KCP&L-233

Exhibit No.:
Issue: Bad Debt Factor-Up
Forfeited Discounts
Witness: Amanda C McMellen
Sponsoring Party: MoPSC Staff
Type of Exhibit: Surrebuttal Testimony
File No.: ER-2010-0355
Date Testimony Prepared: January 5, 2011

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

AMANDA C. MCMELLEN

KANSAS CITY POWER & LIGHT COMPANY

FILE NO. ER-2010-0355

Jefferson City, Missouri
January 2011

Staff Exhibit No. KCP&L-233
Date 1/18/11 Reporter LmB
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KANSAS CITY POWER & LIGHT COMPANY

FILE NO. ER-2010-0355

Q. Please state your name and business address.

A. Amanda C. McMellen, Governor Office Building, P.O. Box 360, Jefferson City, Missouri 65102.

Q. By whom are you employed and in what capacity?

A. I am a Utility Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Are you the same Amanda C. McMellen who has previously contributed to the Staff's Cost of Service Report in Case No. ER-2010-0355 dated November 10, 2010 for Kansas City Power & Light Company (KCPL or Company)?

A. Yes, I am. In addition, I contributed to the Staff's Cost of Service Report filed on November 17, 2010 for KCP&L Greater Missouri Operations Company (GMO).

Q. What is the purpose of your Surrebuttal Testimony?

A. The purpose of my testimony is to respond to the rebuttal testimony of KCPL witness John P. Weisensee with regard to bad debt expense and forfeited discounts (late payment fees).

EXECUTIVE SUMMARY

Q. Please briefly summarize your Surrebuttal Testimony pertaining to this rate case.

A. In this testimony, I respond to KCPL's request to recover for a level of bad debt expense in excess of the experienced level calculated in this case. I explain Staff's recommendation that KCPL not be allowed to recover bad debt expense at a level which includes the full impact of the revenue requirement increase in this rate case. KCPL's request to include an adjustment for bad debt expense associated with revenue requirement increase (or decrease) is commonly referred to as bad debt "factor up" or "gross up."

The Company's rationale for making this request is based on the assumption that any increase in revenue requirement granted by the Commission will cause bad debt expense to also directly increase proportionally. However, the Company has not demonstrated a direct correlation between the level of rates and the percentage of bad debts that would justify the reflection of the full impact of increased bad debt expense in rates.

Staff does not recommend adoption of KCPL's bad debt "factor up" request; however it is Staff's position that if the Commission does grant KCPL's request to "factor up" bad debt expense proportionate with an increase in revenue requirement, then it is also the best regulatory practice to also "factor up" forfeited discounts for the same reason. If the Commission concludes that it is reasonable and appropriate to "factor up" bad debt expense for purposes of setting rates, on the premise that KCPL will experience a higher level of bad debts as a result of a rate increase, then it is reasonable and appropriate to conclude that KCPL will also experience a higher level of late payment revenue resulting from those higher rates.

BAD DEBT EXPENSE

Q. Do Staff and KCPL differ regarding the level of bad debt expense to reflect in KCPL's rates?

A. Yes. Although the bad debt issue is only listed as part of the true-up items in Mr. Weisensee's rebuttal testimony (Schedule JPW2010-7 under Operating Income), there is still a difference in methodology between Staff and KCPL in calculating the ongoing level of total bad debt expense. KCPL adjusted bad debt expense to include a portion for the requested revenue increase in this case, which is referred to as a bad debt "factor up" or "gross up". Staff has based its recommendation on experienced levels of bad debt.

Q. Does Staff believe that it is reasonable to assume that there will be bad debts associated with the revenue requirement increase granted in this rate case?

A. In principle, the Staff agrees that bad debts may increase to some extent as a result of an increase in KCPL's revenue requirement. However, the Staff does not agree with the position that any increase in a company's revenue requirement should cause bad debt expense also to directly increase proportionally, on a dollar-for-dollar basis. The Staff has simply seen no evidence of this direct correlation, and KCPL has not produced any evidence of a direct correlation in its testimony or workpapers. In fact, several times as revenues go up, bad debts have <u>actually</u> declined. In other instances, the Staff has seen bad debts going up while revenues decreased.

Q. What is a bad debt "factor up" or "gross up", and what is the rational behind its use?

A. The usual justification for use of the bad debt "factor up" is the belief that it is necessary to properly match the level of bad debt expense established in a rate case with the amount of revenue requirement increase that will be determined by the Commission in that case. This additional amount of bad debt expense, if the "factor up" is granted, will be calculated and added to the annualized and normalized level of bad debt expense found reasonable for inclusion in the utility's revenue requirement. The amount of any ordered bad debt "factor up" will be derived by applying the bad debt expense ratio to the expected revenue requirement increase to be granted by the Commission.

KCPL's use of a bad debt "factor up" is based on the assumption that any amount of increased revenues resulting from this rate case will directly cause bad debt expense to increase proportionally as well, all things being equal. In other words, the Company believes it is reasonable to assume that if some ratepayers are not able to pay their current utility bills when they fall due, chances are that some of these same customers would not be able to pay their bills when the utility bills go up as a result of a rate increase. However, while Staff believes that this view may seem reasonable on a theoretical basis, Staff has found from a practical point of view that this theory does not always hold true in reality. In other words, use of bad debt "factor up" means it is a virtual certainty that with each rate increase bad debts will go up by the same percentage. This is not a realistic view. In order for the KCPL proposal to use a bad debt "factor-up" to be justified, a substantial amount of analysis would be needed to demonstrate a direct correlation between revenue levels and bad debt levels.

Q. Does KCPL's requested bad debt "factor up" work in the same way as an income tax "factor up"?

A. Yes. The income tax factor assumes that for every increase in earnings to a utility resulting from a rate case there will be a direct and absolute proportional increase in income taxes. This is a well-known and established relationship, and in this case both

Company and the Staff have applied an income tax "factor up" to the additional revenue requirement calculation to determine the proper level of rate increase recommended in this case. If the Commission authorizes a rate increase in this proceeding, then a corresponding income tax amount will have to be added to the additional revenue requirement amount or the Company may not be able to recover the authorized amount of increase in revenue requirement. However, it is clear from the analysis conducted by the Staff that no such direct relationship exists between increased rates and increased bad debt expense.

Q. Why doesn't Staff recognize a proportionate increase as necessary?

A. To recommend that any increase in bad debt levels be in proportion to an increase in revenue requirement levels would require a basis to believe that the two have the correct relationship of size, quantity, or degree to something else, or remaining in the same relationship when things change. While the Staff acknowledges there may be some relationship between bad debt expense and increased revenues resulting from a rate case, when it has examined this relationship in rate cases for other utilities, the Staff has generally found that rate increases do not always cause a proportional increase in bad debt expense, as KCPL is suggesting in this case. There are no indications that an increase in revenue requirement should or will result in a proportional increase in bad debt expense.

Q. Has the Staff performed any analysis that would support the position that no direct relationship exists for bad debts relating to additional revenue requirement for KCPL?

A. Yes. Attached to this surrebuttal testimony, as Schedule ACM-1, is a historical monthly analysis of KCPL's bad debts and retail revenue levels for KCPL. The Company's own historical data does not support the position that there is always a corresponding direct relationship between revenues and bad debt expense; whereby any revenue increase will always result in an automatic increase in bad debt expense in the same magnitude and proportion.

Q. How did the Staff review KCPL's historical relationship of bad debt expense to sales revenue?

A. The Staff employed various methods of data analysis in its review, yet none of those methods produced any substantive evidence to support the direct relationship that must exist between the two items to justify inclusion of a full bad debt "gross up" in this case. The Staff utilized both numerical and graphical presentations in its review.

Q. What does Schedule ACM-1 show?

A. The Staff believes the information shown in Schedule ACM-1 clearly demonstrates that there is no direct relationship between bad debts and increased revenues that would have to exist to justify total bad debt "factor up" calculation.

Q. What are some historical examples specific to KCPL when bad debts did not increase proportionately to a rate increase?

A. The Staff reviewed the changes or variations that occurred between electric retail revenues and actual bad debt write-offs for a five-year period from January 2005 through December 2009 (see attached schedules). In other words, using the Company's data, Staff reviewed how bad debts varied in relation to revenues for that five-year (or 60-month) period.

About half of the data reviewed showed that there was no relationship. That is, while electric revenues increased (or decreased), actual bad debt write-offs tend to decrease (or increase) by different amounts. In August 2007, KCPL experienced a decrease of about 42.03 % in revenues, but had an increase in bad debt write-off of 2.73%.

In the following month (September 2007), revenues increased by 61.22%, while bad debt write-offs decreased by 8.74%. In November 2007, revenues increased by 2.72%, and bad debt write-offs decreased by 16.38%. Even in situations where revenues and bad debts tend to go in the same direction, the Staff observed that they were either increased or decreased by different, not the same, amounts. This situation does not in any way support the argument that bad debt write-offs and revenues have proportional relationship.

Q. Did KCPL include the bad debt "factor up" in its initial rate filing?

A. Yes. KCPL has included an adjustment for bad debt match up with revenue requirement increase, since the Commission's Report and Order in KCPL's previous rate case, Case No. ER-2006-0314. It is understood in the last two KCPL's rate case, Case Nos. ER-2007-0291 and ER-2009-0089, that the Company made similar adjustments.

Q. Did the Staff include a bad debt "factor up" in its recommendation?

A. No. At this time, the Staff has not included any additional amount in rates for an increase in the level of bad debts proportionate to the increase in revenue requirement. The Staff's position is based on its analysis of actual KCPL data that shows no direct correlation exists between revenue increases and increases in bad debt expense. The analysis does not support the position that an increase in revenue will result in proportionate increase in bad debt expense.

FORFEITED DISCOUNTS

Q. What are "forfeited discounts"?

A. Forfeited discounts also known as "late payment fees" are charges that KCPL charges its customers for non-payment of customer bills whenever they fall due. The charges are assessed on the remainder of the unpaid bill.

Q. What is the issue(s) between the Staff and the Company regarding forfeited discounts?

A. There are two issues with regards to forfeited discounts in this case. The first issue concerns whether to include gross receipts taxes (GRT) when calculating the normalized level of forfeited discounts. The second issue is whether to "factor up" forfeited discounts for the revenue requirement increase in this case.

Q. Does the Staff agree with Mr. Weisensee's statement on page 28 of his rebuttal testimony that it would be incorrect to subsequently adjust forfeited discount revenue by including GRT revenue in the calculation?

A. Yes. Since both the Staff and the Company excluded GRT from revenues and expenses in this case, GRT should not be included when normalizing forfeited discounts.

Q. Was this Staff's position when the cost of service report was filed on November 10, 2010?

A. No. Staff had discussions with the Company after the report was filed and agreed that including the GRT in this calculation was inappropriate.

Q. Did the Company propose to "gross up" forfeited discount (late payment fees) consistent with its requested bad debt gross up for revenue requirements increases?

A. No.

Q. Is it consistent to treat forfeited discounts in the same manner as bad debt expense levels with respect to the "factor up" issue?

A. Yes. The Staff's position is that if the Commission decides to grant KCPL's request to increase bad debt expense proportionate to any increase in revenue requirement, then it is the best regulatory practice to "gross up" forfeited discounts for the same reason. If the Commission concludes that KCPL will experience a proportionately higher level of bad debt as a result of a rate increase, then it would follow that KCPL will experience a higher level of late payment revenue.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

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 Continue the Implementation of Its Regulatory Plan)	File No. ER-2010-0355

AFFIDAVIT OF AMANDA C. MCMELLEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Amanda C. McMellen, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 9 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Amanda C McMellen
Amanda C. McMellen

Subscribed and sworn to before me this 3rd day of January 2011.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

D Suzie Mankin
Notary Public

Kansas City Power & Light Company
Case No. ER-2010-0355
Missouri Bad Debt Write-Off
Prepared by: Amanda C. McMellen

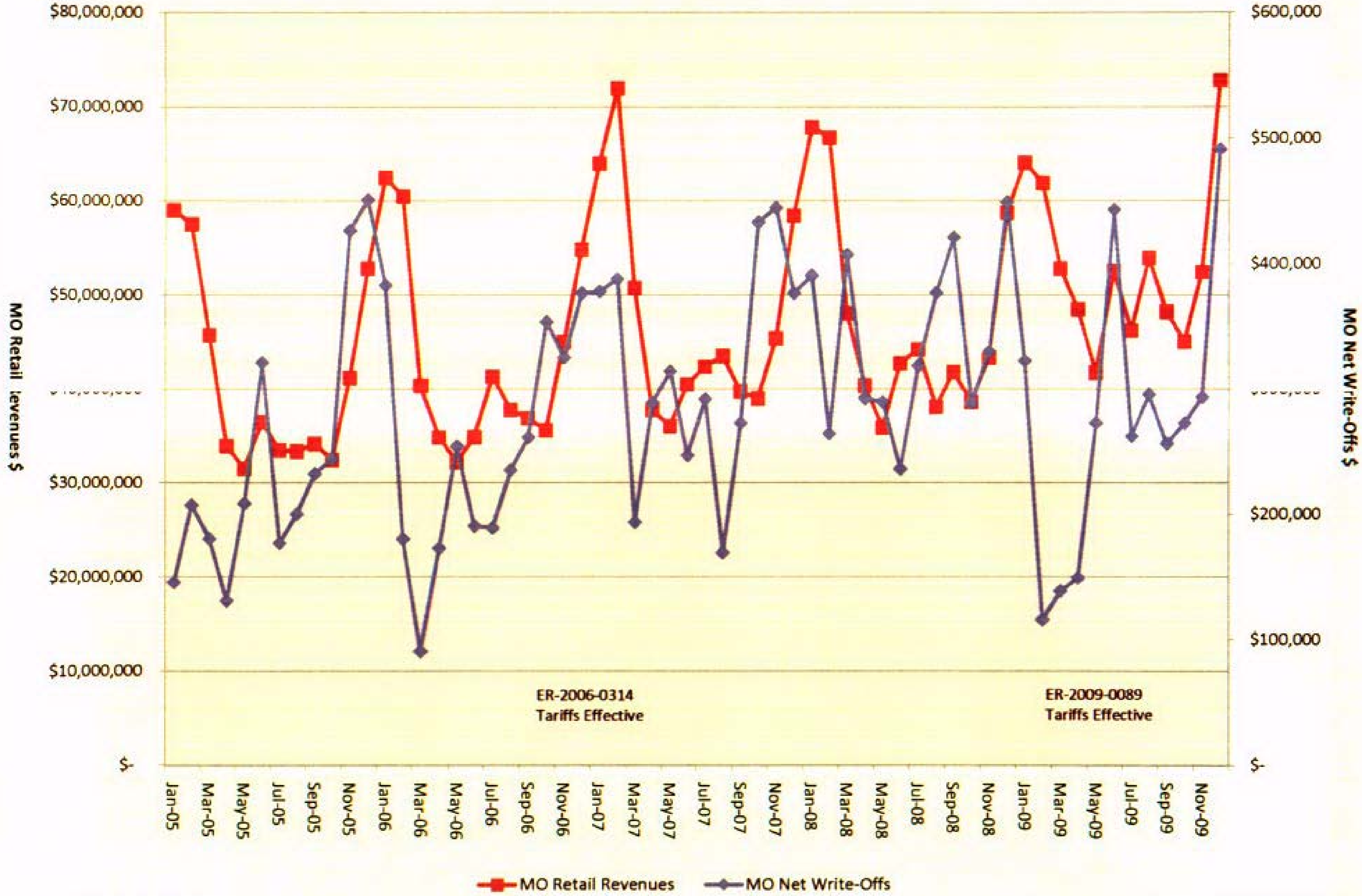
	Missouri Bad Debt Net Write-Offs	Missouri Retail Revenue w/o GRT*	Change in Write-Offs	Change in Revenues	No. of Occurrence**
Jan-05	$ 145,280	$ 58,951,530			
Feb-05	$ 206,863	$ 57,506,146	42.39%	-2.45%	1
Mar-05	$ 179,824	$ 45,694,910	-13.07%	-20.54%	
Apr-05	$ 130,553	$ 33,901,935	-27.40%	-25.81%	
May-05	$ 208,065	$ 31,490,850	59.37%	-7.11%	2
Jun-05	$ 320,610	$ 36,430,499	54.09%	15.69%	
Jul-05	$ 176,447	$ 33,448,924	-44.97%	-8.18%	
Aug-05	$ 199,677	$ 33,327,066	13.17%	-0.36%	3
Sep-05	$ 231,860	$ 34,106,792	16.12%	2.34%	
Oct-05	$ 243,979	$ 32,422,473	5.23%	-4.94%	4
Nov-05	$ 426,130	$ 41,132,580	74.66%	26.86%	
Dec-05	$ 450,732	$ 52,757,294	5.77%	28.26%	
Jan-06	$ 382,277	$ 62,405,677	-15.19%	18.29%	5
Feb-06	$ 179,711	$ 60,438,218	-52.99%	-3.15%	
Mar-06	$ 90,207	$ 40,294,695	-49.80%	-33.33%	
Apr-06	$ 172,477	$ 34,803,162	91.20%	-13.63%	6
May-06	$ 253,848	$ 32,171,877	47.18%	-7.56%	7
Jun-06	$ 190,048	$ 34,832,011	-25.13%	8.27%	8
Jul-06	$ 188,815	$ 41,248,430	-0.65%	18.42%	9
Aug-06	$ 234,782	$ 37,730,216	24.34%	-8.53%	10
Sep-06	$ 261,035	$ 36,858,501	11.18%	-2.31%	11
Oct-06	$ 353,242	$ 35,552,918	35.32%	-3.54%	12
Nov-06	$ 324,907	$ 44,964,450	-8.02%	26.47%	13
Dec-06	$ 376,258	$ 54,783,793	15.80%	21.84%	
Jan-07	$ 377,494	$ 63,947,529	0.33%	16.73%	
Feb-07	$ 387,508	$ 71,913,979	2.65%	12.46%	
Mar-07	$ 193,280	$ 50,698,258	-50.12%	-29.50%	
Apr-07	$ 288,473	$ 37,719,881	49.25%	-25.60%	14
May-07	$ 313,806	$ 35,984,381	8.78%	-4.60%	15
Jun-07	$ 246,604	$ 40,428,059	-21.42%	12.35%	16
Jul-07	$ 291,521	$ 42,320,923	18.21%	4.68%	
Aug-07	$ 169,007	$ 43,474,834	-42.03%	2.73%	17
Sep-07	$ 272,475	$ 39,673,795	61.22%	-8.74%	18
Oct-07	$ 432,698	$ 38,963,929	58.80%	-1.79%	19
Nov-07	$ 444,468	$ 45,345,485	2.72%	16.38%	
Dec-07	$ 376,258	$ 58,411,947	-15.35%	28.82%	20
Jan-08	$ 390,285	$ 67,795,339	3.73%	16.06%	
Feb-08	$ 263,900	$ 66,684,457	-32.38%	-1.64%	
Mar-08	$ 407,035	$ 47,996,828	54.24%	-28.02%	21
Apr-08	$ 292,212	$ 40,304,350	-28.21%	-16.03%	
May-08	$ 289,225	$ 35,873,682	-1.02%	-10.99%	
Jun-08	$ 235,734	$ 42,709,680	-18.49%	19.06%	22
Jul-08	$ 318,096	$ 44,177,542	34.94%	3.44%	
Aug-08	$ 376,588	$ 38,073,380	18.39%	-13.82%	23
Sep-08	$ 420,915	$ 41,770,951	11.77%	9.71%	
Oct-08	$ 288,230	$ 38,575,028	-31.52%	-7.65%	
Nov-08	$ 329,529	$ 43,308,928	14.33%	12.27%	
Dec-08	$ 448,968	$ 58,747,464	36.25%	35.65%	
Jan-09	$ 322,146	$ 64,051,199	-28.25%	9.03%	24
Feb-09	$ 115,444	$ 61,884,812	-64.16%	-3.38%	
Mar-09	$ 138,427	$ 52,754,046	19.91%	-14.75%	25
Apr-09	$ 148,939	$ 48,460,483	7.59%	-8.14%	26
May-09	$ 272,456	$ 41,703,769	82.93%	-13.94%	27
Jun-09	$ 442,680	$ 52,531,177	62.48%	25.96%	
Jul-09	$ 261,951	$ 46,152,084	-40.83%	-12.14%	
Aug-09	$ 295,343	$ 53,897,415	12.75%	16.78%	
Sep-09	$ 255,985	$ 48,177,188	-13.33%	-10.61%	
Oct-09	$ 272,418	$ 45,001,549	6.42%	-6.59%	28
Nov-09	$ 292,956	$ 52,401,440	7.54%	16.44%	
Dec-09	$ 490,949	$ 72,772,830	67.58%	38.88%	

* Based on 6-month lag

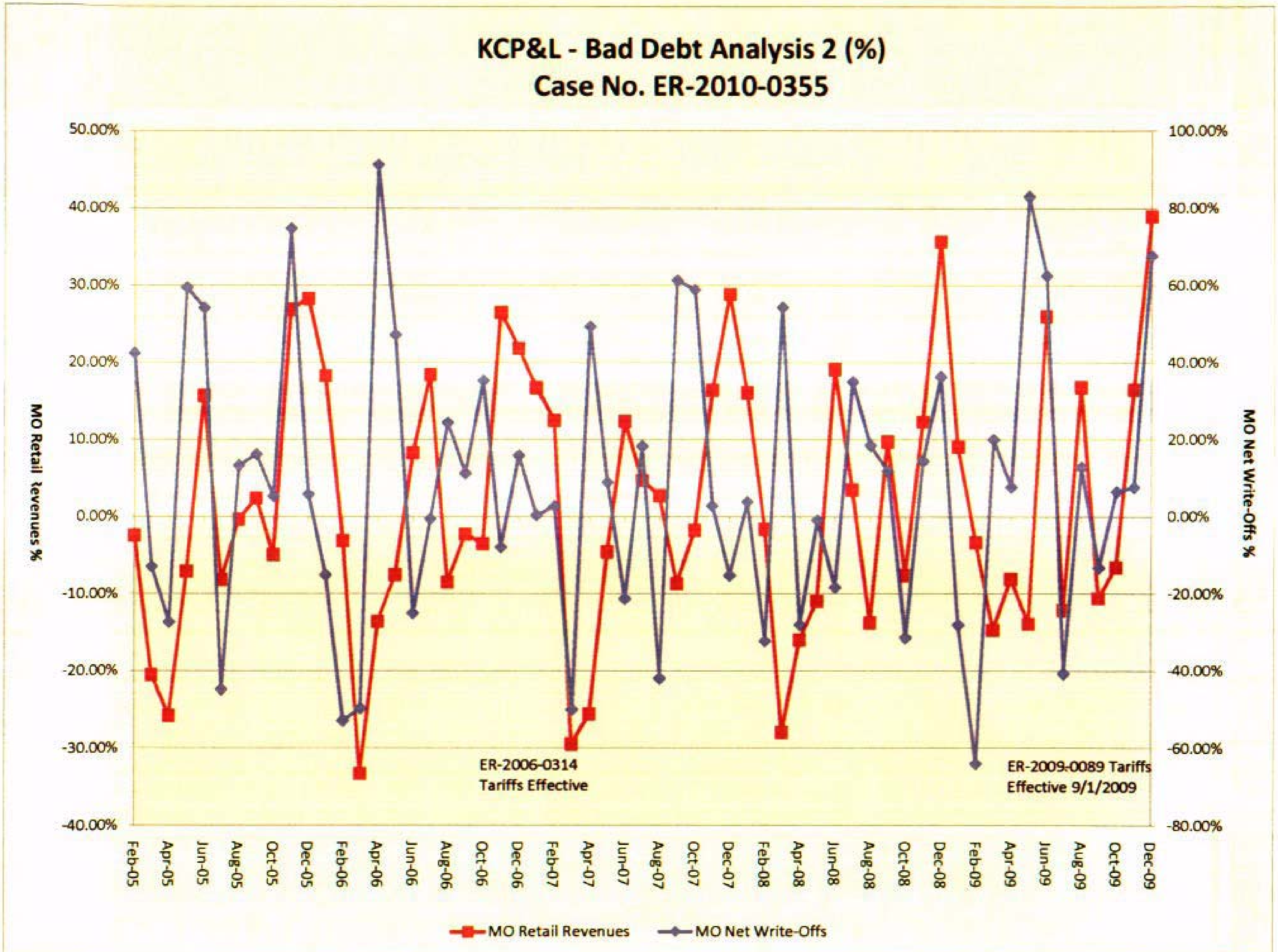
** This shows the number of times Revenue and Bad Debt moved in different directions. Based on change on Sales and change in Bad Debt Write-Offs.

Schedule ACM-1A

KCP&L - Bad Debt Analysis 1 ($)
Case No. ER-2010-0355



Schedule ACM-1B



Schedule ACM-1C