Exhibit No.:	
Issue:	*Interchange Sales Margin*
Witness:	*Steve M. Traxler*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Rebuttal Testimony*
Case No.:	*ER-2006-0314*
Date Testimony Prepared:	*September 8, 2006*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

STEVE M. TRAXLER

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2006-0314

Jefferson City, Missouri
September 2006

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

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REBUTTAL TESTIMONY

OF

STEVE M. TRAXLER

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER 2006-0314

Q. Please state your name and business address.

A. Steve M. Traxler, Fletcher Daniels State Office Building, Room G 8, 615 East 13th Street, Kansas City, Missouri 64106.

Q. Have you prefiled direct testimony in this proceeding?

A. Yes, I have.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony will address the direct testimony of Kansas City Power & Light Company (KCPL) witnesses Chris B. Giles and Michael M. Schnitzer on the issue of Off System Sales Margin.

Q. Please summarize your rebuttal testimony on the off-system sales margin issue.

A. 1) The Commission's July 28, 2005, Report And Order and the agreed to language in KCPL's Experimental Regulatory Plan Stipulation And Agreement, Case No. EO-2005-0329, Section III.B.1.j., as amended by the July 26, 2005, Signatory Parties' Response To Order Directing Filing specifically precludes KCPL from proposing any adjustment in a rate case to remove any portion of its off-system sales margin. KCPL is proposing a $19 million (Total Company) reduction to its 2005 off-system sales margin for the purpose of sharing the "risk" of off-system sales between customers and shareholders (Giles direct, page 23, lines 17-19).

2) On page 23 of his direct testimony, KCPL's witness, Chris P. Giles, describes his risk sharing proposal:

> Q. Does an 11.5% return on equity adequately address the substantial risk of KCPL's off-system sales?
>
> A. No it does not. . . . The risk of this market is too large for either the Company or its customers to bear entirely. Because these risks are so large, the Company believes that it would not be acceptable to retail consumers to incorporate the full costs of the risks to capital within the rate of return. Therefore, KCPL has decided not to request a rate of return above 11.5% and proposes to share the off system sales risk with customers and shareholders.

The "risk sharing" mechanism being proposed by KCPL is an assignment of $19 million of the profit from off-system sales in 2005 to shareholders. Reducing the profit from off-system sales in this fashion violates the Stipulation And Agreement in Case No. EO-2005-0329.

3) KCPL's proposed $19 million reduction to its 2005 off-system sales margin and reduction in the allocation percent of 2005 off-system sales margin to Missouri, due to an unprecedented and unjustified allocation methodology, represents 32% of KCPL's requested $55.8 million rate increase in this case. This allocation methodology, which unjustifiably reduces the off-system sales margin to the Missouri jurisdiction by an additional $8 million, is contrary to the Stipulation And Agreement and the Commission's Report and Order in Case No. EO-2005-0329.

4) KCPL's witness, Chris P. Giles attempts to support KCPL's proposed reduction to off-system sales margin based upon the significant "risk" KCPL faces in this area of its operations. KCPL's historical experience as well as its own budgeted expectations don't support Mr. Giles risk assessment.

5) The direct testimony of KCPL's outside witness on this issue, Mr. Michael M. Schnitzer of NorthBridge Group, Inc., indicates that Mr. Giles "selection" of a ** ___ ** million off-system sales margin for this rate case has a ** ____ ** probability of being lower than what will be KCPL's actual experience after rates in this case become effective. This equates to a ** ____ ** probability that KCPL's ratepayers will pay excessive rates if KCPL's proposed level of off-system sales margin is adopted by the Commission.

6) KCPL's high percentage of base load generation has been and will continue to be a significant advantage for KCPL in the off-system sales market.

Q. What are off-system sales?

A. Off-system sales are sales of electricity made at times when utilities have met all obligations to serve their native load customers and have excess energy to sell to other utilities. The off-system sale transactions occur between utilities resulting in profits (net margin) to the selling entity, in this case, KCPL. Also KCPL might have energy to sell from its own units if it purchases energy from another utility at a lower cost than KCPL would incur in generating the energy from its own units.

Q. Please provide a brief explanation of the issue between the Staff and KCPL regarding the level of off-system sales margin (profit) to be included in cost of service in this rate case, Case No. ER 2006-0314.

A. There are two issues between the Staff and KCPL regarding the level of off-system sales margin to be reflected in cost of service in this rate case.

One, KCPL is proposing to assign approximately $19 million in off-system sales margin in 2005 (Total Company) to its shareholders for the stated purpose of sharing the risk between retail customers and the Company. The Staff has included the actual 2005

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off-system sales margin of approximately ** ___ ** million in the cost of service in its direct filing. It is the Staff's position that KCPL's proposed treatment for off system sales margin is both, improper regulatory treatment and contradictory to the stated treatment provided for in the amended KCPL Experimental Regulatory Plan Stipulation and Agreement and the Commission's Report And Order in Case No. EO-2005-0329.

Two, KCPL is proposing a jurisdictional allocation method, which it calls the "Unused Energy" allocator, for assigning the off-system sales margin among the Missouri retail, Kansas retail and FERC wholesale jurisdictions. This allocation method has never been proposed by KCPL in any prior rate case and results in an additional $8 million (Missouri retail jurisdictional impact) in off-system sales margin being removed from the Missouri cost of service and attributed to the Kansas retail and FERC wholesale jurisdictions. Staff witnesses Cary G. Featherstone and Lena M. Mantle will be addressing this allocation issue in their rebuttal testimony.

Q. What specific treatment for off system sales margin was provided for in the Commission's Report and Order in Case No. EO-2005-0329?

A. The agreement of the signatory parties on off system sales margin is stated on page 18 of the Commission's Report And Order:

> Under the terms of the Stipulation, KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated "above the line" for ratemaking purposes. **KCPL will not propose any adjustment that would remove any portion of its off-system sales** from its revenue requirement determination in any rate case. KCPL agrees that **it will not argue that these revenues and associated expenses should be excluded** from the ratemaking process. During the hearing, KCPL also stipulated that it would agree to this ratemaking treatment for off-system sales as long as the Iatan 2 costs were included in KCPL's rate base. (Tr. 1037-38).[4] (Emphasis added).
>
> [4] Also in their July 26 Response to Order Directing Filing, the Signatory Parties memorialized KCPL's agreement that all of its

> off-system sales would be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in determining those rates, and amended Section III.B.1.j. of the Stipulation and Agreement.

Q. Does KCPL's proposal to assign $19 million in off-system sales margin to shareholders contradict the language in the Commission's Report And Order in Case No. EO-2005-0329 stating that KCPL will "not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement in any rate case"?

A. Yes it does. Despite Mr. Gile's direct testimony at page 29, lines 3-10, his other direct testimony at page 23, lines 14-19, on off-system sales, his response to Staff Data Request No. 213.1 and the direct testimony of Mr.Schnitzer are clear regarding KCPL's intent to remove $19 million in off-system sales margin from cost of service in this case, ER 2006-0314, for the purpose of sharing the risk of off-system sales between customers and shareholders. KCPL's proposed sharing mechanism contradicts the Report And Order and the amended language of the Stipulation And Agreement on off-system sales in Case No. EO-2005-0329. KCPL's elimination of $19 million of actual off-system sales margin in 2005 from traditional ratemaking treatment and lower allocation to the Missouri retail jurisdiction of off-systems sales margin represent 32% of KCPL's requested $55.8 million rate increase in this case, ER 2006-0314.

Q. Where, in KCPL's direct testimony, does KCPL identify its proposal of reducing the margin on off-system sales in 2005 for the purpose of sharing the risk of off-system sales between customers and shareholders?

A. On page 23 of the direct testimony of KCPL witness Chris B. Giles, the following question and partial answer appear:

> Q. Does an 11.5% return on equity adequately address the substantial risk of KCPL's off-system sales?
>
> A. No it does not. . . . The risk of this market is too large for either the Company or its customers to bear entirely. Because these risks are so large, the Company believes that it would not be acceptable to retail consumers to incorporate the full costs of the risks to capital within the rate of return. Therefore, **KCPL has decided not to request a rate of return above 11.5% and proposes to share the off-system sales risk with customers and shareholders**. (Emphasis added).

Q. Is there any restriction in the Stipulation And Agreement or the Report And Order in KCPL's Experimental Regulatory Plan case, EO-2005-0329, that would preclude KCPL for requesting any return on equity (ROE) in a rate case it believed was appropriate or that it could justify?

A. No there is not. There is no justification for KCPL's proposal to reduce the margin on off-system sales by $19 million in order to avoid filing for an ROE above 11.5%. If KCPL believes that an ROE above 11.5% is justified in this rate case, then it should have filed direct testimony supporting the "real" ROE it believes is justified by its case. The total ROE KCPL is requesting is, by its own admission, a combination of the 11.5% ROE supported in its direct testimony and the assignment of $19 million in off-system sales margin to its shareholders.

Q. Did you enquire of KCPL as to what ROE would have been required in lieu of its proposal to assign $19 million in off-system sales margin to shareholders?

A. Yes. Attached as Schedule 1 to this rebuttal testimony is KCPL's response to Staff Data Request No. 213.1. KCPL provided the following response to question 4:

> ** ____
> ____
> __________

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____
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____
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__________ **

Rather than attempt to justify an ROE of ** ____ **%, KCPL chose instead to attempt to evade the Commission's Report And Order and the amended KCPL Experimental Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329, by reducing the margin on off-system sales by $19 million by proposing what it characterizes as a sharing of the risk of off-system sales margin. KCPL's proposal results in assigning to shareholders an additional $19 million in off-system sales as an additional equity return.

Q. You mentioned previously that KCPL's proposed reduction to the 2005 off-system sales margin is $19 million. Please explain the reference to $24 million in your last answer.

A. The initial $24 million value was based upon the direct testimony of KCPL's witness, Chris B. Giles. He stated that the 2005 off-system sales margin was approximately ** ____ ** million and that KCPL was including ** ___ ** million in its cost of service – a $24 million reduction. KCPL's work papers indicate a reduction of $19 million. A $19 million reduction is reflected in KCPL's updated cost of service calculation. The additional reduction to the off-system sales margin included in KCPL's cost of service results from the "unused energy" allocation factor proposed by KCPL witness Don A. Frerking. I previously noted that Staff witnesses Cary G. Featherstone and Lena M. Mantle will address the "unused energy" allocation factor in their rebuttal testimony.

Q. Does KCPL agree with your characterization of its off-system sales margin proposal as an assignment of $19 million in off-system sales margin to shareholders as an equity return?

A. Yes. KCPL's principal witness on this issue, Chris B. Giles, provided the following response to question 2 in Staff Data Request No. 213.1 attached as Schedule 1 to this rebuttal testimony:

> ** ____
> ____
> ____
> ____
> ____________________________
>
> ____
> ____
> ____
> ____
> ____
> ____________ **

Q. How did KCPL determine the ** ___ ** million in net margin on off-system sales to be included in its cost of service calculation?

A. On page 23 of his direct testimony, KCPL witness, Chris B. Giles indicates that the NorthBridge Group, Inc. was retained to perform a detailed risk analysis of the off-system sales market which is contained in the direct testimony of Michael M. Schnitzer.

Q. Please summarize the results of Mr. Schnitzer's risk analysis.

A. Mr. Schnitzer's analysis assigns a probability of occurrence to various levels of off-system sales margins as reflected on his Schedule MMS-5. KCPL's budgeted off-system sales margin for 2007, ** ____ ** million, represents the ** ___ ** percentile in Mr. Schnitzer's analysis. The 2007 budgeted level of ** ____ ** million has a ** _____** probability of being higher than the level that will be experienced by KCPL

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during the year that rates set in this case are in effect. The 2007 budgeted level has an equal ** ____ ** probability of being lower than the actual level that will be experienced by KCPL during the year rates set in this case are in effect. The ** ___ ** million level of off-system sales margin, **chosen** by KCPL for cost of service recognition in this case, represents the ** ___ ** percentile on Schedule MMS-5. The ** ___ ** million level of off-system sales margin selected by KCPL for this case has a ** ____ ** probability of being **lower** than the actual level that will be experienced by KCPL during the year rates set in this case are in effect. Adopting KCPL's level of off-system sales margin has a ** ____ ** probability of overstating rates set in this case based upon Mr. Schnitzer's analysis.

Q. Does Mr. Schnitzer's direct testimony include a recommendation for using ** ___ ** million in off-system sales margin for cost of service recognition in this case?

A. No. The decision to use ** ___ ** million as the level of off-system sales margin for cost of service recognition in this case was made by KCPL and sponsored by KCPL witness Chris B. Giles. Mr. Schnitzer makes this clear on page 2 of his direct testimony:

> As described in the testimony of Mr. Chris B. Giles, KCPL proposes to establish the level of net revenues from off-system sales (i.e. revenues less associated expenses) (Off-System Contribution Margin") at ** __________** and account for this as a reduction to KCPL's test year revenue requirements.

Q. Can Mr. Giles selection of a ** ___ ** million off-system sales margin for this case be fairly characterized as being unfairly protective of shareholder interests on this issue?

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A. Yes. In addition to the other statements that I have already made, I would characterize Mr. Giles selection of a ** ___ ** million off-system sales margin for this case as being unfairly protective of shareholder interests on this issue. As stated previously, Mr. Schnitzer's risk analysis indicates that there is a ** ____ ** probability that KCPL's actual off-system sales margin will exceed the ** ___ ** million level chosen by KCPL for cost of service recognition in this case. In other words, there is a ** ____ ** probability that KCPL's shareholders will earn a higher return as a result of KCPL's actual off-system sales margin exceeding the level included in cost of service in this rate case. Conversely, there is a ** ____ ** probability that KCPL's ratepayers will pay excessive rates as a result of KCPL's actual off-system sales margin exceeding the ** ___ ** million level used for setting rates in this case.

Q. What level of off-system sales margin in Mr. Schnitzer's analysis provides equal risk to KCPL's customers and shareholders?

A. KCPL's budgeted 2007 level of ** ____ ** million represents the ** ___ ** percentile on Mr. Schnitzer's Schedule MMS-5. Adopting the 2007 budgeted level would assign an equal ** ____ ** probability to both shareholders and ratepayers based upon Mr. Schnitzer's direct testimony and analysis. The KCPL budgeted level for 2007 is only a 7% increase over the actual level experienced in 2005. To the contrary and regardless of KCPL's recent experience, the ** ___ ** million level "selected" by KCPL represents a 28% reduction to KCPL's budgeted level for 2007.

Q. Mr. Giles states that he is supporting KCPL's proposed reduction in off-system sales margin based upon a need to share the "risk" of off-system sales margin between customers and shareholders. Has the Staff identified the risk associated with off-system sales margin in this case for KCPL?

A. Yes. The risk associated with off-system sales should be readily apparent by analyzing a company's historical experience. Significant annual volatility (fluctuation) in the off-system sales margins would indicate a significant level of risk.

Q. Has the Staff historically addressed significant volatility in the off-system sales margin area?

A. Yes. When a company is experiencing significant volatility in annual off-system sales margin, which cannot be attributed to an abnormal event like the extended loss of a base load generating unit, the Staff has recommended an average of historical levels for cost of service recognition to mitigate annual volatility.

Q. Is KCPL experiencing significant "risk" resulting from volatility in its annual off-system sales margins?

A. Certainly not. KCPL's actual and budgeted off-system sales margins from 2001 through 2007 are reflected below:

Year	Actual Dollars	Budget Dollars
2001	** __________ **	Not Available
2002	** __________ **	Not Available
2003	** __________ **	** ___________ **
2004	** __________ **	** ___________ **
2005	** __________ **	** ___________ **
2006		** ___________ **
2007		** ___________ **

[KCPL Response to Staff Data Request No. 99.1R and 234]

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KCPL has experienced a significant increase in annual off-system sales margins from 2001 through 2004. The level experienced in 2004 continued in 2005 and has increased in 2006. The annual volatility experienced in 2004 and 2005 is less than 1%. The budgeted amounts for 2006 and 2007 reflect less than 3% in annual volatility. More importantly, KCPL's historical experience does not reflect any significant downward reduction in its off-system sales margin since 2001. Significant volatility is exhibited by significant fluctuations which go both up and down from year-to-year. To the contrary, KCPL has experienced a continuing increase which has stabilized in 2005 with some additional growth expected in 2006 and 2007. This upward trend cannot be characterized as volatile or risky under any reasonable definition. Mr. Giles significant concern over the "risk" associated with KCPL's annual off-system sales margins is not justified based upon historical experience and budgeted expectations.

Q. Does KCPL's most recent annual off-system sales margin support Mr. Giles concern over the risk associated with off-system sales margins?

A. Certainly not. In an updated response to Staff Data Request No. 99.1, KCPL provided the actual off-system sales margin experienced by KCPL for the 12-month period ending July 2006. KCPL's actual off-system sales margin for the 12-month period ending July 2006 was ** ____ ** million. KCPL's proposed ** ___ ** million off-system sales margin for setting rates in this case represents a 31% reduction from its most recent annual experience.

Q. Is KCPL's base load capacity a contributing factor as to why KCPL's actual off- system sales margins have improved and experienced very little volatility or "risk" historically?

A. Yes. KCPL has a much higher percentage of base load capacity than Aquila, Inc. and The Empire District Electric Company, for example. In the year 2005, KCPL was able to supply approximately 94% of its load, including off-system sales, with base load capacity. KCPL's significant base load capacity has given KCPL an advantage in competing in the off-system sales market. KCPL's most recent experience in off-system sales margin and KCPL's own budgeted levels for 2006 and 2007 don't support Mr. Giles' concern of significant risk to KCPL's off-system sales margin to justify a $19 million reduction to the 2005 level for setting rates in this case.

Q. Given KCPL's most recent actual experience and budgeted 2006 and 2007 levels for off-system sales margin, why did Staff reflect the lower off-system sales margin for 2005 in its direct filing?

A. The Staff has consistently opposed the use of budgeted data for traditional cost of service ratemaking purposes due to known and measurable and matching principle issues. However, KCPL's recent increase in its actual annual off-system sales margin can be addressed in the true-up audit for the period ending September 30, 2006 agreed to for this case in the KCPL Experimental Regulatory Plan Stipulation And Agreement.

Q. Did any other parties to this case file direct testimony which included a recommendation for the level of off-system sales margin to be recognized in cost of service in this case?

A. Yes. Mr. James R. Dittmer, retained by the United States Department of Energy (DOE), and Mr. Ralph C. Smith, retained by the Office of the Public Counsel (OPC), propose levels of margin on off-system sales in their direct testimonies.

Q. What levels of off-system sales margin did Mr. Dittmer and Mr. Smith recommend for cost of service recognition in this case?

A. On page 13, line 1-4 of his direct testimony, Mr. Dittmer recommended the median value calculated by KCPL's witness, Michael M. Schnitzer. The median value of ** ____ ** million is the value at the ** ___ ** percentile and is reflected on Mr. Schnitzer's Schedule MMS-6. The ** ____ ** million level is also KCPL's budgeted level for 2007. Mr. Smith also recommended the ** ____ ** million median value on Mr. Schnitzer's Schedule MMS-6 (Smith direct, page 7, lines19-20).

Q. How do the off-system sales margins recommended by OPC and DOE compare to the level recommended by the Staff in its direct testimony?

A. The Staff's direct filing includes the actual off-system sales margin for 2005, ** ___ ** million.

Q. If the Commission chose to adopt KCPL's proposed "Unused Energy" allocator for allocating off-system sales margin among KCPL's Missouri retail, Kansas retail and FERC wholesale jurisdictions, should consideration be given to including the highest level of off-system sales margin in cost of service which can be supported by the evidence in this case?

A. Yes. KCPL's use of the "Unused Energy" allocator baselessly rewards the Kansas retail and FERC wholesale jurisdictions by allocating an additional $9 million in off-system sales margin to the Kansas and FERC jurisdictions than would occur if KCPL used its Energy Allocator **consistent** with how KCPL's allocated its **firm** off system sales margin. An Energy Allocator has been used consistently by the Staff and other utilities in Missouri for allocating the energy component of both non-firm (the issue in this case) and firm (capacity sales) off-system sales margin. The Staff is opposed to this novel allocation methodology. This issue is addressed in the rebuttal testimonies of Staff witnesses Cary G. Featherstone and Lena M. Mantle. However, if the Commission were to decide to adopt KCPL's Unused Energy allocator, the Staff believes that the highest level of off-system sales margin supported by evidence should be adopted by the Commission in order to mitigate this significant negative impact on Missouri retail customers. KCPL's actual off-system sales margin for the 12-month period ending July 2006 was ** ____ ** million.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.

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SCHEDULE 1

HAS BEEN DEEMED

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IN ITS ENTIRETY