply of electricity. Because of  
10 the restructuring of the electric industry toward the increased competitive supply of  
11 electricity, I have also focused my attention on the issue of market power within the  
12 electric industry.

13 **Q. IN THE INSTANT CASE, WHAT IS THE PURPOSE OF YOUR**  
14 **REBUTTAL TESTIMONY?**

15 A. First, I will provide background information respecting the August 12, 1994  
16 Amended and Restated Power Supply Agreement (Agreement) between Kansas City  
17 Power & Light Company (KCPL) and GST Steel Company (GST Steel). Then, with  
18 respect to the specific issues raised by the direct testimony of GST Steel witnesses, my  
19 rebuttal testimony will address the issue of GST Steel's right or claim to any part of the  
20 insurance compensation, which KCPL has received as a result of the Hawthorn Unit 5  
21 being out of service. This issue is raised in the direct testimony of GST Steel's witness  
22 Steven C. Carver. I will also address the issue of declining unit availability as such an  
23 event relates to the existing Agreement.

**BACKGROUND**

**Q. DO YOU HAVE ANY DIRECT CONNECTION TO THE SPECIAL CONTRACT BETWEEN KANSAS CITY POWER & LIGHT (KCPL) AND GST STEEL THAT MIGHT BE RELEVANT TO THIS SPECIFIC CASE?**

A. Yes. In October of 1994, I reviewed the Agreement between Kansas City Power & Light Company and GST Steel Company. On October 21, 1994, along with another member of the Staff, I filed a Staff Recommendation on Case No. EO-95-67 in which this proposed "special contract" was recommended for approval to the Commission. (That Staff Recommendation is attached as Appendix B to GST Steel's Petition for An Investigation.)

GST Steel, and its predecessor, ARMCO Steel, operated under the terms of special contracts since the late 1970's. However, the proposed contract in 1994 was different in two respects. \*\*

\*\* At the time of the Agreement, the appropriate capacity reserve requirements

1 were with the MOKAN Power Pool. This pool no longer exists, and the appropriate  
2 capacity reserve requirements are now determined by the Southwest Power Pool (SPP).

3 **Q. AT THE TIME YOU RECOMMENDED THE APPROVAL OF THIS**  
4 **SPECIAL CONTRACT, WHAT WAS YOUR VIEW OF HOW THIS CONTRACT**  
5 **WOULD OPERATE OVER THE LIFE OF THE CONTRACT?**

6 A. It was my view that GST Steel was a "competitive load customer" of KCPL.

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14 \*\* It is important to note for  
15 purposes of the instant case, that GST Steel, as a "special contract" customer, would not  
16 be subject to the rate increases, or benefit from the rate decreases that are applicable to  
17 KCPL's regular retail Missouri customers. Moreover, the "special contract" customer is  
18 totally dependent on the terms and conditions of the contract to set charges and special  
19 conditions of service, unless the "special contract" otherwise provides. Also notice that  
20 outside of \*\*

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**Q. WITH THE FILING OF THIS CASE, HAVE YOU REVIEWED BOTH  
THE AGREEMENT AND YOUR RECOMMENDATION IN CASE NO.  
EO-95-67?**

6

A. Yes, I have.

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**Q. HAS YOUR VIEW OF HOW THE AGREEMENT IS TO OPERATE  
CHANGED FROM YOUR INITIAL RECOMMENDATION?**

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A. No, it has not. I should add that from GST Steel's direct testimony, it does  
appear that \*\*

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**Q. DID THE AGREEMENT ANTICIPATE THAT SUCH A CHANGE  
MIGHT OCCUR?**

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A. Yes, it did. \*\*

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1           **Q. ARE THERE ANY OTHER PROVISIONS IN THE AGREEMENT**  
2 **RELATED TO \*\*** \_\_\_\_\_ **\*\*?**

3           A. Yes. The only other provisions that might be related to \*\* \_\_\_\_\_  
4 \_\_\_\_\_  
5 \_\_\_\_\_  
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7 \_\_\_\_\_  
8 \_\_\_\_\_  
9 \_\_\_\_\_ **\*\***

10          In addition, \*\* \_\_\_\_\_  
11 \_\_\_\_\_  
12 \_\_\_\_\_ **\*\***

13           **Q. BASED ON THESE TERMS IN THE AGREEMENT, WHAT IS YOUR**  
14 **PERSPECTIVE OF \*\*** \_\_\_\_\_  
15 \_\_\_\_\_ **\*\***

16          A. The terms of this special contract provide \*\* \_\_\_\_\_  
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24 \_\_\_\_\_ **\*\***

1           **Q. GIVEN THESE \*\***\_\_\_\_\_ **\*\***

2           **WHY IS THIS CASE NOW BEFORE THE COMMISSION?**

3           A. It is my understanding that GST Steel asked for an investigation under the  
4 existing agreement seeking that the Commission award it approximately three million  
5 dollars for either of two reasons. First, GST Steel claims that KCPL has not exercised  
6 good utility practice, and that failure resulted in: a) the explosion at the Hawthorn 5 unit,  
7 and b) the lower availability of all of KCPL's generation units. GST Steel claims that  
8 these events have resulted in higher incremental generation costs on KCPL's system.  
9 Second, GST Steel claims that it is entitled to receive a portion of the insurance  
10 compensation paid to KCPL for higher cost generation it has had to purchase to replace  
11 power from the Hawthorn 5 unit.

12           Apparently, KCPL and GST Steel have not been able to resolve their differences  
13 related to: a) KCPL's performance under the existing Agreement, and b) changes to the  
14 existing Agreement because of \*\*

15 \_\_\_\_\_ **\*\***

16           **REBUTTAL OF STEVEN C. CARVER**

17           **Q. WHAT IS YOUR UNDERSTANDING WITH RESPECT TO THE**  
18 **DIRECT TESTIMONY OF GST STEEL WITNESS STEVEN C. CARVER?**

19           A. At page 14 of his direct testimony, Mr. Carver states:

20           Even though there is no fuel adjustment clause in Missouri, GST has also been  
21 charged higher replacement energy costs following the Hawthorn 5 explosion  
22 through the contract rates set forth in the Power Supply Agreement between  
23 KCPL and GST. In my opinion, those ratepayers that have been charged higher  
24 replacement energy costs as a result of this explosion should reasonably expect to  
25 receive the corresponding benefit of any proceeds from the "extra expense --  
26 replacement power" insurance policy.



1           **Q. DOES MR. CARVER'S POSITION THAT GST STEEL SHOULD**  
2 **SHARE IN INSURANCE PAYMENTS MADE TO KCPL FOR "EXTRA**  
3 **EXPENSE – REPLACEMENT POWER" DEPEND ON THE ARGUMENT THAT**  
4 **KCPL HAS NOT FOLLOWED GOOD UTILITY PRACTICE RESULTING IN**  
5 **THE EXPLOSION AT THE HAWTHORN 5 UNIT?**

6           A. No, it does not. Instead, at page 18 in his direct testimony, Mr. Carver argues  
7 that GST Steel's claim to receive some portion of these insurance payments is "a  
8 reasonable application of standard regulatory accounting methods and procedures." This  
9 statement appears to be based on a theory by Mr. Carver that in contract-related charges,  
10 GST Steel was contributing to the cost of the premiums paid by KCPL for this insurance.

11 At pages 18 and 19, Mr. Carver asserts:

12           As a matter of regulatory policy, I do not believe that KCPL should be allowed to  
13 charge ratepayers, including GST, for: the cost of insurance premiums, including  
14 coverage for replacement energy; the cost of energy, including higher replace-  
15 ment energy; and be allowed to retain all insurance proceeds, related to the  
16 increased cost of replacement power. As long as ratepayers are bearing the brunt  
17 of the cost of replacement energy, the insurance proceeds must be used to offset  
18 those higher costs – before KCPL has any claim to retain such proceeds for the  
19 benefit of its shareholders.

20 Further on page 19, Mr. Carver completes his argument with the following statement:

21           The energy charge paid by GST also includes a fixed markup on a per kWh basis.  
22 Beyond incremental energy costs (plus markup), the Power Supply Agreement  
23 also requires GST to pay a demand charge, a delivery system charge and a  
24 customer charge. The combination of the markup and the fixed charges provide  
25 GST's contribution to KCPL's fixed cost of service, including insurance  
26 premiums.

27           **Q. DO YOU AGREE WITH MR. CARVER'S ASSERTION THAT GST**  
28 **STEEL IS ENTITLED TO SOME PAYMENT FROM THE INSURANCE**

**1    COMPENSATION RECEIVED BY KCPL FOR HAVING TO PAY HIGHER**  
**2    GENERATION COSTS BECAUSE HAWTHRON UNIT 5 IS OUT OF SERVICE?**

3            A. No, I do not. First, whatever GST Steel is entitled to receive from KCPL is  
4    determined by the conditions set out in the existing Agreement. There are no specific  
5    conditions in the Agreement related to sharing insurance compensation that KCPL might  
6    receive because of unit outages.

7            Second, Mr. Carver incorrectly argues that \*\* \_\_\_\_\_

8    \_\_\_\_\_  
9    \_\_\_\_\_ \*\* This argument is incorrect for two reasons. First,

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11    \_\_\_\_\_ \*\* As indicated in the background section of this testimony, \*\* \_\_\_\_\_

12    \_\_\_\_\_  
13    \_\_\_\_\_ \*\* At the time of

14    the Agreement, there was no discussion or intention that \*\* \_\_\_\_\_ \*\*

15    would give GST Steel any additional rights not covered by the contract. In fact, if

16    Missouri ratepayers were subject to a fuel adjustment clause, which they are not, I would

17    argue that KCPL's regular ratepayers would be entitled to the full amount of the

18    insurance compensation, and special contract customers would not be entitled to share in

19    this benefit unless \*\* \_\_\_\_\_ \*\* and their

20    contracts include a specific provision for such sharing.

21            Third, Mr. Carver incorrectly argues that the fixed charges, \*\* \_\_\_\_\_

22    \_\_\_\_\_ \*\* include payments related to a portion

23    of KCPL's fixed production costs. This simply is not correct. \*\* \_\_\_\_\_

Rebuttal Testimony of  
Michael S. Proctor

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14 includes some cost and therefore benefit to GST Steel is misplaced.  
15 Ignoring the absence of a specific right in the Agreement, at best, Mr. Carver's  
16 argument would apply only to the energy taken at firm power levels by GST Steel. But,  
17 by the very nature of a special contract, the rates paid are not intended to be subject to  
18 "traditional" regulatory treatment. Moreover, if GST Steel wants the benefits of the  
19 "traditional" regulatory treatment of costs, \*\* \_\_\_\_\_  
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1 \_\_\_\_\_\*\* Thus, Mr. Carver is asking that benefits  
2 given to regular tariff customers be given to GST Steel, which is paying a discounted rate  
3 through a special contract. This would be poor policy for the Commission to establish.

4 **Q. DOES THIS SAME ARGUMENT APPLY TO THE FALLING**  
5 **AVAILABILITY OF KCPL'S GENERATION UNITS?**

6 A. Yes, it does. How the Staff treats this issue in a rate case or complaint case  
7 will be addressed in the rebuttal testimony of Ms. Eve Lissik. In general, the Staff would  
8 make an adjustment for falling generation unit availability. But this would apply only to  
9 the rates charged to KCPL's regular tariff customers. If special contract customers want  
10 comparable treatment, they must negotiate such treatment as a part of their contracts with  
11 KCPL. Of course, inclusion of such conditions in a contract, shifts the risk of higher  
12 unscheduled outages onto KCPL. It follows that what KCPL is willing to give up in the  
13 form of lowered special contract charges will diminish as it assumes more risk.

14 **Q. WHAT THEN IS THE ECONOMIC PRINCIPLE THAT UNDERLIES**  
15 **YOUR REBUTTAL OF GST STEEL'S POSITION?**

16 A. The economics of contracts is fundamentally about how risks affect profits.  
17 There is a direct relationship between the risks that a supplier takes on and the  
18 compensation paid by the buyer: *the higher the risk to the seller, the higher the payment*  
19 *the seller will require from the buyer.* On the other side of this same coin, there is an  
20 inverse relationship between the risk the buyer is willing to take on and the payments  
21 made to the supplier: *the higher the risk to the buyer, the lower the payment the buyer*  
22 *will be willing to make to the seller.* The terms and conditions of a contract are more

1 than a statement of applicable charges. In addition, they specify the risks that each party  
2 to the contract is willing to take in conjunction with the financial charges.

3 From an economic perspective, the application of this economic principle to the  
4 instant case makes it clear that GST Steel is not entitled to benefits that are not included  
5 as terms or conditions of its contract. This does not address the issue raised by GST Steel  
6 that KCPL is not performing good utility practice under the Agreement. Instead, that  
7 issue is not one of who is paying for taking on identified risk, rather it is one of the  
8 supplier increasing the risk beyond normal or accepted levels for the industry.

9 **Q. IF GST STEEL AND KCPL ARE ABLE TO REACH AGREEMENT**  
10 **ON CHANGING THE TERMS OF THE EXISTING AGREEMENT WOULD**  
11 **THAT BE ACCEPTABLE TO THE STAFF?**

12 A. Not necessarily. The Staff does not want to leave the impression that any  
13 change to the existing Agreement would be acceptable to it. The Staff would expect that  
14 if any changes to the existing Agreement were negotiated, the amendments would be  
15 filed with the Commission for approval.

16 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

17 A. Yes, it does.

