

DOE/NNSA Exhibit No. 802

FILED  
Oct. 15, 2007  
Data Center  
Missouri Public  
Service Commission

Exhibit No.:  
Issues: Incentive  
Compensation  
Hawthorn No. 5  
Litigation  
Recoveries  
R&D Tax Credits  
Witness: James R. Dittmer  
Type of Exhibit: Direct Testimony  
Sponsoring party: DOE-NSSA  
Case No.: ER-2007-0291  
Direct Testimony Date: July 24, 2007

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0291

# PUBLIC VERSION

DIRECT TESTIMONY

OF

JAMES R. DITTMER

ON BEHALF OF

THE DEPARTMENT OF ENERGY – NATIONAL  
NUCLEAR SECURITY ADMINISTRATION

Kansas City, Missouri  
July 2007

\*\*\* [REDACTED] \*\*\* Designates that "Highly Confidential" or "Proprietary",  
information has been removed pursuant to the Standard Protective Order

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Case No(s) ER-2007-0291  
Date 10/1/07 Rptr MV

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**DIRECT TESTIMONY  
OF  
JAMES R. DITTMER  
KANSAS CITY POWER AND LIGHT COMPANY  
CASE NO. ER-2007-0291**

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

8 A. My name is James R. Dittmer. My business address is 740 Northwest Blue  
9 Parkway, 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  
13 consulting firm engaged primarily in utility rate work. The firm's engagements  
14 include review of utility rate applications on behalf of various federal, state and  
15 municipal governmental agencies as well as industrial groups. In addition to  
16 utility intervention work, the firm has been engaged to perform special studies  
17 for use in utility contract negotiations.

18  
19 **Q. ON WHOSE BEHALF ARE YOU APPEARING?**

20 A. Keres Consulting, Inc. holds a contract with the United States Department of  
21 Energy ("DOE") to provide a number of services, including assistance with  
22 utility procurement, contracts and rates administration, as well as intervention in  
23 utility rate proceedings that significantly impact large DOE facilities. Utilitech,  
24 Inc. is a subcontractor to Keres Consulting, Inc. Keres Consulting/Utilitech,  
25 Inc. have been retained by the United States Department of Energy to review

1 Kansas City Power and Light Company's ("KCPL" or "Company") application  
2 to the Missouri Public Service Commission ("MPSC" or "Commission") to  
3 increase Missouri electric retail rates. Thus, the testimony I am presenting is  
4 offered on behalf of the United States Department of Energy that is representing  
5 the interest of the National Nuclear Security Administration ("DOE-NNSA")  
6 and other affected Federal Executive Agencies.

7  
8 **Q. WILL DOE-NNSA BE ADDRESSING A BROAD NUMBER OF ISSUE**  
9 **AREAS?**

10 A. No. I will be addressing only a limited number of revenue requirement issues in  
11 direct testimony.

12  
13 **Q. PLEASE BRIEFLY STATE THE ISSUES OR TOPICS YOU WILL BE**  
14 **ADDRESSING WITHIN YOUR DIRECT TESTIMONY?**

15 A. First, consistent with the MPSC's order from KCPL's 2006 rate case, I am  
16 proposing that all incentive compensation linked to achieving earnings per share  
17 or total shareholder return, be eliminated from the adjusted test year cost of  
18 service. Second, I am proposing that certain litigation recoveries received by  
19 KCPL during the historic test year related to an explosion at Hawthorn Unit No.  
20 5 in 1999, be amortized over a period of five years. Third, I am proposing that  
21 Research and Development Federal Tax Credits anticipated to be received by  
22 KCPL related to amended federal income tax returns filed for tax years 2000  
23 through 2005 be amortized over a five year period. Finally, I am proposing that

1 the outside services expense incurred in undertaking the analysis, and assisting  
2 in the filing of amended returns necessary to claim the Research and  
3 Development tax Credits, also be amortized over five years.

4  
5 **I. QUALIFICATIONS**

6 **Q. BEFORE DISCUSSING IN GREATER DETAIL THE ISSUES YOU**  
7 **BRIEFLY DESCRIBED ABOVE, PLEASE STATE YOUR**  
8 **EDUCATIONAL BACKGROUND?**

9 A. I graduated from the University of Missouri - Columbia, with a Bachelor of  
10 Science Degree in Business Administration, with an Accounting Major, in 1975.  
11 I hold a Certified Public Accountant Certificate in the State of Missouri. I am a  
12 member of the American Institute of Certified Public Accountants.

13  
14 **Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

15 A. Subsequent to graduation from the University of Missouri, I accepted a position  
16 as auditor for the Missouri Public Service Commission. In 1978, I was  
17 promoted to Accounting Manager of the Kansas City Office of the Commission  
18 Staff. In that position, I was responsible for all utility audits performed in the  
19 western third of the State of Missouri. During my service with the Missouri  
20 Public Service Commission, I was involved in the audits of numerous electric,  
21 gas, water and sewer utility companies. Additionally, I was involved in  
22 numerous fuel adjustment clause audits, and played an active part in the  
23 formulation and implementation of accounting staff policies with regard to rate

1 case audits and accounting issue presentations in Missouri. In 1979, I left the  
2 Missouri Public Service Commission to start my own consulting business.  
3 From 1979 through 1985 I practiced as an independent regulatory utility  
4 consultant. In 1985, Dittmer, Brosch and Associates was organized. Dittmer,  
5 Brosch and Associates, Inc. changed its name to Utilitech, Inc in 1992.

6  
7 My professional experience since leaving the Missouri Public Service  
8 Commission has consisted primarily of issues associated with utility rate,  
9 contract and acquisition matters. For the past twenty-eight years, I have  
10 appeared on behalf of clients in utility rate proceedings before various federal  
11 and state regulatory agencies. In representing those clients, I performed revenue  
12 requirement studies for electric, gas, water and sewer utilities and testified as an  
13 expert witness on a variety of rate matters. As a consultant, I have filed  
14 testimony on behalf of industrial consumers, consumer groups, the Missouri  
15 Office of the Public Counsel, the Missouri Public Service Commission Staff, the  
16 Indiana Utility Consumer Counselor, the Mississippi Public Service  
17 Commission Staff, the Arizona Corporation Commission Staff, the Arizona  
18 Residential Utility Consumer Office, the Nevada Office of the Consumer  
19 Advocate, the Washington Attorney General's Office, the Hawaii Consumer  
20 Advocate's Staff, the Oklahoma Attorney General's Office, the Oregon Citizens  
21 Utilities Board, the West Virginia Public Service Commission Consumer  
22 Advocate's Staff, municipalities and the Federal government before regulatory  
23 agencies in the states of Alaska, Arizona, Colorado, Florida, Hawaii, Indiana

1 Kansas, Maine, Michigan, Mississippi, Missouri, Nevada, New Mexico, New  
2 York, Ohio, Oklahoma, Oregon, Texas, Washington and West Virginia, as well  
3 as the Federal Energy Regulatory Commission.  
4

5 **II. INCENTIVE COMPENSATION**

6 **Q. PLEASE BRIEFLY DESCRIBE GPE'S AND KCPL'S INCENTIVE**  
7 **COMPENSATION PROGRAM.**

8 A. First, GPE and KCPL have a Long-Term Compensation Plan for officers and  
9 other key employees of GPE and KCPL. Compensation under the Long-Term  
10 Compensation Plan is equity-based, consisting of performance share grants and  
11 time-based restricted shares. Compensation paid under the Long-Term  
12 Compensation Plan is linked exclusively to GPE's achievement of total  
13 shareholder return ("TSR") relative to other peer companies.  
14

15 GPE and KCPL also have cash-based incentive compensation plans that are  
16 dependant upon achievement of annual – or shorter term – goals. Specifically,  
17 there is an Annual Incentive Plan for senior management that, for GPE  
18 executives for 2006, was dependant upon achievement of short term goals that  
19 were weighted as follows:

- 20 • 50% - achievement of an earnings per share goal  
21 • 30% - achievement of Key Business Objectives consisting of the  
22 following subcomponents:

23 **\*\*** [REDACTED]  
24 [REDACTED]

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[REDACTED]

- 20% - Individual performance

The 2006 goals for the KCPL executive short term incentive compensation was very similar to GPE, consisting of the following:

- 50% - achievement of an earnings per share goal
- 30% - achievement of Key Business Objectives consisting of the following subcomponents:

[REDACTED]

- 20% - Individual performance

GPE and KCPL also have a short term cash-based incentive compensation plan for non-union management employees that is referred to as "ValueLink." Compensation awarded under this plan is based 40% upon achievement of GPE or KCPL Key Business Objectives (delineated immediately above), 40% upon

1 specific goals for various divisions, and 20% based upon individual employee  
2 evaluations.

3  
4 Finally, KCPL also has a short term, cash-based incentive compensation plan  
5 for its union employee, referred to as the "Rewards Plan." Payments under this  
6 plan are based 50% upon achievement of KCPL Key Business Objectives  
7 (again, delineated above) and 50% based upon achievement of divisional goals.

8  
9 **Q. DO YOU BELIEVE THAT ALL OF THE COST OF THE NOTED**  
10 **INCENTIVE COMPENSATION PROGRAMS SHOULD BE INCLUDED**  
11 **WITHIN THE DEVELOPMENT OF KCPL'S COST OF SERVICE**  
12 **BASED RATES?**

13 A. No. Incentive compensation tied primarily, if not exclusively, to  
14 achievement of earnings or returns to shareholders should not be included  
15 within the development of the cost of service underlying retail rates.  
16 Comparative earnings or returns to shareholders are not a criteria or element  
17 directly considered as a cost component in establishing electric utility rates. In  
18 and of itself, efforts to enhance earnings or returns may not be consistent with  
19 the interests of utility customers or reasonable pricing for the regulated  
20 business, where changes in the level of rate base assets and the cost of capital  
21 are more directly relevant to earnings achievable by the utility.

22



1           Therefore, as a matter of regulatory policy, I believe it is unwise to encourage  
2           incentive compensation programs that are entirely or even primarily driven by  
3           earnings achievements or total return to shareholders vis-à-vis allowing  
4           recovery of such plan costs through regulated utility rates. "Superior," "above  
5           authorized," "exceeding peers," or "above targeted" earnings can sometimes be  
6           achieved or influenced by short term management decisions that, while  
7           temporarily boosting earnings, may not encourage the development of safe and  
8           reliable service at the lowest long term achievable costs.

9  
10           For instance, some maintenance may be deferred temporarily – thereby boosting  
11           earnings. But deferral of maintenance can lead to safety concerns or higher  
12           subsequent "catch-up" costs. Additionally, incentive compensation based on  
13           achievement of earnings can lead to exaggerated or aggressive rate filings  
14           which, under a best case scenario leads to extra audit and litigation work, and  
15           under a worst case scenario leads simply to unnecessarily high utility rates. In  
16           short and in sum on this point, rate recovery of incentive compensation that is  
17           based entirely upon earnings or stock performance is simply bad regulatory  
18           policy.

19  
20           **Q.    IS YOUR POSITION AND REASONING CONSISTENT WITH THE**  
21           **CONCLUSION OF THIS COMMISSION'S LAST RATE ORDER FOR**  
22           **KCPL?**

1 A. Yes, I believe so. Specifically, in this Commission's rate order from KCPL  
2 Case No. ER-2006-0314 the Commission stated and found the following  
3 regarding the issue of incentive compensation:

4 Incentive Compensation

5 *What amount, if any, of incentive compensation should be*  
6 *included in rates?*

7 KCPL requests that all of its incentive compensation be  
8 included in cost of service. Staff objects, stating that roughly  
9 35% of the cost should be disallowed on the grounds that it is  
10 either tied to earnings per share (EPS), and thus has negligible, if  
11 any, benefit to ratepayers, or is awarded for vague reasons.

12 The Commission finds that the competent and substantial  
13 evidence supports Staff's position, and finds this issue in favor of  
14 Staff. As far as compensation tied to EPS, the Commission notes  
15 that KCPL management has the right to set such goals.  
16 However, because maximizing EPS could compromise service to  
17 ratepayers, such as by reducing customer service or tree-  
18 trimming costs, the ratepayers should not have to bear that  
19 expense. What is more, because KCPL is owned by Great  
20 Plains Energy, Inc., and because GPE has an unregulated asset,  
21 Strategic Energy L.L.C., it follows that KCPL could achieve a  
22 high EPS by ignoring its Missouri ratepayers in favor of devoting  
23 its resources to Strategic Energy.

24 KCPL's attempt to state that Staff has no evidence to  
25 support its theory that maximizing EPS might not benefit KCPL  
26 shareholders misses the point; KCPL has the burden to prove that  
27 the Commission should approve the tariffs. Further, KCPL's  
28 argument that disallowing any of its incentive compensation  
29 costs would put it at a competitive disadvantage fails. KCPL  
30 management is free to offer whatever compensation packages it

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wants. Nevertheless, if the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then these costs should be borne by shareholders, and not included in cost of service. (KCPL Rate Order, Case No. ER-2006-0291)

**Q. WHAT ARE YOUR SPECIFIC RECOMMENDED ADJUSTMENTS REGARDING INCENTIVE COMPENSATION IN THE INSTANT CASE?**

A. First, as previously described, awards under GPE's Long Term Incentive Plan are dependant upon GPE's total shareholder return in relationship to an industry peer group. Since this element of incentive compensation is tied exclusively to achievement of returns to shareholders, I am recommending that all of the cost of Long Term Incentive Compensation be eliminated from KCPL's Missouri jurisdictional cost of service.

Second, I am recommending that the portion of GPE's and KCPL's officers' and executives' Annual Incentive Plan compensation that is weighted for achievement of Earnings per Share goal also be disallowed. Additionally, I am recommending that the portion of officers' and executives Annual Incentive Plan compensation that is purely "discretionary" also be eliminated from cost of service development.

**Q. YOU HAVE PREVIOUSLY DISCUSSED WHY YOU DO BELIEVE THAT INCENTIVE COMPENSATION TIED TO EARNINGS OR**

1           **RETURNS FOR INVESTORS SHOULD NOT BE INCLUDED IN THE**  
2           **DEVELOPMENT OF COST OF SERVICE. WHY ARE YOU ALSO**  
3           **RECOMMENDING THAT INCENTIVE COMPENSATION THAT IS**  
4           **“DISCRETIONARY” BE DISALLOWED?**

5           A.    By definition, compensation that is “discretionary” is not tied to achievement of  
6           specific goals or targets. As such, it is impossible to draw a correlation between  
7           this “cost” and ratepayer benefits. Accordingly, this component of incentive  
8           compensation should also be disallowed.

9  
10          **Q.    HAVE YOU PREPARED A SCHEDULE SHOWING THE**  
11          **DEVELOPMENT OF THE SPECIFIC INCENTIVE COMPENSATION**  
12          **ADJUSTMENTS THAT YOU ARE PROPOSING?**

13          A.    Yes, I have affixed as Schedule JRD-1 the calculations eliminating the various  
14          components of incentive compensation that I have discussed. As shown on the  
15          top of Schedule JRD-1, removal of all Long Term Incentive Plan costs consists  
16          of merely eliminating 2006 test year actual recorded Long Term Incentive Plan  
17          costs charged to expense.

18  
19          Removal of just certain elements of the executive and officers’ Annual  
20          Incentive Compensation Plan costs is undertaken in two steps. After identifying  
21          the various subcomponents that contribute to the total amount of Short Term  
22          Incentive Compensation it was necessary to develop factors that appropriately

1 allocate those elements of the Short Term Incentive Compensation that were  
2 driven by achievement of earnings.

3  
4 I would note that the incentive compensation adjustment reflected on Schedule  
5 JRD-1 is an *incremental* adjustment that should be posted to KCPL's "as  
6 adjusted" updated cost of service study. More specifically, KCPL posted an  
7 adjustment to reflect the true-up of 2006 incentive compensation costs that  
8 occurred in March 2007. I am not taking issue with this KCPL adjustment. My  
9 adjustment, therefore, should be posted to the "as adjusted" or "as annualized"  
10 level of incentive compensation that KCPL is proposing within its updated cost  
11 of service.

12

13 **Q. ARE YOUR RECOMMENDATIONS IN THIS CASE CONSISTENT**  
14 **WITH THIS COMMISSION'S FINDINGS IN KCPL'S 2006 RATE**  
15 **CASE?**

16 A. With regard to the Annual Incentive Compensation Plan, I note that the goals  
17 and weightings of goals changed from the plan that was in effective for calendar  
18 year 2005 (i.e., the prior case test period). Thus, while the disallowance  
19 percentages have changed from the prior case due to the changes in the plan  
20 goals between the two test years, I believe I have calculated an Annual  
21 Incentive Compensation Plan adjustment that is consistent conceptually with  
22 what this Commission ordered in KCPL's prior Missouri retail rate case.

23

1 Regarding the Long Term Incentive Plan, I note that this issue was raised by  
2 Staff in the prior case. However, it is my understanding that this issue was  
3 settled along with a number of other issues, such that this Commission was not  
4 required to make a determination as to cost of service inclusion for the cost of  
5 GPE's and KCPL's Long Term Incentive Plan. That stated, I believe the  
6 arguments supporting disallowance, and this Commission's reasoning for  
7 disallowing, elements of GPE's and KCP's Annual Incentive Plan are consistent  
8 and equally applicable for disallowing all of the cost of GPE's and KCPL's  
9 Long Term Incentive Plan.

10  
11 **III. RECOVERIES FROM HAWTHORN NO. 5 EXPLOSION**  
12 **LITIGATION**

13  
14 **Q. PLEASE DISCUSS YOUR NEXT ADJUSTMENT REGARDING**  
15 **RECOVERIES FROM LITIGATION SURROUNDING AN EXPLOSION**  
16 **AT KCPL'S HAWTHORN UNIT NO. 5.**

17 A. The Commission will no doubt recall that KCPL's Hawthorn Unit No. 5  
18 experienced a significant explosion in 1999 that caused that unit to go out of  
19 commercial operation from February 1999 through June 2001. This event has  
20 been the subject of a great deal of litigation that is summarized as follows  
21 within GPE's 2006 Annual Report to Shareholders:

22 **Hawthorn NO. 5 Subrogation Litigation**

23 KCP&L filed suite in 2001, in Jackson County, Missouri Circuit  
24 Court against multiple defendants who are alleged to have  
25 responsibility for the 1999 Hawthorn No. 5 boiler explosion.  
26 KCP&L and National Union Fire Insurance Company of

1 Pittsburgh, Pennsylvania (National Union) have entered into a  
2 subrogation allocation agreement under which recoveries in this  
3 suit are generally allocated 55% to National Union and 45% to  
4 KCP&L. Prior to 2006, certain defendants were dismissed from  
5 the suit and various defendants settled, with KCP&L receiving a  
6 total of \$38.2 million, of which \$18.5 million was recorded as a  
7 recovery of capital expenditures. Trial of this case with the one  
8 remaining defendant resulted in a March 2004 jury verdict  
9 finding KCP&L's damages as a result of the explosion were  
10 \$452 million. In May 2004, the trial judge reduced the award  
11 against the defendant to \$0.2 million. Both KCP&L and the  
12 defendant appealed this case to the Court of Appeals for the  
13 Western District of Missouri, and in May 2006, the Court of  
14 Appeals ordered the Circuit Court to enter judgment in KCP&L's  
15 favor in accordance with the jury verdict. The defendant filed a  
16 motion for transfer of this case to the Missouri Supreme Court,  
17 which was denied. After deduction of amounts received from  
18 pre-trial settlements with other defendants and an amount for  
19 KCP&L's comparative fault (as determined by the jury), KCP&L  
20 received proceeds of \$38.9 million in 2006 pursuant to the  
21 subrogation allocation agreement after payment of attorney's  
22 fees. The proceeds reduced purchased power expense by \$10.8  
23 million and fuel expense by \$3.7 million. The proceeds also  
24 increased wholesale revenues by \$2.5 million and included \$6.1  
25 million of interest that increased non-operating income. The  
26 remaining \$15.8 million of proceeds were recorded as a recovery  
27 of capital expenditures.

28 I am proposing that the proceeds received by KCPL in the 2006 historic test  
29 year, described in the 2006 Shareholder's Report, that were effectively recorded  
30 as "negative" expense be amortized over a five year period.

1 Q. WHY IS IT APPROPRIATE THAT RECOVERIES RESULTING FROM  
2 LITIGATION SURROUNDING THE 1999 HAWTHORN NO. 5  
3 EXPLOSION BE AMORTIZED AS A CREDIT TO THE COST OF  
4 SERVICE AT THIS POINT IN TIME?

5 A. This Commission has often allowed Companies – including KCPL – to amortize  
6 “extra-ordinary”, “non-recurring” or “infrequently occurring” *costs* over a  
7 multi-year period so that shareholders are not required to bear the entire cost of  
8 such events. The “negative” expense or “income” recorded as a result of  
9 receiving recoveries from the Hawthorn litigation can also be characterized as  
10 “extra-ordinary”, “non-recurring” or “infrequently occurring”. Consistent with  
11 this Commission’s past precedent of amortizing significant or extraordinary  
12 “costs” over a multi-year period, I am recommending that this significant and  
13 extraordinary *negative expense* or *income* similarly be amortized over a multi-  
14 year period.

15

16 Q. HAVE YOU PREPARED A SCHEDULE THAT REFLECTS THE TEST  
17 YEAR ADJUSTMENT THAT YOU ARE PROPOSING WITH REGARD  
18 TO AMORTIZING HAWTHORN NO. 5 LITIGATION RECOVERIES?

19 A. Yes. On attached Schedule JRD-2 I show the *incremental* adjustment to the  
20 Company’s proposed adjusted test year cost of service to reflect the five-year  
21 amortization of the Hawthorn litigation recoveries. I emphasize that the  
22 calculations reflect the *incremental* adjustment to the Company’s *adjusted* cost  
23 of service. It should be remembered that when calculating its proforma fuel and



1 purchased power expense adjustment that the Company effectively eliminated  
2 all Hawthorn litigation recoveries that had been recorded during the test year as  
3 negative expense. Accordingly, the adjustment reflected on attached Schedule  
4 JRD-2 adds back one-fifth of the test year recoveries from Hawthorn litigation  
5 that, before elimination by KCPL through its normalization adjustments, had  
6 been recorded as negative expense within the historic test year.

7  
8 **IV. AMORTIZATION OF RESEARCH AND DEVELOPMENT**  
9 **TAX CREDITS**

10  
11 **Q. PLEASE DISCUSS YOUR NEXT ADJUSTMENT TO TEST YEAR**  
12 **OPERATING EXPENSE.**

13 A. I am proposing that tax credits anticipated to be received by KCPL related to  
14 filing amended federal income tax returns for calendar years 2000 through 2005  
15 be deferred and amortized as a credit to the cost of service over a five-year  
16 period.

17  
18 **Q. WHAT IS THE NATURE OR ORIGIN OF TAX CREDITS**  
19 **ANTICIPATED TO BE RECEIVED BY KCPL THROUGH THE FILING**  
20 **OF AMENDED FEDERAL INCOME TAX RETURNS?**

21 A. The tax credits appear to arise from increasing research activities. In 2006  
22 KCPL retained the accounting firm of Ernst & Young to assist the Company in  
23 determining what research and development ("R&D") tax credits could be  
24 claimed for tax years 2000 through 2005 pursuant to Internal Revenue Code  
25 Section 41. Additionally, Ernst & Young was retained to assist KCPL in

1           establishing criteria for claiming research and development credits  
2           prospectively.

3  
4           **Q.   WHY WERE THESE CREDITS NOT TAKEN WHEN THE ORIGINAL**  
5           **TAX RETURNS WERE FILED FOR YEARS 2000 THROUGH 2005?**

6           A.   I do not know, though additional discovery on this topic has recently been  
7           submitted. By way of background, I first became aware of the Company's  
8           intentions to file amended federal tax returns when discovery was submitted  
9           regarding test year expenditures for Ernst & Young outside services (DOE-  
10          NSSA Data Request No. 53). The studies that accompanied the Company's  
11          response to DOE-NSSA Data Request No. 53 have been marked by KCPL as  
12          "Confidential." However, I have affixed as Schedule JRD-3 the non-  
13          confidential narrative response to DOE-NSSA Data Request No. 53 that briefly  
14          describes the work undertaken, and the nature of the Research and Development  
15          Tax Credits analyzed by, Ernst & Young.

16  
17          **Q.   WHY ARE YOU RECOMMENDING THAT THE RESEARCH AND**  
18          **DEVELOPMENT TAX CREDITS RESULTING FROM FILING**  
19          **AMENDED RETURNS FOR TAX YEARS 2000 THROUGH 2005 BE**  
20          **AMORTIZED AS A CREDIT TO KCPL'S RETAIL COST OF SERVICE**  
21          **OVER A FIVE-YEAR PERIOD?**

1       A.     These tax credits have never before been reflected within KCPL's cost of  
2             service. As such, ratepayers have never received credit for these newly-claimed  
3             tax credits which KCPL is receiving.

4  
5             Further, KCPL has proposed to include the full cost of the Ernst & Young  
6             services undertaken so that KCPL may avail itself of the noted tax credits within  
7             the development of its retail cost of service. It would be unfair to charge  
8             ratepayers for the "cost" of obtaining these tax credits without concurrently  
9             reflecting the attendant benefits derived from the Ernst & Young efforts within  
10            the retail cost of service being established within this proceeding. I note that I  
11            am separately proposing to amortize the cost of the Ernst & Young efforts over a  
12            five-year period consistent with my recommendation regarding the amortization  
13            of the R&D tax credits.

14  
15            I also note that amortization of significant, non-recurring or infrequently-  
16            recurring events, has been authorized by this Commission for KCPL as well as  
17            other Missouri utilities. For instance, in 2002 KCPL was authorized to amortize  
18            over five years the cost of cleaning up a significant ice storm that occurred in  
19            January 2002. The treatment that I am proposing for these tax credits is  
20            consistent with this Commission's amortization treatment of extraordinary  
21            costs.

22

1 Finally, I note that KCPL's earnings during the years 2000 through 2005 were  
2 adequate, if not robust, in relation to returns being authorized by this as well as  
3 other state regulatory commissions during the noted years. Thus, I do not  
4 believe that KCPL can credibly argue that its shareholders are entitled to these  
5 credits relating to prior years when it was already earning adequate if not  
6 excessive rates of return during the relevant period.

7  
8 For all the reasons noted, I believe it is appropriate to amortize the Research and  
9 Development Tax Credits expected to be received for years 2000 through 2005  
10 over five years.

11  
12 **Q. HAVE YOU CALCULATED THE AMOUNT OF TAX CREDIT**  
13 **AMORTIZATION THAT SHOULD BE REFLECTED WITHIN THE**  
14 **RETAIL JURISDICTIONAL COST OF SERVICE IN THE INSTANT**  
15 **CASE?**

16 **A.** No. As previously noted, I have only recently become aware of the Company's  
17 filing of amended federal tax returns. Follow up discovery has been submitted  
18 on the topic which should provide for a precise quantification of the appropriate  
19 amount to credited to the cost of service. However, based upon the confidential  
20 attachments included within the Company's response to DOE-NSSA Data  
21 Request No. 53, I estimate the credit to be amortized as a reduction to the test  
22 year Missouri jurisdictional cost of service will be approximately  
23 \$\*\* [REDACTED] \*\*. I am ultimately recommending that the total R&D tax credit for

1 years 2000 through 2005 be quantified within the true-up phase of this  
2 proceeding.

3  
4 **Q. HAS THE COMPANY REFLECTED AN ONGOING AMOUNT OF**  
5 **RESEARCH AND DEVELOPMENT TAX CREDITS TO BE INCLUDED**  
6 **WITHIN THE DEVELOPMENT OF THE COST OF SERVICE IN THIS**  
7 **CASE FOR CALENDAR YEARS 2006 AND BEYOND?**

8 A. The Company did not reflect any Research and Development Tax Credit within  
9 the retail cost of service that it originally filed on February 1, 2007. However,  
10 within the Company's "update" prepared in recent weeks I observe a line item  
11 within the cost of service income tax calculation entitled "WIND PROD/R&D  
12 TAX CREDIT" that replaces a similar line within the Company's original cost  
13 of service income tax calculation that was only labeled as "WIND  
14 PRODUCTION TAX CREDIT." Further, the amount included in the "update"  
15 filing as a credit to the cost of service income tax calculation has been  
16 increased. Thus, it would *appear* that the Company is now advocating  
17 reflection of an "ongoing" Research and Development Tax Credit within its cost  
18 of service income tax expense calculation. Follow up discovery should clarify  
19 the Company's position. In any event, I would definitely recommend that an  
20 ongoing level of Research and Development Tax Credit be included in the cost  
21 of service income tax calculation *in addition to* the five-year amortization of  
22 Research and Development Tax Credits that I am proposing for credits  
23 anticipated to be received for years 2000 through 2005.

1 **V. ERNST & YOUNG OUTSIDE SERVICES EXPENSE**

2 **Q. IN AN EARLIER RESPONSE YOU BRIEFLY DISCUSSED THE RATE**  
3 **TREATMENT THAT YOU ARE RECOMMENDING FOR THE TEST**  
4 **YEAR COST OF THE ERNST & YOUNG TAX RESEARCH. PLEASE**  
5 **EXPAND UPON THAT RECOMMENDATION.**

6 A. During the historic test year KCPL paid Ernst & Young \$700,000 relating to the  
7 work on the Research and Development Tax Credit. In response to DOE-NSSA  
8 Question No. 55 (affixed as Schedule JRD-3) KCPL indicated that 1) it had not  
9 incurred any cost for comparable work in any of the three previous calendar  
10 years, and 2) it was only budgeting \$40,000 per year for related follow up tax  
11 services work for calendar years 2007 and 2008. Thus, the cost incurred for the  
12 Ernst & Young work undertaken during the historic test year is largely non-  
13 recurring. Inasmuch as I am recommending that the "benefits" in the form of  
14 anticipated federal tax credits be amortized over five years in this case, I am  
15 concurrently and consistently recommending that the extraordinary costs  
16 incurred in obtaining the tax refunds also be amortized over five years.

17

18 **Q. HAVE YOU PREPARED AN ADJUSTMENT TO REFLECT THE RATE**  
19 **TREATMENT YOU ARE PROPOSING FOR THE ERNST & YOUNG**  
20 **TEST YEAR COSTS INCURRED?**

21 A. Yes. On Schedule JRD-4 I reflect the calculation of the adjustment required to  
22 amortize the non-recurring Ernst & Young costs over a five-year period.

23

1 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

2 A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

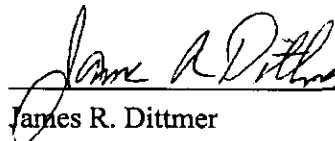
In the Matter of the Application of Kansas City )  
Power & Light Company to Modify Its Tariff to ) Case No. ER-2007-0291  
Begin the Implementation of Its Regulatory Plan )

**AFFIDAVIT**

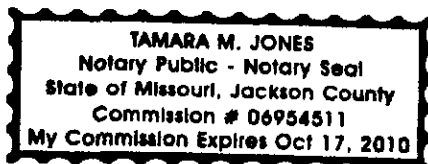
STATE OF MISSOURI )  
  ) SS.  
COUNTY OF JACKSON )

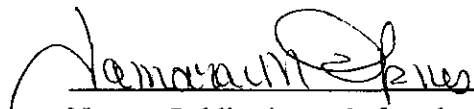
BEFORE ME, the undersigned notary public, this day personally appeared JAMES R. DITTMER, to me known, who being duly sworn according to law, deposes and says:

“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

SUBSCRIBED AND SWORN to before me, a notary public, on this 26<sup>th</sup> day of July, 2007.



  
\_\_\_\_\_  
Notary Public in and for the State of Missouri

My Commission Expires: 10-17-2010



Witness: J. Dittmer

KANSAS CITY POWER & LIGHT COMPANY  
CASE NO. ER-2007-0291  
ADJUSTMENT FOR INCENTIVE COMPENSATION LINKED TO  
ACHIEVEMENT OF EPS OR SHAREHOLDER RETURN

Schedule JRD-1  
Page 1 of 1

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	<b>Long Term Incentive Compensation:</b>		
2	Eliminate Equity-Based Long Term Incentive Compensation	KCPL Updated Payroll	
3	Charged to KCPL FERC Account 920 in Historic Test Year	Adjustment Workpapers 20a	\$ (2,435,212)
4	<b>Short Term Incentive Compensation:</b>		
5	GPE Executive Annual Incentive Plan Costs Based Upon		
6	Earnings and Key Business Objectives	Staff DR 0205	** [REDACTED] **
7	Percentage Related to Core Earnings	Staff DR 0205	50.0%
8	Percentage Related to Key Business Objectives	Staff DR 0205	30.0%
9	Subtotal:	Line 7 + Line 8	80.0%
10	Core Earnings/Sum of Core Plus KBO Scorecard	Line 7 / Line 9	62.5%
11	Total GPE Disallowance of Executive Short Term Incentive		
12	Based Upon Achievement of Earnings Per Share	Line 6 X Line 10	** [REDACTED] **
13	Discretionary Bonus Portion of GPE 2006 Executive Short		
14	Term Incentive Plan	Staff DR 0205	** [REDACTED] **
15	Total GPE Disallowance of Executive Short Term		
16	Incentive Plan	Line 12 + Line 14	** [REDACTED] **
17	Percentage of GPE STI Allocated to KCPL	KCPL Payroll Workpapers	67.25%
18	Disallowance of GPE Executive Short Term Incentive		
19	Compensation Allocated to KCPL	Line 16 X Line 17	** [REDACTED] **
20	KCPL Executive Annual Incentive Plan Costs Based Upon		
21	Earnings and Key Business Objectives	Staff DR 0205	** [REDACTED] **
22	Percentage Related to Core Earnings	Staff DR 0205	50.0%
23	Percentage Related to Key Business Objectives	Staff DR 0205	30.0%
24	Subtotal:	Line 22 + Line 23	80.0%
25	Core Earnings/Sum of Core Plus KBO Scorecard	Line 22 / Line 24	62.5%
26	Total KCPL Disallowance of Executive Short Term Incentive		
27	Based Upon Achievement of Earnings Per Share	Line 21 X Line 25	** [REDACTED] **
28	Discretionary Bonus Portion of KCPL 2006 Executive Short		
29	Term Incentive Plan	Staff DR 0205	** [REDACTED] **
30	Total KCPL Disallowance of Executive Short Term		
31	Incentive Plan	Line 27 + Line 29	(2,159,832)
32	<b>Total KCPL Disallowance of GPE and KCPL Executive</b>		
33	<b>Short Term Incentive Compensation Before Capitalization</b>	Line 19 + Line 31	(2,362,005)
34	KCPL Percentage Allocated to Expense	KCPL Payroll Workpapers	75.00%
35	Total Company Disallowance of Executive Short Term		
36	Incentive Plan Costs Charged to Expense	Line 33 X line 34	(1,771,504)
37	<b>Total KCPL Disallowance of Long Term and Short Term</b>		
38	<b>Incentive Compensation - Expense Portion</b>	Line 3 + Line 36	(4,206,716)
39	Missouri Jurisdictional Allocation Factor	Salary and Wages	54.0031%
40	Missouri Jurisdictional Disallowance of Long Term and Short		
41	Term Incentive Compensation Linked to Achievement of		
42	Earnings and/or Shareholder Return	Line 38 X Line 39	\$ (2,271,757)

Witness: J. Dittmer

KANSAS CITY POWER & LIGHT COMPANY  
CASE NO. ER-2007-0291  
ADJUSTMENT TO AMORTIZE HAWTHORN NO. 5  
LITIGATION RECOVERIES OVER FIVE YEARS

Schedule JRD-2  
Page 1 of 1

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	Credits to FERC Expense Account Nos.:		
2	547 Fuel Expense	Staff DR 0228	\$ 3,589,704
3		Staff DR 0228	77,735
4		Staff DR 0228	10,765
5	Total Account 547- Fuel Expense	Sum Lines 2 - 4	<u>\$ 3,678,204</u>
6	555 Purchased Power Expense	Staff DR 0228	10,544,755
7		Staff DR 0228	228,346
8		Staff DR 0228	31,622
9	Total Account 555 - Purchased Power Expense	Sum Lines 6 - 8	<u>10,804,722</u>
10	447 Off-System Sales	Staff DR 0228	\$ 2,467,921
11		Staff DR 0228	53,443
12		Staff DR 0228	7,401
13	Total Account 447 - Off-system Sales	Sum Lines 10 - 12	<u>\$ 2,528,765</u>
14	419 Other Interest Income	Staff DR 0228	\$ 6,104,025
15	Total Test Year Credits Charged to Operating		
16	Revenues and Expense in 2006 Historic Test Year	Lines 5+9+13+14	\$ 23,115,716
17	Amortization Period Proposed - Years		<u>5.00</u>
18	Total Company Amortization Credit Adjustment	Line 16 / Line 17	4,623,143
19	Missouri Jurisdictional Allocation Factor	D1	<u>53.569%</u>
20	Missouri Retail Jurisdictional Adjustment to Amortize		
21	Hawthorn No. 5 Litigation Recoveries Recorded as		
22	Negative Expense Within the Historic Test Year		
23	Over Five Years	Line 18 x 19	<u>\$ (2,476,572)</u>

DATA REQUEST- Set DOE\_20070606

Case: ER-2007-0291

Date of Response: 06/27/2007

Information Provided By: Lori Wright

Requested by: Campbell Lewis

Question No. : 55

Please provide the following regarding Ernst & Young "R&D Tax Credit Services" provided during the historic test year that was noted in response to DOE Data Request No. 37:a. Explain in greater detail what services were providedb. Provide any studies or reports prepared pursuant to this engagement.c. Provide amounts paid in years 2003, 2004 and 2005 for comparable services and provide budgeted/forecasted amounts for 2007 and 2008.

Response:

Ernst & Young was engaged to provide the following R&D tax credit services during 2006:

- Assist the company in applying for the 2005 through 2009 Pre-filing agreement (PFA) with the Internal Revenue Service (IRS) related to the research credit under IRC Code Section 41 and the deduction for research and experimental expenditures under IRC Code Section 174, including pre-PFA planning.
- Assist the company in co-developing the PFA process guidelines with the IRS.
- Assist the company in facilitating and working with the IRS through the PFA process. This included assisting with qualitative and quantitative data gathering and analysis, computation of the research and experimentation credit, negotiating with the IRS, and executing the closing agreement.
- Subject to the PFA agreement with the IRS, assist the company in filing and sustaining refund claims for Section 41 and 174 on an expedited basis with the IRS and the states of Missouri and Kansas for any open year, utilizing the methodology developed in the 2005 PFA process for the Company's tax years ended December 31, 2000 through December 31, 2004.

The costs incurred in 2006 related to tax years 2000-2005. Therefore, no amounts were paid in 2003, 2004, and 2005 for comparable services. Budgeted amounts for 2007 and 2008 are \$40,000 a year for Ernst & Young to provide services under the PFA negotiated with the IRS during 2006.

The following paper copies of Ernst & Young Studies are provided as part of this response:

2005 R&D Tax Credit Study (in draft form)  
2000-2004 R&D Tax Credit Study

Due to the nature of the sensitive financial information contained in the studies, the studies have been marked "**CONFIDENTIAL**".

Attachments – Hard Copy only:

2005 R&D Tax Credit Study (in draft form)

2000-2004 R&D Tax Credit Study

Witness: J. Dittmer

KANSAS CITY POWER & LIGHT COMPANY  
CASE NO. ER-2007-0291  
ADJUSTMENT TO AMORTIZE OUTSIDE SERVICES INCURRED  
TO ACHIEVE REFUNDS FOR R&D TAX CREDITS

Schedule JRD-4  
Page 1 of 1

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	Total Company Charges for Ernst & Young Outside		
2	Services Related to Facilitating Refunds for Prior		
3	Year Research and Development Tax Credits;		
4	Charges to FERC Account 923 Outside Services	USDOE-NSSA No. 37	\$ 700,000
5	Proposed Period to Amortize - Years		<u>5</u>
6	Total Company Amortization Expense Proposed	Line 4 / Line 5	140,000
7	Total Company Adjustment to Amortize Test Year		
8	Outside Services Costs Incurred to Facilitate		
9	Federal Tax Refunds for Claiming Research and		
10	Development Tax Credits	Line 6 - Line 4	(560,000)
11	Missouri Retail Jurisdictional Allocation Factor	E2	<u>56.9315%</u>
12	Missour Retail Jurisdictional Adjustment to		
13	Amortize Test Year Outside Services Costs Incurred		
14	to Facilitate Federal Tax Refunds for Claiming		
15	Research and Development Tax Credits	Line 10 X Line 11	<u>(\$318,816)</u>