

PUBLIC VERSION

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

REBUTTAL TESTIMONY OF

WM. EDWARD BLUNK

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

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

DOCKET NO. 07-KCPE-905-RTS

1 **Q:** Are you the same Wm. Edward Blunk who submitted Direct Testimony in this
2 proceeding?

3 **A:** Yes, I am.

4 **Q:** What is the purpose of your Rebuttal Testimony?

5 **A:** My Rebuttal Testimony responds to two fuel-related issues. First, I respond to
6 Citizens' Utility Ratepayer Board ("CURB") witness Andrea C. Crane and Kansas
7 Corporation Commission ("Commission") Staff ("Staff") witness Larry W.
8 Holloway's testimonies regarding coal inventory. Second, I respond to Staff witness
9 Dr. John Cita's testimony regarding natural gas hedging.

1 I. COAL INVENTORY

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

4 A: CURB recommended that coal inventory be based on the average balance for the
5 thirteen months ended December 2006.

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

8 A: Yes, I do. CURB's recommendation produces a result that is inconsistent with
9 Commission policy and traditional ratemaking principles that rates should be
10 reflective of ongoing normal operations. KCPL's coal inventories have been reduced
11 within the past few years because of major rail disruptions. In fact, the Company
12 maintains inventory in anticipation of such fuel supply disruptions. CURB
13 acknowledges that rail disruptions, speculative traders, and clean air regulations have
14 all impacted coal supplies. For the 10 years (January 1995 through December 2004)
15 before the rail disaster of 2005, KCPL's coal inventory averaged **■■■■** of then
16 prevailing operational targets. The 13-month period CURB recommends for setting
17 KCPL's coal inventory follows the worst fuel delivery crisis the Company has faced
18 in more than 15 years. In other words, the 13-month period from December 2005
19 through December 2006, in which coal inventory averaged **■■■■** of the
20 operational target, is not representative of normal operations. To set the Company's
21 coal inventory levels at these unusually low levels would penalize the Company for
22 using its inventory to mitigate reductions in generation. Therefore, I recommend that

1 the Commission accept the normalized coal inventory levels as filed in KCPL's case
2 and reject the reduction as proposed by CURB.

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

5 A: The coal inventory targets in the Company's Application are ** [REDACTED] **
6 than the Company's operational inventory targets for 2007. This difference is
7 primarily a function of normalizing unit outages and system load. Uncertainty or
8 variability in the fuel requirement distributions is dampened by these normalizations.
9 In effect, the high burns are reduced and the low burns are increased. That, in turn,
10 affects the degree to which those differing distributions press upon delivery
11 constraints.

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

1 **Q: How do the coal inventory targets in the Company's Application compare to the**
2 **current level of coal inventory the Company has on hand?**

3 A: The coal inventory targets in the Company's Application are ** [REDACTED] **
4 than the actual amount of coal the Company had on hand August 1, 2007.

5 **Q: Staff witness Holloway expressed concerns about using inventory targets to**
6 **develop the cost of coal inventory in the ratemaking procedure. What is your**
7 **understanding of Mr. Holloway's concerns?**

8 A: Staff is concerned that if KCPL does not actually invest in inventory at the level
9 included in the ratemaking procedure, then the Company will be allowed to recover
10 costs it did not incur while at the same time subjecting ratepayers to greater risk of
11 fuel shortages and higher fuel costs.

12 **Q: How did Staff recommend addressing Mr. Holloway's concerns?**

13 A: As I understand it, Staff advocates using the annual Energy Cost Adjustment
14 ("ECA") true-up to compensate KCPL's Kansas retail ECA customers for times when
15 actual inventory is significantly less than the target level used to establish rates.
16 KCPL witness Tim M. Rush addresses this issue of using the annual ECA true-up to
17 adjust rates for fuel inventory variances in his Rebuttal Testimony.

18 **Q: Do you have concerns with adjusting the target inventory levels in the**
19 **ratemaking procedure?**

20 A: Yes, I have two concerns. First, CURB and Staff appear only to be supportive of
21 downward adjustments. That is, their positions do not reflect the fact that inventory
22 values often exceed target levels. Schedule WEB-10 shows that while KCPL's coal
23 inventory averaged ** [REDACTED] ** of the operational targets over the 10-year period from

1 January 1995 through December 2004, it varied from ** [REDACTED] ** to ** [REDACTED] ** of
2 target. My second concern is if the Company is not allowed to recover the cost of
3 inventory targets that it will be incentivized to reduce inventory to those levels that
4 are recovered.

5 **Q: Earlier you mentioned that the coal inventory targets in the Company's**
6 **application are ** [REDACTED] ** than the Company's operational**
7 **inventory targets. Assuming the same relationship would have existed between**
8 **past operational targets and normalized targets, would the long-term historical**
9 **average inventory level have exceeded the normalized inventory targets?**

10 A: Yes, it would have. If that same relationship had existed from 1995 through 2004,
11 coal inventory for that period would have averaged about ** [REDACTED] ** of the
12 normalized targets.

13 **Q: You pointed out that actual inventory levels fluctuate above and below target**
14 **levels. Do the inventory costs also fluctuate above and below the target levels?**

15 A: Yes, they do. Schedule WEB-9 graphically illustrates the costs associated with
16 maintaining inventory. It shows the cost of holding inventory and the expected cost
17 of running out of inventory for various levels of inventory. The target levels
18 recommended by the Company in this case are those levels (plus basemat) that
19 represent the lowest points on the curve for the sum of holding cost and expected
20 shortage cost. That is, the target level is the point at which the total cost is lowest.
21 The point I want to make with this graph is that the inventory-related costs are not
22 symmetric around that low point. The cost of having too little inventory is much
23 greater than having too much inventory.

1 **Q: Why is the cost of having too little inventory so much greater than having too**
2 **much inventory?**

3 A: There are several components to the cost of running out of fuel. While the exact
4 order of these costs can vary by inventory location, typically the first cost for KCPL
5 is the opportunity cost of foregone non-firm off-system power sales. After that would
6 be the incremental cost of non-economic dispatch or the cost of purchasing additional
7 energy. The last point on the curve is the socio-economic cost of failing to meet load.
8 That compares to the relatively minor cost of having too much inventory, which is
9 essentially the cost capital required to finance the investment.

10 **II. HEDGE PROGRAM APPLICATION**

11 **Q: What is your understanding of Staff's recommendation on whether KCPL**
12 **should have a natural gas hedging program?**

13 A: At this time, Staff has not made a recommendation on whether KCPL should have a
14 natural gas hedging program. Staff Witness Dr. John Cita recommends that KCPL
15 not be allowed to pass any natural gas hedging costs or revenues through the
16 proposed ECA tariff before KCPL files a Gas Hedge Program Application and
17 receives approval of such hedge program.

18 **Q: In your Direct Testimony you described KCPL's natural gas hedge program. Is**
19 **KCPL seeking approval of its natural gas hedging program?**

20 A: No, it is not.

21 **Q: How did Staff recommend treating the costs and revenues from KCPL's natural**
22 **gas hedge program if the Company's natural gas hedge program was not**
23 **approved by the Commission?**

1 A: Dr. Cita characterized a hedge program that passed through the ECA as being on
2 behalf of the ECA customers and a hedge program that did not pass through the ECA
3 as being on behalf of the Company's shareholders. In the case where the hedge was
4 on behalf of the shareholders, Dr. Cita said:

5 "…to hedge on behalf its shareholders, that could be reasonable. However in
6 that case, Staff would recommend the Commission take all hedging costs and
7 revenues below the line (meaning the net dollar effect of the hedging would
8 accrue to only shareholders)."
9

10 **Q: How does KCPL recommend treating the costs and revenues from its natural**
11 **gas hedge program?**

12 A: KCPL recommends taking all natural gas hedging costs and revenues below the line
13 such that the net dollar effect of the hedging activity would accrue only to
14 shareholders.

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

16 A: Yes, it does.

SCHEDULES WEB-9 AND WEB-10

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