Exhibit No.:	
Issue:	Policy
Witness:	Chris B. Giles
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	Kansas City Power & Light Company
Case No.:	ER-2006-0314
Date Testimony Prepared:	September 8, 2006

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2006-0314

REBUTTAL TESTIMONY

OF

CHRIS B. GILES

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

Kansas City, Missouri
September 2006

"[redacted]**" Designates that "Highly Confidential" Information has been Removed Pursuant To The Protective Order In This Case.**

REBUTTAL TESTIMONY

OF

CHRIS B. GILES

Case No. ER-2006-0314

Q: Please state your name and business address.

A: My name is Chris B. Giles. My business address is 1201 Walnut, Kansas City, Missouri 64106.

Q: By whom and in what capacity are you employed?

A: I am employed by Kansas City Power & Light Company ("KCPL") as Vice President - Regulatory Affairs.

Q: Are you the same Chris B. Giles who pre-filed direct testimony in this case?

A: Yes, I am.

Q: What is the purpose of your testimony?

A: The purpose of my testimony is primarily to rebut direct testimony of several witnesses for the Staff of the Missouri Public Service Commission ("Staff"). In some instances I will also rebut the direct testimony of witnesses for other parties to this case. However, because the Staff is the only party to file a complete case including proposed revenue requirement, return on equity, amortization, and off-system sales margin, I will focus primarily on Staff's testimony.

Q: After reviewing the direct testimony filed by other parties, do you think it is appropriate to provide some context for this rate case?

A: Yes, I do. KCPL is engaged in a $1.3 billion investment program during the next five years. This program, referred to by KCPL as its comprehensive energy plan ("CEP"), was developed in a collaborative process that culminated in a stipulation and agreement signed by several parties in this case, including the Staff and Office of Public Counsel ("OPC"). The announcement of such an ambitious program for a company the size of KCPL ordinarily would have resulted in a credit rating downgrade. The Stipulation and Agreement and, in particular, the provision contained in the Stipulation and Agreement regarding additional amortization expense, kept a credit rating downgrade from happening.

Because KCPL did not have a rate case on file with the Commission at the time the Stipulation and Agreement was negotiated, the signatories to the Stipulation thought that additional amortization expense was the best means available to provide some assurance to creditors that, in future rate cases, KCPL would be able to maintain sufficient cash flow to maintain its credit ratings.

Additional amortization expense is the same in principle as accelerated depreciation. It provides a non-cash expense and is included in revenue requirement and in the rates paid by customers. However, additional amortization or accelerated depreciation provides no earnings to the Company.

Ideally, return on equity should be determined prior to determination of any additional amortization or accelerated depreciation. The cash earnings provided through a reasonable return on equity would provide sufficient cash flow to maintain KCPL's credit rating without additional amortization. A reasonable return on equity, however, would need to account for KCPL's large investment program, and its reliance on a wholesale off-system sales market to contribute approximately 50 percent of its earnings.

This rate increase request is KCPL's first in more than 20 years. It is an extremely important case to shareholders, creditors and customers, because the outcome will have a significant impact on KCPL's ability to complete its investment program in the most economic and efficient manner. That program, when completed, will provide KCPL's customers with a long-term supply of reliable, low-cost energy, an improved environment, and reliable and efficient transmission and distribution of energy.

However, financing this level of investment over the next five years will require that Great Plains Energy's ("GPE") stock price and KCPL's credit ratios are maintained. Protecting stock price and credit ratios was KCPL's objective when it entered into the Stipulation and Agreement regarding our investment program. However, if the Commission was to adopt the Staff's recommendations in this case, the impact would be a decline in GPE's stock price and the inability of KCPL to maintain its credit ratings. Company witnesses Dr. Sam Hadaway and Mr. Michael Cline provide more detail in their rebuttal testimony.

With that overview, my rebuttal testimony will primarily address three significant components of Staff's case, off-system sales margins, return on equity, and amortization or accelerated depreciation.

Q: Why are off-system sales margins so critical in the determination of the revenue requirement in this case?

A: Approximately 50 percent of KCPL's earnings currently are attributable to this volatile and uncertain market. Retail customers no longer provide the bulk of KCPL's earnings.

Deregulation and increased wholesale prices, driven primarily by higher natural gas prices, have provided KCPL with the opportunity to sell into the wholesale market when retail load is less than the available capacity, and when the marginal cost of that extra capacity is below the market price of power. These sales benefit retail customers because the margin from those sales is a reduction to KCPL's retail revenue requirement. However, as I stated in my direct testimony, it is not appropriate to set a return on equity for a regulated utility with approximately 50 percent of its earnings attributable to the wholesale market, at the same level or based upon the same methodology as that used for a utility with virtually no earnings from the wholesale market. This increased risk profile must be accounted for when a return on equity is established.

Q: Did Staff or any other parties recognize the increased risk of the off-system sales market in their proposed return on equity or in the level of off-system sales included in determining revenue requirement?

A: No. Based on the Staff's most recent "EMS" attached to the rebuttal testimony of Company witness Mr. Don Frerking, the Staff is recommending the inclusion in revenue requirement of **[redacted]** in off-system sales on a total Company basis. The Staff uses an allocation factor of 56.68%, which results in approximately **[redacted]** on a Missouri jurisdictional basis. The Staff bases the **[redacted]** on calendar year 2005 and uses an allocation factor based on the ratio of Missouri retail jurisdictional kwh sales to total Company retail kwh sales.

Q: Do you agree with Staff's methodology and recommendation?

A: No, for two reasons. First, calendar year 2005 has absolutely nothing to do with the expected level of off-system sales in 2007, the first and only year rates will be in effect as a result of this case. Second, it is not appropriate to allocate total Company off-system sales margins to Missouri on a kwh ratio. Mr. Michael Schnitzer provided testimony in KCPL's direct case and subsequently updated his analysis and provided it to all parties based upon data as of June 2006. Mr. Schnitzer is also providing rebuttal testimony. Mr. Schnitzer's updated analysis indicates that based on probabilistic analysis the median expectation of total Company off-system sales for 2007 is **[redacted]**. Based on Mr. Schnitzer's updated analysis, a 25 percent probability exists that KCPL's 2007 off-system sales margins will be below **[redacted]** and a 75 percent probability exists that KCPL's off-system sales margins will be above **[redacted]**.

Q: **Has anyone taken issue with Mr. Schnitzer's analysis in direct testimony?**

A: No. Staff does not address Mr. Schnitzer's testimony in its direct case. OPC witness Mr. Ralph C. Smith recommends setting off-system sales margins at **[redacted]** based on the most likely outcome contained in Mr. Schnitzer's testimony. Mr. Maurice Brubaker, on behalf of Praxair and Missouri Industrial Energy Consumers, takes a similar position. Mr. Jim Dittmer, on behalf of DOE/NNSA, also takes a similar position.

Q: **Several witnesses are critical of KCPL's recommendation to use the 25 percent point on the probability distribution of **[redacted]** versus the median level of **[redacted]** contained in Mr. Schnitzer's analysis. In your direct testimony, you explained the rationale for utilizing the **[redacted]** figure. Would you please elaborate on that rationale in light of the other parties' direct testimony?**

A: Several reasons justify setting the off-system sales level at **[redacted]**. Mr. Schnitzer's methodology provides for a probability distribution that represents a risk adjustment to the return on equity in this case. As I stated previously, the off-system sales market has additional risk compared to retail sales. It is appropriate to recognize this additional risk. I have been involved in Missouri and Kansas rate cases on behalf of KCPL for the past thirty years. During my tenure at KCPL, in every rate case I have reviewed or been involved in, I have seen the same methodologies utilized to estimate return on equity.

Various models, including discounted cash flow ("DCF"), capital asset pricing method ("CAPM") or other methods have been and continue to be used to estimate what is deemed a reasonable return on equity without regard to the risks of the competitive wholesale market. This is not surprising because the competitive wholesale market is relatively new. It has been a major component of KCPL's earnings only since 2001 and has represented a majority of its earnings in only the past two years.

The evidence in this case, based upon the disparate recommendations of the various parties, supports the fact that the determination of a "reasonable return on equity" is a very subjective one. Very different outcomes can result even when experts use similar modeling techniques because of the different assumptions they use – for example, selecting "comparative utilities."

Based upon KCPL's capital structure and allocation of total off-system sales margin to its Missouri jurisdiction, the value in return on equity in this case is worth **[redacted]** basis points for each $1 million of off-system sales margin included in revenue requirement. As an illustration, if the Commission includes **[redacted]** of wholesale margins in KCPL's revenue requirement, **[redacted]** of which is jurisdictional to Missouri, and KCPL actually achieves total Company wholesale margins of **[redacted]** in 2007, or **[redacted]** margin on a Missouri jurisdictional basis, this will result in a

[redacted] basis point increase in return on equity, all other things being equal. If the Commission had authorized a return on equity in this case of 11.5 percent, KCPL's actual return on equity, in this example, would be **[redacted]** percent, all other things equal. The foregoing example is a reflection of the risk of the competitive off-system sales market where return on equity continues to be established without regard to this recently developed market even when approximately 50 percent of KCPL's earnings are dependent on the competitive off-system sales market. The methodology KCPL has employed in this case to adjust the return on equity to reflect this additional risk will remain appropriate until such time as the rate of return experts develop more robust models to take into account the percentage of earnings attributable to retail sales versus off-system sales and incorporate this factor into the return on equity estimate.

Q: How does this compare to sharing of off-system sales margins between customers and Company?

A: Some utilities in various venues have proposed sharing off-system sales margins between customers and the company. In fact, in its most recent rate increase request, AmerenUE proposed to account for the risk of off-system sales in the same manner KCPL is proposing in this case. AmerenUE also proposed an alternative that is based on sharing off-system sales margins between customers and the Company. As a number of witnesses in this case have noted, KCPL has agreed in its testimony in this case, and in the Stipulation and Agreement approved in 2005 by the Commission, that it has no inherent right to earnings from the off-system sales market as long as the costs of the assets generating those wholesale earnings are in retail prices. The Commission must recognize, however, wholesale revenue and earnings have different financial characteristics than retail revenues and earnings. As examples, if a major generating unit is out of service, retail revenue continues, but off-system sales revenue declines or ceases altogether. If gas prices fall, profit margins from retail customers are not significantly impacted, but off-system sales decline.

One means to recognize this risk is to include margins at the 25 percent level of expected margins during the year that the rates would be in effect as proposed by KCPL. This is not a sharing mechanism. This recognizes the risk of the competitive off-system sales market, which has been generating approximately 50 percent of KCPL's earnings, while KCPL's required return on equity continues to be established without regard to this fact.

Q: What is the significance of this policy decision to KCPL in light of AmerenUE's proposal to share off-system sales margins between customers and AmerenUE?

A: It doesn't matter how the risk premium is generated. A sharing approach as AmerenUE has proposed, as an alternative to the risk approach of KCPL, or a risk adder to the return on equity generates the same result -- a higher return on equity than the otherwise traditional methods of estimating return on equity would yield. This will be the case until rate of return experts develop more robust models that account for the different risk profiles of wholesale and retail markets.

Q: You stated there are several reasons the Commission should adopt KCPL's recommendation regarding off-system sales margins. What are some others?

A: As I stated in my direct testimony and in this rebuttal testimony, cash flow and the ability to maintain both the Company's stock price and credit rating is critical during the year these rates will be in effect (2007). Mr. Brubaker indicates that the provision for additional amortization provides the Company with this protection and thus the Company does not need additional assurances of cash flow. I disagree with Mr. Brubaker. The additional amortization is established after the results of the revenue requirement and return on equity in this case is established. It must be recognized that testimony and analysis in this case is based upon a traditional rate case test year methodology. Regardless of the return established in this case and regardless of the level of off-system sales levels included in revenue requirement, the Company must still earn that return and achieve those off-system sales margins for the additional amortization to have fulfilled its purpose. KCPL is not asking for a guaranteed rate of return in 2007, it is simply requesting that the Commission eliminate 25 percent of the risk of an off-system sales market that other companies don't participate in, even though their allowed returns on equity are being calculated the same way that KCPL's return on equity is being calculated.

The Commission also should recognize the importance of this rate case to investors, creditors and customers. In a conference call to which all parties were invited, representatives of Standard and Poors stated that, all other things being equal, they are only waiting to see the outcome of this case to determine whether to lower KCPL's business risk from a 6 to a 5. If this occurs, it will result in a much lower metric for funds from operations to average debt percentage. This, in turn, will lower the amount of cash required for KCPL to maintain its credit rating. That will result in savings for customers over the course of the five-year investment period. On the other hand, adopting the Staff's recommendations regarding return on equity, off-system sales margins, and additional amortization will result in lowering GPE's stock price and a downgrade in

KCPL's credit rating, as explained in more detail in Dr. Hadaway and Mr. Cline's rebuttal testimony.

Q. What is your recommendation to the Commission regarding off-system sales margin?

A: I recommend the Commission include **[redacted]** of off-system sales margin on a total Company basis and **[redacted]** on a Missouri jurisdictional basis. Alternatively, I recommend the Commission include an additional return on equity of **[redacted]** basis points for each $1 million of off-system sales margin included in revenue requirement above **[redacted]** on a Missouri jurisdictional basis.

Q: You previously stated that you disagreed with the Staff's allocation of off-system sales margins to the Company's Missouri jurisdiction based on a kwh ratio. Please explain.

A: This issue is more fully explained in the rebuttal testimony of Mr. Don Frerking. Off-system sales revenues traditionally have been allocated on a per kwh ratio. However, traditionally, off-system sales revenues were much smaller and margins were $6 or $7 per mwh compared to today's margins of $30 to $40 per mwh. Allocation of off-system sales revenue on a kwh basis was consistent with allocation of fuel on a kwh ratio. To my knowledge margins were never allocated directly to jurisdictions. Because off-system sales margins have increased so dramatically, it is no longer appropriate to allocate between jurisdictions based on kwh. Thus, KCPL utilized an allocation methodology that correlates with the unused capacity that enables the Company to make the off-system sales. KCPL's Missouri jurisdiction has a higher load factor than its Kansas jurisdiction. Thus, more generation capacity is available and unused in Kansas than Missouri. This unused capacity is allocated to the Kansas jurisdiction on a coincident peak basis. Thus, the allocation of off-system sales should reflect the unused capacity that Kansas customers are paying for in their rates. It represents an equitable allocation between the two jurisdictions. To do otherwise places a greater burden on Kansas customers for unused capacity without the corresponding benefit of the sales of that unused capacity into the off-system market.

Q: You mentioned that Staff's recommendations of return on equity, off-system sales, and amortization would result in a decline in KCPL's stock price and downgrade of its credit rating. Why do you believe this to be the case?

A: Each of these components is linked. I have previously demonstrated the relationship between off-system sales margins included in determination of revenue requirement and return on equity. The Staff's return on equity in this case is 9.3 to 9.4 percent. DOE/NNSA recommends a return on equity of 9.0 percent, and OPC recommends 9.9 percent. As a point of reference, the Kansas Corporation Commission's Staff recommends a return on equity of 10.55 percent in KCPL's current rate case in Kansas. KCPL's rate of return witness Dr. Sam Hadaway recommends a return on equity of 11.5 percent. As I stated earlier, none of these experts account for the additional risk of the off-system sales market contributing approximately 50 percent of KCPL's earnings. It is not my intent to rebut the testimony of rate of return witnesses in this case. Dr. Hadaway provides rebuttal testimony on behalf of KCPL regarding return on equity. My testimony is focused on the relationship between return on equity and additional amortization.

Q: Please explain.

A: As I indicated in the introduction to my rebuttal testimony, the concept of additional amortization was a means to assure the credit community that KCPL would be able to achieve sufficient cash flow to maintain its credit rating. It is not a lower cost method of financing than equity as shown in the rebuttal testimony of Mr. Michael Cline. Cash is generated from earnings. Establishing earnings levels to generate sufficient cash to maintain credit ratios would result in the same credit rating outcome without additional amortization. In fact, in KCPL's direct case, amortization was not required based upon an 11.5 percent return on equity and inclusion of Missouri jurisdictional **[redacted]** of off-system sales margins. Credit quality is not the only objective, however. As I stated previously, KCPL should not contribute to a decline in GPE's stock price as a result of this rate case. GPE must continue to issue additional equity during the next five years to fund the significant investment contained in the Stipulation and Agreement approved by the Commission in 2005. Each $1 million in amortization including taxes, displaces **[redacted]** basis points of return on equity, all other things equal. Thus, the difference between Staff's recommended return on equity and KCPL's return on equity is 220 basis points (1150-930) and represents **[redacted]** in amortization ((1150-930)/**[redacted]**).

Q: What is Staff's recommendation for additional amortization in this case?

A: Staff's current recommendation for the amortization amount based on the latest EMS run is approximately $55 million before grossing the amount up for taxes. If you gross this amount up for taxes, the amortization becomes $89.4 million; however, Staff currently does not reflect the taxes associated with the amortization in its case. Given Staff's current amortization recommendation of $55 million taken together with the Staff's EMS run of a negative $37 million, Staff's overall rate increase to the Company is an $18 million increase in rates ($55 million - $37 million). If you included taxes associated with the amortization, the amount becomes a $44.4 million increase in rates ($89.4 million - $37 million). The Staff's current EMS and amortization is attached to the testimony of Company witness Don Frerking. Staff has agreed that it will update these numbers to reflect the period ending September 30, 2006. When you factor in the cost of service changes, wind investment and other factors that will be updated with the September numbers, you may see increases exceeding the request made by the Company in its original filing, even though Staff's revenue requirement is based on a 9.3 to 9.4 percent return on equity. This would lead one to conclude that amortization to meet credit ratios is not lower cost than equity return.

Q: Would KCPL be able to meet the credit ratios contained in the Stipulation and Agreement approved by the Commission in 2005 given Staff's proposed amortization?

A: No. Staff does not gross up the cash requirement of the amortization to reflect income taxes. There is absolutely no question that the revenue attributable to the additional amortization or accelerated depreciation is taxable income. Mr. Hriszko provides testimony on behalf of KCPL regarding taxes related to the amortization. Given that this revenue is taxable, a cash requirement of $55 million to meet the credit ratios will require pre-tax revenue of $89.4 million. Put another way, if it takes $55 million in cash to meet the credit ratios, then Staff's proposed amortization will provide only $33.8 million, $21.2 million short of the cash requirement. It appears certain that a credit downgrade would follow shortly after a Commission order adopting Staff's amortization, as Mr. Cline testifies.

Q: You mentioned that additional amortization is nothing more than accelerated depreciation. Could you explain?

A: The Stipulation and Agreement approved by the Commission in 2005 requires, that any additional amortization be assigned to plant accounts no later than the end of the five-year Regulatory Plan. The additional amortization or accelerated depreciation will be recorded in the accumulated reserve for depreciation and will be an offset to rate base just as any other reserve for depreciation. At the end of the Regulatory Plan, an adjustment will need to be made to reduce the depreciation rates of the affected plant accounts so that the acceleration of depreciation is reversed. This has no impact on KCPL's future earnings, but will result in less cash flow from depreciation expense due to the lower rates. This is the reverse of the accelerated depreciation.

Q: Could it be a bad policy decision to reverse large amounts of additional amortization at the end of the Regulatory Plan?

A: Yes, reducing cash flow due to lower depreciation rates after the Regulatory Plan is completed could be cause for concern. At this point, it appears likely that KCPL will continue to be in need of substantial cash flow to fund additional investment in environmental equipment between the end of the Regulatory Plan (summer 2010) and 2015. Lower depreciation rates will result in less cash flow, which then will require additional regulatory amortization structure, perhaps beyond 2010 to meet credit ratios.

Q: What have you learned from working with the concept of creating additional amortization or accelerated depreciation to meet credit ratios?

A: Amortization is not a substitute for cash earnings. It is not less costly to customers. If it is to be used, it should be limited to a reasonable amount, including gross up for taxes. That amount is dependent on the return on equity established by the Commission and the amount of off-system sales margins included in the revenue requirement.

Q: Do you have any additional recommendations for the Commission based upon Staff's case?

A: Yes, I continue to recommend the Commission adopt KCPL's proposal for off-system sales, return on equity and amortization as filed in its direct testimony. All things being equal this will result in maintaining GPE's stock price and not result in a credit downgrade. In fact, it will result in a lower business risk for KCPL that, in the future, will require less cash to meet reduced credit ratios.

Q: Does that conclude your testimony?

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 Begin the Implementation of Its Regulatory Plan	)))	Case No. ER-2006-0314

AFFIDAVIT OF CHRIS B. GILES

STATE OF MISSOURI)
) **ss**
COUNTY OF JACKSON)

Chris B. Giles, being first duly sworn on his oath, states:

1. My name is Chris B. Giles. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Vice President Regulatory Affairs.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Kansas City Power & Light Company consisting of fifteen (15) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

Chris B. Giles

Chris B. Giles

Subscribed and sworn before me this 8th day of September 2006.

Nicole A. Wehry

Notary Public

My commission expires: Feb. 4 2007

NICOLE A. WEHRY
Notary Public - Notary Seal
STATE OF MISSOURI
Jackson County
My Commission Expires: Feb. 4, 2007