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| *Exhibit No.:* | |
| *Issues:* | *Severance, Projects, Account 254 balance* |
| *Witness:* | *Charles R. Hyneman* |
| *Sponsoring Party:* | *MoPSC Staff* |
| *Type of Exhibit:* | *Surrebuttal Testimony* |
| *Case No.:* | *ER-2006-0314* |
| *Date Testimony Prepared:* | *October 6, 2006* |

# MISSOURI PUBLIC SERVICE COMMISSION

## UTILITY SERVICES DIVISION

# SURREBUTTAL TESTIMONY

# OF

# CHARLES R. HYNEMAN

# KANSAS CITY POWER AND LIGHT COMPANY

# CASE NO. ER-2006-0314

***Jefferson City, Missouri***
***October 2006***

****Denotes Highly Confidential Information**** **NP**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of Its Regulatory Plan. | ) ) ) ) | Case No. ER-2006-0314 |

AFFIDAVIT OF CHARLES HYNEMAN

STATE OF MISSOURI )
) ss.
COUNTY OF COLE )

Charles Hyneman, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 21 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Charles Hyneman

Subscribed and sworn to before me this 5th day of October 2006.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

ASHLEY M. HARRISON
My Commission Expires
August 31, 2010
Cole County
Commission #06898978

**SURREBUTTAL TESTIMONY**

**OF**

**CHARLES R. HYNEMAN**

**KANSAS CITY POWER AND LIGHT COMPANY**

**CASE NO. ER-2006-0314**

**SURREBUTTAL TESTIMONY**

**OF**

**CHARLES R. HYNEMAN**

**KANSAS CITY POWER AND LIGHT COMPANY**

**CASE NO. ER-2006-0314**

Q. Please state your name and business address.

A. Charles R. Hyneman, Fletcher Daniels Office Building, 615 East 13th Street, Room G8, Kansas City, Missouri, 64106.

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

A. I am a Utility Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Are you the same Charles R. Hyneman who filed direct testimony in this case?

A. Yes, I am. I filed direct testimony in this case on August 8, 2006, on the areas of fuel and purchased power expense, fuel inventories, severance and miscellaneous adjustments.

## EXECUTIVE SUMMARY

Q. Please provide a summary of your surrebuttal testimony?

A. In my surrebuttal testimony I will address the rebuttal testimonies of Kansas City Power & Light Company (KCPL or Company) witness Lori Wright with respect to severance payments and the rate base treatment of corporate project costs. I will describe and provide examples of why KCPL's proposed severance adjustment should be rejected. I will also show that while the Staff of the Commission (Staff) believes that the expenses of two

KCPL projects should be recovered over a five-year period, these expenses do not meet the tests for rate base inclusion and should not be included in KCPL's rate base in this case.

Finally, I will respond to the comments of the Office of the Public Counsel (OPC) witness Ryan Kind with respect to the Staff's proposed dollar amount of KCPL's emission allowance regulatory liability (Account 254 Regulatory Liability) to include in KCPL's rate base.

## SEVERANCE COSTS

Q. What was the original revenue requirement impact of the severance issue?

A. In its direct filing KCPL proposed to include in its cost of service $1.7 million in severance costs. Since the Staff's recommendation to the Commission is that no severance costs should be included in KCPL's cost of service, the revenue requirement impact of this issue on a total Company basis was $1.7 million ($980,000 Missouri jurisdictional basis). In its rebuttal testimony, KCPL revised its position on this issue.

Q. What is KCPL's revised position and what it the revised revenue requirement impact of the severance issue?

A. In her rebuttal testimony, KCPL witness Lori Wright proposed a reduction in KCPL's severance cost adjustment from $1.7 million to $897,040 on a total Company basis. KCPL removed the severance payments made to two Great Plains Energy (GPE) executive officers who left the Company in 2005. GPE is the parent company of KCPL. The severance cost of these two former GPE executive officers is described at page 23 of my direct testimony.

Since the Staff is still proposing no recovery of severance costs, the value of the issue is currently $897,040 on a total company basis and $512,000 on a Missouri jurisdictional basis.

Q. What is the basis for KCPL's changed position on severance costs?

A. In her rebuttal testimony, Ms. Wright did not explain why KCPL changed its position. In her revised adjustment she simply removed the 2005 severance payments made to two former executive officers.

Q. What is the basis of the Staff's adjustment to remove all severance costs from KCPL's cost of service?

A. The severance cost that KCPL is proposing to recover as a "normalized" cost of service expense in this case is not a recurring cost of providing electric service. Normally severance costs are incurred on an irregular basis. When severance costs are incurred, they normally are incurred with the expectation of labor costs savings that will benefit both the utility and its regulated customers. Such is not the case with KCPL's proposal. There is no evidence that the act of incurring severance costs by KCPL will benefit any party other than KCPL's shareholders.

There is evidence that the sole reason why KCPL pays severance to departing employees is to protect the interests of its shareholders. These shareholder-protection costs should be paid by the party who benefits - KCPL's shareholders, not the party who receives no benefit - KCPL's customers.

Finally, because of the nature of severance payments, KCPL has likely recovered all of its past severance costs through the ratemaking mechanism known as regulatory lag. I will address each of these reasons why the Staff opposes rate recovery of KCPL's severance costs later in this testimony.

Q. What support for the inclusion of severance costs did Ms. Wright provide in her rebuttal testimony?

A. Ms. Wright stated that KCPL incurs some amount of severance cost each year and that there are many reasons why KCPL pays severance costs including changing job requirements, corporate reorganization and downsizing.

Q. Has KCPL had corporate reorganizations, downsizings, or employees who changed job requirements?

A. Every organization the size of KCPL has periodic corporate reorganizations. Companies also change employee job requirements from time to time. KCPL did have a reorganization in 2001 due to the creation of the GPE parent company. It also just completed an employee realignment in 2006 in which is terminated approximately 120 employees. However, corporate reorganizations and employee realignments are not, and should not, be common occurrences.

KCPL is not in a downsizing mode of operation at this time and hasn't been for several years. In fact, KCPL stated that the purpose of its 2006 employee reorganization was to realign the Company's organization. It also stated that this realignment will not result in any employee reductions or payroll savings. The employees who were terminated by KCPL in 2006 are expected to be replaced by new employees, many in time for the September 30, 2006, true-up audit.

Q. Has the Staff recommended recovery of certain types of severance payments in past cases?

A. Yes. When a utility company demonstrates that a corporate reorganization did result in net payroll savings that would be passed through to customers, the Staff has recommended rate recovery of the costs to achieve these savings. As recently as Aquila Inc.'s last rate case, No. ER-2005-0436, the Staff recommended rate recovery of Aquila's transition costs, including non-executive severance costs, it incurred in its acquisition of the former St. Joseph Light & Power Company.

Q. Does KCPL have a written policy on providing severance payments?

A. No. When KCPL implemented a corporate reorganization in 2001 it created a "guidance document" that discusses eligibility requirements for severance benefits in connection with job eliminations caused by corporate reorganizations.

However, with respect to severance benefits paid outside of the context of corporate reorganizations, KCPL has no written policy. KCPL explained in its response to Data Request 521, that due to the varied circumstances under which an employee can leave the Company, the decision by KCPL to offer severance benefits is made on a case-by-case basis.

Q. Earlier you described how KCPL removed the cost of the severance benefits paid to two former senior executive officers in 2005. Does the amount of KCPL's proposed severance adjustment include payments to other senior executives?

A. Yes. On May 24, 2001, GPE's then Chairman, President and Chief Executive Officer (CEO) Bernie Beaudoin announced the appointment of a new Vice President of Human Resources. Mr. Beaudoin stated in a KCPL press release that after a nationwide search, KCPL was extremely pleased to have this individual join its management team. Mr. Beaudoin also stated that this individual had the necessary experience and leadership skills to support the Company's efforts to develop and implement policies that will continue to promote diversity in the work place and to prosper in an increasingly competitive environment.

In February 2004, after less than three years of employment with KCPL, this individual resigned with a severance payment of ** ________________________________ ________________________________________________________________________ ____________________ **

Q. What could be the business purpose of making this severance payment?

A. I cannot think of one. This is a situation where KCPL paid a lot of money to hire a high-level corporate officer who was employed by KCPL for less than 36 months. Either this was a bad hiring decision and this employee could not handle the job responsibilities, or the individual just decided to leave the Company. Either way, there is no reason why KCPL should charge its regulated customers for this severance payment.

Q. Please continue.

A. In addition to the GPE officer described above, KCPL is also seeking recovery of $1.2 million in severance paid to Mr. Beaudoin in December 2003. According to Exhibit 10.1k to GPE's 2004 SEC Form 10-K, Annual Report, this amount represents the value of 18 months of salary and benefits and 12 months of annual incentive payments.

As described above, Mr. Beaudoin is GPE's former Chairman and CEO. He retired from GPE on December 31, 2003. According to pages 9 and 10 of KCPL's 2004 proxy statement filed with the Securities and Exchange Commission, Mr. Beaudoin's total compensation from KCPL in 2003 was $4.1 million. This amount includes a base salary of $435,000, a bonus of $391,300, restricted stock awards of $348,386, lump sum retirement benefits of $1,895,266 and $998,111 in additional supplemental retirement benefits. On top of this compensation, KCPL wants its regulated utility customers to pay for Mr. Beaudoin's severance payment of $1.2 million.

Q. Can the Staff think of any legitimate business reason why KCPL would pay its CEO a severance benefit of $1.2 million at his retirement date?

A. No.

Q. Did Staff ask KCPL why it made such a payment?

A. Yes. The Staff asked the following question and received the following response in Data Request No. 517.

> Q. In addition to his regular pension, SERP, stock options and other compensation paid to a former GPE CEO upon his retirement, please explain why it is reasonable to charge Missouri ratepayers for the $1.2 million is severance payments paid to this former CEO and included in KCPL's severance adjustment as described on page 10 of Ms. Wright's rebuttal testimony.
>
> A. The Company incurs severance cost each year. Severance payments will fluctuate from year to year and a three-year average compensates for spikes and valleys in severance payments. As stated in the rebuttal testimony of Lori Wright, the three-year average severance amount is representative of an ongoing level of severance costs.

Q. Do you consider KCPL's response to this question to be responsive to the question you asked in this data request?

A. No. Since KCPL did not answer the question, I have no explanation why KCPL believes it was reasonable to charge Missouri ratepayers for Mr. Beaudoin's $1.2 million severance payment.

Q. Please elaborate on why KCPL's proposed severance adjustment is not a recurring cost to be included in utility rates.

A. While KCPL believes that because it has had severance costs in the past, it will necessarily have them in the future. However, severance costs are not a normal cost of providing utility service. Severance expenses are different from normal recurring expenses that are included in utility rates. For example, payroll will certainly be incurred every year, so will fuel expense, taxes, pensions, and so on. But the act of incurring severance costs to create a customer benefit, such as lower payroll costs, occurs infrequently. This occurrence is primarily through major employee downsizings or corporate reorganizations resulting from a merger that created merger synergies or savings.

The realignment that KCPL experienced during 2006 does not occur every year, nor does the payment of severance to key senior management occur frequently. KCPL's position seeking an on-going level in rates for severance payments indicates an expectation that the events surrounding the need for past severance payments will occur on an annual basis. The types of severance payments made by KCPL are not the types of severance payments that the Staff has recommended being included in utility rates in the past. KCPL's severance payments benefit no entity except KCPL's shareholders. To be considered for ratemaking treatment, severance costs have to be incurred, not already recovered in rates, and directly result in tangible customer benefits, such as reduced payroll costs.

Q. Is there evidence in this case that KCPL itself does not consider severance to be a normal recurring cost?

A. Yes. Part of KCPL's incentive compensation plan is based on KCPL's earnings. The higher the level of KCPL's earnings, the more KCPL's management is compensated. To increase the level of earnings for incentive compensation purposes in 2005, KCPL has decided to exclude its severance costs as a normal recurring expense in the calculation of earnings per share (EPS). In other words, KCPL believes its regulated customers should be responsible for the payment of severance in rates, but its management should not be held responsible for the level of severance the Company incurs each year. In response to Data Request No. 471, KCPL explained why it excludes severance from EPS and its incentive plan payouts.

> Q. Provide the rationale for excluding severance costs in determining the EPS for incentive plan payouts in 2005.
>
> A. Severance costs are charges, which fluctuate annually, and based on materiality may or may not be included in "core" earnings used in calculating incentive plan payouts.

Q. Earlier you stated that because of the nature of severance payments, severance expenses are often recovered in rates over and above the amount actually paid through regulatory lag. Please explain.

A. Regulatory lag is the passage of time between when a utility's financial results change, and when that change is reflected in the utility's rates. By proposing an adjustment to recover a "normalized" level of severance costs, KCPL has decided to ignore the positive regulatory lag financial benefits that continue to accrue to the Company as a result of terminating an employee and paying severance benefits.

As an example, assume as a result of this rate case, KCPL recovers payroll, pension, OPEB and other benefit costs for employee John Doe in the amount of $150,000. After rates are set from this case in January 2007, KCPL terminates Mr. Doe and provides severance benefits to him in the amount of $100,000. In the first 12 months that rates are in effect KCPL will collect $150,000 in utility rates for John Doe (payroll and other benefit costs) and only pay out $100,000 in severance. The Company has a net pre-tax gain of $50,000 to income. In the second year that these rates are in effect, all $150,000 of Mr. Doe's salary and benefits that KCPL's regulated customers are paying in rates will accrue to the benefit of the shareholders.

This simple example shows how severance costs are often, at a minimum, recovered dollar for dollar in utility rates.

Q. Earlier in this testimony you stated that the reason for KCPL's payment of severance benefits is to protect its shareholders. Please explain.

A. In Data Request 521, the Staff asked KCPL to describe the circumstances under which KCPL will make or has made severance payments. KCPL's response was that "overall, the companies use severance agreements to extinguish all potential claims an employee may have had against the companies."

Q. Should regulated customers pay for protection against claims of improper conduct on the part of KCPL management?

A. No. Since regulated customers should not be charged for penalties, fines, or other damages that are incurred due to illegal actions by utility management, they should also not be charged for protection against such costs.

Q. Did KCPL pay its former Chairman and CEO Mr. Beaudoin more that what he was due in order to secure his agreement not to process any claims against the Company?

A. Yes it did. This is clearly stated in Paragraph 7 of Mr. Beaudoin's severance agreement:

> ** ____________________ ____________________ ____________________ ____________ ** its affiliated entities, officers, directors, managers, agents and employees ** ____________________ ____________________ ** including any and all liability, whether in their personal or representative capacities, for claims or charges under state or federal discrimination laws, including Title VII of the Civil

> Rights Act and the Age Discrimination in Employment Act, arising out of his employment with the Company or the termination of that employment or any other circumstances or events, whether known or unknown, occurring up to and including the date of retirement (emphasis added)

Q. Does KCPL's severance adjustment include very generous severance payments made to other senior level officers in order to keep them from making claims against KCPL?

A. Yes. For example, in January 2004 KCPL paid over ** ______________ ** to a former KCPL controller who worked for the Company for approximately 25 years, and was eligible for retirement. In order for this individual to get this severance payment, ** __ ______________________________________________________________ **

Q. Has the Commission previously ruled on the issue of rate recovery of severance costs?

A. Yes. In its Report and Order in Case No. ER-97-394, Aquila Inc., the Commission ruled that severance costs should not be recovered in rates. Specifically, the Commission stated at page 45 of the Report and Order:

> The Staff has proposed an approximate $142,600 disallowance for test year severance costs. The Staff witness states that such costs are largely non-recurring and are quickly offset by savings in payroll expense. The typical severance pay is six months salary.
>
> UtiliCorp disagrees with the Staff's position. UtiliCorp states that payroll savings are achieved, to the benefit of the ratepayers, by severing employees. UtiliCorp believes that the concurrent severance costs, therefore, should also be borne by the ratepayers.
>
> UtiliCorp also points out that it regards severance pay as a management tool and therefore seeks inclusion of what it considers an ongoing amount of severance costs in rates. The test year severance expense was a result of the UtiliCorp reorganization program, referred to as "Building Tomorrow's UtiliCorp," or BTU. The UtiliCorp witness explains that the BTU program is ongoing, along with a certain level of severance costs. UtiliCorp maintains that these costs should properly be reflected in rates.

> The Commission finds the weight of evidence in this issue indicates that the severance costs in question were a one-time occurrence and not an ongoing expense. In addition, while some benefit to the ratepayer may accrue, the evidence is insufficient on that point.
>
> Therefore, the Commission will adopt the proposed adjustment of the Staff.

**CORPORATE PROJECTS AND STRATEGIC INITIATIVES**

Q. Please summarize this issue.

A. In its direct filing, the Staff removed the test year expenses KCPL charged to Project LED-LDI (Leadership Development) and CORPDP-KCPL (Corporate Development/Planning KCPL). These projects consist of payments to outside consultants and are described in the direct testimony of Staff witness Graham Vesely. The Staff then combined the test year cost of these projects (excluding internal payroll costs) with the cost of the projects incurred in 2006 and amortized this amount to expense over a five-year period. The Staff did not include the unamortized balance of these costs in its proposed rate base for KCPL.

Q. Does KCPL agree with the Staff's proposal?

A. KCPL agrees with the five-year amortization but disagrees with the Staff's exclusion of these costs from rate base. At page 13 of her rebuttal testimony, KCPL witness Wright states that:

> KCPL agrees the costs associated with these projects reflect KCPL's efforts to reshape and align the Company to implement the CEP. Therefore, KCPL is supportive of the Staff's proposal to amortize these costs over 5 years. KCPL believes these amounts should be included in rate base because these are cash expenditures, the recovery of which Staff is proposing be deferred.

Q. What evidence does KCPL put forth to support rate base inclusion of these costs?

A. The only support put forth by KCPL can be found at page 14, line 8, of KCPL witness Wright's rebuttal testimony. Ms. Wright states "these costs are cash expenditures for which the Staff is proposing to defer recovery; therefore, KCPL believes the non-payroll costs to be deferred and amortized should be included in rate base."

Q. Is a Staff proposal to defer costs for future recovery a standard for inclusion in rate base?

A. No.

Q. What is the standard for inclusion in rate base?

A. To be included in rate base, a deferred cost, such as these project costs, has to meet the definition of an asset. After it meets this test, the asset then has to meet the same tests as KCPL's plant in service - used and useful in the provision of utility service.

Q. Please describe these standards.

A. In order for an item to be added to rate base, it must be an asset. Assets are defined by the Financial Accounting Standards Board (FASB) as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events" (FASB Concept Statement No. 6, Elements of Financial Statements). Once an item meets the test of being an asset, it must also meet the ratemaking principle of being "used and useful" in the provision of utility service. Used and useful means that the asset is actually being used to provide service and that it is actually needed to provide utility service. This is the standard adopted by many regulatory jurisdictions, including the Missouri Public Service Commission.

Q. Does the Staff believe that the deferred costs of these two projects meet the definition of an asset?

A. No. The Staff does not believe that these project cost deferrals meet the "probable future benefit" test of an asset. As discussed below, no material weakness in KCPL's management existed to be corrected by these projects.

KCPL's management is tasked to ensure that the utility provides safe and adequate service at reasonable prices. The Staff believes that KCPL has met this task. From the comments of its Chairman and CEO described below, it appears that the Company also believes it has accomplished this task very well. The lack of a management problem to address with the expenditure of millions of dollars in outside consultant costs raises doubt as to the existence of probable future economic benefits from the initiation of these projects.

Q. Why did Staff take the position that the KCPL should be allowed recovery of these cost through an amortization to cost of service, but not a recovery on these costs by inclusion in rate base?

A. The Staff concluded that some long-term benefits may or may not be realized as a result of these projects. Given this possibility, the Staff believes the best rate treatment of these costs in this case is to allow recovery over a finite period of time. Because these costs do not meet the well-established tests for rate base inclusion, the Staff opposes any rate base treatment of these costs.

The Staff does not believe it is appropriate to recommend disallowance of these project costs on the basis that they were not necessary to provide electric service or that they were a non-recurring cost. However, Staff also did not want to support a total and complete recovery of those costs. The position taken by the Staff is a compromise between the extreme positions of no recovery and a total recovery of and on these costs.

Q. Would the Staff characterize these costs as meeting the used and useful standard at this time?

A. No. The Staff believes that the costs incurred for these two projects were incurred with the intention to improve the effectiveness and leadership skills of KCPL and GPE management. These costs are similar to normal employee training costs that are included in KCPL's cost of service, but not included in its rate base. Therefore, the Staff would classify these costs as reasonable and recommends recovery of these costs over a five-year period.

However, there is no evidence that KCPL's management lacked the leadership skills necessary to provide safe and adequate service at a reasonable price prior to KCPL's implementation of these two projects. In fact, there is strong evidence, put forth by KCPL itself, that prior to the implementation of Projects LED-LDI and CORPDP-KCPL, KCPL had a very solid management team in place that produced excellent financial and customer service results.

Q. Please describe this evidence.

A. In Great Plains Energy's 2003 Annual Report at page 3, GPE's Chairman and CEO, Mr. Michael Chesser made the following comments. Mr. Chesser became Chairman and CEO in October 2003:

> Great Plains Energy Plains Energy delivered a very solid performance in 2003. Our electric utility operations excelled, and our energy management business continued to grow in a disciplined manner.
>
> Earnings and the value of our stock responded positively, as exhibited by Edison Electric Institute ranking of Great Plains Energy Plains Energy in the top 10 for total shareholder return.
>
> Kansas City power & Light benefited from our low-cost coal and nuclear generation fleet. This fleet allowed the Company to provide

> low-priced power to our customers and also drove strong margins on wholesale power sales during off-peak times.
>
> I am delighted with the skill, experience and depth of our management team. I want to personally congratulate Bernie (GPE's former Chairman and CEO) for his legacy in preparing Great Plains Energy for future success.
>
> As your new chairman, I come to Great Plains Energy Plains Energy because I see opportunity. I feel extremely fortunate to take the helm of a company with real strengths. Our employees are loyal, proud, dedicated and talented. We have a competitive generation fleet, a reliable transmission and distribution system, and one of the most successful non-regulated business ventures in the industry.
>
> This family of businesses has achieved solid results in the past and holds promise to continue growing in the future.
>
> Our total return to shareholders was 47 percent during the year, representing a stock price increase of 39 percent, in addition to an attractive dividend.
>
> Distribution of electricity to our 490.000 KCP&L customers ranked in the top tier of the Midwestern utilities with a very low frequency and duration of interruptions.
>
> We continued to upgrade customer service in 2003 through enhancements in our call center, billing and web site.
>
> Great Plains Energy achieved an average return on equity of 15 percent.
>
> The Kansas City Star ranked Great Plains Energy No. 1 in its annual "Star 50" performance review of public companies - highlighting our focus on the core business, solid financial results and stable cash flows.
>
> We also were rated one of Kansas City's "best places to work" by the Business Journal, citing our commitment to employee training and development.
>
> We are in solid shape and prepared for the challenges of 2004 and beyond.

Based on these statements by GPE's Chairman and CEO, it does not appear that there was any problem with KCPL management's leadership skills prior to the creation and implementation of these two management leadership projects.

Q. Even if these project expenditures do not meet the used and useful test of rate base inclusion, does the Staff believe that by making these expenditures, KCPL is making a reasonable attempt to improve management leadership skills and this effort has the potential for future benefits?

A. Yes. This is precisely the reason why the Staff is proposing that these project costs be recovered over a five-year period. The Staff is not making any judgment that these costs are imprudent or that they may not have some future benefit.

Q. Since KCPL wants to classify these project costs as rate base assets, is there a glaring inconsistency between this classification and the accelerated recovery period of five years KCPL is proposing?

A. Yes. One of the principles of accounting and ratemaking is referred to as the matching principle. This principle requires costs incurred for current service to be "expensed" in the current year. It also requires that those costs that are necessary to provide service over future years are to be capitalized or deferred and recovered by a charge to expense over the useful life of the underlying asset or the period in which the asset will provide benefits.

Applying this principle to KCPL's proposal, the only conclusion one can reach is that KCPL expects that the benefits it obtains as a result of these projects will last no longer than five years. This is the inconsistency. It is obvious that if actual benefits are created from spending millions of dollar to improve the leadership skills of the Company's management, these benefits should last well beyond five years.

Q. If the Commission decides that these project costs should be included in KCPL's rate base in this case, what amortization period does the Staff recommend that the Commission order for these assets?

A. The Federal Energy Regulatory Commission (FERC) Uniform System of Accounts defines the term amortization as follows:

> Amortization means the gradual extinguishment of an amount in an account by distributing such amount over a fixed period, over the life of the asset or liability to which it applies, or over the period during which it is anticipated the benefit will be realized.

The Staff believes that the Commission should order an amortization period of not less than 15 years. This period would more closely match the benefits of the projects with their costs.

Q. Has the Commission recognized the importance of matching costs with benefits so that the utility customers who enjoy the benefits created by the costs are also the customers who are responsible to pay the cost?

A. Yes. The Commission recognized this very important ratemaking principle in its Report and Order on Remand in Case No. WO-2002-273, Missouri American Water Company:

> The AAO is one of the Commission's chief regulatory tools for implementing another aspect of the Matching Principle. As discussed above, one aspect of the Matching Principle is to match revenues and expenses with the period in which they were incurred. However, under another aspect of the Matching Principle, "ratepayers are charged with the costs of producing the service they receive."[41] The purpose is to match costs with benefits so that the ratepayers that enjoy the benefits of utility property also bear the costs thereof.[42]

Q. Has the Commission recognized the importance of matching the amortization period of a regulatory asset deferral to the period in which benefits are anticipated to be realized?

A. Yes. In its Report and Order in Case No. GR-98-140, Missouri Gas Energy, issued on August 21, 1998, the Commission recognized the importance of tying the amortization period of a regulatory asset deferral to the period in which the benefits of the expenditures that created the regulatory asset will be enjoyed:

> The Commission finds that competent and substantial evidence has been presented and adduced to support the Commission's approval of the recovery of the SLRP carrying cost over a ten-year period.
>
> Ten years relates better to the period in which it is anticipated the benefits will be realized and ten years relates closer to the deferral period itself, and is, therefore, just and reasonable.
>
> The Commission does note that Staff has provided ample evidence to show that its proposal of the 20-year amortization period was not extreme as noted in the Commission's Report and Order in the prior MGE rate case, Case No. GR-96-285.
>
> While Staff has produced sufficient evidence to support its position, the Commission finds that it is not necessary to relate the amortization period for the deferral or carrying costs to the life of the property constructed but rather to the deferral period or the period during which it is anticipated the benefits will be realized.

The Commission clearly ties the amortization of cost deferrals included in rate base to a period over which the benefits resulting from incurring the deferred costs are enjoyed.

**SO2 PREMIUMS**

Q. Please summarize this issue.

A. On July 28, 2005, in Case No. EO-2005-0329, the Commission issued a Report and Order that approved KCPL's experimental regulatory plan. That order also approved a Stipulation and Agreement (Stipulation and Agreement) which includes the following language:

> KCPL currently purchases coal from vendors under contracts that indicate nominal sulfur content. To the extent that coal supplied has a lower sulfur content than specified in the contract, KCPL may pay a premium over the contract price. The opportunity to burn coal with lower sulfur content is both advantageous to the environment and reduces the number of SO2 emission allowances that must be used. To

> the extent that KCPL pays premiums for lower sulfur coal up until January 1, 2007, it will determine the portion of such premiums that apply to retail sales and will record the proportionate cost of such premiums in Account 254. But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually.

In its direct filing in this case, the Staff proposed to treat all SO2 premiums paid by KCPL to its coal suppliers against the Account 254 Regulatory Liability in rate base instead of charging these payments to fuel expense. The Staff also reduced KCPL's June 30, 2006, balance in Account 254 by the annual amount of SO2 premiums KCPL is actually paying to its coal suppliers. The Staff's reduction of the Account 254 Regulatory Liability has the effect of increasing KCPL's rate base.

Q. At page 5 of his rebuttal testimony OPC witness Kind states that the Staff proposed a ratemaking treatment for SO2 premiums that is not allowed by the Stipulation and Agreement. Does the Staff agree Mr. Kind's assertion?

A. No. Mr. Kind reads the Stipulation and Agreement as barring the Staff from proposing future ratemaking treatment of KCPL's SO2 liability in a different manner from how KCPL is required to account for this liability on its books and records through the period ending December 31, 2006. The Staff does not read the Stipulation and Agreement as barring the Commission from ordering any type of ratemaking treatment of this liability as a result of this rate case.

Q. What is the basis of Mr. Kind's position?

A. Mr. Kind states that the relevant portion of the Stipulation and Agreement appears on pages 9 and 10 of the agreement and he quotes this language at page 5 of his rebuttal testimony. He puts an emphasis on the Stipulation language that he feels has been violated by the Staff proposal. The language Mr. Kind points to states: "But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually."

Q. How does the Staff interpret this requirement of the Stipulation?

A. The Staff views this requirement as simply preventing KCPL from charging more than $400,000 to this account on an annual basis up to and including calendar year 2006. The rates from this case do not go into effect until January 2007, which is after the ending date of the period specified in the Stipulation and Agreement for this issue, December 31, 2006.

Q. Does KCPL agree with Staff's proposed treatment of SO2 emission allowances?

A. Yes. KCPL has not identified any disagreement with the way Staff treated the SO2 emission allowances in this case.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.