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**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

REBUTTAL TESTIMONY OF

WM. EDWARD BLUNK

**ON BEHALF OF
KANSAS CITY POWER & LIGHT COMPANY**

**IN THE MATTER OF THE APPLICATION OF
KANSAS CITY POWER & LIGHT COMPANY
TO MODIFY ITS TARIFFS TO BEGIN THE
IMPLEMENTATION OF ITS REGULATORY PLAN**

DOCKET NO. 06-KCPE-828-RTS

1 **Q: Please state your name and business address.**

2 A: My name is Wm. Edward Blunk. My business address is 1201 Walnut, Kansas City,
3 Missouri 64106-2124.

4 **Q: By whom and in what capacity are you employed?**

5 A: I am employed by Kansas City Power & Light Company (“KCPL”) as Supervisor, Fuel
6 Planning.

7 **Q: Are you the same William Edward Blunk who pre-filed direct testimony in this**
8 **case?**

9 A: Yes, I am.

1 **Q: What is the purpose of your rebuttal testimony?**

2 A: My rebuttal testimony responds to four fuel-related issues. First, I respond to the
3 Citizens' Utility Ratepayer Board ("CURB") witness Andrea C. Crane's and KCC Staff
4 ("Staff") witness Larry W. Holloway's testimonies regarding coal inventory. Second, I
5 respond to CURB witness Andrea C. Crane's and Staff witness William E. Baldry's
6 testimonies regarding expenses related to the Montrose coal transportation rate complaint
7 case filed before the Surface Transportation Board ("STB"). I will also comment on
8 Mr. Holloway's testimony regarding exclusion of an "emissions" factor in Staff's
9 proposed Energy Cost Adjustment ("ECA") mechanism. Finally, I will respond to Staff
10 witness John Cita's recommendation that KCPL submit a Hedge Program Application.

11 **I. COAL INVENTORY**

12 **Q: What is your understanding of CURB's recommendation to adjust the Company's**
13 **claim for coal inventory?**

14 A: CURB recommended that coal inventory be based on the average balance for the thirteen
15 months ended September 2005.

16 **Q: Do you have any concerns with CURB's recommended adjustment to the**
17 **Company's claim for coal inventory?**

18 A: Yes. KCPL's coal inventories have been reduced because of major rail disruptions
19 within the past few years. In fact, the Company maintains inventory in anticipation of
20 such fuel supply disruptions. CURB acknowledges that rail disruptions, speculative
21 traders, and clean air regulations have all impacted coal supplies. However, the
22 thirteen months from September 2004 through September 2005 that CURB used for
23 determining coal inventory represented the lowest 13-month average coal inventory level

1 that KCPL has experienced since February 1999. In other words, the 13-month period
2 from September 2004 through September 2005 is not representative of normal operations.
3 CURB's adjustment is comparable to a ** [REDACTED] ** reduction in coal inventory
4 quantities from the average of either the 13-month period ending September 2003 or the
5 one ending September 2004. To set the Company's coal inventory levels at these
6 unusually low levels would penalize the Company for using its inventory to mitigate
7 reductions in generation, and is inconsistent with Commission policy and traditional
8 ratemaking principles that rates should be reflective of ongoing normal operations.

9 **Q: What is your understanding of Staff's recommendation to adjust the Company's**
10 **claim for coal inventory?**

11 A: Staff agrees with KCPL's position that rail delivery uncertainty implies that the Company
12 should attempt to build its coal stockpiles. Staff recognized that KCPL's actual average
13 coal inventories for 2003 through 2005 have been below the Company's targets for those
14 years. Staff then recommended adjusting the Company's rate normalized coal inventory
15 targets by the average amount that actual average coal inventories have been below
16 operational targets for the most recent three-year period, 2003 to 2005.

17 **Q: Have you reviewed Staff's adjustment calculations?**

18 A: Yes. I have reviewed Staff Exhibit LWH-1 filed as part of the confidential direct
19 testimony of Staff witness Larry W. Holloway.

20 **Q: Do you have any concerns with Staff's determination of an adjustment based on**
21 **those calculations?**

22 A: Yes. I have two concerns. My first concern relates to the time period used to determine
23 "normal" fuel inventory. The current fuel supply disruption, which is still ongoing,

1 began in the second half of 2004 and escalated to a major disruption with the May 2005
2 derailments and track destruction that were discussed in my direct testimony. Since June
3 2004, KCPL has experienced some of the lowest coal inventory levels in many years. On
4 the other hand, the actual average coal inventory for the period January 1996 through
5 April 2005 was ** [REDACTED] ** and the average from January 1996 through
6 June 2004 was ** [REDACTED] **. In other words, over a relatively normal
7 long-term period, ** [REDACTED] **.

8 My second concern relates to two errors in Staff Exhibit LWH-1. The first error
9 was in the data KCPL provided in response to Missouri Public Service Commission Staff
10 Data Request No. 154, which served as the source document for Staff Exhibit LWH-1.
11 That document inadvertently reported the LaCygne bituminous target as the actual
12 average inventories. As for the second error, it appears that Staff associated the wrong
13 years with the actual average inventories. For example, the average actual inventory for
14 2005 was shown as the average inventory for 1996, the average actual inventory for 2004
15 was shown as the average inventory for 1997. As shown in confidential Exhibit WEB-8,
16 the net effect of correcting those errors would reduce the magnitude of Staff's proposed
17 adjustment from ** [REDACTED] **. That
18 adjustment, however, is on total venture inventories, which include Aquila, Empire
19 District Electric, and Western Resources' share of the inventories. Adjusting for KCPL's
20 ownership share of the inventory, Staff's proposed corrected adjustment would be ** [REDACTED]
21 [REDACTED] **. The total impact of these corrections would reduce Staff's
22 proposed total Company rate base adjustment from (\$6,196,199) to (\$4,442,466). That
23 would be an increase to jurisdictional rate base of \$738,567.

1 **Q: How do the coal inventory targets in the Company's Application differ from the**
2 **Company's operational inventory targets?**

3 A: The coal inventory targets in the Company's Application are **** [REDACTED] **** lower
4 than the Company's operational inventory targets for 2006. This difference is primarily a
5 function of normalizing unit maintenance and system load. Uncertainty or variability in
6 the fuel requirement distributions is dampened by these normalizations. In effect, the
7 high burns are reduced and the low burns are increased. That, in turn, affects the degree
8 to which those differing distributions press upon delivery constraints.

9 The standard deviation for the rate normalized fuel requirement distribution used
10 to develop the coal inventory targets was **** [REDACTED] ****, which compares to
11 **** [REDACTED] **** for the 2006 operational targets. The greater the uncertainty
12 (i.e., standard deviation) in fuel requirements, the greater the need for inventory to cover
13 that uncertainty. In addition to the operational targets not having normal uncertainty
14 "normalized" out, the absolute fuel requirements are greater. This is especially
15 significant because it pushes KCPL closer to fuel delivery capacity. As KCPL presses in
16 on the delivery capacity, there is less surplus capacity to recover from a fuel supply
17 disruption. Consequently, it takes longer to recover and the Company is exposed to
18 greater risk. Again, this yields a greater need for increased inventory.

19 While Staff takes the position that KCPL's coal inventory targets should be
20 adjusted based on the historical relationship of actual coal inventory to target inventory, I
21 would like to point out that the process of using "normalized" fuel requirements has in
22 effect already reduced the coal inventory Application for rate base by **** [REDACTED] ****.
23 To apply Staff's adjustment on the rate "normalized" coal inventory targets would

1 than the cost of operating a hypothetical “stand-alone” railroad and 180 percent of the
2 railroad’s variable cost for the contested move.) Moreover, the STB included in its order
3 information suggesting that the contested rate was significantly less than the minimum
4 rate it would prescribe.

5 On February 27, 2006, the STB instituted a rulemaking proceeding (Ex Parte No.
6 (657 Sub-No. 1)) to address major issues regarding the proper application of the stand-
7 alone cost test in rail rate cases and the proper calculation of any rail rate relief. The STB
8 identified five major issues that it plans to address in the rulemaking, any one of which
9 may have significant bearing on any STB rate prescription. Moreover, the order
10 initiating STB Ex Parte No. 657 (Sub-No. 1) declared that the changes in determining rail
11 rate relief that are adopted as a result of the rulemaking will be applied to KCPL’s case.
12 As part of that order, the STB suspended KCPL’s case until the Ex Parte No. 657
13 (Sub-No. 1) proceeding is closed.

14 Without knowing the new rules the STB will use to calculate any rail rate relief, it
15 is impossible to estimate such relief. Prior to the Otter Tail decision and the STB’s
16 initiation of Ex Parte No. 657 (Sub-No. 1), KCPL estimated that potential freight cost
17 savings ranged from ** [REDACTED] **. That range of rate
18 prescriptions combined with other uncertainties would have resulted in a range of refunds
19 from ** [REDACTED] **. KCPL expected those refunds to be fully
20 unencumbered at the conclusion of the railroad’s probable appeal or sometime in the first
21 quarter of 2009. By suspending KCPL’s case, the STB’s rulemaking will delay an order
22 in the Company’s case and receipt of any refunds. Moreover, we expect that the
23 rulemaking will affect the determination of any rate prescription and the amount of the

1 associated refunds. ** [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]**

5 **Q: What is your recommended treatment of the STB case costs?**

6 A: I recommend that we treat the costs related to the STB case as a regulatory asset. Those
7 costs would then be amortized to expense over five years beginning in January 2007, the
8 month when electric rates for this proceeding will go into effect. If the STB complaint
9 case results in a refund, any refund received by KCPL would first offset any existing
10 balance of STB case costs in the regulatory asset, with the remainder of the refund
11 offsetting fuel costs as determined in a future proceeding.

12 **Q: Why are you recommending this treatment?**

13 A: There are multiple reasons why I am recommending that the costs related to the STB case
14 be amortized starting in 2007. Beginning in 1982, KCPL has filed four cases with the
15 STB and its predecessor the Interstate Commerce Commission ("ICC"). On average that
16 would be a case about every five years. ** [REDACTED]

17 [REDACTED]
18 [REDACTED]
19 [REDACTED]
20 [REDACTED]
21 [REDACTED]
22 [REDACTED]

1 [REDACTED]

2 [REDACTED]**

3 **III. SO₂ ALLOWANCE COST IN ECA**

4 **Q: What is your understanding of Staff’s proposed treatment of sulfur dioxide (“SO₂”) allowance costs in its proposed ECA mechanism?**

6 A: Staff pointed out that KCPL’s Regulatory Plan contains specific provisions for the treatment of SO₂ allowances. For that reason, Staff proposed to not include an “emissions” factor in its proposed ECA.

9 **Q: How does KCPL’s Regulatory Plan treat SO₂ allowances?**

10 A: KCPL’s Regulatory Plan provides that the proceeds from selling SO₂ allowances be recorded as a regulatory liability and offset to rate base for ratemaking purposes. It also provides that to the extent KCPL pays for SO₂ coal premiums prior to January 1, 2007, it may record the portion of such premiums associated with retail sales as a reduction of the regulatory liability up to \$327,000 per year. It does not provide for recovery of any costs for purchasing emission allowances.

16 **Q: What are your concerns with Staff’s proposed treatment of SO₂ allowance costs in its proposed ECA mechanism?**

18 A: I have multiple concerns regarding Staff’s proposed treatment of SO₂ allowance costs in its proposed ECA mechanism. My first concern centers around designing an ECA that we know will need to be modified in the near future. SO₂ is not the only fuel-related emission that has or will have tradable allowances. Beginning in 2009 KCPL will be required to offset NO_x emissions with allowances. ** [REDACTED]

23 [REDACTED]

1 [REDACTED]

2 [REDACTED]

3 [REDACTED]**

4 ** [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

21 [REDACTED]

22 [REDACTED]

23 [REDACTED]

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]**

5 **Q. If an ECA is adopted in this proceeding, how do you propose treating the proceeds**
6 **from emission allowance sales?**

7 A. As Mr. Giles has testified in his rebuttal, KCPL does not object to an ECA mechanism
8 but it must be an appropriate design. I recommend that all components of any ECA be
9 treated consistently. That would mean including all components of the marginal cost of
10 generation that bear significant price risk. The issues related to including proceeds (or
11 costs) from emissions allowances warrant more discussions. Since Mr. Giles mentioned
12 that KCPL will file a case in 2007, I do not believe it is imperative that the emissions
13 factor issue be settled in this proceeding.

14 **Q. Are there market volatility issues that can be addressed without an ECA**
15 **mechanism?**

16 A. Yes. The SO₂ premium portion of the cost of coal is tied directly to the market price of
17 SO₂ emission allowances. The price of SO₂ emission allowances has demonstrated
18 significant movement. For example, SO₂ went from about \$140/ton in January 2003 to
19 about \$1,600/ton in December 2005 and then dropped to a low of \$535/ton in May 2006.
20 Currently SO₂ emission allowances are trading for about \$650/ton.

21 **Q. How can that market volatility be mitigated?**

22 A. The KCPL Regulatory Plan provides that KCPL may record a limited portion of its
23 SO₂ coal premiums as a reduction of the regulatory liability. That provision of KCPL's

1 Regulatory Plan expires December 31, 2006. The SO₂ market volatility could be
2 mitigated by allowing the Company to charge all of its SO₂ coal premiums against the
3 regulatory liability starting January 1, 2007.

4 KCPL requests the Commission adopt this policy in this case and include such in its
5 Order.

6 **Q. Does KCPL have sufficient funds in Account 254 to cover these charges for SO₂**
7 **premiums?**

8 A. Yes. In 2005, KCPL paid about ** [REDACTED] ** in SO₂ premiums. As I discussed else
9 where, December 31, 2005, KCPL had accumulated a net total Company balance of
10 ** [REDACTED] ** in
11 Account 254.

12 **IV. Hedge Program Application**

13 **Q. Have you discussed submitting a Hedge Program Application with Staff?**

14 A. Yes, and based on that discussion, KCPL's existing natural gas hedge program appears to
15 be consistent with those requirements.

16 **Q: Does that conclude your testimony?**

17 A: Yes, it does.

EXHIBIT WEB-8

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