

Exhibit No.:

Issues: Interchange Sales
Jurisdictional
Allocations
Amortization
Expense

Witness: James R. Dittmer

Type of Exhibit: Surrebuttal Testimony

Sponsoring party: DOE-NSSA

Case No.: ER-2006-314

Surrebuttal Testimony Date: October 6, 2006

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2006-0314

Public Version

SURREBUTTAL TESTIMONY

OF

JAMES R. DITTMER

ON BEHALF OF

**THE DEPARTMENT OF ENERGY – NATIONAL
NUCLEAR SECURITY ADMINISTRATION**

**Kansas City, Missouri
October 2006**

FILED

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*Missouri Public
Service Commission*

*** [REDACTED] *** Designates that "Highly Confidential" or "Proprietary"
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DOE Exhibit No. *805*
Case No(s). *ER-2006-0314*
Date *10-16-06* Rptr *KF*

1 **SURREBUTTAL TESTIMONY**
2 **OF**
3 **JAMES R. DITTMER**
4 **KANSAS CITY POWER AND LIGHT COMPANY**
5 **CASE NO. ER-2006-0314**
6

7 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

8 A. My name is James R. Dittmer. My business address is 740 Northwest Blue Parkway,
9 Suite 204, Lee's Summit, Missouri 64086.
10

11 **Q. BY WHOM ARE YOU EMPLOYED?**

12 A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a consulting firm
13 engaged primarily in utility rate work.
14

15 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS CASE?**

16 A. Yes. On August 8, 2006 I filed direct testimony on behalf of the United States
17 Department of Energy that is representing the interest of the National Nuclear
18 Security Administration ("DOE-NNSA") and other affected Federal Executive
19 Agencies. On September 8, 2006 I filed rebuttal testimony--also on behalf of DOE-
20 NNSA.
21

22 **Q. ON WHOSE BEHALF ARE YOU FILING SURREBUTTAL TESTIMONY IN**
23 **THIS CASE?**

24 A. This surrebuttal testimony is also being filed on behalf of DOE-NNSA.
25

1 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

2 A. I will be addressing two topics. First, within its initial direct filing, through witness
3 Mr. Don Frerking, KCPL proposed to allocate off-system sales margins between the
4 Missouri retail, Kansas retail and wholesale jurisdictions employing a new allocation
5 methodology that KCPL refers to as the “unused energy allocator.” Within rebuttal
6 testimony filed on September 8, 2006 Mr. Frerking continued to embrace the concept
7 of employing the “unused energy allocator” to assign off-system sales margins to the
8 various jurisdictions. However, while continuing to embrace the concept of
9 employing the “unused energy allocator,” Mr. Frerking nonetheless revised and
10 purportedly corrected the calculation underlying the noted allocator. One purpose of
11 this surrebuttal testimony is to establish that, notwithstanding the Company’s revision
12 to its allocator development, all arguments that I made in rebuttal testimony in
13 opposition to the use the “unused energy allocator” remain valid. In fact, the revision
14 actually further highlights one of the significant problems of its use that I discussed
15 within rebuttal testimony.

16
17 Second, KCPL witness Mr. Michael Cline has filed rebuttal testimony addressing the
18 topic of the Additional Amortization required to achieve financial metrics agreed to
19 by a number of parties signing the Stipulation and Agreement in Case No. EO-2005-
20 0329. Mr. Cline provides a rebuttal schedule that attempt to show that the revenue
21 requirement is lower in the short run if capital requirements are funded through
22 ‘traditional ratemaking’ rather than through “Additional Amortization.” There are
23 elements to Mr. Cline’s analysis that are very misleading. Accordingly, a second

1 purpose of this surrebuttal testimony is to respond to some of Mr. Cline's assertions or
2 conclusions.

3
4 **UNUSED ENERGY ALLOCATOR**

5 **Q. PLEASE BEGIN BY FIRST PROVIDING YOUR UNDERSTANDING OF**
6 **THE COMPANY'S REVISED CALCULATION OF ITS PROPOSED**
7 **"UNUSED ENERGY ALLOCATOR."**

8 A. KCPL originally developed the unused energy allocator for each jurisdiction
9 (Missouri, Kansas, and FERC) in the following manner:

10 Average of 12 Coincident MW Demands
11 for the Jurisdiction (whether it is Missouri, Kansas or FERC)

12
13 Times Total Hours in a Year (8,760)

14
15 Equals-Subtotal "Available Energy" for each Jurisdiction.

16
17 Less: Actual Energy Served to Each Jurisdiction for the Year (Sales plus Line
18 Losses For Each Jurisdiction)

19
20 Equals-"Unused Energy" for Each Jurisdiction

21
22 This calculation was originally made for each jurisdiction - Kansas, Missouri and
23 FERC. Using this algorithm, each jurisdiction's "unused energy allocator" was then
24 developed by dividing its calculated "unused energy" by the calculated total company
25 amount of "unused energy." KCPL's original development of its "unused energy
26 allocator" is shown on the top half of Schedule JRD-1 that was attached to my rebuttal
27 testimony filed on September 8, 2006.

1 Within its rebuttal filing, KCPL revised the development of the "unused energy
2 allocator." Specifically, now KCPL proposes to calculate the "Available Energy"
3 employed in its factor development for each jurisdiction by multiplying the total
4 system capacity available times each jurisdictions' demand factor times the total
5 number of hours in the year (i.e., 8,760). The actual development of KCPL's revised
6 "unused energy allocator" can be found on the top half of attached Surrebuttal Schedule
7 JRD-1.
8

9 **Q. WHAT IS THE IMPACT OF THIS KCPL REVISION?**

10 A. KCPL originally calculated the Missouri jurisdictional "unused energy allocator" to be
11 46.18%. KCPL's revised Missouri jurisdictional "unused energy allocator" is 51.55%.
12 Thus, KCPL's revision causes over five percent more of non-firm off-system sales
13 margins to be allocated to the Missouri jurisdiction. I would note that a portion of that
14 shift is caused by updating for the twelve months ending December 2005 versus
15 KCPL's original filing that was based on the twelve months ending September 2005.
16 Ultimately the revenue requirement value of this allocation issue to the Missouri
17 jurisdiction will be dependent upon the "total company" off-system sales margin
18 determined by this Commission to be reasonable. As noted elsewhere in this record,
19 there is also a significant difference among the parties as to quantification of the
20 appropriate ongoing level of total company off-system sales margins to be considered
21 within cost of service development. On the bottom half of attached Surrebuttal
22 Schedule JRD-1 I show the value of this allocation issue at the Company-proposed as

1 well as DOE-NSSA-proposed total company level of non-firm off-system sales
2 margins being proposed.

3
4 **Q. WITHIN AN EARLIER ANSWER YOU STATED THAT,**
5 **NOTWITHSTANDING THE KCPL REVISIONS DESCRIBED WITHIN ITS**
6 **REBUTTAL TESTIMONY, THE ARGUMENTS YOU MADE WITHIN YOUR**
7 **REBUTTAL TESTIMONY REMAINED VALID. PLEASE EXPAND UPON**
8 **THAT COMMENT.**

9 A. Within my rebuttal testimony I addressed four arguments in opposition to the
10 adoption of KCPL's "unused energy allocator." Notwithstanding a fairly significant
11 change in its development, adoption of the KCPL-revised "unused energy allocator"
12 would still be inappropriate. None of the criticisms stated within my rebuttal
13 testimony have been addressed with the KCPL revision. To the contrary, the revised
14 calculation actually emphasizes one of the flaws of the allocator that I addressed
15 within rebuttal testimony.

16
17 **Q. PLEASE EXPLAIN THE FLAW THAT HAS BEEN EMPHASIZED AS A**
18 **RESULT OF THE KCPL REVISION.**

19 A. Within my rebuttal testimony I described how the purported propriety of the "unused
20 energy allocator" is built upon an implicit assumption that virtually all "unused" MWHs
21 that become the basis for the "unused energy allocator" would have been "used" to make
22 additional off-system sales. I went on to explain and quantify how KCPL was

1 achieving off-system MWH sales volumes that were but a fraction of the calculated
2 “unused energy.”

3
4 KCPL has revised the calculation of the “unused energy” to consider the maximum
5 capacity that each jurisdiction was “paying for” rather than only the 12 CP average of
6 each jurisdiction’s demands as had been employed within its original calculation. As a
7 result of this revision, the calculated total company “unused energy” grew from the
8 originally-calculated amount of 7,205,409 MWHs to a revised amount of 22,760,083
9 MWHs. This revision highlights and emphasizes a point made within my rebuttal
10 testimony—namely, that because of market conditions, KCPL undertakes sales that are
11 but a mere fraction of the theoretical amount of “unused energy” that it has to sell.
12 Thus, to suggest—as employment of the “unused energy allocator” implicitly does—that
13 the level of off-system sales margins being achieved is significantly influenced by
14 “available energy” simply does not comport with the facts of the situation.
15 Accordingly, for this, and other reasons stated within my rebuttal testimony, I
16 strongly urge the rejection of this never-before-adopted allocation methodology.

17
18 This very key assumption that the majority of the calculated “unused energy” is being
19 sold is simply incorrect. Specifically, in each year, there are many hours when KCPL
20 does not make interchange sales from a number of units that are not being “used” to
21 make retail sales. Because the market price for interchange sales is below the
22 variable running cost for many of its units, no interchange sales are made from
23 KCPL’s relatively high cost units for many hours of the year even though such units

1 are clearly available to make additional interchange sales (and used within the
2 development of the "unused energy allocator"). In fact, during calendar year 2005,
3 KCPL had non-firm interchange sales of only ** [REDACTED] ** MWHs. Clearly, many
4 of the "unused" MWHs calculated to be available for sale into the wholesale market (as
5 discussed above--22,760,083) are not being sold on the non-firm interchange market.
6 KCPL's "unused energy allocator" fails to recognize that, just because a jurisdiction is
7 not "using" all the energy it is "paying for," does not mean that KCPL will have a market
8 in which to sell such "unused energy."

9
10 It cannot be overemphasized that employment of this erroneous assumption that is
11 implicit within the development of KCPL's "unused energy allocator" invalidates its
12 adoption. Jurisdictions should not be given "credit" for unused energy when clearly
13 significant amounts of so called "available" energy are not being sold because market
14 conditions do not permit.

15
16
17 **"ADDITIONAL AMORTIZATION" ANALYSIS**

18 **Q. PLEASE STATE THAT PORTION OF MR. MICHAEL CLINE'S REBUTTAL**
19 **TESTIMONY THAT YOU WILL BE ADDRESSING.**

20 **A.** At page 5 of his rebuttal testimony Mr. Cline states the following:

21 Ratepayers are disadvantaged in the short-run if a high level of cash
22 flow for financing is provided through Additional Amortizations rather
23 than the cash being sourced through traditional ratemaking. This
24 concept is illustrated in the attached Schedule MWC-3. The Schedule

1 illustrates two scenarios for financing a \$1 million capital expenditure.
2 The first solves for the mix of equity and debt required to generate the
3 necessary earnings needed to reach an FFO to Total Debt ratio of 25%
4 without Additional Amortizations. The second scenario assumes the
5 expenditure is financed with 100% debt. Since there are no marginal
6 earnings under this scenario, full reliance on Additional Amortizations
7 is required in order to maintain a 25% FFO to Total Debt ratio. The
8 resulting Additional Amortization is \$400,000, or 40% of the
9 expenditure amount. *The revenue requirement in the second scenario*
10 *is over 300% greater than that of the scenario with no Additional*
11 *Amortizations.* (Michael W. Cline Rebuttal Testimony, page 5,
12 *Emphasis included within original testimony text*)
13

14 Because I will be addressing Mr. Cline's rebuttal Schedule MWC-3, for convenience I
15 have affixed a copy of the noted document to this testimony as Surrebuttal Schedule
16 JRD-2.
17

18 **Q. WHAT WAS THE PURPOSE OF MR. CLINE'S TESTIMONY YOU HAVE**
19 **QUOTED.**

20 A. In an earlier discussion leading up to the quote above Mr. Cline asserts a conclusion
21 that an over-reliance on Additional Amortization would be inferior to achieving a
22 similar financial metric through means such as granting a higher return on equity or
23 other means of traditional rate relief. However, that discussion segued into a question
24 of 'what would be the impact on ratepayers' of granting more Additional Amortization
25 in lieu of more 'traditional' rate relief. The quote above was provided in answer to this
26 latter question. Thus, it would appear that the purpose of Mr. Cline's testimony is to

1 draw the reader to a conclusion that even in the short run it is cheaper for ratepayer if
2 more rate relief is granted in the form of "traditional" cost of service rate relief *rather*
3 *than* through reflection of "Additional Amortization."

4
5 **Q. WHAT EXCEPTION DO YOU TAKE TO MR. CLINE'S REBUTTAL**
6 **TESTIMONY?**

7 A. First, I want to disperse any mistaken notion that might be drawn from Mr. Cline's
8 rebuttal testimony and Mr. Cline's rebuttal Schedule MWC-3 (again, that has been
9 affixed to this surrebuttal testimony as Surrebuttal Schedule JRD-2) that the granting
10 of a higher return on equity or the granting of some other form of "traditional" rate
11 relief might some how be less expensive for ratepayers *even in the short run*. Second,
12 while I disagree with assumptions employed in Mr. Cline's schedules, I would agree
13 that his math works in *his* example—for a one year period. However, even by Mr.
14 Cline's admission, this is a "short run" calculation. By limiting his analysis to one year
15 Mr. Cline conceals the much higher cost to ratepayers *over the long run* if this
16 Commission were to substitute the granting of rate relief to achieve agreed-upon
17 targeted financial metrics through authorizing a higher return on equity rather than
18 granting "Additional Amortization" expense.

19
20 **Q. DOES MR. CLINE'S REBUTTAL SCHEDULE MWC-3 DEMONSTRATE**
21 **THAT THE GRANTING OF RATE RELIEF IN THE FORM OF**
22 **TRADITIONAL RATE RELIEF IS LESS EXPENSIVE TO RATEPAYERS IN**

1 **THE SHORT RUN THAN GRANTING RATE RELIEF IN THE FORM OF**
2 **“ADDITIONAL AMORTIZATION?”**

3 A. Absolutely not. Schedule MWC-3 is a mathematical exercise that calculates the
4 incremental revenue requirement cost, for one year only, of financing \$1.0 million of
5 incremental capital investment in two different ways. Under one scenario it is
6 assumed that the \$1.0 million of capital investment will be financed with 68% equity
7 and 32% debt, with equity and debt costs of 11.5% and 6.0%, respectively. Under the
8 second scenario, it is assumed that 100% of the incremental capital investment will be
9 financed with debt with an interest rate of 6.0%. Both scenarios target a Funds-From-
10 Operations to Debt ratio of 25%, which is consistent with one of the financial metric
11 targets included within the Case No. EO-2005-0329 Stipulation and Agreement.

12
13 With the 68% equity/32% debt scenario, a relatively small amount of Funds-From-
14 Operation (‘FFO’) is required to meet the incremental financing that is only 32% debt
15 financed. In fact, not-too-coincidentally under this first scenario, all of the targeted
16 FFO percentage can be met with an 11.5% return on the assumed (68%) equity
17 financing of the investment.

18
19 Under the 100%-debt-financing scenario described, with absolutely no Funds-From-
20 Operations (‘FFO’) generated from any assumed equity return requirement, and with a
21 much higher “debt” base upon which the 25% FFO/Debt ratio is calculated, this
22 hypothetical scenario calculates a needed after-tax “Additional Amortization” amount
23 of \$250,000 (\$1,000,000 debt base times the targeted FFO/Debt ratio of 25%).

1 Further, under the 100% debt-financing scenario, the after-tax amortization amount is
2 grossed up for assumed federal and state income taxes to arrive at the revenue
3 requirement impact of the "Additional Amortization" calculated. From Schedule
4 MWC-3 Mr. Cline appears to lead the reader to a conclusion that it is cheaper, at least
5 in the short run, if more "traditional" rate relief—such as in the form of authorizing a
6 higher equity return and/or assuming a higher equity ratio – is recognized when
7 developing retail rates in lieu of allowing more "Additional Amortization" expense.
8

9 **Q. DO YOU AGREE WITH SUCH A CONCLUSION?**

10 A. No. I believe Mr. Cline's example was created utilizing unrealistic assumptions with a
11 specific intention to incorrectly draw a conclusion that "Additional "Amortization" is
12 more expensive for ratepayers—at least in the short run—than the granting of additional
13 "traditional" rate relief. In actuality, I believe the only thing that Mr. Cline's example
14 points out is that it is a mathematical certainty that if a company were to undertake a
15 required financing with 100% debt, and if one were to assume that there were no
16 Funds-From-Operations being generated from existing operations in excess of the
17 targeted minimums, that the utility would be looking for some form of rate relief that
18 would provide incremental FFO to meet the targeted FFO/Debt ratio on any
19 incremental debt financing.
20

21 **Q. PLEASE DISCUSS THE ELEMENTS AND ASSUMPTIONS SURROUNDING**
22 **MR. CLINE'S EXAMPLE WITH WHICH YOU TAKE EXCEPTION.**

1 A. First, his analysis was limited to considering only the cost of capital and FFO/Debt
2 ratio required for the assumed *incremental* capital investment. It does not consider
3 the fact that the FFO resulting from depreciation expense, deferred tax expense and
4 equity return on *existing* plant investment already included in rate base could be
5 available to meet all or a portion of the 25% FFO/Debt ratio on the *incremental* debt
6 financing assumed within his two scenarios. In fact, it would only be logical to
7 assume that the *existing* capital structure—prior to the incremental financing required—
8 was already relatively equity-thick and thus generating substantial FFO before a
9 company would consider financing a significant capital investment with 100% debt
10 financing. To the extent that FFO from existing operations was more than adequate
11 to meet the minimum targeted FFO/Debt ratio for existing debt it could be possible
12 that no “Additional Amortization” would be required to meet the incremental FFO/Debt
13 ratio associated with the *incremental* debt financing assumed in Mr. Cline’s example.
14
15 Second, Mr. Cline’s simple illustration completely fails to recognize the fact that the
16 *incremental* capital investment will result in *incremental* non-cash depreciation and
17 deferred income tax expense that will yield more FFO than he has reflected within his
18 example. If Mr. Cline had reflected the FFO resulting from non-cash depreciation
19 and deferred income taxes associated with the assumed incremental investment, a
20 lower amount of Additional Amortization expense would have been required under
21 both scenarios analyzed.
22

1 Third, I am not a cost of capital expert, but I believe that most cost of capital experts
2 would agree that a capital structure financed with 68% equity—which Mr. Cline uses
3 in the scenario designed to generate the purported lower short run revenue
4 requirement – would be costly and inefficient. If a Company were to finance
5 incremental capital investment with such a high percentage of equity, I submit it
6 would probably do so only because its capital structure had become, or was
7 becoming, too debt leveraged. In sum on this point, I believe this proportionately
8 high equity financing assumption is unrealistic and has been specifically employed to
9 create an example that will support a pre-conceived conclusion. Conversely, as
10 already noted, I believe it is reasonable to assume that a utility would only undertake
11 the financing of a significant capital investment with 100% debt financing if its
12 capital structure already had a proportionately high equity ratio that was generating a
13 FFO/Debt ratio in excess of the targeted minimum that would be available to provide
14 coverage on all or a significant portion of incremental debt financing. In short, I
15 believe Mr. Cline's financing assumption have been specifically established to be able
16 to undertake the mathematical calculations that would purportedly support his desired
17 conclusion—namely, that in the short run Additional Amortization is more expensive
18 to ratepayers than granting other forms of traditional rate relief or recognizing other
19 mixes for financing incremental capital investment required

20
21 Fourth, Mr. Cline's limited example fails to reveal that rate relief in the form
22 Additional Amortization can be substituted for a higher equity return to achieve the
23 same targeted minimum FFO/Debt ratio. Specifically, I would emphasize that

1 Additional Amortization can be substituted for a higher return on equity yielding
2 exactly the same targeted FFO/Debt ratio as well as the same level of required rate
3 relief. While rates for the immediate future will be no higher when Additional
4 Amortization is substituted for a higher equity return, future rates will be reduced
5 from that otherwise calculated as the "Additional Amortization" is eventually returned
6 as a "credit" amortization to ratepayers within ensuing test year cost of service studies.
7

8 **Q. REFERRING TO THE LAST POINT MADE, PLEASE FURTHER EXPAND**
9 **UPON HOW ADDITIONAL AMORTIZATION CAN BE SUBSTITUTED FOR**
10 **A HIGHER EQUITY RETURN TO ACHIEVE THE SAME TARGETED**
11 **MINIMUM FFO/DEBT RATIO.**

12 A. This result is simply a mathematical outcome of the way the FFO/Debt ratio is
13 calculated and can be observed by example. Specifically, on attached Surrebuttal
14 Exhibit JRD-3 I first show within columns (c) and (d) the two scenarios designed by
15 Mr. Cline within his Schedule MCW-3. I note that column (b) of attached Surrebuttal
16 Schedule JRD-3 also shows the source of, or describes the calculation underlying,
17 amounts shown on a given line.
18

19 As shown within column (e), I have revised the "return on equity" assumed from the
20 Company-proposed 11.5% to the DOE-NSSA-proposed 9.0%. When the lower
21 DOE-NSSA-proposed return is reflected, the targeted FFO/Debt ratio is no longer
22 met, and accordingly, a level of Additional Amortization is calculated to achieve the
23 additional FFO to meet the targeted FFO/Debt ratio. As one can observe from a

1 review of calculations shown in column (c), the targeted FFO/Debt ratio can be met
2 through the granting of rate relief in the form of Additional Amortization versus a
3 higher return on equity with no difference in required rate relief. Thus, *in the short*
4 *run*, rate relief granted will be the same whether authorized in the form of Additional
5 Amortization or a higher equity return. However, all other things equal, rates will be
6 lowered *in the long run* if the rate relief in the short term is granted in the form
7 Additional Amortization *rather than* in the form of a higher equity return. Again, this
8 occurs inasmuch as costs deferred through the Additional Amortization would, in
9 subsequent years, be reflected as a "credit" or reduction to the otherwise-calculated test
10 year cost of service.

11
12 In the example shown in column (e) of Surrebuttal Schedule JRD-3, one can observe
13 that the revenue requirement remains the same with Additional Amortization and a
14 9.0% return on equity as it had been with the Company-proposed 11.5%. However,
15 the before-tax Additional Amortization in the amount of \$27,441 that is being
16 deferred in year one in this example would eventually be returned to ratepayers "with
17 interest" over ensuing years following the heavy construction period. The "interest" to
18 be returned to ratepayers would be in the form of a rate base offset as the deferred
19 credit balance generated with the Additional Amortization expense is reflected as a
20 reduction to rate base in future rate proceedings.

21
22 **Q. WHAT IS THE PURPOSE THE CALCULATIONS SHOWN ON COLUMNS**
23 **(F) AND (G) OF SURREBUTTAL SCHEDULE JRD-3?**

1 A. The primary purpose of calculations reflected within column (f) is to simply show
2 how, with continuing employment of the Company's assumption that there is no
3 available "excess" FFO from existing operations to meet the FFO requirement for
4 incremental debt financing, that the revenue requirement will automatically change
5 by merely moving from the Company's original 68% equity/32% debt financing split
6 to a 50% equity/50% debt financing plan. The point being, under the rigid
7 assumptions that KCPL employed in establishing its original two scenarios, the mere
8 shifting of financing assumptions drives the revenue requirement outcome of the
9 calculation. Mr. Cline attempts to draw a conclusion from calculations under his two
10 original scenarios that the revenue requirement will be lower through the granting a
11 higher equity return or other traditional cost of service increases than it would be
12 through the granting of rate relief based upon Additional Amortization. In reality,
13 what Mr. Cline's calculations demonstrate is simply that in the short run financing
14 with debt will be more expensive than financing with equity *if one assumes that the*
15 *targeted FFO/Debt ratio cannot be maintained with FFO from existing operations.*
16

17 Column (g) simply shows, once again, how the revenue requirement in this initial
18 year under analysis will not change if the rate relief granted is based on Additional
19 Amortization rather than a higher return on equity even under the 50%-equity/50%-
20 debt financing assumption that is reflected within Column (f).
21

22 Q. YOUR DISCUSSION THUS FAR HAS ADDRESSED THE SHORT RUN, OR
23 FIRST YEAR IMPACT, OF VARIOUS FINANCING PROPOSALS AND/OR

1 **BASES FOR GRANTING RATE RELIEF. SHOULD THE LONG TERM**
2 **IMPACT OF VARIOUS FINANCING ALTERNATIVES ALSO BE**
3 **CONSIDERED IN ANY ANALYSIS OF ALTERNATIVES BEING**
4 **CONSIDERED?**

5 A. Yes. As I have noted, Mr. Cline's analysis and discussion was limited to a one year
6 period. For reasons previously stated, I believe his analysis is flawed—at least from
7 the perspective of attempting to defend the conclusion he wishes to draw from such
8 calculations. However, forgetting those disagreements for the moment, I would
9 simply emphasize that any analysis that addresses the revenue requirement impact of
10 granting rate relief on the basis of a traditional cost of service versus Additional
11 Amortization, or financing with debt versus equity, should always consider the
12 expected impact over a period of more than one year.

13
14 As already noted, rate relief in the form of Additional Amortization expense will
15 result in future savings to ratepayers as the deferred credit is eventually considered
16 within future test year cost of service calculations. Second, undue reliance on equity
17 financing is expensive to ratepayers. Specifically, not only is the return on common
18 equity typically the highest cost of alternative sources of capital, common equity
19 returns are required to be "grossed up" for additional federal and state income. For
20 example, after converting for required income tax payments, the before-tax cost—or
21 revenue requirement impact—of a 9.0% return on equity is 14.4% (9.0% times the
22 gross tax conversion factor of 1.602564 equals 14.4%). The true cost—or before-tax
23 cost of equity—is more than double the interest cost of 6.0% reflected within Mr.

1 Cline's Schedule MWC-3. Thus, the high cost of equity-rich financing *over the life*
2 *of the capital investment* should be carefully evaluated when financing alternatives
3 are explored.

4

5 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

6 A. Yes, it does.

In the Matter of the Application of Kansas City)
Power & Light Company to Modify Its Tariff to) Case No. ER-2006-0314
Begin the Implementation of Its Regulatory Plan)

STATE OF MISSOURI)
) SS.
COUNTY OF JACKSON)

‘My name is JAMES R. DITTMER. I am of legal age and a resident of the State of Missouri. I certify that the foregoing testimony and exhibits, offered by me on behalf of the Department of Energy–National Nuclear Security Administration, are true and correct to the best of my knowledge and belief.’

James R. Dittmer

KARA DANIELLE INCE
Notary Public - Notary Seal
State of Missouri, Cass County
Commission # 06905947
My Commission Expires Jun 26, 2010

Karl Danell Inc.

My Commission Expires: 6-26-2010

**Reconciliation of KCPL and DOE's Recommendations
Regarding Interchange Sales Margins
Reflects Impact of Allocation Issue at KCPL's and DOE's
Recommended Total Company Margin Level
Case No. ER-2006-0314**

Line No.	Description (a)	Reference (b)	Total Company (c)	Missouri (d)	Kansas (e)	Wholesale (f)
<u>Development of Allocators:</u>						
1	Production - kW		2,652.1	1,427.4	1,201.5	23.2
2	Production - %		100.00%	53.82%	45.30%	0.88%
3	Peak Capacity Allocated on Demand Basis		4,389.0	2,362.2	1,988.3	38.5
4	Annual Hours		8,760	8,760	8,760	8,760
7	Total Energy - mWh	Ln 1 x Ln 5	38,447,640	20,692,771	17,417,938	336,930
9	Energy With Losses - mWh		15,687,557	8,960,193	6,583,077	144,287
10	Energy With Losses - %		100.00%	57.12%	41.96%	0.92%
12	Unused Energy - mWh	Ln 7 - Ln 9	22,760,083	11,732,578	10,834,861	192,643
13	Unused Energy - \$		100.00%	51.55%	47.60%	0.85%
14						
15						
16						
17	Value of Allocation Issue Utilizing KCPL's Proposed					
18	Level of Total Company Off-System Sales Margins					
19		Line 13 X Line				
20	Energy - Profit on Sales (KCPL's Unused Energy)	20, Col. C **				**
21						
22		Line 10 X Line				
23	Energy - Profit on Sales (Energy With Losses)	23, Col. C **				**
24						
25	Difference - Value of Allocation Issue Utilizing					
26	KCPL's Proposed Total Company Off-System					
27	Sales Normalized Margin Level	Ln 23 - Ln 20 **				**
28						
29	Value of Allocation Issue Utilizing DOE's Proposed					
30	Level of Total Company Off-System Sales Margins					
31		Line 13 X Line				
32	Energy - Profit on Sales (KCPL's Unused Energy)	32, Col. C **				**
33						
34		Line 10 X Line				
35	Energy - Profit on Sales (Energy With Losses)	35, Col. C **				**
36						
37	Difference - Value of Allocation Issue Utilizing					
38	DOE's Proposed Total Company Off-System					
39	Sales Normalized Margin Level	Ln 35 - Ln 32 **				**
40						
41	Total Impact on Missouri Rev Requirement					
42	of DOE-NSSA Margin Adjustment	Ln 20- Ln 35		<u>\$(21,125,097)</u>		

Schedule MWC-3
Impact of Financing on Revenue Requirements

	<u>Equity Financing</u>	<u>Debt Financing</u>
Capital Investment	1,000,000	1,000,000
Equity Financing	684,932	
Debt Financing	315,068	1,000,000
Total Financing	<u>1,000,000</u>	<u>1,000,000</u>
Return on Equity	11.50%	11.50%
Earnings	78,767	-
Amortization		400,641
Deferred Taxes	-	(150,641)
Funds from Operations	<u>78,767</u>	<u>250,000</u>
FFO / Debt Ratio	25%	25%
Interest Rate	6%	6%
Interest Expense	18,904	60,000
Tax Rate	37.60%	37.60%
Total Income Taxes	47,462	-
Deferred Taxes	-	(150,641)
Current Taxes	47,462	150,641
Revenue Requirement	145,133	460,641
<u>Proof</u>		
Revenue	145,133	460,641
Amortization	-	400,641
Interest Expense	<u>18,904</u>	<u>60,000</u>
Pre-tax Income	126,229	-
Income Taxes	<u>47,462</u>	<u>-</u>
Earnings	<u><u>78,767</u></u>	<u><u>-</u></u>

This schedule was originally affixed to Mr. Michael Cline's rebuttal testimony filed on September 8, 2006 and has been reproduced here only for convenience when reviewing the Surrebuttal Testimony of James Dittmer

**Analysis of Alternatives Regarding Authorized Returns, Capital Mix for Incremental Financings,
& "Equity Returns" Versus Recognition of Additional "Amortization Expense"**

Line No.	Description	Reference	Duplication of Company's Example		Company Suggested Financing Split but Assuming a 9.00% ROE	50/50 Debt/Equity Financing	Assumed 9.00% ROE & 50/50 Debt/Equity Financing
			Equity Financing	Debt Financing	(e)	(f)	(g)
1	Capital Investment Required	Assumed	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
2	Equity Financing	Assumed	684,932		684,932	500,000	500,000
3	Debt Financing	L. 1 - L. 2	315,068	1,000,000	315,068	500,000	500,000
4	Total Financing	Line 1	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
5	FFO/ Debt Ratio Required	Per S&A	25%	25%	25%	25%	25%
6	Required Funds From Operation	Line 3 * Line 5	78,767	250,000	78,767	125,000	125,000
7	Authorized Return on Equity	Assumed	11.50%	11.50%	9.00%	11.50%	9.00%
8	Equity Earnings on Assumed Equity Financing	Line 2 * Line 7	78,767	-	61,644	57,500	45,000
9	Additional FFO Required After						
10	Considering After Tax Equity Returns						
11	- In the Form of After-tax Amortization	Line 6 - Line 8	(0)	250,000	17,123	67,500	80,000
12	Tax Gross Up Factor	1/(1-Tax Rate)	1.602564	1.602564	1.602564	1.602564	1.602564
13	Before-Tax Amortization	Line 11 * Line 12	(0)	400,641	27,441	108,173	128,205
14	Assumed Interest Rate	Assumed	6.0%	6.0%	6.0%	6.0%	6.0%
15	Interest Expense	Line 3 * Line 14	18,904	60,000	18,904	30,000	30,000
16	Tax Rate	Given	37.60%	37.60%	37.60%	37.60%	37.60%
17	Income Taxes on Equity Return	(L. 12 - 1) * L. 8	47,462	-	37,144	34,647	27,115
18	Deferred Taxes	L. 11 - L. 13	0	(150,641)	(10,318)	(40,673)	(48,205)
19	Total Current Taxes	Line 17 - Line 18	47,462	150,641	47,462	75,321	75,321
20	Revenue Requirement	Lines 8+13+15+17	145,133	460,641	145,133	230,321	230,321
21	Proof:						
22	Revenue Requirement:	Line 20	145,133	460,641	145,133	230,321	230,321
23	Amortization	Line 13	(0)	400,641	27,441	108,173	128,205
24	Interest Expense	Line 14	18,904	60,000	18,904	30,000	30,000
25	Pre-tax Income	Sum Lines 22 - 24	126,229	-	98,788	92,147	72,115
26	Income Taxes	Line 24 * Line 16	47,462	-	37,144	34,647	27,115
27	Earnings	Line 25 - Line 26	78,767	-	61,644	57,500	45,000