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Kansas Corporation Commission
/s/ Susan K. Duffy

Before The State Corporation Commission
of the State of Kansas

In the Matter of the Application of)
Kansas City Power & Light Company)
To Modify Its Tariffs to Continue the)
Implementation of Its Regulatory Plan)

STATE CORPORATION COMMISSION

AUG 03 2007

Susan K. Duffy Docket
Room

Kansas City Power & Light Company
Docket No. 07-KCPE-905-RTS

Prepared Direct Testimony of

Donald Johnstone

On behalf of

Midwest Utility Users Group (MUUG)

August 2007



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of the State of Kansas

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Affidavit of Donald Johnstone

Spencer Talbot Docket Room

State of Missouri)
County of Jackson) ss

Donald Johnstone, of lawful age, on his oath states: that he has reviewed the attached written testimony in question and answer form, all to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; that such matters are true to the best of his knowledge, information and belief.

Donald Johnstone
Donald Johnstone

Subscribed and sworn before me this August 3, 2007

Angela Hedges
Notary Public



[SEAL]

My Commission expires: 8-15-09

Before The State Corporation Commission
of the State of Kansas

Kansas City Power & Light Company

Docket No. 07-KCPE-905-RTS

Prepared Direct Testimony of Donald Johnstone

1 Q PLEASE STATE YOUR NAME AND ADDRESS.

2 A Donald Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, Missouri,
3 65049.

4 Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

5 A I am employed as President of Competitive Energy Dynamics, L. L. C.

6 Q PLEASE DESCRIBE YOUR QUALIFICATIONS AND EXPERIENCE.

7 A My qualifications and experience are set forth in Appendix A.

8 Q ON WHOSE BEHALF ARE YOU APPEARING?

9 A I am appearing on behalf of the Midwest Utility Users Group (MUUG). This is an
10 ad hoc group formed for the purpose of intervening in this proceeding.

Competitive Energy
DYNAMICS

1 Participants include the City of Mission, The City of Overland Park, Danisco
2 Ingredients USA, Inc., and the Shawnee Mission School District. The area and
3 constituents of MUUG participants are substantial in relation to the Kansas
4 service territory of KCPL and in relation to numbers of ratepayers.

5 **SUMMARY OF RECOMMENDATIONS**

6 Q PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

7 A On behalf of MUUG I support the proposition that rates should be based
8 primarily on the cost of the services provided and I support base rates as the
9 preferred method of designing rates. As such, my clients oppose the
10 introduction of the fuel adjustment clause proposed by KCPL, which is referred
11 to as the Energy Cost Adjustment or ECA.

12 While an ECA is proposed, my clients oppose the ECA because such
13 mechanisms increase retail rate volatility and because a full pass through of
14 fuel costs and the profits from off-system sales in a rider, essentially eliminates
15 the financial consequences of changes in fuel costs and off-system sales profits
16 for KCPL. This would be inconsistent with the fundamental principles of free
17 enterprise and would ignore the importance of proper incentives to the
18 creation and maintenance of efficient/low cost service for consumers.

1 In the event that KCPL exigencies result in a fuel rider I recommend:

- 2 ➤ The duration of the FAC be limited to the period of need (through
- 3 June 1, 2010),
- 4 ➤ A design that aligns the interests of KCPL and of customers (a
- 5 sharing mechanism),
- 6 ➤ Minimum performance standards for base load units,
- 7 ➤ A rate cap provision (5%),
- 8 ➤ A design that will maintain the current relationship in prices
- 9 between time periods, and
- 10 ➤ A design that will not enrich KCPL with uncompensated customer
- 11 provided cash.

12 While the KCPL ECA proposal, like any typical fuel cost mechanism, is
13 offensive to customer interests, these recommendations would minimize the
14 problems and limit the duration of the ECA to the period of the Regulatory
15 Plan, which presumably is the period of KCPL's need for the ECA.

16 **CLASS COST OF SERVICE**

17 **Q WHY IS IT APPROPRIATE TO DESIGN RATES TO REFLECT THE COST OF**
18 **PROVIDING THE SERVICE RENDERED?**

19 **A** As a fundamental matter of equity customers expect to pay the cost of the
20 services they receive. Conversely, any customer, or group of customers, does
21 not expect to pay costs that are incurred by the utility in order to provide

1 service to other customers.

2 **Q WHAT ARE SOME OF THE BENEFITS OF COST BASED RATES?**

3 **A** The first benefit is equity, as explained above. Another benefit is efficiency in
4 consumption decisions.

5 Cost based rates provide customers with important information that is
6 needed to make better consumption decisions. When rates are based on costs,
7 customers will properly pay the higher prices for consumption choices
8 associated with higher costs for the utility. Likewise, customers will properly
9 pay the lower prices for consumption choices associated with lower costs for
10 the utility. All in all, they will be able to make more economic choices.

11 Another way to think of the efficiency that accompanies cost based rates
12 is that cost-effective conservation will be promoted. Customers will be
13 encouraged to take cost effective actions to reduce the types of consumption
14 that lead to high utility bills.

15 Stability is yet another attribute of cost based rates. When rates are
16 based on costs they will not be subject to arbitrary rate changes. Stability is
17 also fostered since utilities will appropriately collect more for the usage that is
18 costly to serve and less for usage that costs less to serve. In other words, the
19 utility will collect revenues that will cover the costs incurred in providing
20 service and that will engender stability in rates as well as stability in earnings.

1 Q HOW ARE COSTS MEASURED FOR THE PURPOSE OF DESIGNING THE RATES
2 FOR A UTILITY SUCH AS KCPL?

3 A One of the important measures is a proper class cost of service study. As a first
4 step all costs associated only with a particular class of service are accumulated
5 for each class. But since many of the categories of costs incurred by a utility
6 are shared among customers, a study must be prepared that will allocate the
7 shared costs among the customer classes. The allocation factors must reflect
8 the manner in which costs are incurred in order to provide a proper measure of
9 the cost of service.

10 Q HOW SHOULD THE ELEMENTS OF THE RATES BE DESIGNED WITHIN EACH
11 RATE CLASS AND RATE SCHEDULE?

12 A Again, the guiding principle should be cost causation for all of the reasons
13 described above.

14 Q ARE THERE APPROPRIATE CONSIDERATIONS BESIDES THE COST OF SERVICE?

15 A Yes, consideration should be given to understandability, customer acceptance
16 and ease of administration. These factors can properly have some impact on
17 the design of a cost based rate, particularly within individual customer classes
18 or rate schedules.

1 **THE KCPL ECA PROPOSAL:**

2 **A RIDER FOR THE NET COST OF FUEL, PURCHASED POWER,**
3 **ENVIRONMENTAL COSTS, AND OFF SYSTEM SALES PROFITS**

4 Q HAS KCPL PROPOSED AN ALTERNATIVE TO BASE RATES TO REFLECT THE
5 COSTS AND REVENUES RELATED TO FUEL, PURCHASED POWER, AND OFF
6 SYSTEM SALES PROFITS?

7 A Yes, KCPL testimony addresses some of its particular perceived needs for rate
8 revenue in the context of the capacity expansion plans that gave rise to the
9 regulatory plan. Among other things, KCPL asserts that it is important to
10 maintain rates that will generate enough cash to allow a relatively favorable
11 financial rating to continue. At the same time KCPL has expressed concern
12 with the impact of uncertain off-system sales profits on its finances.

13 Q WHAT COMMENTS DO YOU HAVE ON THE FINANCIAL NEEDS OF KCPL?

14 A It practically goes without saying that customers have an interest in KCPL
15 maintaining adequate financial health along with economical rates for service.
16 KCPL offers a discussion of the rate implications of its current financial
17 situation (see the direct testimony of Mr. Giles and Mr. Rush) and in response
18 proposes, among other things, the ECA for the purpose of providing cash flow.

19 Q DOES MUUG SUPPORT THE ADOPTION OF A FUEL RIDER?

20 A No. As the general rule traditional base rate regulation offers the best

1 approach for setting rates for electric service. Traditional rate regulation is
2 preferable for customers for at least two reasons.

3 First, when rates change only pursuant to traditional rate cases there
4 are important benefits. As a part of the rate setting process there is the
5 opportunity to review all relevant considerations to ensure that the costs that
6 form the basis for rates are reasonable and prudently incurred. Also, abnormal
7 events are typically evaluated and treated in a way that excludes costs that are
8 unreasonable and nonrecurring. Instead, rates are set based on a normal level
9 of such costs. In contrast, a rider mechanism such as that proposed by KCPL
10 tends to pass through all of the ups and downs, with the undesirable result of
11 rates that vary unnecessarily and unpredictably.

12 A second important benefit of traditional base rate regulation is that
13 there is a consistent ongoing motivation for KCPL to improve efficiency and to
14 reduce costs. If net costs are minimized or decrease for any reason, KCPL
15 earnings will be better. On the other hand, if net costs are allowed to escalate
16 or increase for any reason there will be a negative effect on earnings.
17 Consequently there is a consistent ongoing financial motivation to operate
18 efficiently on a total cost basis.

19 In contrast to the consistent ongoing financial motivation, the KCPL ECA
20 proposal would pass through 100% of the variations in the ECA net costs (fuel,
21 purchased power cost, certain environmental costs, off-system sales profits) so

1 that all financial motivation is decimated for the ECA components. The
2 Commission and rate payers are left with a reliance on the good intentions of
3 KCPL and regulatory oversight. That is not a good place to be, not because
4 there is any lack of good intention on the part of KCPL or regulators, but
5 because even in the best of circumstances a heavy burden would be shouldered
6 by regulators and because KCPL, as an investor owned company, would lose the
7 financial motivation that would otherwise be present.

8 Another perspective on the incentive implications of the ECA is that the
9 financial motivations that resulted in current level of rates would fade over
10 time. Rather than a focus on achieving low costs, what would instead become
11 important for KCPL would be merely the ability to demonstrate “prudence” so
12 as to avoid any ECA cost disallowances.

13 While the lack of financial motivation to lower cost and efficient
14 operations is an important problem with an ECA, another very practical
15 problem of any fuel clause is the exposure to more frequent and unpredictable
16 rate changes. For example, absent an adequate consumer protection
17 provision, the fuel cost effect associated with an unusual or extraordinary
18 event such as a major generation plant outage could pass right through to
19 ratepayers. In contrast, the recovery of the cost in the context of base rates
20 would depend on the filing of a rate case and then in that context there could
21 be a thorough review and sorting out of the appropriate rate recovery due to

1 the situation.

2 **Q IS THERE A PROBLEM WITH THE ECA PROPOSED BY KCPL?**

3 A There are several. One of the most important problems is the failure of the
4 proposed ECA to align the interests of KCPL with the interests of ratepayers.

5 **Q CAN AN ECA BE DESIGNED TO ALIGN KCPL'S INTEREST WITH THE INTERESTS**
6 **OF KCPL'S RATEPAYERS?**

7 A Yes. And to the extent that an ECA is considered, it should, by design, align
8 the interests of customers and KCPL.

9 **Q WHAT DO YOU MEAN BY "ALIGN THE INTERESTS"?**

10 A In the example of fuel costs, interests are better aligned when fuel cost
11 efficiencies benefit both customers and KCPL. For example if fuel costs are
12 reduced customers receive a benefit under any rider mechanism. When
13 interests are aligned KCPL would also receive a benefit. Similarly, when fuel
14 prices are rising, under a fuel rider mechanism customers receive a benefit if
15 the increases are minimized. Interests are aligned when KCPL is also better off
16 (in a direct way) as it strives to minimize any increases in fuel costs.

17 **Q ARE THE INTERESTS ALIGNED IF THE COSTS THAT KCPL WOULD INCLUDE IN**
18 **ITS PROPOSED ECA INSTEAD REMAIN UNDER TRADITIONAL BASE RATE**
19 **REGULATION?**

1 A Generally yes. Under base rate regulation, if there is a net reduction in costs
2 the benefit directly accrues to KCPL until the rates are changed in a base rate
3 proceeding. Similarly, when there is a net increase in costs the financial
4 burden remains on KCPL until base rates are changed. However, once base
5 rates are reviewed and adjusted in a base rate proceeding the effect of
6 increases and decreases in fuel costs, as reflected in the test year as adjusted,
7 are shifted to customers. Of course all other relevant costs are also considered
8 in the context of the test year and the base rate process. The point is that
9 base rate regulation provides a continuing financial incentive to KCPL to
10 operate efficiently with respect to all costs, including fuel and any other
11 components of an ECA. In this important respect, there is an alignment of the
12 interests of both customers and KCPL under base rate regulation.¹

13 Q HOW IS IT POSSIBLE TO DESIGN AN ECA THAT CONTINUES TO ALIGN THE
14 INTERESTS OF CUSTOMERS AND KCPL?

15 A To the extent that a fuel rider is considered, I recommend an approach that
16 retains a significant measure of the alignment of interests that is inherent in
17 base rates. This means that while rates might change more frequently, KCPL
18 would retain a continuing financial interest in low fuel cost (and by extension

¹ There are many related considerations including, but not limited to the timing of fuel costs changes as compared to the timing of base rate changes and there is also the matter of changes in all of the other costs of service. In this docket and in its Regulatory Plan KCPL raises for consideration the possibility that circumstances may combine to harm the financial health of the company. In fact it is in large part the Regulatory Plan that now gives rise to the fuel rider discussion.

1 low rates). Between rate cases a significant measure of the benefits of
2 increased efficiencies should remain with KCPL by operation of a sharing
3 mechanism. This is accomplished simply by a fuel rider designed to pass
4 through only a portion of the changes in fuel costs. In order to achieve rates
5 that fully reflect the then current fuel costs it would continue to be necessary
6 to have a base rate case. In effect, each base rate case would reset the bar at
7 the then current level of costs and operating efficiencies. This is a time
8 honored approach that need not be abandoned entirely in an ECA.

9 **Q CAN YOU PROVIDE AN EXAMPLE OF A SHARING MECHANISM THAT WOULD**
10 **CONTINUE TO ALIGN THE INTERESTS OF CUSTOMERS AND KCPL?**

11 **A** Yes. I suggest as a first step that the “base rate” amount for fuel costs be set
12 pursuant to a base rate proceeding where there is an adequate process for
13 parties to investigate costs and efficiencies and for the Commission to
14 determine the correct level of costs/revenue requirement for base rates. As a
15 second step I suggest that the subsequent variations in the costs subject to the
16 rider be split between base rate treatment and rider treatment. For example,
17 if the total fuel costs subject to a rider go up by \$100, the increase could be
18 split 60/40 between the rider and base rates. In other words, \$60 would pass
19 through to customers as an increase under a fuel rider while \$40 would not pass
20 through and would instead continue to be afforded base rate treatment.

21 If total fuel costs were to decrease by \$50, in this design example the

1 same 60/40 split would be used. The effect would be to reduce the charges to
2 customers \$30 by operation of the rider (60% of the reduction) and the
3 remaining \$20 of the reduction would again receive base rate treatment.

4 The effect of the “base rate treatment” of 40% of the cost variations is
5 to ensure that KCPL has significant continuing interests in the efficient
6 operation of its generation and the procurement of low cost fuel. For only in a
7 future base rate case would the amount of the base rate fuel costs (and all
8 other costs) again be established. Just as would occur under current base rate
9 regulation, the then current test year costs would impact the determination of
10 rates in the future rate case. If the ECA continued, subsequent variations
11 would be measured against the newly defined base rate fuel costs.

12 **Q DOES YOUR EXAMPLE ALIGN THE INTERESTS OF CUSTOMERS AND KCPL?**

13 **A** Yes, if there is to be a rider, this approach will ensure that both customers and
14 KCPL are better off when costs are held to lower levels. This is particularly
15 attractive as compared to a rider that would simply pass through 100% of the
16 variations in costs. In the 100% pass through approach the direct benefits to
17 KCPL would be eliminated and instead there would be a reliance on good
18 intentions and presumably oversight through a prudence review process. In
19 contrast, with interests aligned good intentions will be reinforced with a direct
20 KCPL financial interest in the outcome.

21 With interests aligned, the degree and character of oversight would

1 change. Since KCPL would have a continuing financial stake in the level of
2 costs, consumers and the Commission can rely on the incentives created by
3 that financial stake in addition to the oversight of a prudence review process.
4 Indeed, the degree of oversight should be reduced when the interests are
5 aligned.

6 **Q DO YOU RECOMMEND 60/40 AS THE APPROPRIATE SHARING RATIO?**

7 **A** No. First the need for any rider should be decided. If there is a finding of
8 need, the level of sharing would then become relevant. Some of the
9 considerations in the determination of a sharing ratio would be: fuel cost
10 volatility, off system sales volatility, rate volatility, mechanisms to explicitly
11 limit rate volatility, performance standards, trends in the non-rider costs, term
12 (length of time) of the rider, and the cash flow situation of KCPL.

13 **Q WHY ARE THE TRENDS IN THE NON-RIDER COSTS RELEVANT?**

14 **A** If the non-rider costs are expected to go up at a high rate and the costs subject
15 to the rider are also expected to go up at a high rate perhaps a case could be
16 made for a larger share of the cost variations to pass through the rider, subject
17 of course to all other considerations including but not limited to rate volatility.
18 On the other hand, if the non-rider costs are flat or trending downward, then
19 perhaps a case could be made for a lower share of costs to pass through the
20 rider.

1 Q SHOULD THE SHARING MECHANISM APPLY TO ALL OF THE COSTS THAT
2 WOULD BE SUBJECT TO ANY ECA?

3 A Yes. The alignment of interests is a concept that would apply equally to fuel
4 purchased power costs, profits from off-system sales, and related costs for
5 which a rider mechanism might be considered.

6 Q RETURNING TO THE POSSIBILITY OF THE PROPOSED ECA, ARE THERE
7 CONSIDERATIONS IN ADDITION TO THE ALIGNMENT OF INTERESTS?

8 A Yes, there are several. First, cost of service principles should be reflected in
9 the design of a fuel rider for essentially the same reasons they should be
10 considered in the design of all utility rates. Fairness and equity both between
11 and among customers is promoted by cost-based rates. Second, the ECA should
12 include provisions to eliminate or substantially mitigate any sharp or
13 extraordinary rate increases. Third, the ECA should include performance
14 standards for KCPL generation so that customers can be assured that only
15 reasonable levels of costs are automatically recovered. Fourth, rate
16 adjustments under any rider would be better based on actual experience rather
17 than a forecast of costs. Fifth, a fuel rider should be limited to an effective
18 period of need not to exceed several years. Finally a fuel rider should include
19 provisions for true-up and prudence reviews.

1 Q PLEASE EXPLAIN THE FIRST CONSIDERATION, COST OF SERVICE PRINCIPLES
2 IN THE DESIGN OF A FUEL RIDER?

3 A Just as it is important in a general sense to design rates to reflect the cost of
4 the service provided, a fuel rider would work in conjunction with the base
5 rates and should reflect similar design considerations, including the cost of the
6 service provided. So long as the rider reflects only fuel costs, the primary cost
7 of service consideration would be the incorporation of the differences in
8 energy losses among the rate schedules, including in particular the differences
9 in voltage level of service. The cost of the additional losses incurred with
10 lower voltage service should be addressed just as the lower level of losses
11 incurred with high voltage service should be reflected.

12 As an aside, with purchased power costs and off-system sales profits
13 being a part of the proposed ECA, another consideration would be the
14 classification of demand related costs. Demand related costs require a separate
15 allocation among the rate schedules in order to properly reflect the costs of
16 service.

17 Q PLEASE EXPLAIN THE SECOND CONSIDERATION, PROVISIONS TO ELIMINATE
18 OR SUBSTANTIALLY MITIGATE ANY SHARP OR EXTRAORDINARY RATE
19 INCREASES.

20 A As a matter of rate stability most, if not all, customers prefer to avoid any
21 sharp or extraordinary increases in rates. Rate changes due to any rider are no

1 exception. For MUUG interveners the pain of any sharp or extraordinary
2 increases would present potential hardships because budgets are typically set
3 well ahead and any sharp or extraordinary increases cannot be accommodated
4 within established budgets. Of course, most customers will share a similar
5 aversion to the pain of sharp or extraordinary increases, regardless of their
6 budgeting practices.

7 The KCPL ECA proposal is based on forecast costs. While there are
8 unavoidable uncertainties associated with any forecast, there is at least a
9 benefit in the sense that the initial ECA rate can be based on normally
10 expected levels of loads, unit availability, and price levels. This is good in the
11 sense that a forecast with a 50/50 expectation of being exceeded would tend
12 to normalize costs. However, the question of sharp or extraordinary increases
13 then arises instead in the true-up process. It appears that KCPL would have
14 ratepayers cover all cost variations in the course of a true-up.

15 **Q IN THE CONTEXT OF AN ECA IS IT POSSIBLE TO ELIMINATE OR MITIGATE**
16 **SHARP OR EXTRAORDINARY INCREASES IN RATES?**

17 **A** Yes. Of the many possibilities, I recommend consideration of several
18 approaches that will moderate the rate changes. First, a cap could be
19 established to limit the amount of increase at any time. This would simply be
20 a limit on the size of rate changes pursuant to the ECA.

21 Second, the cost increases or variations incurred in any shorter time

1 period could be collected for an extended period of time. For example,
2 consider the KCPL proposal to average the effect of changes in profits from off-
3 system sales over an entire year. The daily and monthly cost variations to be
4 passed along to customers would be spread over a year. By this mechanism the
5 rate impact of the cost in any extraordinary period would be mitigated. This is
6 a good thing because pain without gain makes no sense.

7 Another form of impact mitigation occurs as a benefit associated with a
8 sharing mechanism designed to align the interests of KCPL with the interests of
9 ratepayers. With a sharing mechanism, only a limited portion of the fuel cost
10 changes would flow through to rates in the rider. For example, 60% of cost
11 variations could be afforded rider treatment while the other 40% of the cost
12 variation could be afforded base rate treatment. Therefore, this approach
13 would mitigate the impact of rate changes between rate cases.

14 **Q IS IT NECESSARY TO SELECT JUST ONE APPROACH TO THE MITIGATION OF**
15 **SHARP OR EXTRAORDINARY RATE CHANGES?**

16 **A** No. In the design of a rider several approaches could be included and applied
17 simultaneously.

18 **Q WOULD THE ELIMINATION OR MITIGATION OF SHARP OR EXTRAORDINARY**
19 **RATE CHANGES HAVE A DELETERIOUS EFFECT ON PRICE SIGNALS?**

20 **A** This question must be considered in more than one context. First, since there

1 is not currently a rider to pass through the variations in fuel costs between
2 base rate cases, a rider (if approved in a particular situation) would tend to
3 make price signals more current. However, as another important context,
4 gradual rate changes would send price information in a more measured pace
5 that could be more easily understood and accepted - and without the pain that
6 would accompany sharp and extraordinary increases that may in reality present
7 conflicting signals as costs go up and down from time to time. Many responses
8 to price require investments that would only occur over time and in this
9 context a consistent price signal would be more beneficial while an erratic
10 price signal may only frustrate and confuse consumers.

11 **Q IS A FUEL RIDER THE BEST MECHANISM FOR REFLECTING THE VOLATILITY OF**
12 **CHANGES IN PRICES FOR FUEL AND PURCHASED POWER, OR THE PROFITS**
13 **FROM OFF-SYSTEM SALES?**

14 **A** No. Depending on the objectives, a fuel rider is not likely to be a good vehicle
15 for that type of price signal. Other rate mechanisms such as real time prices or
16 a cost based credit for usage reduction are more appropriate for the purpose.
17 These other mechanisms are more appropriate in large part because they can
18 be optional and focused on customers with an ability and desire to respond to
19 short term price changes. Thus there is no need to use a fuel rider of general
20 applicability as the vehicle for these types of price signals. An important point
21 is this: if rapid response is not feasible, then larger short term price variations

1 are not useful as an end in their own right.

2 **Q PLEASE EXPLAIN THE THIRD CONSIDERATION, PERFORMANCE STANDARDS.**

3 **A** Performance standards should be considered as a mechanism to ensure that
4 only reasonable levels of fuel costs will flow to customers under the more or
5 less automatic provisions of any rider. By establishing a threshold level of
6 generation performance any extraordinary costs that may arise due to
7 substandard equipment performance will not automatically pass through to
8 customers. On the other hand, cost variations that arise due to changes in the
9 cost of fuel or other market conditions would pass through pursuant to the
10 other terms and conditions of the rider.

11 A related consideration is the insurance to recover the replacement
12 energy costs of a base load unit. To the extent that fuel costs increase
13 because of an insurable event at a base load facility, there is no reason to pass
14 through the insured replacement fuel costs to customers. In effect rates would
15 be destabilized by going up temporarily in the short run, going down
16 temporarily when the insurance proceeds are later received and passed
17 through, and then up again when the credit expires. In this situation
18 performance standards will avoid rate pain where there would be no net gain.

1 Q AS AN ADDITIONAL CONSIDERATION, DOES KCPL PROPOSE ECA RATE
2 ADJUSTMENTS BASED ON ACTUAL COSTS?

3 A KCPL proposes that ECA charges initially be based on an annual forecast of the
4 net ECA costs that is biased to produce higher rates, but then proposes an true-
5 up to reflect actual costs as a second step. The use of a forecast would
6 introduce complexities because of the need for forecast assumptions, forecast
7 models, judgments, reviews of the same, and the reconciliation of the
8 inevitable variations of actual results from the forecasts.

9 On the other hand, an ECA with a forecast properly incorporated, could
10 tend to match rates and costs and avoid some of the initial variations that
11 would occur with actual costs. In this context, the need for provisions to
12 mitigate volatility and avoid inappropriate and unnecessary increases or
13 decreases would focus on i) the high side bias of the proposed forecast
14 procedure, ii) the volatility that would consequently follow in the true-up
15 process, and iii) the defective proposal for the removal of the initial forecast of
16 ECA costs from base rates. While a forecast basis for an ECA has some
17 attributes and could be workable, the KCPL proposal in any event must be
18 rejected or changed to resolve several inherent design problems.

19 Q SHOULD THE CAPITAL EXPANSION NEEDS OF KCPL BE A PART OF THE
20 CONSIDERATIONS RELATED TO ANY RIDER PROPOSAL?

21 A Yes. The various fuel rider considerations operate in the context of all other

1 costs and costs related to the capital expansion needs of KCPL are no
2 exception. Among other things, the costs of capital expansion, along with all
3 other costs, would be appropriately considered in determining the need for a
4 fuel rider and also, if there is to be a rider, in the design of the sharing
5 mechanism that is necessary to the alignment of customer and KCPL interests.

6 Q SHOULD A PRUDENCE REVIEW BE A PART OF A FUEL RIDER?

7 A Yes. Rates should only reflect costs that are prudently incurred. While a fuel
8 rider design that aligns interest will reduce the reliance on the administrative
9 prudence review process for the achievement of the lowest reasonable costs,
10 there will still be circumstances in which prudence issues arise.

11 **ECA RECOMMENDATIONS**

12 Q WHAT ARE YOUR RECOMMENDATIONS FOR CHANGES IN THE KCPL ECA
13 PROPOSAL?

14 A MUUG opposes the establishment of the proposed ECA. The proposal will
15 greatly diminish the incentive for KCPL to control its fuel costs and will
16 destabilize rates for consumers at the same time. The ECA proposal favors
17 KCPL in far too many respects at the expense of consumers.

18 While opposing the ECA proposed by KCPL, there are enhancements and
19 modifications to the proposal that would make it more tolerable from a
20 consumer perspective. The enhancements and modifications will at least

1 mitigate the limitations and problems of the proposal.

2 The following modifications are offered for the purpose of better
3 maintaining the incentives, the rate stability, and the consumer protections
4 inherent in the present base rate approach to cost recovery.

- 5 ▪ Limit the initial duration of any ECA to coincide with the
6 duration of the KCPL Rate Plan (through June 1, 2010),
- 7 ▪ Align the interests of KCPL with the interests of customers
8 (Enhance the ECA proposal to include a sharing of the net
9 costs subject to the ECA between the ECA[80%] and base
10 rates[20%]),
- 11 ▪ Enhance the ECA proposal to include minimum performance
12 standards for major generators,
- 13 ▪ Enhance the ECA proposal to include a 5% cap(monthly) on the
14 rate increase for any ECA rate adjustment to eliminate the
15 possibility of any sharp or extraordinary increases in rates,
- 16 ▪ Eliminate the initial rate impact/instability due to design
17 (Remove ECA costs from base rates on the same month by
18 month basis that will be used to apply forecast ECA costs),
- 19 ▪ Change the off-system sales profit forecast to a 50/50 basis or
20 at least provide for the true-up to occur quarterly so that
21 ECA charge with a 75% probability of being too high are not
22 perpetuated for 15 months according to the KCPL proposal,
- 23 ▪ Provide for an after-the-fact prudence review.

24 While MUUG continues to oppose a fuel rider and instead recommends a

1 continuation of base rates for all costs and credits included in the KCPL
2 proposal, these modifications and enhancements would provide a combination
3 of incentives and consumer protections that will better align the interests of
4 KCPL and consumers and protect consumers from the unnecessary rate
5 volatility inherent in the current KCPL proposal. These enhancements and
6 modifications will ensure a continuing financial stake for KCPL in efficiency and
7 low rates, will provide risk sharing between customers and KCPL, and will
8 promote the rate stability that is important for most consumers.

9 **Q WHY IS IT APPROPRIATE TO LIMIT ANY ECA TO THE DURATION OF THE RATE**
10 **PLAN?**

11 **A** The ECA proposal is motivated primarily by the same cash flow concerns of
12 KCPL that led to the rate plan. Since that is the problem any decision as to
13 another ECA after the rate plan should be evaluated in the then current
14 circumstances. Undoubtedly conditions will be different and there is no reason
15 to expect that an ECA established now to remain appropriate in the face of a
16 material change in circumstances. The obvious example is the current KCPL
17 focus on cash flow implications that is likely to be less critical in the future.

1 Q WHAT DEGREE OF COST SHARING DO YOU RECOMMEND FOR THE PURPOSE
2 OF ALIGNING THE INTERESTS OF KCPL WITH THE INTERESTS OF
3 RATEPAYERS?

4 A In the last case I recommended 50/50 sharing. In consideration of the current
5 proposal and the cash flow concerns of KCPL it is reasonable to consider a
6 higher level of pass through of cost variations for the period of the rate plan.
7 On the other hand the sharing needs to be meaningful if interests are to be
8 aligned. If there is to be an ECA, I recommend consideration of 80% ECA
9 recovery/20% base rate recover of ECA costs in these circumstances.

10 Q WHAT DO YOU RECOMMEND FOR PERFORMANCE STANDARDS?

11 A In the context of the KCPL proposal for forecast ECA costs I recommend that
12 unit capacity factors used for base load units represent normal performance.
13 The effect of any extraordinary outages occasioned by an event that would, for
14 example, be an insurable loss or for which a third party might be liable should
15 not be allowed. In the context of the after the fact true-up, I suggest that the
16 base load generation should be held to a level of not less than 90% of forecast,
17 unless it is demonstrated that the output was not needed on an economic basis
18 to serve load or system sales.

19 Q WHAT DO YOU RECOMMEND FOR A RATE CAP?

20 A A specific rate cap is a particular challenge since the primary KCPL justification

1 for the ECA is its concern with cash flow. I recommend that rate caps be
2 reserved for consideration in the event that any proposed ECA charges per kWh
3 would increase the average rate per kWh for any customer class in a month by
4 more than 5% over the average rate in effect for the corresponding month one
5 year earlier. Depending on circumstances the decision could be made by the
6 Commission in context of circumstance as to whether a cap or pass through is
7 appropriate.

8 **Q WHAT APPROACH DO YOU RECOMMEND TO MAINTAIN THE CURRENT**
9 **RELATIONSHIPS IN RATES BY TIME PERIOD?**

10 **A** The initial ECA charges should be removed from each rate schedule on the
11 same month by month basis proposed for ECA charges. The amount removed
12 should be the calculated monthly ECA amounts for the initial forecast period.
13 The forecast should be based on the 50/50 forecast, not the 25/75 forecast.

14 With the approach I recommend changes would accrue to the months
15 going forward, but any unnecessary and unwarranted rate impacts caused by
16 the inconsistent design of base rates and the ECA rates would be avoided. In
17 other words, the method I recommend would preserve rate stability and
18 eliminate the impacts and rate instability KCPL has proposed as a part of the
19 ECA. One surprising aspect of the KCPL presentation is that it has not revealed
20 the degree of the month to month changes it is proposing for each rate
21 schedule.

1 The rate impact should be disclosed by KCPL. It is always important to
2 consider customer impact and I would oppose any ECA approach where rate
3 impacts inherent in the design are not revealed to the Commission and all
4 parties.

5 **Q WOULD THE KCPL ECA PROPOSAL GENERATE CASH FLOW FOR THE**
6 **COMPANY?**

7 **A**Yes. KCPL proposes to remove ECA costs from rates using a 50/50 forecast of
8 off-system sales profits, but to charge ECA rates based on a forecast of off-
9 system sales profits that has a 75% probability of being exceeded. That means
10 there is a 75% probability that ECA revenues will exceed net ECA costs, thereby
11 generating additional cash flow. KCPL also gives itself the ability to raise the
12 ECA during the year if actual profits are less than the 25 percentile forecast it
13 would use to establish each initial annual ECA. At the same time KCPL
14 proposes to retain any excess revenues for a full year. For customers it seems
15 to be heads KCPL wins, tails customers lose. There is no fairness or
16 justification for such a one-sided result. Furthermore, there is a 75% chance of
17 a refund that could be large and would itself create rate instability first when
18 it would go into effect and again when it expired.

19 **Q WHAT CHANGES DO YOU RECOMMEND IN THE FORECAST OF ECA CHARGES?**

20 **A**I recommend use of the 50/50 probability forecast of off-system sales profits.

1 Otherwise KCPL is not using the ECA to track costs, but instead converting the
2 ECA to a mechanism to generate free cash flow. It is my understanding that
3 KCPL has otherwise asked for CIAC cash and it makes no sense to also convert
4 any ECA to a cash generation mechanism to address the same request.
5 Alternatively, the true-up refund process should be applied quarterly to
6 forestall the build-up of a large refund pot that is 75% likely to occur.

7 **Q WITH THESE CHANGES DO YOU RECOMMEND AN ECA?**

8 **A No.**

9 **Q WHY NOT?**

10 **A I am aware of no customer support for an ECA. This is not surprising in that I**
11 **have seldom found customers in support of an automatic rate adjustment**
12 **mechanism such as the ECA. The potential for uncontrolled rate changes and**
13 **the lack of incentive to control costs are easily understood and almost always**
14 **lead to customer opposition to such mechanism.**

15 **Q DO YOU AGREE WITH THE STAFF CONTENTION IN THE LAST CASE THAT AN**
16 **ECA IS NECESSARY TO PASS THROUGH TO CUSTOMERS ALL OF THE PROFITS**
17 **FROM OFF SYSTEM SALES?**

18 **A No. The profits from off system sales can also pass through base rates. It is**
19 **interesting that Staff has in the past expressed a desire to ensure the pass**

1 through of all the off-system sales profits while KCPL instead focuses on its
2 desire to pass through any shortfall in off-system sales profits (and then some
3 with its lopsided forecast proposal). The result in either case is not good for
4 consumers.

5 The Commission will address the issue of the level of off-system sales in
6 this proceeding. For the foreseeable future the base rate approach can
7 continue to work and is preferable to an ECA because frequent rate cases are
8 likely and because there is no evidence that the effect of changes in off-system
9 sales cannot be reasonably captured with continued reliance on base rates.

10 **Q DOES THE BASE RATE APPROACH ADDRESS KCPL'S CASH FLOW CONCERNS?**

11 **A** It addresses the concern annually, but not more frequently unless more
12 frequent cases can be filed. Of course KCPL proposes an ECA that changes only
13 annually (except in extraordinary circumstances) so the difference from a cash
14 flow perspective seems to come down to the possibility of an interim rate
15 change under the proposed ECA.

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

17 **A** Yes it does.

Appendix A

Qualifications of Donald E. Johnstone

1 Q PLEASE STATE YOUR NAME AND ADDRESS.

2 A Donald E. Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, MO
3 65049.

4 Q PLEASE STATE YOUR OCCUPATION.

5 A I am President of Competitive Energy Dynamics, L. L. C. and a consultant in the
6 field of public utility regulation.

7 Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

8 A In 1968, I received a Bachelor of Science Degree in Electrical Engineering from
9 the University of Missouri at Rolla. After graduation, I worked in the customer
10 engineering division of a computer manufacturer. From 1969 to 1973, I was an
11 officer in the Air Force, where most of my work was related to the Aircraft
12 Structural Integrity Program in the areas of data processing, data base design
13 and economic cost analysis. Also in 1973, I received a Master of Business
14 Administration Degree from Oklahoma City University.

15 From 1973 through 1981, I was employed by a large Midwestern utility
16 and worked in the Power Operations and Corporate Planning Functions. While
17 in the Power Operations Function, I had assignments relating to the peak
18 demand and net output forecasts and load behavior studies which included such

1 factors as weather, conservation and seasonality. I also analyzed the cost of
2 replacement energy associated with forced outages of generation facilities. In
3 the Corporate Planning Function, my assignments included developmental work
4 on a generation expansion planning program and work on the peak demand and
5 sales forecasts. From 1977 through 1981, I was Supervisor of the Load
6 Forecasting Group where my responsibilities included the Company's sales and
7 peak demand forecasts and the weather normalization of sales.

8 In 1981, I began consulting, and in 2000, I created the firm Competitive
9 Energy Dynamics, L.L.C. As a part of my twenty-five years of consulting
10 practice, I have participated in the analysis of various electric, gas, water, and
11 sewer utility matters, including the analysis and preparation of cost-of-service
12 studies and rate analyses. In addition to general rate cases, I have participated
13 in electric fuel and gas cost reviews and planning proceedings, policy
14 proceedings, market price surveys, generation capacity evaluations, and
15 assorted matters related to the restructuring of the electric and gas industries.
16 I have also assisted companies in the negotiation of power contracts
17 representing over \$1 billion of electricity.

18 I have testified before the state regulatory commissions of Delaware,
19 Hawaii, Illinois, Iowa, Kansas, Massachusetts, Missouri, Montana, New
20 Hampshire, Ohio, Pennsylvania, Tennessee, Virginia and West Virginia, and the
21 Rate Commission of the Metropolitan St. Louis Sewer District.