

In the Matter of the Application of Kansas)
City Power & Light Company for Approval)
to Make Certain Changes in Its Charges for) Docket No. 07-KCPE-905-RTS
Electric Service to Begin the Implementation)
of its Regulatory Plan)

STATE CORPORATION COMMISSION

AUG 03 2007

 Docket
Room

DIRECT TESTIMONY

PREPARED BY

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UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

1 **Q: State your name, employer and address at which you are employed.**

2 **A:** John Cita, Kansas State Corporation Commission (“Commission”), 1500 S.W.
3 Arrowhead Rd. Topeka, KS, 66604-4027.

4 **Q: In what capacity are you employed by the Commission?**

5 **A:** My title is Chief of Economic Policy and Planning. I am responsible for directing
6 the combined and individual efforts of two to three other Commission-employed
7 economists. Together, we are responsible for providing the Commission with
8 economic analysis of various issues relating to regulatory and market-based
9 restructuring policies.

10 **Q: What is your educational background?**

11 **A:** I received the Bachelor of Science, Master in Arts, Doctorate of Philosophy
12 degrees, all in economics. My undergraduate degree is from Colorado State
13 University; the graduate degrees are from the University of Kansas.

14 **Q: Have you previously testified before the Commission?**

15 **A:** With over fifteen years of experience at the Commission, I have testified on
16 numerous occasions and on a variety of issues, in both the energy and
17 telecommunications arenas.

18

19 **Introduction**

20 **Q: What is the purpose of your testimony?**

21 **A:** I make three recommendations, each is contingent on the Commission granting
22 Kansas City Power and Light Company’s (“KCPL”) request to implement an
23 Energy Cost Adjustment (“ECA”) mechanism. If the Commission grants that

1 request, then I recommend the Commission: (1) Require KCPL to submit to Staff
2 informational reports that will enable Staff to better assess the reasonableness of
3 KCPL's: (a) monthly ECA prices and (b) annual actual cost adjustment ("ACA")
4 factor; (2) Require KCPL to submit for Commission approval an Application for a
5 Gas Hedge Program; and (3) Require KCPL to comply with the Commission's
6 Order dated September 25, 2002: in Docket No. 75-GIMC-009-GIG, regarding
7 the Commission's own investigation of standards for evaluating utility decisions
8 (i.e., contracts) to purchase natural gas.

9 **Q: Can you provide a brief outline of your testimony.**

10 A: Yes, it is divided into three sections with each corresponding to one of the
11 recommendations listed above.

12
13 **Section One: Filing ECA-Informational Reports**

14 **Q: If the Commission allows KCPL to implement an ECA mechanism, then you**
15 **recommend the Commission require KCPL to file "informational reports"**
16 **that would enable Staff to review and evaluate KCPL's monthly ECA prices**
17 **and annual ACA factor. What "informational reports" do you recommend?**

18 A: I recommend three, and refer to them in this testimony as the:

- 19 1. Annual Budget ECA Report¹
- 20 2. Monthly ECA Report, Appendix,² and
- 21 3. Annual ACA Report.³

¹ In the context of Westar Energy's most recent rate Application (Docket No. 05-WSEE-981-RTS), I refer to this report as the *Preliminary RECA Pricing Report*.

² Referred to as the *Monthly Staff Report* in Docket No. 05-WSEE-981-RTS.

³ Referred to as the *Annual Generation Performance Report* in Docket No. 05-WSEE-981-RTS.

1 **Q: Before describing their proposed content, what is the basic motivation for**
2 **having KCPL file these reports?**

3 A: Through the ECA mechanism KCPL would recover, primarily, its generation fuel
4 expense, generation O&M expense, and purchase power expense.⁴ By requiring
5 these reports to be filed, the Commission would effectively establish a formal
6 *framework* through which the ECA expenses can be routinely monitored and
7 examined for reasonableness (i.e., prudence). Naturally, the *content* of the reports
8 would provide the evidentiary basis for that examination.

9 **Q: But ECA expenses are already reviewed for reasonableness in the context of**
10 **rate cases, are they not?**

11 A: In the rate case context, it has been my experience that ECA expense reviews
12 occur depending on the perceived need and the availability of Staff resources;
13 however, it is generally the intent of Staff to perform those reviews in some
14 fashion. But the key point is that, regardless of whether ECA expenses are
15 actually reviewed during a rate case, with rate case applications being periodic,
16 the time between those applications can span several years; consequently, it is
17 likely the Commission's review of ECA expenses will effectively lapse between
18 rate cases.⁵ The purpose of having KCPL submit (and the Commission review)
19 the recommended informational reports is to reduce the chance of those lapses
20 occurring.

⁴ Fuel delivery expenses would also be recovered through the ECA, as would generation expenses associated with compliance with environmental regulations, such as the SO₂ allowances expense. If a carbon tax were implemented, the expense associated with that tax would probably be recovered through the ECA. Certain transmission expenses may also be recovered through the ECA.

⁵ This potential lapse of review is possible for only those electric utilities that rely on ECA mechanisms. Because the allowed rates for electric utilities that do not rely on the ECA mechanism are fixed between rate cases, this sort of review lapse would not occur with non-ECA utilities. That is not to suggest their allowed rates would not become stale over time.

1 **Q: What about the annual audits of the ECA expenses performed by Staff (i.e.,**
2 **ECA audits), do those audits constitute a prudence review of the ECA**
3 **expenses?**

4 A: Typically, no. As I understand it, the audits assure that actual expenses recovered
5 through the ECA mechanism are tied to actual invoices that, in turn, are tied to
6 documented purchase contracts, agreements, or other purchase arrangements.
7 Whether those “purchase contracts, agreements, or other purchase arrangements”
8 are prudent goes beyond the scope of the usual ECA audit. However, that is not to
9 suggest that prudence issues cannot be examined within the context of an annual
10 ECA audit, sometimes they are, but not routinely

11 **Q: So, the purpose of the recommended reports is to facilitate a more routine**
12 **and, in some sense, more complete review of the utility’s ECA expenses. The**
13 **filing and review of the reports would effectively fill-in the review gaps that**
14 **are likely to result from having only periodic rate cases and would provide a**
15 **basis to possibly examine utility decisions that are not usually the focus of an**
16 **ECA audit. Is that a fair summary of your testimony thus far?**

17 A: Yes it is. The recommended reports and their review would be tantamount to
18 having routine – meaning, between rate case – prudence-type reviews of ECA
19 expenses.⁶ That said, Staff understands that an effective review process cannot be
20 overly burdensome for the parties involved and, therefore, is open-minded about
21 the development of this process.

22 **Q: Turning now to the first ‘informational report’ on your list of three. What**
23 **content would be included in the *Annual Budget ECA Report*?**

⁶ The proposed reviews would be on an annual, not monthly basis.

1 A: I propose the following:
2 a) forecast monthly ECA prices, which would be based on KCPL's,
3 budgeted (i.e., forecast) ECA expenses and forecast ECA sales,⁷
4 b) forecast monthly natural gas prices (per MMBtu),
5 c) forecast purchase power prices (per MWh),
6 d) planned maintenance schedules and outages,
7 e) assumptions underlying and methods used to make load forecasts (e.g.,
8 normal weather, least-cost dispatch, normal grid congestion, etc.),
9 f) other information deemed useful by the Company, Staff and the
10 Commission.

11 In short, the *Annual Budget ECA Report* would reveal what the monthly ECA
12 prices are likely to be under normal, budget conditions. It would also provide a
13 brief description of the assumptions, methods (i.e., models), and data used to
14 derive those forecast ECA prices.

15 **Q: At what point during the year would the *Annual Budget ECA Report* need to**
16 **be filed?**

17 A: Prior to the start of the ECA-year. In this case, KCPL is proposing to implement
18 its ECA mechanism starting January 2008. Consistent with that, and presuming
19 the Commission grants KCPL's ECA request, KCPL would need to file this
20 report some time before the start of the next calendar year.⁸

⁷ As I understand it, KCPL and other jurisdictional utilities through their annual budget process establish various expense and sales forecasts. Using those same forecasts, monthly ECA prices can easily be derived. The forecast sales amount would need to be consistent with the ECA tariff provisions, whatever they may be. Finally, the ECA prices I refer to throughout this testimony are gross of any credits due to off-system sales profits and ACA factor.
⁸ KCPL is proposing an ECA-year equivalent to the calendar year.

- 1 **Q: How would Staff use the *Annual Budget ECA Report* to review the ECA**
2 **expenses?**
- 3 A: The forecast monthly ECA prices reported via the *Annual Budget ECA Report*
4 would be interpreted as the monthly ECA prices that would result under *normal*
5 *conditions*. Moreover, if the forecast ECA expenses are based on a least-cost
6 dispatch of KCPL's power plant and fuel portfolios, which Staff presumes would
7 be the case, then the forecast monthly ECA prices revealed through the *Annual*
8 *Budget ECA Report* would provide a reasonable *benchmark* against which the
9 actual monthly ECA prices could be compared.⁹
- 10 **Q: It is your contention the forecast monthly ECA prices that would be**
11 **contained in the *Annual Budget ECA Report* would provide a reasonable**
12 **benchmark or basis against which the actual monthly ECA price could be**
13 **subsequently compared over the course of the ECA-year, is that correct?**
- 14 A: Yes. So that explains both the content and function and, by inference, the purpose
15 of the *Annual Budget ECA Report*.
- 16 **Q: Are there any jurisdictional utilities currently using a Commission-approved**
17 **ECA mechanism that file a report like the *Annual Budget ECA Report* you**
18 **describe here?**

⁹ Arguably, since the forecast monthly ECA prices would be based on a least-cost dispatch of the system being operated under assumed, normal conditions, those prices would be optimal and, therefore, would provide a meaningful basis for comparison. That said, while the forecast monthly ECA prices may be interpreted as "optimal," Staff also recognizes they are conditional upon fuel price and other forecasts. Therefore, Staff understands that subsequent differences between the forecast and actual monthly ECA prices do not necessarily imply a departure from optimal behavior by the utility. Rather than using the forecast monthly ECA prices as benchmark for comparison, the amounts budgeted to cover ECA expenses would serve as an equally good benchmark (consistent with one of the basic uses of budget information). Lastly, there is no logical basis for developing generation-related budgets that are not based on least-cost dispatch. that KCPL would use least-cost dispatch as an integral part of its budgeting process.

1 A: Yes, just prior to start of its current ECA-year, Westar Energy filed such a report
2 in December 2006.¹⁰ Empire District Electric Company has also submitted a
3 comparable, though less detailed report per its ECA mechanism.

4 **Q: Would the forecast monthly ECA prices reported in the *Annual Budget ECA***
5 ***Report* be binding in any way?**

6 A: No, the forecast monthly ECA prices are filed for informational purposes.
7 Differences between forecast and actual monthly ECA prices provide a signal to
8 Staff of the utility's potential departure from its optimal (i.e., least-cost budgeted)
9 path. That is the signal to examine why a departure has occurred.

10 **Q: In summary, the *Annual Budget ECA Report* provides a set of 12 forecast**
11 **monthly ECA prices and a brief description of the assumptions, method, and**
12 **data on which those forecasts are based. The forecast monthly ECA prices**
13 **subsequently serve as non-binding benchmarks for the actual monthly ECA**
14 **prices that are submitted, each month, during the ECA-year. Is that a**
15 **reasonable summary?**

16 A: Yes it is.

17 **Q: Is your proposed *Annual Budget ECA Report* consistent with the ECA**
18 **framework KCPL is proposing?**

19 A: I believe it is, at least in concept. In his Direct Testimony, Company witness Mr.
20 Tim Rush ("Rush") describes a process where KCPL would develop, and submit
21 to the Commission, forecasts of its monthly ECA prices for the upcoming ECA-
22 year. (See Rush Direct, page 7, lines 10-12.) It appears both Staff and the

¹⁰ Westar Energy refers to its ECA mechanism as its retail energy cost adjustment ("RECA") mechanism. The RECA-year starts January 1.

1 Company support deriving a set of 12 monthly ECA price forecasts, one for each
2 month of the ECA-year, prior to the start of that year. That would constitute the
3 originally forecast set of monthly ECA prices.

4 **Q: The second item on your list of informational reports is the *Monthly ECA***
5 ***Report, Appendix* (hereafter, *Appendix*). What would be the content of that**
6 ***Appendix*?**

7 A: First, as background, I start with a very brief description of the *Monthly ECA*
8 *Report*, and follow with a description of the proposed *Appendix* to that report.
9 Secondly, my description of the *Monthly ECA Report* is consistent with the
10 monthly reporting of ECA prices by Westar Energy, Empire District Electric
11 Company (“EDE”), MidWest Energy (“MWE”), and Mid-Kansas Electric
12 Company (“MKEC”).

13 **Q: Please continue.**

14 A: When a utility implements an ECA mechanism, it recovers its ECA expenses on a
15 monthly basis through rates that are frequently referred to as “monthly ECA
16 prices.” The monthly ECA prices appear as a separate charge on the monthly bills
17 of ECA customers. Before monthly ECA prices are allowed to appear on any
18 bills, they are submitted to Staff through the utility’s *Monthly ECA Report*. The
19 utility-requested monthly ECA prices are subject to a cursory review by Staff.

20 **Q: What does the *Monthly ECA Report* consist of?**

21 A: Very simply, it shows the summary data and formulas used to *compute* the actual
22 monthly ECA price. That data includes monthly totals of the ECA expenses. For

1 most utilities with ECA (or PGA) mechanisms, the “monthly totals” represent the
2 utility’s *estimate* of its monthly, total ECA expenses.¹¹

3 **Q: Why would a utility rely on cost estimates when computing its actual**
4 **monthly ECA price?**

5 A: There are a number of possible reasons, but most have to do with timing
6 mismatches. For example, there is a time lag between when the utility incurs its
7 ECA expenses and when it receives revenue to cover those expenses; there is a
8 time lag between a customer’s actual consumption of electricity and the actual
9 payment of her monthly bill; there is a time lag between when meters are read
10 (and monthly usage is measured) and when monthly bills are rendered; there is a
11 time lag between actual operations and the invoicing and recording of actual
12 expense amounts. All of these and possibly other time lags result in a mismatch
13 between when the utility incurs an expense and when it receives actual payment.
14 In an attempt to reduce that mismatch, the utility will estimate its ECA expenses
15 over a specific billing cycle. Since the actual monthly ECA prices must be
16 checked by Staff prior to their appearance on monthly bills and, thus, prior to the
17 start of the next billing cycle, one way for the utility to reduce timing mismatches
18 is to base the actual monthly ECA prices on estimates of its ECA expenses over
19 next month’s billing cycle.¹²

20 **Q: You say Staff reviews the actual monthly ECA prices and, thus, effectively**
21 **reviews the *Monthly ECA Reports*. What does that review consist of?**

¹¹ The purchase gas adjustment (“PGA”) mechanism is the natural gas utility’s equivalent of the ECA mechanism.

¹² Not all of the utilities that rely on (ECA and/or PGA) pass-through mechanisms use cost estimates. Some use actual cost data; however, use of estimated costs is by far the more common approach.

1 A: It is a check mainly of the calculations underlying the proposed ECA price; it is
2 also a check of the proper inclusion of estimated expenses – only certain expenses
3 are allowed pass-through treatment by the Commission.¹³

4 **Q: So then, the *Monthly ECA Report* details how the actual monthly ECA price**
5 **is calculated by the utility. Staff checks those calculations, validating their**
6 **accuracy. With that as background, can you describe the content of your**
7 **proposed *Appendix***

8 A: In an earlier part of this testimony I discussed the comparison of originally
9 forecast monthly ECA prices with the actual monthly ECA prices; to be clear, the
10 former would be reported through the *Annual Budget ECA Report*, and the latter
11 would subsequently come to the Commission over the course of the ECA-year via
12 the *Monthly ECA Reports*.

13 **Q: Please continue.**

14 A: In the *Appendix*, the utility would briefly describe why the actual ECA price
15 differs from the originally forecast monthly ECA price. In short, the utility would
16 offer its explanation of why the actual monthly ECA price departed from the price
17 that was originally forecast through the budget process (and presented through the
18 *Annual ECA Budget Report*). Departures could be attributed to a large number of
19 factors: for example, natural gas prices and, thus, purchase power prices being
20 different than originally forecast; unexpected coal delivery problems prompting

¹³ It should be noted that Staff's review of ECA prices (and PGA prices) generally does not extend beyond these two considerations. For instance, Staff does not evaluate the reasonableness (i.e., prudence) of the estimated ECA expenses on which the actual monthly ECA price is based. To do so would not be consistent with the Commission standard of reviewing only those expenses that are "known and measureable," as opposed to those that are estimated or forecast. However, as indicated in the previous footnote, the actual monthly ECA prices may be based on actual ECA expenses. In those cases, a prudence review of the monthly ECA expenses might be feasible.

1 greater than expected reliance on purchased power and other coal conservation
2 measures; unplanned generation plant outages; or an abnormally cool summer
3 could result in an abnormally small natural gas expense. There are many reasons
4 why the actual monthly ECA prices could be different from those monthly ECA
5 prices originally forecast through the annual budget process.

6 **Q: Why would it be useful for Staff to have an explanation of why actual
7 monthly ECA prices depart from the originally forecast values?**

8 A: Since Staff is proposing to use the originally forecast monthly ECA prices as a
9 type of performance benchmark, having an explanation of why the actual monthly
10 ECA prices depart from the benchmark prices would provide Staff with an
11 indication of the abnormal and/or unexpected conditions that KCPL has
12 encountered over the ECA-year and, more importantly, how it has responded to
13 those conditions. For instance, if unplanned conditions prompt KCPL to engage in
14 costly coal-conservation measures resulting in an actual monthly ECA price
15 higher than originally forecast, KCPL would explain those measures, and their
16 costs, in the *Appendix*. With such explanations, Staff would have a better
17 understanding of KCPL's actual operating conditions over the ECA-year and how
18 it responded to conditions that were unplanned, unexpected, or otherwise not
19 foreseen as part of its forecasting (or budgeting) process. In short, through
20 reporting of information in the proposed *Appendix*, KCPL would explain why it is
21 off-budget per ECA expenses. What is proposed here is consistence with the use
22 of the basic budgeting process and tools that are used to track and explain off-
23 budget outcomes.

1 **Q: If there are departures between the originally forecast and actual ECA**
2 **prices, would Staff attempt to do a prudence review of KCPL's decisions?**

3 A: Any prudence examination of ECA expenses would not occur until the end of the
4 ECA-year, when all of the ECA expenses for the year would be known. That is,
5 once the ECA expenses effectively go from being estimated to actual, Staff could
6 then review the actual (i.e., known and measurable) ECA expenses. However, that
7 review (of actual ECA expenses at the conclusion of the ECA-year) would be
8 greatly facilitated, and streamlined, by information and evidence routinely
9 submitted over the year through the *Appendices* – hence the motivation for the
10 submittal of that information. In short, the information provided through the
11 monthly *Appendices* would provide Staff with an indication of how well KCPL
12 managed and controlled its actual ECA expenses throughout the ECA-year.

13 **Q: Is there a risk the Company would bias its forecast ECA expenses in order to**
14 **reduce the potential for a subsequent prudence review?**

15 A: Since positive differences between actual and forecast monthly ECA prices would
16 trigger Staff concerns about prudence, yes, there is a potential that the forecast
17 monthly ECA prices would be upwardly biased. However, Staff can and would
18 check for forecast bias, though checking for that bias may require an
19 accumulation of data (and, thus, an elapse of time).

20 **Q: Can you provide a summary of how Staff would use the monthly *Appendices*?**

21 A: The information provided through the monthly *Appendices* would keep Staff
22 apprised through the year of how KCPL is managing and controlling its ECA
23 expenses, especially in response to unexpected or unplanned events, as well as to

1 any deviations between forecast and realized fuel prices. Staff can gain a better
2 understanding of the conditions in which KCPL is actually confronted. With that
3 understanding, Staff would then have more of a foundation on which to review
4 the decisions KCPL makes over the ECA-year per its actual ECA expenses.

5 **Q: Are there any jurisdictional utilities that currently provide Staff with reports**
6 **like the monthly *Appendices* you describe?**

7 A: Yes, Westar Energy, since September 2006, has provided these reports. What I
8 call the monthly “Appendix” is equivalent to what it refers to as its “Supplemental
9 Monthly ECA Reporting,” which is effectively attached to or otherwise
10 accompanies its monthly ECA reports. Westar uses that reporting to, in its words,
11 “explain the likely source of differences between the monthly forecast and the
12 non-binding forecast information.” That is equivalent to the difference between
13 the actual (estimated) monthly ECA price (that will actually appear on monthly
14 bills) and the originally forecast monthly ECA price.

15 **Q: Is your description of monthly reporting and updating of ECA prices**
16 **consistent with the ECA mechanism KCPL is proposing?**

17 A: No. Rather than updating its originally forecast monthly ECA prices on a monthly
18 basis, KCPL is proposing that it be given the *option* to update monthly forecast
19 ECA prices on a quarterly basis. KCPL’s proposed quarterly “adjustment” dates
20 are April, July, and October. (Rush Direct, page 9, lines 13-18.)

21 **Q: What KCPL is proposing for its ECA mechanism differs from the ECA**
22 **mechanisms that have already been approved by the Commission for Westar**
23 **Energy, EDE, MWE, and MKEC, is that true?**

1 A: It is. All of the Commission-approved ECA mechanisms provide for monthly
2 updating of ECA prices. The same is true for all of the Commission-approved
3 PGA mechanisms utilized by its jurisdictional gas utilities. All of the pass-through
4 mechanisms currently approved by this Commission provide for monthly, not
5 quarterly, updating of pass-through prices. Nor is the updating in any way
6 recognized as being at the Company's option.

7 **Q: Is it your position that KCPL is seeking a significant difference for its ECA**
8 **mechanism compared with the Commission's currently approved pass-**
9 **through mechanisms, several of which have been in use for years?**

10 A: Yes. Moreover, it is my position that KCPL has not provided a sufficient basis for
11 this Commission to now change the design of, and policy pertaining to, its pass-
12 through mechanisms.

13 **Q: Do you consider monthly updating superior to KCPL's proposed quarterly**
14 **updating?**

15 A: Yes, and I will explain why; but before I do, I want to remind the Commission of
16 the larger picture. Keep in mind, the issue concerns updating the originally
17 forecast monthly ECA prices and, if updates occur, that would be tantamount to
18 replacing one forecast price with another (updated) forecast price. So the question
19 is, at what *frequency* does it make the most sense to update the forecasts with new
20 forecasts?

21 **Q: Is it your position that the proper frequency is monthly?**

22 A Yes, and here is a list of reasons for that:

1 1. The need for, and size of, year-end true ups for forecast error is smaller
2 with monthly updating (i.e., monthly updating yields a smaller ACA
3 factor, which I discuss below).

4 2. Monthly updating assures a better match between the actual monthly
5 ECA prices and actual, monthly generation costs and, therefore, improves
6 price signaling and, thus, the decisions consumers make regarding energy
7 conservation.

8 3. Because they cover a shorter time period over which less change can
9 occur, monthly updates are likely to be smaller than quarterly updates.
10 Therefore, it is possible, if not likely, that quarterly updating, with the
11 potential for large quarterly adjustments would result in *higher* ECA price
12 volatility for the year.¹⁴

13 4. Quarterly updating amounts to a type of quarterly smoothing of prices;
14 monthly updating is in line with only monthly smoothing of prices. Any
15 type of price smoothing deadens the incentives for energy conservation –
16 the shorter the period over which prices are smoothed, the better.

17 5. Following from the point above, monthly updating is far closer to real-
18 time-pricing (“RTP”) than quarterly updating. Economists have shown
19 that RTP of any commodity provides the incentives for achieving optimal
20 use and, thus, conservation of that commodity.

21 6. If KCPL’s originally forecast monthly ECA prices are good forecasts,
22 which largely depends on KCPL, then the need for sizable updates of

¹⁴ Since the variance of monthly ECA prices is determined by the size of the true-up squared, minimizing that variance calls for minimizing the size, not the frequency of true-ups.

1 those forecasts should, in any case, be small. If those original forecasts are
2 accurate, then monthly updates of those forecasts should be small (and
3 provide an equal probability of being either positive or negative) and not a
4 problem for anyone. If those original forecasts are not accurate, then why
5 wait for several months to make an update?¹⁵

6 7. Monthly updating is consistent with this Commission's current policy
7 per pass-through mechanisms.

8 8. Quarterly updating largely defeats the whole purpose of using pass-
9 through mechanisms in the first place, and that is to reduce regulatory lag
10 so that utility rates better reflect the utility's costs.

11 **Q: Can you think of any reason why quarterly updating as proposed by KCPL**
12 **makes sense?**

13 A: No. It is my sense that KCPL is confusing the use of price smoothing and
14 meaningful (risk) management of price change risk. If KCPL is concerned about
15 ECA price volatility, it should consider hedging fuel price volatility. In fact, if
16 KCPL's originally forecast monthly ECA prices are based on all fuel prices being
17 fully hedged (e.g., locked-in) for the year ahead, then there may be little need for
18 subsequent updating, on either a quarterly or monthly basis. (I discuss hedging in
19 greater detail in subsequent testimony.)

20 **Q: KCPL expresses some interest in enabling their ECA customers to better**
21 **“plan” their monthly bills. What is your reaction to that?**

¹⁵ This point is especially salient if updates would favor ECA customers by reducing their rates. Why should ECA customers be forced to wait possibly several months for a quarterly rate reduction when they could realize reductions on a monthly basis?

1 A: First, for ECA customers there are two components that make for an uncertain
2 and, thus, possibly “hard to plan” utility bill: the monthly ECA price and monthly
3 usage. To make the monthly ECA prices easier to plan around requires *real* risk
4 management of ECA prices (via financial derivatives), not price smoothing
5 (through a regulatory mechanism with only quarterly updating) that only conceals
6 and does not reduce or eliminate the underlying uncertainty.¹⁶ Second, regarding
7 usage uncertainty, customers already understand their monthly usage is largely
8 driven by random weather; they also understand energy prices are likely to be
9 sensitive to weather as well.¹⁷ Arguably, customers already know their utility bills
10 are largely weather dependent and, therefore, already understand how to plan for
11 uncertain weather.¹⁸ Third, it is not clear to what extent KCPLs’ customers are
12 actually demanding the ability to “plan” their monthly bills. A few years ago, the
13 jurisdictional gas utilities (and Staff) made an effort to survey gas customers in an
14 attempt to determine their demand for hedging services and, thus, their demand
15 for more stable, easier to “plan” monthly bills. Based on the survey results, the
16 demand for billing stability and the ability to “plan” monthly bills may not be
17 strong. For example, the majority of customers surveyed wanted to keep the
18 downside risk and avoid only the largest (not all) price increases. That provides a

¹⁶ Quarterly compared to monthly updating of ECA prices is likely to result in greater ACA factor uncertainty/risk. KCPL’s inference that *overall* billing uncertainty is relatively less with quarterly updating does not take into account the increased uncertainty of the ACA factor (that comes with quarterly updating).

¹⁷ Several years ago Kansas Gas Service Company (“KGS”) offered its PGA customers a billing option referred to as the WeatherProof Bill. Through that billing option the participating customer could fully hedge both the monthly PGA price and usage amounts, and without the risk of a year-end “true-up.” In short, the WeatherProof billing option enabled PGA customers to lock-in their monthly bill amounts for a year in advance, enabling to “plan” their monthly bills with perfection. Customer interest in the WeatherProof billing options was always relatively limited, with only about 10 to 20 percent of eligible customers taking advantage. That shows clear evidence that customers may not have a significant demand for bill stability and, thus, having monthly bills that are easy to plan for.

¹⁸ Quarterly updating of ECA prices does nothing to help customers deal with usage uncertainty.

1 clear indication that the customers' concern is primarily with the risk of extremely
2 large bills and not their inability to plan for monthly bills generally.¹⁹ Moreover,
3 none of the customers surveyed showed a desire to pay a large amount for risk
4 management services, revealing a limited demand for stable, easy-to-plan bills.²⁰
5 Fourth, if it is KCPL's intent to provide, at the start of the ECA-year, all of its
6 ECA customers with the originally forecast monthly ECA prices so customers can
7 "plan" their monthly bills, that may be far more trouble than it is worth. For one,
8 KCPL will have to represent those prices as forecasts. If customers are not clear
9 on that and, perhaps, believe the ECA prices shown by the Company at the start
10 of the year will be the actual prices, there is likely to be great confusion if KCPL
11 subsequently decides to update those prices.²¹ Lastly, for planning purposes,
12 giving ECA customers the year-ahead price forecasts should work the same even
13 if there are subsequent monthly, rather than quarterly, updates of ECA prices.

14 **Q: Might KCPL prefer quarterly rather than monthly updating because it is**
15 **concerned about the possible regulatory review of and, thus, burden**
16 **associated with those monthly updates?**

17 A: Perhaps, and I understand that concern. However, in terms of what I am
18 proposing, the reporting through the monthly *Appendices* would be largely for
19 informational purposes. Staff does not envision performing a prudence review of

¹⁹ It is Staff's position that customers' aversion to risk/uncertainty is probably asymmetric. In that case, they seek to avoid upside price risk, but keep downside price risk. In that case, it is hard to argue customers seek monthly bills that are easier to "plan." Smaller monthly bills are unlikely to be hard to plan for. If KCPL does a reasonable job forecasting their monthly ECA prices at the start of the year, then there should be a 50/50 probability that monthly updating would yield a *lower* ECA price than originally forecast. It is not clear customers actually want to give that chance up (as required with quarterly updating) in exchange for having possibly greater ability to plan their bills.

²⁰ The reports summarizing the survey results are available upon request.

²¹ At this time, there are no jurisdictional utilities that provide their customers with year-ahead forecasts of monthly pass-through prices.

1 monthly ECA expenses. In fact, Staff understands that it isn't until the end of the
2 ECA-year that all of the actual ECA expenses are known and measurable and,
3 thus, ready for review. Monthly updating with submittal of the monthly
4 *Appendices* should not be a source of hang-ups during the year and will only
5 streamline the actual review that would occur at year's end.

6 **Q: Finally, turning to the last information report on your list, the *Annual ACA***
7 ***Report*, what would be its purpose?**

8 A: First, a bit of background may be useful. Once the ECA-year has been completed,
9 and again because of various time lags, as described above, there is almost always
10 a need to reconcile the amount of total revenue the utility recovers through the
11 ECA mechanism during the ECA-year and its *actual* ECA expenses over that
12 year. Since the actual monthly ECA prices are based on estimated ECA expenses,
13 it is almost guaranteed that the amount of ECA revenue received differs from the
14 actual ECA expense.

15 **Q: So, at the end of the ECA-year, and once all of the actual ECA expenses for**
16 **the entire year have been tabulated and summed up, the total (known and**
17 **measurable) ECA expense usually differs from the total revenue received**
18 **from the actual monthly ECA prices that were assessed during the year. Why**
19 **and how are those differences, as you put it, reconciled?**

20 A: It is natural to reconcile difference between estimated and actual expenses. For
21 pass-through mechanisms, actual revenues recovered through the mechanism
22 match the estimated, not actual expenses. Thus, one reason to reconcile or "true-
23 up" at the end of the year is to simply correct for estimation error. For ECA-type

1 expenses, the Commission does not grant the utility any profit, therefore, ECA
2 customers should pay an amount that is no more nor less than the total ECA
3 expense – provided that expense was reasonably incurred. That provides another
4 reason for reconciling the annual ECA revenues and expenses. The actual
5 reconciliation or “true-up” is accomplished through application of the Actual Cost
6 Adjustment (“ACA”) factor. The ACA factor is usually applied on a volumetric
7 (i.e., kWh) basis and applied to sales over the subsequently ECA-year. The ACA
8 factor can be a positive or negative charge depending in whether actual ECA
9 expense was more or less than actual ECA revenue, respectively. Usually, the
10 ACA factor is relatively small compared with the average monthly ECA price
11 and, in the long run, should average close to zero.

12 **Q: With that background, can you describe the content of the *Annual ACA***
13 ***Report?***

14 **A:** I propose that it consists of two basic components:

- 15 1. ACA factor calculation – showing the actual total ECA revenue and
16 actual total ECA expense used to compute of the requested ACA
17 factor, and
- 18 2. Company support of its actual ECA expense.²²

19 With the second component, the Company can provide evidence it believes would
20 support the reasonableness of its *actual* ECA expense-related decisions over the
21 ECA-year. Arguably, the Company would need to show that its actual ECA
22 expense was consistent with the minimal amount necessary given the actual

²² These two components largely comprise the content of current submissions for ACA factors.

1 operating conditions and fuel prices it faced during the ECA-year. That is, the
2 Company would need to show it was economical per its ECA decisions.²³

3 **Q: Is Staff recommending KCPL seek formal Commission approval of its**
4 **requested ACA factor?**

5 A: Yes, because approval of that factor is identical to approving the “numbers” that
6 go into its calculation, one of those numbers being the Company’s actual (known
7 and measurable) ECA expense for the (previous) ECA-year. Thus, approval of the
8 ACA factor is tantamount to Commission approval of the actual ECA expense. Of
9 course, to make that determination necessitates a Commission review of that
10 expense – approval of the ACA factor begs the review and approval of the actual
11 ECA expenses. For those reasons, and in recognition that the ACA factor is like a
12 rate, Staff recommends KCPL be required to file an ACA Factor Application,
13 which could include submittal of the recommended *Annual ACA Report*.²⁴

14 **Q: What if the Commission were to find the Company had imprudently**
15 **incurred some ECA expenses?**

16 A: The Commission could then decide whether to allow the Company to actually
17 recover those expenses from its ECA customers. The Commission could decide to
18 disallow those questionable expenses either in full or in part. If the Commission
19 decided to disallow recovery, then the requested ACA factor could be adjusted

²³ Since the budgeted ECA expenses (equivalently, forecast monthly ECA prices) are based on least-cost dispatch of system assets and contract portfolios, they provide a baseline for evaluating actual ECA expenses. If the Company can show that differences between budgeted and actual ECA expenses (except those resulting from fuel price forecast errors) are consistent with least-cost behavior by the Company during the ECA-year, then that may suffice as a showing that KCPL stayed on the least-cost path throughout the year. For example, if rail congestion forced KCPL to incur actual expenses in excess of budgeted amounts, a showing by KCPL that its response to rail congestion was the least-cost response would provide a basis for finding its actual ECA expenses were reasonable, even when they exceed the budgeted amounts.

²⁴ This is consistent with current practices per Westar Energy and EDE.

1 accordingly.²⁵ Alternatively, the Commission could require any disallowances to
2 appear as a credit amount on monthly bills. The Commission could always select
3 other options for dealing with disallowances.

4 **Q: Please summarize.**

5 A: By submitting the three, recommended “informational reports,” a framework and
6 process are established whereby the Commission can monitor and review KCPL’s
7 actual ECA expenses. Having that process in place over the course of the ECA-
8 year should streamline the Commission’s review of KCPL’s Application for an
9 ACA factor, which would be submitted shortly after the end of the ECA-year
10 (once all *actual* ECA expenses are tabulated and totaled).

11 **Q: Is KCPL’s proposed year-end review similar to your proposal?**

12 A: I believe so. As I understand it, KCPL would file its Application for an approved
13 ACA factor “on or before March 1” of each year, and that factor would be applied
14 starting with bills rendered after April 1. (Rush Direct, page 9, lines 2-10.) Staff
15 does envision the need for *Commission approval* of the requested ACA factor. It
16 is not clear to me how long that review process will take. It may require more
17 than a month. If it does and if a new, but not-yet-approved ACA factor were to go
18 into effect on April 1, then it would need to be subject to refund.

19 **Q: In comparing your proposals for reviewing and implementing an ECA
20 mechanism with those offered by KCPL, what are the key differences?**

21 A: There are some minor differences, but only one of particular significance. KCPL
22 is proposing the option to engage quarterly updates of the monthly ECA prices; I

²⁵ For instance, if the requested ACA factor were positive, a disallowance would reduce the size of that factor.

1 strongly recommend monthly updating accompanied by an explanation for the
2 update (as contained in the *Monthly ECA Report Appendices*). What I propose in
3 this testimony is modeled after the process Staff already has in place for Westar
4 Energy and, to a lesser extent, EDE.

5
6 **Section Two: The Commission's Gas Hedge Program Policies**

7 **Q: What is the purpose of your testimony in this section?**

8 A: Based on the Direct Testimony of KCPL witness, Mr. Ed Blunt, it is my
9 understanding that KCPL has a program, process, or practice through which it
10 hedges some proportion of the natural gas it uses as a generating fuel. Moreover,
11 if the Commission grants KCPL's request to implement an ECA mechanism, it is
12 my understanding that KCPL would continue to hedge some proportion of its
13 natural gas purchases. My purpose is to address KCPL's hedging practices in the
14 event the Commission grants KCPL's ECA request.

15 **Q: If the Commission grants the ECA request and KCPL continues hedging its**
16 **gas purchases, that would be equivalent to KCPL hedging on behalf of its**
17 **ECA customers, is that correct?**

18 A: Yes. If KCPL hedges (physical) gas purchases whose expense would be recovered
19 through the ECA mechanism, then KCPL would necessarily be hedging on behalf
20 of its ECA customers. Accordingly, I recommend that KCPL file a Gas Hedge
21 Program Application so the Commission can determine whether KCPL's hedging
22 practices/program would be consistent with the public interest. Moreover, if
23 KCPL is allowed to implement an ECA mechanism, I recommend KCPL not be

1 allowed to pass any hedging costs or revenues (i.e., derivative payoffs, either
2 positive or negative) through that mechanism absent Commission approval of its
3 hedging activities.²⁶

4 **Q: Does Staff have any recommendation on whether KCPL should have a**
5 **hedging program on behalf of its ECA customers?**

6 A: At this time, no. If KCPL wants to hedge on behalf of its ECA customers, it
7 should seek Commission approval to do so. If it prefers to hedge on behalf of its
8 shareholders, that could be reasonable. However, in that case, Staff would
9 recommend the Commission take all hedging costs and revenues below the line
10 (meaning the net dollar effect of the hedging would accrue to only shareholders).

11 **Q: Have other jurisdictional utilities sought Commission approval of their**
12 **hedging activities/programs?**

13 A: Yes. All of the jurisdictional gas utilities. Moreover, the gas utilities sought
14 approval of their hedge programs not within the context or consequence of any
15 other proceedings, nor at the prompting of Staff and/or the Commission.

16 **Q: What about the electric utilities?**

17 A: Aquila (formerly d/b/a WestPlains) implemented an approved program nearly two
18 years ago. Empire District Electric Company has a Hedge Program Application
19 currently under review, and Westar Energy, it is my understanding, is in the
20 process of putting together such an application.

²⁶ Jurisdictional utilities with Commission-approved pass-through mechanisms (either ECA or PGA) and hedge programs, present and track the pass-through implications of their hedge programs separately from all other pass-through expenses. That is accomplished by simply reporting the hedge implications on separate sheets, basically the “hedge transaction sheets,” of the monthly ECA/PGA reports to Staff.

1 **Q: Do you have any thoughts for the Commission regarding the value of**
2 **jurisdictional utilities having gas hedge programs?**

3 A: Because such a large proportion of the monthly natural gas bill is attributable to
4 the gas-only expense and given the expected volatility of natural gas prices, it is
5 my opinion that the hedge programs employed by the gas utilities have worked
6 well, and economically, to reduce the *volatility* of monthly gas bills. On the other
7 hand, for electric utilities I think the evidence may be less compelling. This is
8 particularly true for utilities, like KCPL, with an annual gas expense that is a
9 small proportion of their total fuel expense and that are usually net sellers of
10 energy, even during the summer months.²⁷

11 **Q: If KCPL files a Hedge Program Application, then KCPL can attempt to**
12 **make the case that its program is likely to reduce the volatility of its ECA**
13 **customers' monthly bills, do you agree?**

14 A: Yes. Another challenge for KCPL would be to show its ECA customers actually
15 want (i.e., are demanding) KCPL to hedge on their behalf. For utility gas
16 consumers, and with the transparency of natural gas prices, the link between price
17 spikes and monthly bill spikes is pretty clear. Not so for electric customers and
18 especially for those that would be introduced to an ECA mechanism for the first
19 time in years, if not for the first time ever. Unlike delivered electricity, hedging is
20 not a necessity item. The gas utilities also made an effort to gather evidence
21 showing their customers actually wanted hedging done on their behalf.

22 **Q: Can you summarize this section of testimony?**

²⁷ Since electric utilities purchase a large amount of gas on a daily basis and since that gas is usually purchased in anticipation of high daily temperatures, those gas purchases can be difficult to hedge because it is difficult to know very far in advance *when* those hot days will occur.

1 A: If KCPL wants to hedge on behalf of its ECA customers, then I recommend it be
2 ordered to submit a Hedge Program Application for Commission consideration.
3 Until such time KCPL is granted Commission approval to hedge, all costs and
4 revenues associated with any of KCPL's hedging activities should be treated
5 below the line, thus financially isolating ECA customers from those activities. If
6 the Commission grants KCPL's request to have an ECA mechanism, and if there
7 is a need to separate out (i.e., isolate) KCPL's hedge costs and revenues, that can
8 be done at the time the ECA mechanism is implemented.

9

10 **Section Three: The Filing of Monthly EPRs**

11 **Q: What are monthly EPRs?**

12 A: First, EPR is an acronym for energy purchase report. Utilities that rely on ECA
13 mechanisms are required to submit EPRs on a monthly basis.

14 **Q: What information is contained in the EPRs?**

15 A: The information submitted through the EPRs, as the Commission may be aware,
16 is detailed in the Commission Order dated September 25, 2002 (Docket No. 75-
17 GIMC-009-GIG). In short, that information provides a summary of contract
18 provisions for newly entered gas contracts whose expenses will be recovered
19 through the ECA mechanism.

20 **Q: How does Staff use the information contained in the EPRs?**

21 A: Staff uses that information to check whether the utilities' gas purchase decisions
22 meet the Commission's gas purchase standard and, thus, whether those decisions
23 are "reasonable" per the public interest.

1 **Q: Why do you broach this matter regarding the filing of EPRs?**

2 A: If the Commission allows KCPL to implement an ECA mechanism, then the
3 Company needs to be apprised, perhaps by the Commission itself, of any
4 compliance matters that would be associated with that implementation. The
5 reporting requirements in the September 25, 2002 Order are one such ECA
6 compliance matter.

7 **Q: The EPRs would also assist Staff in evaluating the reasonableness of KCPL's**
8 **actual ECA expenses and, therefore, would facilitate Staff's review of**
9 **KCPL's Applications for ACA factor approval, do you agree?**

10 A: Yes, the review of actual gas expenses passed through the ECA is made easy with
11 the EPRs. It may be advisable to expand the use of EPR-type reports to include
12 reporting of purchase decisions on commodities other than natural gas, such as
13 coal, diesel oil, and related petroleum products used for generation, purchased
14 power, and processed uranium.

15 **Q: Your summary point for this section is that if the Commission approves ECA**
16 **implementation for KCPL, then KCPL would need to start filing EPRs;**
17 **moreover, filing EPRs is likely to streamline some of the review of ACA**
18 **factor Applications. Is that a fair summary?**

19 A: Yes.

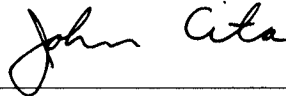
20 **Q: Does this conclude your Direct Testimony?**

21 A: It does.

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

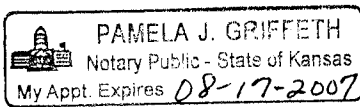
VERIFICATION


John Cita, being duly sworn upon his oath deposes and says that he is the Chief of Economic and Planning Policy in the Utilities Division of the Kansas Corporation Commission; that he has read and is familiar with the foregoing *Direct Testimony*, and that the statements therein are true to the best of his knowledge, information and belief.



John Cita
Chief of Economic Policy, Utilities Division
The State Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 3rd day of August, 2007.





Notary Public

My Appointment Expires:

August 17, 2007

CERTIFICATE OF SERVICE

07-KCPE-905-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing Direct Testimony was placed in the United States mail, postage prepaid, or hand-delivered this 3rd day of August, 2007, to the following:

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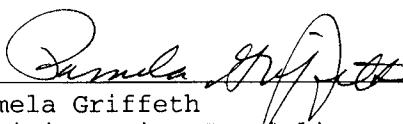
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* Denotes those receiving the Confidential version