BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power and 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**

FINAL POST HEARING BRIEF OF
KANSAS CITY POWER & LIGHT COMPANY

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Kansas City Power & Light Company ("KCPL" or "Company") respectfully submits its Final Post Hearing Brief in accordance with the Commission's Order Setting Procedural Schedule issued on March 29, 2006. KCPL will discuss the issues addressed by the parties in their Post-Hearing Briefs filed on November 17, 2006, and its position on the list of issues considered in the True-Up Proceeding held on November 16, 2006. Although KCPL anticipated and responded to most of the arguments raised by other parties in its Post-Hearing Brief, a few additional comments need to be made in response to the Post-Hearing Briefs filed by other parties in this proceeding:

A. <u>Executive Summary</u>

Contrary to the unsubstantiated arguments of Staff, Public Counsel and other parties that were laced throughout the hearings and in their briefs, KCPL does not want "to extend the extraordinary run of over earnings it has enjoyed over the last twenty years through its upcoming construction period." (Public Counsel Br., p.3). In fact, KCPL does not have a history of "over earnings" complaint cases. In reality, KCPL has lowered its rates with the agreement of the Commission, Staff, Public Counsel and other customer representatives on four separate occasions when the facts suggested such reductions would result in just and reasonable rates. As Mr. Robert Camfield has demonstrated in his unrebutted testimony, KCPL's rates have been falling at a faster rate than the electric industry as a whole or its neighboring electric companies.

(Ex. 36, pp.14-15; Schedule RJC-2). However, as the competent and substantial evidence in this proceeding clearly demonstrates, after twenty years of rate reductions, KCPL now needs a rate increase if it is to continue to provide safe and adequate service at just and reasonable rates, as well as to implement its Comprehensive Energy Plan.

As explained below, the Company's overall rate increase request at the conclusion of the true-up proceeding is now $55.8 million. However, the components of the overall increase have changed as a result of the trued-up information. KCPL's September true-up case reflects a traditional revenue requirement of $42.2 million under traditional ratemaking, and a $13.6 million increase of Additional Amortization to meet its credit metrics to stay at an investment grade rating. (Ex. 56, p.8).

Following the True-Up Proceeding, Staff's proposed revenue requirement increase is a positive $27 million. (Tr. 1658). Staff is now recommending that the Commission adopt a negative $28 million under Staff's traditional ratemaking case (Ex. 164, p.13), and a $55 million Additional Amortization to meet KCPL's credit metrics. (Tr. 1658). The details of the True-Up Proceeding will be discussed below in the True-Up Proceeding section of this brief.

B. Revenue Requirement

1. Cost of Capital

The major disagreement among the parties is whether a mechanical application of the discounted cash flow ("DCF") methodology should be used to grant KCPL a return on equity ("ROE") in the range of 9%, or whether a more realistic approach recognizing the demands of the marketplace and contemporary economic conditions that yields a base ROE of 11% should be adopted, as proposed by KCPL's Dr. Samuel Hadaway. The related issue is whether an adjustment of 50 basis points should be added because of construction risks to KCPL as it embarks upon a $1.3 billion infrastructure program. A common sense evaluation of the experts' testimony, in the context of investor expectations and the specific construction plans of KCPL, clearly justifies the Commission ordering an ROE of 11.50%.

The major difference between Dr. Hadaway and the other experts is that he used a Constant Growth DCF analysis that considered long-term growth forecasts consistent with the U.S. Gross Domestic Product (GDP) index. (Tr. 1260-61, 1282-83). Although he conducted a traditional Constant Growth DCF analysis, similar to the other experts, it failed his "checks of reasonableness" because it yielded ROE rates that were inconsistent with ROEs issued by the Federal Energy Regulatory Commission (FERC) and other state regulatory commissions, as well as contrary to what equity investors would expect as a reasonable rate of return. (Tr. 1285-87). Dr. Hadaway's Constant Growth (GDP Growth) DCF analysis, combined with his Multistage Growth Model, yielded an ROE range of 10.6% to 11.3%. (Ex. 33, Hadaway Direct Testimony at 35). He noted at the evidentiary hearing that FERC has routinely used GDP growth rates in gas pipeline cases, as have other state regulatory commissions, including the New Hampshire and Utah Commissions. (Tr. 1286-87). The use of such "sustainable growth" methods is consistent with the DCF cash-flow models that were first developed in the 1950's. (Tr. 1285). They also avoid extremely high or extremely low growth rates that do not appear reasonable over time. (Tr. 1286-87).

The 50 basis point adder proposed in this case is premised entirely on construction risk. (Ex. 33, Hadaway Direct Testimony at 3-5; Tr. 1248-49, 1297, 1305). Contrary to Staff's suggestion, KCPL has not recommended that 50 to 100 basis points be added to the 11.50% requested ROE. What Staff in its Initial Post-Hearing Brief at 72 was apparently referring to was Robert Camfield's statement that such an adjustment could be "fully justified" by KCPL's excellent performance (Tr. 1405). However, Mr. Camfield clarified that it was "not correct" for Staff to suggest that 50 or 100 basis points be added to Dr. Hadaway's 11.5% recommendation. (Tr. 1408-09).

Similarly, Staff's claim that Dr. Hadaway "admitted" that his use of the DCF model did not accord with the Supreme Court decisions in Bluefield Waterworks & Improv. Co. v. PSC, 262 U.S. 679 (1923), and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944), is erroneous. To the contrary, he testified that the DCF analysis was not even developed until the 1950's (Tr. 1285). Dr. Hadaway explained that the Bluefield quote on page 14 of his Direct Testimony did not mean that experts today would be limited by a 1923 Supreme Court case to using only short-term growth rates. (Tr. 1260-61). He observed that "the models that we use do evolve over time and the correct models are those that are more robust than the one that [Staff's] Mr. Barnes applied." (Tr. 1261). Summarizing his methodology, Dr. Hadaway testified:

> I presented the [DCF] traditional method using these low estimates to show that a 9.3 or 9.4 is what you get. I tested that against the risk premium numbers and those results failed to pass the test of reasonableness, so I rejected them. I went back to the 6.6% forecast GDP growth rate, put it into the model and it produces approximately 11% ROE, slightly higher than that. [Tr. 1287].

This common sense, practical application of the DCF method entirely justifies an 11% base ROE.

Finally, the 50 basis point adder for construction risk is appropriate, as well as consistent with assessments of risk made by this Commission in other cases. See In re Empire Dist. Elec. Co., No. ER-2004-0570 (Mo. P.S.C., Mar. 10, 2005) (30 basis points added for risk). It was undisputed that KCPL is embarking upon an infrastructure program that "relative to the size of the projected construction programs from comparable companies" is "almost twice as big." (Tr.

1305). As Exhibit 1 to Dr. Hadaway's Direct Testimony indicated, KCPL's total capital spending relative to net plant exceeds 95%, compared with a 56.2% figure for the 24 companies in Dr. Hadaway's peer group. (Sched. SCH-1, Ex. 33). In response to questions from Commissioner Clayton, Dr. Hadaway acknowledged that a measure of protection is offered to the Company's bondholders by the Stipulation, given its explicit approval of adjustments to maintain bond ratings. (Tr. 1305-06, 1309-10). However, it does not directly address the interests of equity holders. Consistent with the testimony of KCPL's Michael Cline (Tr. 1087-88; Ex. 23, Cline Direct Testimony at 5-6; Ex. 24, Cline Rebuttal at 3-4) and Chris Giles (Tr. 799-800), Dr. Hadaway noted: "If you substitute a large amount of amortization for a very low ROE, then the earnings of the company are hurt now and they're hurt as you go forward because its rate base is smaller." (Tr. 1310). He noted that this "two-edge sword" "could cut both ways." Id.

None of the other ROE experts offered persuasive testimony to contradict Dr. Hadaway's analysis. While DOE's Dr. Woolridge accepted Dr. Hadaway's group of 24 comparative companies, his extreme application of the Constant Growth DCF model led to the lowest ROE of all the experts, 9.0%. It is likely that if Secretary of Energy Samuel W. Bodman (who Dr. Woolridge could not even identify) was aware of his punitive recommendation, the Secretary would view it as completely inconsistent with his efforts to promote electric utility infrastructure in the United States, consistent with the Energy Policy Act of 2005. (Tr. 1332-33).

While OPC's Michael Baudino criticized Dr. Hadaway for failing to use the Constant Growth DCF model, Mr. Baudino himself, in the exercise of professional judgment, recommended that the Commission not rely on his Capital Asset Pricing Model (CAPM) calculations because they yielded an ROE on the high side of 12.49%. (Tr. 1099-1100).

Acceptance of those results would have put Mr. Baudino's ROE in the neighborhood of 11%, similar to that of Dr. Hadaway. Finally, the opinions of Staff's Matthew Barnes must be rejected in their entirety because there were only five companies in the comparative group in his Constant Growth DCF analysis, none of which are located in the Midwest and most of which have operations and business lines quite different from KCPL. (Tr. 961-69). Indeed, he testified that Hawaiian Electric, with little if any off-system sales and with major banking operations, was "probably the most comparable to KCP&L, in my opinion." (Tr. 971).

KCPL's recommendation of an 11% base ROE with a 50% basis point adder for construction risk is reasonable, particularly considering the compelling evidence of the Company's excellent performance over the past decade. (Tr. 1412).

2. <u>Off-System Sales</u>

a. What level of off-system sales margin should be included in determining KCPL's cost of service?

The parties who oppose KCPL's proposal to set rates for off-system sales at the 25% point on the probability range presented by Michael Schnitzer uniformly fail to appreciate the risks that KCPL faces in this volatile market. They also misconstrue KCPL's proposal as a violation of the Stipulation when its purpose is simply to recognize the risk of this market.

Mr. Giles has provided several means to accomplish this: (1) Set the amount to be included in the revenue requirement at the 25% point on the probabilistic curve. Thus, if margins should exceed this amount in 2007, it would result in a higher ROE than is established in this case. Such an increase in ROE would then account for this risk which no ROE witness has proposed to manage, and would mean customers and the Company would share risk equally below the 50% point on the curve. (2) Add a cap to the recommendation contained in (1) by creating a regulatory liability for the amount of margin exceeding the 50% point on the curve.

(3) Establish a regulatory asset/liability structure for the duration of the rates set in this case. As Mr. Giles testified at the hearing, if revenues exceed the 25% point, any excess would flow back to ratepayers in the next rate case, and if they fall short of the 25% point, a regulatory asset would be established such that the Company would be made whole. (Tr. 792). Thus, there would be no additional risk to this market and the ROE established in this case would not need to be adjusted to reflect this additional risk as Proposals (1) and (2) attempt to do.

Although most of the opponents' witnesses conceded that the wholesale electricity market into which off-system sales are made is unpredictable and volatile, OPC and DOE argued that the 50% point on the probability curve should be chosen to strike what they view as a fair balance between interests of the company and ratepayers. Staff ignored the risk analysis and provided no counter-analysis. Instead, it relied entirely upon a traditional historical analysis based upon off-system revenues from 2004 and 2005. Staff did so despite the fact that the amount of off-system sales and the prices at which power was sold in those years were vastly different, thus confirming the need for this Commission to establish a mechanism to deal with this volatile piece of the Company's revenue picture. (Ex. 32, p.5-6; Tr., p.841 (Traxler)).

Despite the caustic rhetoric of OPC in its initial pre-hearing brief, KCPL's proposal is consistent with the testimony of its witness Ralph Smith. (Ex. 210, p.11). As Mr. Smith suggested, an "alternative mechanism" whereby KCPL establishes "a regulatory liability (or asset) account" is entirely consistent with the Stipulation and would not have been proposed by OPC if it thought Mr. Smith's recommendation would violate the Stipulation's terms. Neither Staff nor any other party has presented any evidence, testimonial or otherwise, suggesting that Mr. Smith's mechanism would be a violation of the Stipulation. Since one of the three proposals presented by KCPL tracks the Smith recommendation, it cannot be argued that KCPL is in violation of the Stipulation. KCPL is indifferent to which of the above proposals the Commission adopts, each of which is a risk management tool. Proposal (3), which is identical to Mr. Smith's alternative, eliminates the risk of the market which KCPL would accept. Proposals (1) and (2) share the risk, rather than eliminate it, and KCPL would accept these mechanisms as well. Given that all three potential outcomes are acceptable, there is no argument that the sharing of risk violates the Stipulation. Staff's position that rates be set under the assumption that off-system sales margins in 2007 will be similar to 2005 must be rejected. There is no basis to rely on historical data and ignore the risk of this market which Staff admits does exist.

What the Stipulation prohibits is "any adjustment that would remove any portion of [KCPL's] off-system sales from its revenue requirement determination in any rate case . . . ." See Stipulation, § III(B)(1)(j) at 22 (emphasis added). The KCPL mechanism is not an adjustment that would send money to shareholders or ratepayers to the detriment of the other. Either the risk is shared or it is eliminated. It is, consistent with OPC witness Ralph Smith, an "alternative mechanism" to deal with the risks of the off-system sales market. Mr. Traxler's opinion that the KCPL proposal "is an assignment of profit for off-system sales" (Tr. 847-48) is simply wrong. To the extent there is any confusion in the record, Mr. Giles made clear in responding to Commissioner Murray's questions that if off-system sales margins exceed the 25% point on the curve, they would be appropriately booked and KCPL "would then flow that regulatory liability back to customers in the next rate case." (Tr. 791-92). Such a system is not an adjustment that would remove any portion of off-system sales margin from the revenue requirement determination and, therefore, is clearly permitted by the Stipulation. It is also consistent with KCPL's long-held position that it has "no inherent right to earnings from the off-system sales market." (Tr. 751; Ex. 4 p. 7).

Staff cites State ex rel. Union Elec. Co. v. PSC, 765 S.W.2d 618 (Mo. App. 1988), as somehow prohibiting this Commission from accounting for risks as it sets rates. However, a careful reading of that case shows that the Commission rejected Union Electric's request that Callaway II cancellation costs be recovered in rates because the utility itself had already accounted for such risks. The Court of Appeals noted the Commission's detailed findings that costs had been transferred to Callaway I from Callaway II through "an accounting maneuver" which "reduced the Company's exposure to possible cost sharing if the Commission had ordered the ratepayers and investors to share the cost of Callaway II." Id. at 623. Furthermore, the Commission noted that the evidence indicated that the announcement of the cancellation of Callaway II had eliminated capital needs that "would markedly improve Union Electric's financial condition." Id. at 624. As a result, projections showed that Union Electric's "cash flow would exceed 300 percent of construction needs, coverage ratios would rise beyond the standards of AA bond rating, the ratio of equity to debt would sharply increase, and that Union Electric would not need access to the financial market for the remainder of the 1980's." Id. The Court observed that these projections "were close to accurate," and that "Union Electric's bond rating were increased from BBB- to A- in Standard & Poor's and from Baa3 to A3 in Moody's Investor Service ratings. Id. Given these and other specific facts showing the reduction of risks to Union Electric and the enhanced financial position of the utility, it was logical for both the Commission and the Court of Appeals to include that "shareholders have been rewarded for their investment and compensated, at least in part, for the risks they incurred." Id.

The facts of this case stand in stark contrast. This Commission's approval of the Stipulation has not resulted in any improvement in KCPL's bond ratings. There has been no evidence of accounting maneuvers or other cost transfers that have mitigated the Company's risks in the wholesale electricity market. If anything, the 1988 Union Electric case stands for the proposition that the Commission is empowered to approve mechanisms to permit a utility to manage its risks, and to take proper account of those situations where the utility has already done so. Missouri law plainly gives this power to the Commission with regard to interim or experimental rates and regulatory plans "as a matter of necessary implication from practical necessity" to deal with financial and other issues that may confront an individual utility. State ex rel. Laclede Gas Co. v. PSC, 535 S.W.2d 561, 566-67 & n. 1 (Mo. App. 1976). See Union Electric Co. v. PSC, 136 S.W.3rd 146, 152 (Mo. App. 2004) (Commission administration of an experimental alternative regulation plan found consistent with its "responsibility to regulate").

KCPL's proposal, as articulated by Mr. Giles at the evidentiary hearing, is a sound method to account for the Company's risks in the off-system sales market and does not violate the Stipulation.

b. How should the off-system sales margin be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?

KCPL proposes using an unused energy allocation methodology to allocate KCPL's margins, or profits, from off-system sales among its Missouri retail, Kansas retail and FERC wholesale jurisdictions. Staff, OPC and Praxair suggest that an energy allocator would be more appropriate. KCPL has never before sought to allocate separately its off-system sales margins among these jurisdictions. (Ex. 5, p.5). KCPL previously allocated total off-system sales revenues on an energy basis. However, "because off-system sales margins have increased so dramatically, it is no longer appropriate to allocate between jurisdictions based on kwh." (Ex. 4, p.10).

Staff argues that KCPL has allocated off-system sales revenues on an energy basis in the past and so therefore should also allocate margins on that basis going forward (Staff Br., p.57).

Staff then argues that KCPL's use of an energy allocator in its past earnings surveillance reports further supports using an energy allocator. (Id.). Such reasoning is flawed because KCPL was required to use an energy allocator in its surveillance reports. In any event, the Commission is free in this case to adopt the allocation methodology that it believes will result in just and reasonable rates independent of KCPL's past practices.

Similarly, Staff and OPC suggest that the Commission should reject the unused energy allocator because it is novel. (Staff Br., p.58; OPC Br., p.18). Every allocation methodology currently in place was novel at one time and likely replaced a preceding, "traditional" methodology. If their argument were adopted, allocation methodologies could never evolve to reflect changes in the industry. The Commission should reject such reasoning as flawed. Instead, the Commission should consider whether an energy allocator or the unused energy allocator will result in just and reasonable rates in today's market environment. DOE and Praxair also attempt to dismiss the unused energy allocator out of hand because KCPL witness Don Frerking has not previously developed an allocation methodology. (DOE Br., p.12; Praxair Br., p.14). Such an argument does not speak to whether the unused energy allocator results in just and reasonable rates.

The parties then suggest that the unused energy allocator "rewards" Kansas and "punishes" Missouri. (Staff Br., pp.58, 62). It is not appropriate to evaluate an allocation methodology in such terms. Moreover, rewarding or punishing jurisdictions is not the intent or result of the unused energy allocator. To the contrary, the unused energy allocator was designed to equitably allocate KCPL's off-system sales margins by considering why KCPL has unused capacity during certain times of the year from which to make such sales. (Ex. 4, p.10). As explained by Mr. Giles, "more generation capacity is available and unused in Kansas than

Missouri." (Ex. 4, p.10). The allocation of off-system sales should "reflect the unused capacity that Kansas customers are paying for in their rates." (Ex. 4, p.10). The unused energy allocator "represents an equitable allocation between [Missouri and Kansas]." (Id.).

Staff suggests that the unused energy allocator "is not in keeping with the letter and intent" of the Regulatory Plan Stipulation and Agreement in Case No. EO-2006-0329. Staff's contention is inaccurate and unsupported by the evidence on the record in this proceeding.

KCPL's unused energy allocation methodology represents a just and reasonable means of allocating KCPL's off-system sales margins. As Staff witness Cary Featherstone acknowledged, it is inequitable for a jurisdiction to receive a share of off-system sales margins that differs from its share of generation plant costs. (Tr. 697). KCPL's proposed unused energy allocation methodology is based upon a demand allocation methodology (the methodology upon which KCPL allocates generation plant cost). KCPL's proposed methodology results in an allocation that is closer to the allocation of generation plant costs than Staff's proposal to use an energy allocation methodology. (Tr. 698-99). The Commission should allocate off-system sales margins using KCPL's proposed unused energy allocation methodology.

c. What parameters does the Commission-approved Stipulation & Agreement in Case No. EO-2005-0329 impose on the treatment of off-system sales revenue in this case?

The Stipulation does not bar or otherwise restrict the Commission from setting off-system sales revenues for ratemaking purposes by means of a risk-sharing mechanism, as described by Mr. Schnitzer and Mr. Giles. Please refer to the arguments set forth above in Subsection (a).

d. Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders? Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?

Under KCPL's proposal customers will eventually receive all the benefit from off-system sales margins. KCPL does not propose sharing such margins with customers, which would be contrary to the Stipulation's Section III.B.1.j at 22.

3. Regulatory Plan Additional Amortizations

a. What amount of Regulatory Plan additional amortizations should be allowed to maintain KCPL's credit rating? Should a "gross up" for taxes be added to this amount? If so, what amount is appropriate?

See discussion below.

b. What risk factor should be used in calculating the Regulatory Plan additional amortizations for off-balance sheet purchased power agreements?

See discussion below.

c. Over what period of time should the Regulatory Plan additional amortizations be treated as an offset to rate base?

See discussion below.

d. Should the capital structure be synchronized with the investment in Missouri jurisdictional electric operations? How should that be accomplished?

See discussion below.

e. Should an amount be added to Missouri jurisdictional rate base to reflect additional investments related to Missouri jurisdictional electric operations?

KCPL, Staff, and other parties expect to file a Non-Unanimous Stipulation And Agreement Regarding Regulatory Plan Additional Amortizations that will address and resolve the issues related to the mechanics of calculating the Additional Amortization, with the exception of the risk factor to be applied to off-balance sheet investments. Since the Staff's position on the risk factor issue was formally updated during the True-Up Proceeding, the risk factor issue will be addressed in the section of brief dealing with the True-Up Proceeding.

This section of the brief, however, will address a few arguments raised by other parties in connection with various aspects of the Regulatory Plan Additional Amortization issue in their respective Post-Hearing Briefs.

<u>Response to Staff Argument</u>

Initially, Staff seeks to buttress its position that under "traditional ratemaking" KCPL is in an "excess earnings" situation, by pointing to the "Current Rate Levels" and "Rate Moratorium" provisions contained in the Regulatory Plan Stipulation And Agreement. (Staff Br., p.21). These provisions of the Regulatory Plan Stipulation are not competent and substantial evidence indicating anything about the earnings position of KCPL in this case. These provisions are merely a reflection of the fact that the Staff had conducted an earnings audit of KCPL as a part of the Regulatory Plan proceeding, and at the conclusion of the audit, KCPL, Staff, Public Counsel and other Signatory Parties agreed that "current rates should be maintained at current levels through December 31, 2006. . .". (Regulatory Plan Stipulation, p. 28).

Much of the Regulatory Plan Stipulation deals with the scheduling and mechanics of future KCPL rate cases (<u>Id</u>. at 29-44), including this 2006 rate case. (<u>Id</u>. at 30). The Signatory Parties agreed, as a part of the Regulatory Plan Stipulation, that the current rates "should be maintained" until the conclusion of this 2006 rate case. The existence of these provisions in no way suggests that KCPL was over earning at that time, or that KCPL is over earning in 2006. If the Signatory Parties thought that KCPL's rates were "excessive," as Staff now suggests, it is highly unlikely that they would have entered into a Rate Moratorium with KCPL. This is particularly evident by the fact that <u>KCPL has reduced its rates on four separate occasions in 1991, 1994, 1996/1997, and 1999</u>. (Ex. 3, p.15). Each of these rate decreases resulted from stipulations and agreements with Staff, Public Counsel and other parties. In each case, the Commission approved these rate reductions. (Id.)

As Staff correctly points out in its Post-Hearing Brief, "KCPL supports the additional amortization mechanism, but not as a . . . substitute for fair ratemaking." (Tr. 1087) (Staff Br., p.22). KCPL has consistently suggested in this case that the Commission should keep its eye on the big picture, and not adopt the aggressive positions of Staff, Public Counsel or DOE that will ultimately hammer KCPL's equity earnings, making it difficult or impossible to raise the equity capital to complete the Comprehensive Energy Plan, and then make up the necessary cash flow to meet its credit metrics by utilizing the Regulatory Plan Additional Amortizations. (Tr. 59-61; Ex. 4, pp.11-15).

Interestingly, Staff's Initial Brief indicates that it agrees with KCPL on this point:

> The Staff has never suggested anything to the contrary. The Staff believes the record shows that KCPL's principal response to the Staff's cases both in general and in specific is rather than acknowledge that the Staff's positions are based on what the Staff believes are legitimate ratemaking principles, different from KCPL's, is to demonize the Staff's positions asserting that the Staff is seeking to use the additional amortizations provisions of the KCPL Regulatory Plan Stipulation And Agreement as a way to provide KCPL the dollars necessary to meet its cost of service revenue requirements on the cheap. (Staff Br., p.22).

KCPL has never sought to "demonize the Staff's positions," irrespective of Mr. Thompson's opening statement. (Tr. 71). Quite to the contrary, KCPL has greatly appreciated the willingness of Staff, Public Counsel, and other Signatory Parties to enter into the KCPL Regulatory Plan to map out a responsible regulatory path that should lead to the completion of the Comprehensive Energy Plan if it is appropriately implemented. However, KCPL respectfully suggests that Staff and Public Counsel may have lost sight of the end goal of this regulatory process. Without attempting to "demonize" anyone in this process, KCPL must vehemently disagree with their view of what is "fair ratemaking" or "legitimate ratemaking principles" -- at least as those terms are embodied in many of their recommendations in this case.

The following candid testimony of Staff witness Steve Traxler illustrates KCPL's concern. Mr. Traxler testified that under "traditional regulation" (at least as that term is used by Staff), <u>KCPL would clearly be in jeopardy of losing its investment grade rating if the Commission accepted the Staff's recommendations in this case without the utilization of the Additional Amortizations</u>:

[Fischer]: Mr. Traxler, you were asked some questions by Commissioner Murray regarding traditional regulation and the stipulation and the investment-grade rating.

[Traxler]: Yes.

[Fischer]: Let's assume for a minute that the Regulatory Plan did not include the Regulatory Plan amortization. Does it follow from what you've said to Commissioner Murray that if the Staff's position was accepted in this case, that KCPL would not meet its financial metrics to stay investment-grade rated and it would be downgraded under traditional ratemaking?

[Traxler]: My answer to that question would be yes, in terms of where the case is right now before the true-up, that there wouldn't be sufficient cash flow to – one of the metrics would be met, one of them would not. (Tr. 1206-07).

At the conclusion of the True-Up Proceeding, Staff is now recommending that the Commission adopt a <u>negative</u> $28 million under Staff's "traditional ratemaking" case (Ex. 164, p.13), and a $55 million Additional Amortization to meet KCPL's credit metrics. (Tr. 1658). So even after KCPL has invested an additional $116 million in Missouri jurisdictional plant in service, including $85 million in the Spearville Wind Generation Facility, Staff's "traditional ratemaking" recommendation would result in KCPL failing to meet its credit metrics to stay investment grade rated—unless a $55 million Regulatory Plan Additional Amortization is included in the Revenue Requirement!

In light of the current recommendations of Staff and Public Counsel, KCPL must respectfully ask these questions:

- Does it make sense to practice the "traditional ratemaking" recommended by Staff and Public Counsel if the clear result would be the downgrading of KCPL, absent an extraordinarily large Additional Amortization?

- Is it good public policy to adopt such a low ROE recommendation, as suggested by Staff, Public Counsel and DOE, that KCPL would be unable to raise equity capital to complete the Comprehensive Energy Plan and would be downgraded, without a $55 million or larger Additional Amortization?

- Doesn't it make better public policy to adopt the ROE recommendation, as proposed by KCPL, that will maintain KCPL's ability to attract equity capital and complete the Comprehensive Energy Plan, especially when the ultimate rate increase to the customer in this case will be still the same? (Ex. 51).

- Does it make good public policy to adopt a $ 12.6 million depreciation adjustment reducing depreciation expense, as proposed by Staff, and then increase the Regulatory Amortization by the same $12.6 million to make up for the reduced cash flow produced by the depreciation adjustment?

- Does it make good public policy to eliminate from the revenue requirement under "traditional regulation" 113 employees who have been hired by KCPL to replace those that retired or left just prior to the September 30, 2006 true-up date? (See discussion of this issue in the True-Up Proceeding section below).

While KCPL disagrees with many of the adjustments recommended by other parties in the name of "traditional regulation," KCPL does not disagree with Staff when it states: "The additional amortization in the Staff's case is a fallout to whatever the numbers generate based upon what the Staff contends are appropriate positions on each particular issue, including return on equity, independent of any Regulatory Plan Additional Amortization calculation." (Staff Br., pp. 22-23). However, KCPL would respectfully request that the Commission recognize the impact of its various decisions in this case, including return on equity, off-system sales, depreciation, payroll, and other cost of service and rate base issues, on the need for the extraordinary Additional Amortization. "Traditional regulation" should not be practiced in Missouri in a way that requires a maximum Additional Amortization -- just to keep public utilities like KCPL from being downgraded as a result of the fallout from "traditional regulation."

Response to Public Counsel

KCPL's comments regarding Public Counsel's arguments related to the additional amortization and the risk factor issue are contained below in the True-Up Proceeding section of this brief.

Response to DOE

DOE argues that Additional Amortizations should be used by the Commission "only if the Commission finds that evidence offered herein supports a finding that Standard and Poor's (S&P) will or is about to downgrade KCPL's credit rating and that a downgrading of KCPL's debt will be more unreasonable and costly to KCPL ratepayers than requiring ratepayers to fund the additional amortization expense." (DOE Br., pp. 18-19).

However, DOE's proposed standard for utilizing the Additional Amortizations is not the standard approved by the Commission in the Regulatory Plan Stipulation. (Ex. 143). In that Stipulation the standard for utilizing the Additional Amortizations was stated as follows:

> The Signatory Parties agree to support an additional amortization amount added to KCPL's cost of service in a rate case when the projected cash flows resulting from KCPL's Missouri jurisdictional operations, as determined by the Commission, fail to meet or exceed the Missouri jurisdictional portion of the lower end of the top third of the BBB range shown in Appendix E, for the Funds from Operations Interest Coverage ratio and the Funds from Operations as a

> Percentage of Average Total Debt ratio. The Signatory Parties agree to adopt an amortization level necessary to meet the Missouri jurisdictional portion of these financial ratios. (Ex. 143, p.20).

The competent and substantial evidence in the record clearly demonstrates that KCPL will fail to meet or exceed the metrics discussed above, especially if the recommendations of Staff, Public Counsel or DOE are adopted by the Commission. (Tr. 1206-07). Even under KCPL's recommendations in the True-Up Proceeding, it will still be necessary to utilize an Additional Amortization. As explained by KCPL witness Tim Rush in the True-Up Proceeding, KCPL's September true-up case reflects a traditional revenue requirement of $42.2 million under traditional ratemaking, and a $13.6 million increase of Additional Amortizations to meet its credit metrics to stay at an investment grade rating. (Ex. 56, p.8).

In its brief, DOE stated that "if the Commission allows any additional amortization, then DOE supports Staff's calculations [related to the gross-up for taxes] in this case." (DOE Br., p.20). As such, it has now joined KCPL, Staff, Public Counsel in recommending that the tax impact of the Additional Amortizations be reflected in KCPL's rates in this case.

For the reasons stated herein, KCPL respectfully requests that the Commission adopt its recommendations relating to the calculation and level of the Regulatory Plan Additional Amortizations, as consistent with KCPL's position in the True-Up Proceeding.

4. <u>Incentive Compensation</u>

a. What amount, if any, of incentive compensation should be included in rates?

Staff ignores the fundamental flaw in its argument and instead makes an unsubstantiated attack on KCPL's evidence on this issue. Of course, the Company is not suggesting that it should prevail on the incentive compensation issue just because it is a good company. What KCPL's cross-examination of Staff witness Harris showed was that Staff avoided the opportunity to test its theory that ratepayers can be harmed by incentive plans that are tied to earnings per share (EPS) or other financial measures. Staff performed no analysis of KCPL's customer service performance and did not take issue with KCPL witness Camfield's findings of KCPL's superior performance. Therefore, Staff's theory that KCPL would sacrifice customer service (by reducing tree trimming or eliminating call centers-to use Staff's hypothetical examples) remains only a theory.

Staff continues its avoidance of the issue with its reference to KCPL's past overearnings. (Staff Br., p.5). The rates to be set in this case are forward looking. Staff's argument that this issue should be decided on the basis of past earnings smacks of retroactive ratemaking and is irrelevant to the setting of rates in this case.

Staff and OPC also argue that since KCPL's incentive plan was tied to unregulated operations, it should not be allowed in rates. (Staff Br., p.6; OPC Br., p.5). As explained by KCPL witness David Cross, KCPL's 2005 incentive plans were funded based on the EPS of Great Plains Energy (GPE). (Ex. 6, p.7). By using GPE EPS as a funding mechanism, the Company must be profitable in order to pay any incentive payments. (Id.) However, once the incentive plan was funded, participants earned an incentive award based on goals that are tied to providing electric service to Missouri ratepayers. (Ex. 6, pp.7-10). EPS was not the primary goal for all GPE and KCPL incentive plans. (Ex. 6, p.10).

In addition, KCPL has changed the design of its 2006 incentive plans. (Ex. 6, p.11). EPS will still be a component of the plan to insure the Company's financial strength. For the Value Link and Rewards 2006 plans, EPS has been eliminated as a specific scorecard plan goal. (Id.) The scorecard goals are focused on operational excellence, reliability, customer satisfaction and a commitment to KCPL's strategic intent. (Id.)

KCPL's incentive compensation plan is consistent with the interests of its ratepayers. Staff witness Harris agreed that being efficient encompasses financial efficiency and that efficiency ultimately benefits ratepayers. (Tr. 174). Incentive compensation based on achieving financial objectives should be included in KCPL's cost of service because it is in the best interests of KCPL's customers to have a financially efficient utility.

5. Pensions

a. How should the expense and contributions relating to pension benefits for (1) Joint Partners and (2) the Supplemental Executive Retirement Plan (SERP) be accounted for in the tracking of the regulatory asset required by the Stipulation and Agreement in Case No. EO-2005-0329?

KCPL believes that this issue has been settled and will be addressed in a Stipulation and Agreement filed with the Commission.

b. Should FAS 88 pension expenses be treated consistently with the KCPL application in this proceeding and its application for an AAO in Case No. EU-2006-0560?

KCPL believes that this issue has been settled and will be addressed in a Stipulation and Agreement filed with the Commission.

6. Hawthorn 5

a. Should the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion in 1999 have been accounted for differently?

See discussion below.

b. Is the AFUDC amount overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?

See discussion below.

c. Is the gross plant value of Hawthorne 5 overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?

See discussion below.

d. Should an adjustment be made to KCPL's books and records regarding the amount for AFUDC to fund the Hawthorn 5 reconstruction?

In its initial brief, Staff takes issue with KCPL's contention that it might have had to file a rate case had it segregated the Hawthorn 5 insurance proceeds and used them only to pay construction costs instead of day to day expenses. Staff insinuates that because KCPL agreed to reduce rates in a stipulation with Staff less than a month before the February 1999 Hawthorn 5 explosion and said nothing about the explosion when the Commission approved the stipulation in April 1999, KCPL was overearning at the time of the explosion.

Besides the fact that Commission should ignore the Staff's retroactive ratemaking argument, Staff's argument ignores the magnitude and timing of the costs that KCPL incurred as a result of the destruction of Hawthorn 5. As shown on Exhibit LAW-2 attached to the rebuttal testimony of KCPL witness Lori Wright, the majority of the replacement power costs had not yet been incurred at the date of the Commission's approval of the rate reduction (April 13. 1999). Therefore, Staff's citing of past rate reduction agreements does not rebut the opinion of Ms. Wright that had KCPL deviated from its normal cash management practices and segregated the insurance funds, the Company might have had to file a rate case or seek financing to meet its obligations during the Hawthorn 5 rebuild.

KCPL followed its normal cash management practices and paid its ongoing operations costs with the insurance proceeds. Not only was this a prudent way to manage its cash, it may have prevented KCPL from filing a rate case. But Staff wants to penalize KCPL for using the insurance funds in this way because of its unsupported belief that the insurance proceeds must be used to pay for the reconstruction costs before they can be used to pay for any other costs that

KCPL incurred. The Staff provides no evidence that the use of the insurance funds by KCPL was restricted in any way.

Staff's other point in its initial brief is that since the Hawthorn 5 unit was rebuilt, it was not withdrawn from service and therefore does not meet the definition of "property retired" under the Uniform System of Accounts (USOA). (Staff Br., p.8). Staff ignores that the definition states that "property retired" means property which has been **destroyed or** which for any cause has been withdrawn from service.

The unit was destroyed and, therefore, KCPL was correct in following the USOA and recording the insurance proceeds as salvage. The entity that mandates the use of the USOA by KCPL, the Federal Energy Regulatory Commission, despite being alerted by Staff , has not taken KCPL to task for its treatment of the insurance proceeds as salvage. Staff cites no decision by any authority that supports its position that the insurance proceeds should have been booked as a credit against the cost of construction. The Commission should reject Staff's unsupported contention that KCPL should not have followed the USOA as well as reject Staff's adjustments to the AFUDC calculation.

In its pre-hearing brief, Staff cites State ex rel. Southwestern Bell Tel. Co. v. P.S.C., 645 S.W.2d 44 (Mo. App. 1982) which it believes shows that the Commission is not bound by the USOA for setting rates. While KCPL agrees that the Commission rules do provide the Commission flexibility in setting rates, a deviation from the USOA is not to be taken lightly due to the fact that an electric utility must utilize the USOA. In the Commission decision underlying the case cited by Staff, the Commission noted that despite FCC accounting rules to the contrary, it had had a long-standing practice of excluding the cost of all plant under construction from rate base. See, In the matter of Southwestern Bell Telephone Co., 23 Mo. P.S.C. (N.S.) 374, 385;

TR-77-214 (1980). Thus, Southwestern Bell was not prejudiced by the Commission's actions as it knew or should have been aware of the Commission's ratemaking practice that was contrary to the FCC rules. In this case, there is no long-standing Commission policy regarding how insurance proceeds should be treated in the event of an explosion of a generation plant. As shown above, KCPL was justified in its decision to follow the USOA and had no reason to believe that Staff would propose that it should not follow the directives of the USOA.

7. Ice Storm Costs

a. What amount of the amortization of the costs associated with the 2002 ice storm should be included in rates?

DOE argues that, at most, only one month's worth of amortization should be included in the test year cost of service in this case. (DOE Br, p.18). DOE's argument ignores the fact that the Commission granted an Accounting Authority Order so that KCPL could defer the 2002 ice storm costs ratably over the period September 2002 through January 2007. No party contests that the entire amount was authorized during the test year period, the update and true-up periods in this case.

Just as other costs that were incurred during the test year are recognized in KCPL's cost of service, the deferred ice storm costs should be recognized by the Commission as well. The test period in this case is 2005 with true up through September 30, 2006. The ice storm amortization was in effect during this entire period and will remain in effect after the order is issued in this case. It is inappropriate to exclude costs that may change on a forward looking basis when costs that will increase on a forward looking basis are not recognized in the cost of service for this case. DOE utilizes selective judgment when it comes to including or excluding known costs. For this reason the full twelve month amortization should be included in the cost of service.

8. <u>EEI Dues</u>

a. What amount of EEI dues should be included in rates?

KCPL believes that this issue has been settled.

9. <u>Severance Costs</u>

a. What amount, if any, of severance costs should be included in rates?

Faced with the reality that KCPL has incurred severance costs over the last five years, Staff is no longer emphasizing that the Company's severance costs are not recurring. Indeed, the Staff recognizes that "KCPL may pay some level of severance costs each year." (Staff's Brief, p.9). Instead, the Staff argues that customers do not receive a benefit from the payment of severance costs. However, a utility's legal costs are part of its cost of service. Extinguishing potential claims, including the prospect of frivolous claims, against the Company is a benefit that ratepayers receive since legal expenses are capped and employees are not distracted by litigation.

Staff's last argument, that KCPL does not hold its management responsible for severance costs in its incentive plan, is a red herring. KCPL normally does include severance costs in the earnings per share calculation for its incentive plan. (Tr. 240).

KCPL requests that the Commission recognize the ongoing nature of KCPL's severance costs and find that $897,024 be included in its cost of service. This amount is less than its five year average of severance payments and is representative of its ongoing level of severance costs. (Ex. 8, p.10).

10. <u>Bad Debts</u>

a. Should the bad debt percentage be applied to reflect the total revenues, including any rate increase in Missouri jurisdictional retail revenues awarded in this proceeding?

KCPL and Staff agree that the Commission should normalize KCPL's annual bad debt expense by applying a 0.61 percent bad debt write-off factor to KCPL's Missouri jurisdictional revenue. (Staff Br., p.10; Tr. 260). The only disputed issue is whether to apply the agreed upon bad debt factor to the Missouri jurisdictional revenue determined by the Commission in this case to be just and reasonable, or to apply that factor to a previous surrogate for KCPL's Missouri jurisdictional revenue requirement.

Staff would have the Commission determine KCPL's Missouri jurisdictional revenue requirement based upon the evidence presented in this proceeding, then disregard that number for the purpose of annualizing KCPL's bad debt expense. Staff would have the Commission apply the agreed upon bad debt factor to a surrogate for KCPL's Missouri jurisdictional revenue requirement that the Commission knows is inaccurate. Such an outcome would likely result in an under recovery by KCPL of its bad debt expenses.

As KCPL witness Don Frerking explained, if the actual Missouri jurisdictional revenue requirement that the Commission concludes is appropriate in this proceeding is greater than the surrogate that Staff proposes to use, then Staff's position will understate the bad debt expense KCPL will incur once the new rates are in place. (Ex. 11, p.15). The Commission should apply the agreed upon 0.61 percent bad debt write-off factor to the Missouri jurisdictional revenue requirement that the Commission determines to be just and reasonable in this proceeding.

11. Fuel & Purchased Power Expense

a. What is the appropriate level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?

After reviewing Staff's calculations related to fuel and purchase power expense, KCPL has accepted the Staff's fuel and purchased power numbers in this proceeding, subject to true-up through September 30, 2006. (Tr. 361). As a result, there is no issue between KCPL and Staff to be resolved by the Commission related to fuel and purchased power expense at this time. Since no other party addressed this issue in their Post-Hearing Briefs, KCPL has no further comments on this issue.

b. What level of natural gas fuel price should be used in the production cost modeling that is used, along with appropriate fuel adders, to quantify the level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?

While Public Counsel initially raised this issue in the pre-filed testimony of Ralph Smith, it did not address this topic in its Post-Hearing Brief. (Public Counsel Br. 1-26). During the hearings, Public Counsel witness Ralph Smith testified that his concerns regarding natural gas prices would be alleviated if the natural gas prices included in the case were trued-up. (Tr. 454). Since KCPL and Staff have trued-up the price of natural gas as a part of the true-up proceeding, the Commission should conclude that there is no longer an issue related to the price of natural gas that needs to be resolved by the Commission. (Tr. 360-61).

12. Surface Transportation Board Litigation

a. Should the deferred expenses associated with the Surface Transportation Board rail rate complaint case that were incurred through June 30, 2006, be included in rate base?

In its Post-Hearing Brief, Public Counsel "commends KCPL for bringing this [Surface Transportation Board rate complaint] action, because it has the potential to achieve refunds and rate reductions that will benefit KCPL's ratepayers." (Public Counsel Br., p.6). Notwithstanding this commendation of KCPL for its actions in attempting to lower transportation costs for its customers, Public Counsel continues to assert that "KCPL should not be permitted to recover—in this case—any of the estimated Missouri jurisdictional expense for the STB litigation." (Id. at 7). Apparently, Public Counsel would require KCPL to win the STB litigation before it could recover these substantial litigation costs as a part of its cost of service in future rate cases! While Public Counsel is fond of "board game" analogies (Public Counsel Br., pp.1-2), it fails to recognize that KCPL must "pay to play" in STB litigation.

As explained in KCPL's Post-Hearing Brief at 38, both KCPL witness Ed Blunk and Staff witness Charles Hyneman have recommended that the Commission treat the actual (not estimated) litigation costs related to the STB case as a regulatory asset. Those costs would then be amortized to expense over five years beginning in January 2007, the month when new electric rates will go into effect. If KCPL's STB complaint case results in a refund, any refund received by KCPL would first offset any existing balance of STB case costs in the regulatory asset, with the remainder of the refund offsetting fuel costs as determined in a future proceeding. (Ex. 118, pp.22-23; Ex. 13, pp.3-4).

Even Public Counsel recognizes that the approach being recommended by Staff and KCPL has merit as an alternative solution:

> If the Commission decides to allow the actual STB litigation costs incurred during the test period in this case, those costs should be spread over a five-year period. Such a recovery period is appropriate for two reasons: (1) such costs are not annually recurring expenditures, and (2) if KCPL is able to achieve a favorable outcome in the STB case, such an outcome would likely have benefits for more than one year. (Public Counsel Br., pp.7-8).

KCPL respectfully requests that the Commission accept the KCPL/Staff position and Public Counsel's alternative position, and treat these litigation costs as a regulatory asset and spread the costs over five years. This solution encourages KCPL and other public utilities to continue to "play" in STB litigation when it is expected to bring benefits to ratepayers.

13. SO_2 Premiums

a. How should SO_2 premiums related to lower-sulfur coal be recorded for book and ratemaking purposes?

See discussion below.

b. What parameters does the Commission-approved Stipulation & Agreement in Case No. EO-2005-0329 impose on the treatment of SO_2 premiums in this case?

As explained in KCPL's Post-Hearing Brief, KCPL and Staff are in agreement that KCPL should be required to charge all of its coal SO_2 (i.e., sulfur dioxide) premiums against the regulatory liability in Account 254, Regulatory Liability, after January 1, 2007. (KCPL Br., pp.42-43) (Ex. 14, p.4) (Tr. 376). In addition, KCPL and Staff expect to file a Stipulation And Agreement which addresses the SO_2 premium issue, among other issues. With regard to the SO_2 premium issues, the Stipulation And Agreement is expected to recommend the following:

> **SO2 Premiums**
>
> 5. 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 pays a premium over the contract price. Likewise, to the extent that coal supplied has a higher sulfur content than specified in the contract, KCPL receives a discount from the contract price.
>
> 6. Beginning January 1, 2007, to the extent that KCPL pays SO_2 premiums (net of SO_2 discounts) for lower sulfur coals, the Commission authorizes KCPL to determine the portion of such premiums, net of joint partners' shares, that apply to retail sales and to record that proportionate cost of such premiums in FERC Account 254 as a reduction of the regulatory liability.

KCPL recommends that the Commission adopt the joint recommendations that will be contained in the Stipulation And Agreement. KCPL believes that this accounting treatment is consistent with the following provision contained in the Stipulation And Agreement approved in Case No. EO-2005-0329:

> KCPL currently purchases coal from vendors under contracts that indicated 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 SO_2 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. The portion of premiums applicable to retail will be determined monthly based on the system-wide percentage of MWh's from coal generation used for retail sales versus wholesale sales as computed by the hourly energy costing model. This system-wide percentage will be applied to premiums invoiced during the same period. (Ex. 143, pp.9-10)

Public Counsel continues to assert the coal sulfur premium provisions of the Regulatory Plan Stipulation referenced above should be interpreted to extend <u>through the end of 2007</u>. (Public Counsel Br., pp.8-9). This interpretation of the Stipulation, however, is incorrect. As explained in KCPL's Post-Hearing Brief, the Stipulation states: "To the extent that KCPL pays premiums for lower sulfur coal up <u>until January 1, 2007</u>, it will determine the portion of such premiums that apply to retail sales and will record the proportional cost of such premiums in Account 254." (Ex. 143, § III.B.1.d, p.10) (emphasis added). The entire provision expires at midnight on January 1, 2007. It is simply not applicable to coal premiums incurred in 2007.

Public Counsel seems to be troubled by the following sentence: "But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually." Public Counsel argues that "the phrase 'but in no event' only has meaning if it prevents something from happening." (OPC Br., p.9). KCPL does not disagree that this phrase must have meaning, but Public Counsel is inappropriately attempting to find meaning for this phrase <u>beyond the term of the entire provision</u> which expires on December 31, 2006. This phrase has effectively prevented KCPL from charging premiums in excess of $400,000 annually in the years 2005 and 2006 while the provision was in effect. KCPL witness Ed Blunk testified that KCPL capped its premiums charged to Account 254 at the $400,000 level in each of 2005 and 2006, even though the actual premiums were significantly higher. (Tr. 380-81).

For the foregoing reasons, the Commission should reject the adjustment proposed by Public Counsel, and instead adopt the position of the Staff and KCPL on this issue.

14. <u>Injuries and Damages</u>

a. What is the appropriate amount of injuries and damages expense to include in rates?

Staff's initial brief ignores the main issue: whether it is appropriate to use a cash basis of accounting for injuries and damages, and at the same time, recommends that KCPL's expense lag be set at 185 days for the purpose of calculating cash working capital. The cash working capital study accounts for the effects of the timing of cash payments versus accrual accounting. (Ex. 8, p.11)

As shown in KCPL's initial brief, Staff's position is inconsistent. Using a cash basis means that Staff is proposing to set rates based on what is actually paid out by KCPL over a period of time instead of the amount accrued by KCPL when the claim occurs. (Tr. 297-298). This is inconsistent with the Staff's argument in its cash working capital analysis that KCPL does not pay its casualty claims until 185 days after they occur. (Tr. 297).

Staff's other point is that KCPL's accrual is only an estimate and therefore its three-year average is more reflective of actual payments. Staff believes that KCPL witness Wright confirms Staff's position that injuries and damages would be overstated if based on accrual methodology. (Staff Br. p.17) Staff ignores the rest of Ms. Wright's testimony at the hearing where she stated that due to timing differences she disagreed with the Staff's assertion that the actual damages do not reflect the estimate. (Tr. 293). Accruals can underestimate damages as seen for the year 2004 where $1,162,510 was accrued by the Company and $1,780,895 was actually paid out. (Ex. 138, p.3). Over several years the overestimates and underestimates for injuries and damages will tend to even each other out when using the accrual method.

For the above reasons, and the reasons set forth in its initial brief, KCPL asks the Commission to set rates concerning the level of injuries and damages expense using the accrual method of accounting.

15. Rate Case Expense

a. What amount of rate case expense should be included in rates?

See discussion below.

b. Should rate case expense be normalized or deferred and amortized? If the latter, then what is the appropriate amortization period for the deferred rate case expense?

See discussion below.

c. Should the costs deferred for future amortization be included in rate base?

Contrary to OPC's argument in its brief, the Commission has amortized rate case expense in previous cases. See, Case No. HR-94-177, In the Matter of St. Joseph Light & Power, 3 Mo. P.S.C. 3d. 207, (1994); Case No. ER-93-41, In the Matter of St. Joseph Light & Power, 2 Mo. P.S.C. 3d. 248 (1993); Case No. ER-78-29, In the Matter of Missouri Public Service, 22 Mo. P.S.C. (N.S.) 193 (1978). In addition, OPC's discussion of this issue makes it sound like the amortization of rate case expense is a violation of ratemaking principles. In fact, the amortization of rate case expenses by placing the amount in an appropriate reserve account and amortizing as an expense over an appropriate number of years, is well recognized. See, Phillips, The Regulation of Public Utilities (3d. Ed., 1993), p.268.

Amortization is the reduction of the value of an asset or liability by prorating its cost over a period of years. Normalization adjustments are made to remove abnormalities and/or non-recurring events that do not reflect a company's ongoing operations. (Ex. 106, p.6). For example, the Company normalizes revenues, by adding or subtracting revenue to remove the effect of colder or warmer weather. The problem with normalizing rate case expense is that rate case expense is not an abnormal or non-recurring event for KCPL. KCPL will incur rate case expense in the next several years due to the rate case filings it has scheduled under the regulatory plan.

OPC and Staff argue that a three year recovery for rate case expense is appropriate because KCPL is not required to file another rate case until the end of the Regulatory Plan. (Staff Brief, p.18). KCPL believes that its two year amortization is more appropriate as KCPL will exercise its option to file another rate case next year, as provided by the Regulatory Plan. (Tr. 828). The Commission recognizes that the appropriate amortization period is tied to the amount of time the rates are likely to be in effect. Even the cases cited by OPC in its brief recognize this ratemaking principal. Given that KCPL will file a rate increase next year, KCPL's two year amortization is consistent with Commission precedent and should be adopted by the Commission in this case.

16. Corporate Projects and Strategic Initiatives

a. Should the costs of the LED-LDI and CORPDP-KCPL projects, which are being deferred and amortized over 5 years, be included in rate base?

Staff contends that it is unreasonable for KCPL to ask for rate base treatment of the costs associated with these projects. However, KCPL, for the reasons explained in its initial brief, believes that the costs meet Staff's test for an asset and therefore should be included in rate base.

17. Payroll, Including A&G Salaries

a. How should annualized payroll costs of Great Plains Energy Services (GPES) employees be allocated to KCPL?

KCPL believes that this issue has been settled.

b. What is the proper method to be used in determining the allocation or assignment of A&G salaries to be capitalized or expensed?

KCPL believes that this issue has been settled.

18. Other Benefits

a. What amount of other benefits should be included in rates?

KCPL believes that this issue has been settled.

19. Maintenance Expense

a. Should an adjustment be made to normalize test year maintenance for production and distribution expenses? If so, how?

In its Post-Hearing Brief, Staff does not dispute that maintenance expenses for production and distribution are increasing annually. (Staff Br., pp.19-20). KCPL's evidence on this escalating trend is totally unrebutted in the record. Instead, Staff quarrels with KCPL's use of the Handy-Whitman index to escalate the dollars in Staff's maintenance adjustments to reflect the current value of these expenses in 2005 dollars. Without citing to any supporting evidence in the record, Staff gives short shrift to KCPL's adjustment by erroneously arguing that "the Handy-Whitman is primarily based on labor costs." (emphasis added) (Staff Br., pp.19-20).

KCPL witness Dana Crawford testified:

> KCPL applied historic cost escalations based on the Handy-Whitman Index, which is a nation-wide database, recognized throughout the United States as an industry standard for documenting changes in historic costs. Between 2004 and 2005, significant escalation was experienced for **bulk materials, labor and other costs associated with maintenance of industrial equipment**. These price increases remain today and are expected to continue over the foreseeable future. According to the Handy-Whitman Index, these impacts increased non-labor O&M costs by 5.08 percent between 2004-2005. Because KCPL sees this trend continuing with no apparent reduction in demand over the foreseeable future, the Company believes its is imperative to view historic costs on the basis of today's costs. Using Mr. Harris' two-year average for steam production adjust to 2005 dollars, results in a positive adjustment of $626,656. (Ex. 17, pp.2-3)(emphasis added).

In his Surrebuttal Testimony, Staff witness Harris revised his maintenance normalization analysis which is contained in Schedule 1 to his Surrebuttal. With his revised adjustment, he analyzed each functional plant group separately and determined what methodology to use for normalizing maintenance expense. (Ex. 117, pp.14-21). His revised approach contains the same flaws as his original adjustment, and should be rejected by the Commission.

KCPL would respectfully request that its adjustment to production maintenance expenses be adopted. It is not realistic to use Staff's recommended level without recognizing that these costs are increasing annually.

However, if the Commission does not accept KCPL's recommendations to escalate the test year distribution maintenance expense level by the Handy-Whitman index, KCPL would respectfully request that the Commission adopt a middle ground position with regard to the distribution maintenance expenses, and at least allow the test year level of $21,629,071 to be included in rates. (Tr. 414). A reduction of $1,877,784 below the 2005 test year level of distribution maintenance expenses, as proposed by Staff, is not supported by the competent and substantial evidence in the record, given the evidence of increasing maintenance expenses. While KCPL believes that such maintenance expenses will continue to increase in 2007, it believes that the test year level of O & M maintenance expenses (i.e. $21,629,071) to be a more realistic and workable level to ensure that KCPL will continue to have the necessary maintenance funds to provide safe and reliable service for its customers in 2007. A reduction in the distribution (or transmission) maintenance expenses could make it more difficult for KCPL to implement the Inventory and System Assessment Project, as well as the other projects associated with the Asset Management Plan.

20. Property Taxes

a. Should property taxes be adjusted to reflect changes in tax jurisdiction assessment values, levy rates, in plant additions, and other factors during the test period, including both the update period and true-up period?

Staff has apparently misunderstood KCPL's request that property taxes be trued-up to reflect the known and measurable changes that have occurred since the original 2005 test year to reflect changes in tax jurisdiction assessment values, levy rates, in plant additions and other factors that are now known and measurable. In its Post-Hearing Brief, Staff summarizes its position as follows:

> The issue concerns how to calculate property tax expense for inclusion in KCPL's cost of service. Staff recommends calculating this figure by multiplying the January 1, 2006, plant-in-service balance by the ratio of the January 1, 2005 plant-in-service balance to the amount of property taxes paid in 2005 (Tr. 6:419). KCPL seeks to include values reflective of higher rates and higher assessments that it expects will be imposed after the operation of law date in this case (*id.*) However, the values that KCPL seeks to use are not yet known and measurable.
>
> The use of estimations and projections improperly exposes ratepayers to paying more than is necessary to cover KCPL's cost of service. (emphasis added) (Staff Br., p.20).

Based upon Staff's summary of KCPL's position in its Post-Hearing Brief, KCPL believes that Staff has misconstrued the nature of KCPL's request that the property tax information should be trued-up to the most recent information available at the time of the September 30, 2006 true-up related to changes in KCPL's assessment values, levy rates, in plant additions, and other know factors such as Payments In Lieu of Property Taxes (PILOTs) on the wind generation facilities that were approved in the true-up proceeding.

KCPL is not requesting that its property taxes annualization be based upon estimates or projections, as suggested by Staff. KCPL is requesting that known and measurable changes in tax levies, property assessments and PILOTS be reflected in its property tax annualization, as contained in KCPL's proposed adjustment.

As explained in the Rebuttal Testimony of KCPL witness Shannon Green, Jr., Staff's adjustment does not reasonably reflect the increased property tax expense that KCPL will incur in 2006, based upon known and measurable changes. (Ex. 20, pp.2-7). As explained in KCPL's Post-Hearing Brief, Staff's adjustment does not reflect known and measurable changes to the property taxes that will be paid by KCPL in 2006, nor does it reflect the additional property taxes and PILOTS due to the applicable plant additions during 2006. (Id.)

To the extent that Staff is arguing that utility property assessments and tax levies are not "known and measurable", Staff is simply wrong! KCPL provided Staff its actual 2006 property assessments of $701,885,630, detailed by county, via DR No. 0427 and as updated and finalized in August 2006. Missouri utility property tax assessments are even posted on the Missouri Tax Commission website: http://www.stc.mo.gov/RUP_2006_10112006.pdf. (See Attachment A). Similarly, county tax levies on public utility property are publicly known and available from the various County Collectors offices in Missouri and County Treasurer offices in Kansas. KCPL, in its 9-30-06 true-up filing, obtained the latest available actual 2006 tax levy rates for counties which represented 96% of the Missouri tax liability and 70% of the Kansas tax liability. For those few counties which the 2006 tax levy rates where not yet available, KCPL used the actual 2005 tax levy rate. Clearly, these are "known and measurable" inputs to KCPL's property tax adjustment.

KCPL's trued-up updates to its case provide revised property tax adjustments that capture the known and measurable changes that have occurred as of September 30, 2006. These include known changes to property assessments in 2006, known changes to tax levies in 2006, and the PILOTs that will be paid on the Spearville Wind Generation Facility that has been found by Staff to meet the in-service criteria (Ex. 160, pp.1-3), and has been included in KCPL's rate base by Staff. (See Ex. 156HC, p.2).

In summary, KCPL has updated its property tax adjustment during the true-up proceeding to include the most recent information available, including tax levies, property assessed values, and the PILOTs on wind generation facilities. KCPL's proposed method is consistent with the provisions of the Stipulation And Agreement in Case No. EO-2005-0329 which requires a true-up of property taxes in this case. KCPL respectfully requests that the Commission incorporate into the revenue requirement in this proceeding the known and measurable changes in property assessments and tax levies, based upon the information that was updated in the true-up proceeding.

21. Decommissioning Expense

a. Should decommissioning expense be reduced to reflect the amount of annual accruals expected under a 60-year license?

This issue has been resolved among the parties and will be addressed in a separately submitted Stipulation and Agreement.

22. True-up

a. What elements of Cost of Service and Rate Base should be updated in the September True Up?

On November 16, 2006, the Commission convened the True-Up Hearings in this case. (Tr. 1595-1671). The primary purpose of the True-Up Hearings was to accept into evidence the information necessary to update the respective cases of KCPL, Staff, Public Counsel and intervenors for the September 30, 2006 true-up period. (Ex. 54-56; 153-164; 219-220). Staff also reported the results of the Staff's true-up audit of the Company. (Ex. 153-164).

In addition, there were two issues that developed during the true-up audit that were considered in the hearings: 1) Employee Levels; and 2) Change in the Risk Factor used in the credit metrics calculation supporting the Regulatory Plan Additional Amortization.[1] These issues which need to be resolved by the Commission will be addressed below.

Overview of KCPL and Staff Cases—Following True-Up Audit

As explained by KCPL witness Tim Rush, the Company's overall rate increase request at the conclusion of the true-up proceeding is now $55.8 million. However, the components of the overall increase have changed as a result of the trued-up information. KCPL's September true-up case reflects a traditional revenue requirement of $42.2 million under traditional ratemaking,

[1] A third issue on the True-Up Issues List filed on November 8, 2006, related to the Spearville Wind Project has been settled and does not need to be addressed by the Commission at this time.

and a $13.6 million increase of Additional Amortization to meet its credit metrics to stay at an investment grade rating. (Ex. 56, p.8).

Staff's proposed revenue requirement increase, on the other hand, is entirely due to Additional Amortizations. As explained by Staff witness Traxler, the Staff's overall revenue requirement recommendation at the conclusion of the true-up proceeding is a positive $27 million. (Tr. 1658). Staff is now recommending that the Commission adopt a <u>negative</u> $28 million under Staff's traditional ratemaking case (Ex. 164, p.13), and a $55 million Additional Amortization to meet KCPL's credit metrics. (Tr. 1658). According to Mr. Traxler, the change in the Staff's case from its position after the June 30, 2006 update, "is due primarily to recognition of an additional $116 million in Missouri jurisdictional plant in service and related rate of return and annual depreciation expense. Approximately $85 million of the additional plant represents KCPL's new wind generating facility in Spearville, Kansas." (Ex. 163, pp.5-6).

Focusing only on the overall level of revenue requirements--the $27 million (Staff) vs. $55.8 million (KCPL)--without considering the underlying components would misrepresent the significance of the differences between the two positions. The following table illustrates the real differences in the components of the cases of KCPL and the Staff:

	<u>KCPL</u>	<u>Staff</u>
Traditional Revenue Requirement	$42.2 million	<$28.0 million>
Amortization Amount	$13.6 million	$55.0 million
Total Rate Increase	$55.8 million	$27.0 million

Even with the addition of $116 million in plant additions that occurred as a part of the true-up proceeding, Staff continues to recommend that all of the rate increase come from the Additional Amortizations. As previously explained in KCPL's Post-Hearing Brief, this approach should be rejected by the Commission, and KCPL's more balanced approach that recovers more from cash earnings and less from the Additional Amortization should be adopted.

1. Employee Levels at September 30, 2006

As a result of the true-up audit, KCPL and Staff have a difference of opinion about whether 113 of KCPL employees and their wages and salaries should be included in the Revenue Requirement. This issue involves Staff's advocated exclusion of approximately $6.3 million from the Revenue Requirement on a total company basis. (Ex. 163, p.8).

As KCPL witness Tim Rush testified, the purpose of the true-up is to include all costs that are known and measurable. The KCPL Regulatory Plan was an attempt to recognize that cash is critical to the Company to meet the credit ratios during a major construction program in order to stay investment grade rated. The Company needs a realistic opportunity to earn its authorized rate of return. (Ex. 55, p.1-2).

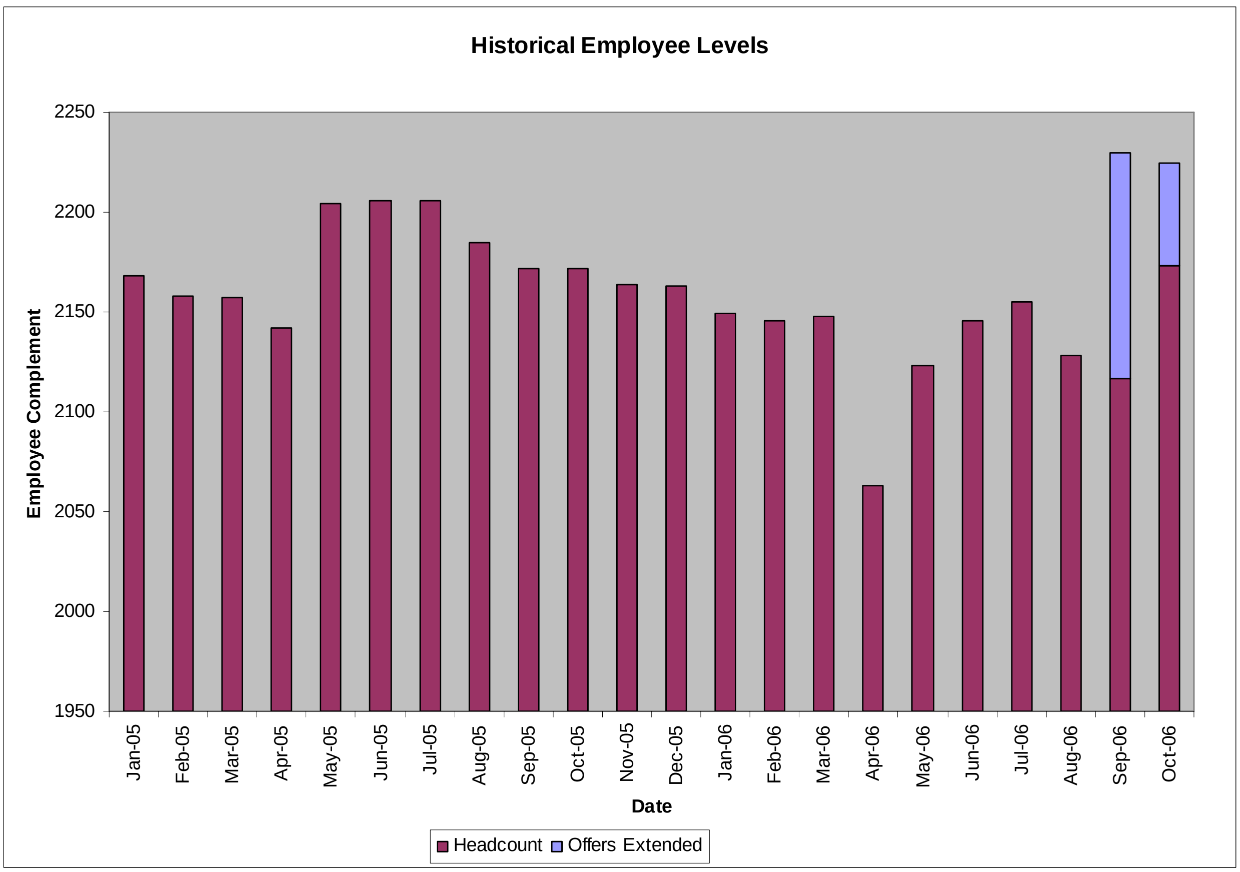
To the extent that known and measurable expenses are excluded as Staff is proposing to do in its payroll annualization in this true-up proceeding, then the Company will be short of its cash requirements and it will not have a realistic opportunity to earn its authorized rate of return.

KCPL witness Tim Rush summarized the KCPL's payroll annualization adjustment as follows (Ex. 54. p.9):

> A typical employee payroll annualization used in setting rates looks at an employee count at the end of the test period and uses the level of employees and their current wage and salary levels to determine an annual payroll dollar amount… Because of the circumstances surrounding the last several months of the test period, it is not appropriate to use this type of method. KCPL has experienced reductions in employee levels during the year with the most significant changes occurring in April and August/September 2006. As a result, the employee levels at the end of September are temporarily far below the employee level expected to be required in the future and what has been experienced in the past. The Company experienced over 50 retirements in August and September. The employee complements were more than 65 below the budget levels. The Company had anticipated these retirements and departures, and filled

many of the positions by the end of September, but many of the new hires had not yet reported for duty. Several had start dates beyond September 30, 2006, but had been hired prior to that date. As a result, the payroll adjustment in the true-up includes both employees currently at the job sites throughout the Company and employees hired, but not yet at the job sites.

For purposes of illustration, Mr. Rush prepared Schedule TMR-4 which is attached to Mr. Rush's Direct True-Up Testimony and a color version of this exhibit was marked in the hearings as Exhibit No. 58. This exhibit demonstrates the number of historical employees on KCPL payroll during the 2005 test period, the June 30, 2006 update period, as well as the September 30, 2006 true-up period:



(The graph does not fully show the upper range.) At the end of September, 2006, true-up period, the Company had full time equivalent employees of 2110 who were at the KCPL job sites. The Company also had outstanding 113 employees who had offers from KCPL that had been accepted, but these employees had not yet reported to their job site. It is these 113 employees that Staff is proposing to exclude from the Revenue Requirement in this case.

The sum of the 2110 employees who were working on site, and the 113 employees to had accepted offers from KCPL totals 2,223 employees. (Ex. 54, pp.9-10) KCPL requests that these 2,223 KCPL employees and their wages and salaries be included in the revenue requirement, while Staff is proposing to include only the 2110 employees who were working on site as of September 30, 2006.

The number of employees who were working at the job site in September, 2006, is reflected by the dark pink bar graph in the column labeled September 2006. This represents the 2,110 employees which Staff is recommending be included in Revenue Requirement.

The light blue bar graph represents the 113 KCPL employees who had accepted offers but had not started working on site by September 2006. Some of these employees were just awaiting their agreed upon start dates. Others were also awaiting the completion of medical and background checks.[2] By November 15, 2006, 74 of the 113 KCPL employees were working on KCPL job sites. (Tr. 1640). The remainder are expected to be working at KCPL job sites shortly.

If the level of employees that were working on KCPL job sites at the end of September 2006, to the rest of the historic employee levels depicted on the exhibit, it will be noted that the September 2006 level of 2,110 employees that Staff is recommending be included in rates, is actually the <u>lowest</u> level that has existed throughout the period, with the exception of April 2006.

[2] During cross-examination of Mr. Rush, Staff seemed to be suggesting that the pending medical and background checks were a significant factor to be considered in determining whether these employees should be included in the revenue requirement. (Tr. 1627-29). However, Mr. Rush put this concern to rest when he explained that very few employees ever fail to pass the medical and background checks since they have already gone through extensive screening at that point in the employment process. Mr. Rush indicated that no more than three of the 113 employees had failed to pass the medical and background checks. (Tr. 1641).

As Mr. Traxler points out in his testimony, KCPL initiated a Workforce Realignment in March 2005 which resulted in the termination of approximately 118 positions as of March 31, 2006. (Ex. 163, p.8). The Workforce Realignment program is the reason for the dramatic decline in the KCPL employee headcounts that is shown for April, 2006.

However, KCPL quickly re-hired employees to replace those employees that left as a part of the Workforce Realignment. In May and June, 2006, the KCPL employee headcount had climbed up to the levels that existed prior to the time of the Workforce Realignment. By July, 2006, the number of employees had actually exceeded the level that had existed prior to the termination of these 118 employees. Clearly, KCPL acted quickly to replace those employees and raise the work force to the level needed to run the Company efficiently.

Mrs. Lora Cheatum, KCPL's Vice-President for Administrative Services, also explained that 50 employees decided to retire in late August and September. The reason for the large number of retirements in August and September related directly to the fact that the Company announces an interest rate change in late August that will affect the amount the employee's lump sum distribution under the retirement plan, depending upon whether the employee retires before or after the new retirement plan year which begins on October 1st of each year. Mrs. Cheatum explained the impact of the interest rate announcement on the decision of employees to retire:

> Under KCPL's retirement program, retirees have an option of receiving monthly payments or a single lump sum payment upon retirement. The interest paid on the 30-year Treasury bill has a direct impact on the value of the lump sum payment option in particular. The 30-year Treasury bill interest rate for each plan year is issued in August of the preceding year. In 2006, the change in the 30-year Treasury bill rate had the effect of reducing the lump sum payment for the 2007 plan year. Consequently, employees who qualified for retirement had a strong financial incentive to retire prior to the 2007 plan year. To do so, those employees had to retire by September of 2006. Approximately 50 employees (in August/September) chose to do so. (Ex. 56, pp.4-5).

In other words, the interest rate paid on Treasury bill has a direct impact on the value of the lump sum option that employees receive when they retire. In August of each year, this interest rate becomes known for the upcoming year beginning on October 1. Once employees know what the next year's Treasury bill interest rate will be, they can determine whether it would be better for them financially to retire by the end of September, or wait until the new interest rate goes into effect for the following retirement year. But they have to make that decision before the beginning of the next retirement year which is October 1st. In effect, the employees have a very short window to decide whether they will retire between the time that the interest rate is known in August, and the end of September, when the retirement year ends. Once they make that decision, they inform the Company of their retirement plans, sometimes only a week prior to their departure date. (Tr. 1635).

When the interest rate was announced in August of 2006, 50 employees made the decision to leave before the end of September because it was going to be financially better off for them if they left during the current retirement year. In addition, there is always normal turnover that occurs. For example, Mrs. Cheatum testified that KCPL has added 176 employees between May and September this year, and has terminated or retired 120 employees. (Ex. 56, p.3-4).

As shown in the bar graph for October 2006, the Company has already moved quickly to replace the people who left in August and September of this year. The dark pink bar graph indicates that approximately 2160 employees were working on site in October 2006, and that there were additional offers extended to bring the total work force headcount to over 2200 employees.

From KCPL's perspective, it does not make sense to choose a level of employees that it is artificially low due to the retirement plan cycle, and annualize the payroll using this unusually low number -- if the Commission is attempting to find a representative number of employees based upon test year information that will be needed by KCPL for the upcoming year.

If the Commission reviews the historic employee levels throughout the 2005 test year, it will find that the KCPL's headcount exceeded the 2110 being proposed by Staff in every single month of the 2005 test year. No party has suggested that any of these employees were unnecessary or should be disallowed. In fact, during the hearings, Mrs. Cheatum testified that the average employee head count for KCPL for the period from 2002 through 2005 has been 2,205 employees. (Tr. 1651).

KCPL's actual headcount exceeded the 2110 being proposed by Staff in every month in 2006, with the exception of April. During the hearings, Mr. Rush explained that that the April employee number reflects another anomaly, the Workforce Realignment that occurred in the Spring of 2006. No party has suggested that these employee levels were inappropriate and that the wages and salaries during the update period should be disallowed in any way.

From KCPL's perspective, it does not make sense to focus on one day of the year, September 30, 2006, and ignore the rest of the employee history in determining the level of payroll to be included in this case. The Commission should not mechanically apply the Staff's "traditional ratemaking" methodology for updating the test year for payroll when the result is that KCPL will be that there will be an exclusion of the wages and salaries of 113 employees that will be needed to provide service in the year that the rates are in effect.

As the Commission knows, KCPL is ramping up to complete its Comprehensive Energy Plan that includes $1.3 billion in investments, including the construction of Iatan 2, the upgrading of its environmental equipment at other power plants, and numerous new customer programs. During the hearings, Mrs. Cheatum explained how KCPL has been ramping up to add the necessary employees to complete the Iatan 2 construction project (Tr. 1652):

[Fischer]: Q. Would he [Steve Easley] be the originator for any employee involved in the construction of IATAN II?

[Cheatum]: A. In general, yes.

[Fischer]: Q. Is that a fairly active area right now?

[Cheatum]: A. It's one of the most active areas that we have. Yes.

[Fischer]: Q. Can you explain how you've ramped up for that area and how that's affected your job?

[Cheatum]: A. Sure. Oh, absolutely. We have probably, since the beginning of the year, hired at least 25 additional head count to support the – the commissioning of the IATAN II plant.

Our expectation is that as we continue through the construction phase of this that we're just now getting started that that will continue to increase, certainly, through this year and – and '07 and '08.

It is reasonable to expect that this massive undertaking related to the construction of Iatan 2 and the $1.3 Billion investment in the Comprehensive Energy Plan, is going to take a modest increase in the number of employees that KCPL has historically employed. However, it is unrealistic to expect that KCPL will be able to complete this program with fewer employees than it had on payroll throughout the test year including the update period. But this unrealistic result would be the implication if the Commission slices 113 people and their wages and salaries from KCPL's revenue requirement.

For the foregoing reasons, KCPL respectfully requests that the Commission adopt KCPL's payroll annualization adjustment, and reject the Staff's unrealistic attempt to focus on one day in the year as the basis for a payroll annualization adjustment.

2. Regulatory Plan Additional Amortizations – Off-Balance Sheet Obligations Risk Factor

As explained in KCPL's Post-Hearing Brief at 19-20, KCPL and Staff agree that the risk factor that should be used in calculating the Regulatory Plan additional amortizations for off-balance sheet purchased power agreements should be a 50% risk factor that is required and used by Standard & Poor's in its analysis of KCPL's debt. Staff initially had taken the position that the Commission should authorize a 30% risk factor for this purpose. However, during the course of the rate case hearings, Staff introduced corrected information from Standard & Poor's that indicated that "As of January 1, 2006, Standard & Poor's had assigned a risk factor of 50 percent" to KCPL. (Tr. 764) (Ex. 147, See also Exs. 151 and 152). Based upon this information, Mr. Traxler testified that Staff now supports the use of a 50% risk factor. (Tr. 1392). During the true-up hearings, Staff witness Traxler updated Staff's case to include the 50% risk factor in its analysis of the Additional Amortization. (Ex. 163, pp.14-16).

Since the very purpose of the Regulatory Plan Additional Amortization mechanism is to ensure that the Company achieves targeted levels for S&P–published credit metrics, the Company believes it is critical to use the same risk factor that is used by Standard & Poor's. If the Commission were to adopt a lower risk factor, the amortization would be determined using a lower level of debt than the level of debt actually used by S&P in determining the Company's credit ratios. As a result, KCPL and Staff recommend that the Commission utilize the 50% risk factor as utilized by Standard & Poor's for KCPL's credit analysis.

23. Weather Normalization/Customer Growth

a. What methodology should be used to compute Large Power class kWh sales and revenues?

The Staff lists four reasons why the Large Power ("LP") class should not be normalized (Staff Br., p.35). Each of the reasons is either not supported by the record in this case or is not sufficiently developed for the Commission to base a decision on.

The first reason (seasonal fluctuations) given by Staff was addressed by KCPL in its initial brief. KCPL showed that the LP class is influenced by temperature. Staff agrees that temperature does affect the LP class but the effect is seasonal. Apart from some vague examples of electric motors running more efficiently in winter and a July drop in automobile production, Staff makes no attempt to relate seasonal fluctuations to the type of customers in the LP class. Staff does provide a graph which it believes shows that the LP class is not weather sensitive because the load v. temperature curve of the LP class is not as steep as the curve of the residential class. (Ex. 121, p.3). Given that the residential load is KCPL's most weather sensitive load, it is not surprising that the LP curve is not as steep as the residential curve. The Staff's graph does not contradict the fact that KCPL witness McCollister took the same LP class data and after performing a statistical regression analysis found that there is a significant statistical correlation (a t-statistic value of 17.7) between temperature and load for the LP class. (Ex. 29, p.2).

Staff contends that this statistical correlation is not important as it was able to show a t-statistic value of 2.095 using KCPL's model and random numbers. (Ex. 121, p. 5). What Staff ignores is the difference between a value of 17.7 and 2.095. The 17.7 value is much more significant than 2.095 which is only slightly over the baseline for determining statistical significance.

The second reason given by Staff is that although some LP customers exhibit weather sensitivity, the overall effect is small enough to be in the margin of error of the weather sensitivity modeling. Nowhere in the record, does Staff explain what this margin of error is. The Commission has no basis for determining if this reason has merit.

The third reason given by Staff is that the weather normalization of LP customer usage would require weather normalization of class revenues, which would be very difficult, if not impossible to do correctly. Staff does not explain this reason either other than to state that the LP rate is complex. (Ex. 121, p.2). Other than this brief statement, the record is silent as to why weather normalization of class revenues cannot be accomplished. A comparison of the tariffs for the LP class and the Large General Service class reveals that the rates are made up of basically the same elements (Customer Charge, Facilities Charge, Demand Charge and Energy Charge) and the LP rates do not appear to be any more complex than the Large General Service class rates for which the Staff weather normalizes the revenues. See, Sheet Nos. 11A, 14A, P.S.C. MO., Tariff No. 7 (effective August 1, 1999).

Finally, the Staff claims that weather normalization is not necessary since customers in this class are annualized individually. This annualization does not take into account the fact what has been established by the record in this case-that the LP class is weather sensitive. Typical weekday loads are approximately 250 MWs up to about 55 degrees and then rise steadily with temperature, reaching about 300 MWs at 80 degrees. (Ex. 29, p.2). Staff's large customer annualization process does not reflect this sensitivity. (Ex. 106, p. 9).

As shown above and in KCPL's initial brief, the LP class should be weather normalized.

24. Jurisdictional Allocations

a. What is the appropriate method (4 CP vs. 12 CP) to use for allocating generation and transmission costs among jurisdictions?

KCPL proposes adopting a 12-month average coincident-peak demand allocation ("12 CP") methodology for allocating KCPL's generation and transmission costs among its Missouri, Kansas and FERC jurisdictions. Staff, Praxair and DOE argue that the 4 CP methodology would be more appropriate.

The parties advocating the use of the 4 CP methodology rely heavily upon the analysis that the Federal Energy Regulatory Commission ("FERC") developed for evaluating potential demand allocators in Carolina Power & Light Co., 4 FERC ¶ 61,107 (1978) ("Carolina Power") (Staff Br., p.39-40; Praxair Br., pp.3-4; DOE Br., pp.22-25), as summarized in Chapter 5 of A Guide to FERC Regulation and Ratemaking for Electric Utilities and Other Power Suppliers, which both KCPL witness Don Frerking and Staff witness Erin Maloney attached to their pre-filed testimony. In each instance, the parties rely solely upon the arithmetical portion of the FERC's analysis. However, the FERC's demand allocator evaluation process involves more than the arithmetical segment. In Carolina Power, FERC expressly stated that "it is necessary to consider the full range of the company's operating realities including, **in addition to system demand**, scheduled maintenance, unscheduled outages, diversity, reserve requirements, and off-system sales commitments." (emphasis added). The parties advocating the 4 CP methodology rely solely upon the system demand data and ignore KCPL's operating realities. In her testimony in the pending Empire rate case (Case No. ER-2006-0315), Ms. Maloney states that "In the adoption of the 12 CP methodology, FERC has cited these operating realities, all of which affect a utility's effective capacity, as important to its determination." (Ex. 10, Schedule DAF-7, p.9). In KCPL's rate case, however, Ms. Maloney chose to ignore KCPL's operating realities despite their acknowledged importance to the determination of which demand allocator is more appropriate.

KCPL witness Don A. Frerking explained that KCPL's proposal to use the 12 CP allocation methodology "is based on the operating and capacity planning realities of the Company's generation portfolio. The Company's capacity planning process takes into account all the hours of the year, not just the peak hour or any seasonal peaks. In addition, the Company utilizes periods of the year, typically in the spring or fall, with lower retail and FERC jurisdictional wholesale peak loads to perform necessary maintenance on its generating facilities and to pursue off-system sales while still maintaining adequate reserve margins." (Ex. 11, p.3).

No party presented evidence refuting the operating realities of KCPL's system as described by Mr. Frerking. Instead, the parties rely upon the demand allocation methodology adopted by the Commission twenty years ago in KCPL's last litigated rate case. (Staff Br., p.44; Praxair Br., p.4). It is clear from the Commission's Report and Order in Case Numbers EO-85-185 and EO-85-224 that rather than making a definitive finding that the 4 CP allocation methodology was appropriate for KCPL, the Commission chose 4 CP over the 1 CP methodology endorsed by Staff in that case. Specifically, the Commission explained that "In the instant case, the Commission has only two proposals before it and both are peak responsibility methods. The Commission cannot adopt Staff's 1 CP method in this case." The Commission chose the 4 CP methodology because "the utilization of multiple peaks does measure some plant usage occurring at times other than the single system peak." The Commission can hardly be said to have endorsed the 4 CP methodology as ideal for KCPL. Twenty years later, the Commission should not rely upon this language to support the continued use of the 4 CP methodology.

KCPL experiences the same operating realities as those experienced by Empire, which Ms. Maloney cited in support of adopting a 12 CP allocation methodology for Empire. (Tr. 605-606). KCPL's uncontested operating realties support the use of the 12 CP methodology. KCPL's capacity planning process takes into account all the hours of the year, not just the peak hour or any seasonal peaks. (Ex. 10, p.6). In addition, KCPL utilizes periods of the year, typically in the spring and fall, with lower retail and FERC jurisdictional wholesale peak loads to perform necessary maintenance on its generating facilities and to pursue off-system sales while still maintaining adequate reserve margins. (Ex. 11, p.3). Moreover, KCPL "is a very heavily base loaded generation utility" (Ex. 125, p.7), a factor FERC has deemed to further support use of the 12 CP methodology, reasoning that base load generation indicates that the utility is building to satisfy year-round load. See, e.g., Southwestern Public Service Co., 22 FERC ¶ 61,341, at pp.61,589-90 (1983).[3]

b. How should A&G expenses be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?

KCPL advocates allocating its A&G costs among jurisdictions using a number of methods depending on the cause of the costs. (Ex. 9, p.10). Specifically, the Commission should allocate KCPL's salaries, employee benefit, and injuries and damages expenses based on the ratio of the allocated sum of the labor portion of the production, transmission, distribution, customer, and sales expenses described previously. The Commission should directly assign regulatory expenses to the jurisdiction of their origin. The Commission should allocate property insurance expenses based on the allocation of KCPL's total plant. The Commission should

[3] The FERC decisions cited by Praxair in support of the 4 CP methodology, Golden Spread Electric Coop. v. Southwestern Public Service Co., 115 FERC ¶ 63,043 (2006) and Puget Sound Energy, Inc., 88 FERC ¶ 63,022 (1999) are both "Initial Decisions" drafted by the administrative law judge for FERC approval. They are not final FERC orders.

allocate general plant maintenance and fleet expenses based on the allocation of the plant with which they are associated. The Commission should allocate general advertising expenses using the Customer allocator. Lastly, the Commission should allocate the remainder of the A&G expenses using the Energy allocator.

25. Depreciation

a. What are the appropriate depreciation rates to be used in establishing rates in this proceeding?

The Commission should reject Staff's proposal to decrease KCPL's annual depreciation expense from $65 million to $55 million. As explained by KCPL witness Don A. Frerking, Staff's depreciation study is too flawed to be relied upon. Staff's depreciation study contains errors in the lifespan analysis and the related interim retirements for the generation accounts. (Ex. 10, pp.16-18). Staff also presumes that certain generation-related assets have an indefinite life, which is factually inaccurate and skews the results of Staff's study toward those assets having a longer-than-reasonable life. Staff made errors in its retirement curve matching for a number of transmission accounts. (Id., pp.18-19). Staff's calculation of net salvage rates is also mathematically and analytically incorrect. (Id., pp.19-20).

Appendix G of the Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329, which the Commission approved in the fall of 2005, provided the depreciation rates that KCPL believed were to be used in this rate case. (Ex. 10, p.15). KCPL supports using the depreciation rates negotiated and agreed to by the parties to the Regulatory Plan Stipulation and Agreement.

The Commission should disregard Staff's depreciation study as flawed and refrain from revising the depreciation rates of KCPL's assets until the conclusion of the Regulatory Plan.

C. Class Cost-of-Service and Rate Design

1. Class Cost-of-Service

a. On what basis should distribution costs be allocated to classes? Should the allocation of primary distribution costs include any customer-related component? What type of demand should be used to allocate the cost of distribution substations and distribution lines?

b. On what basis should production capacity and transmission costs be allocated to classes?

c. What is the appropriate method to use for allocating margins on off-system sales among Missouri retail customer classes? (MIEC)

d. Do KCP&L's computation of coincident peak demands and class peak demands properly recognize line losses?

e. To what extent, if any, are current rates for each customer class generating revenues that are greater or less than the cost of service for that customer class?

f. What is the appropriate basis for allocating Administrative and General Expense Account Numbers 920, 922, 923, 930.2, and 931 among Missouri retail customer classes?

KCPL believes these issues have been settled and are addressed in a Stipulation and Agreement.

2. Rate Design

a. Should revenue adjustments among classes be implemented in order to better align class revenues to class cost-of-service? If so, what percentage increase or decrease should be assigned to each customer class?

b. Should class revenue adjustments be implemented even if no increase or decrease in revenue requirement is granted?

c. Should revenue adjustments be phased-in over multiple years?

d. Should revenue adjustments among the non-residential classes be applied uniformly or non-uniformly?

e. How should any increase in the revenue requirement be implemented?

f. Should a comprehensive analysis of KCPL's class cost-of-service issues and rate design be conducted after the conclusion of the regulatory plan and the in-service date of Iatan 2? Should the cost-basis of general service all-electric rates be included in this analysis?

KCPL believes these issues have been settled and are addressed in a Stipulation and Agreement.

3. Availability of General Service Space-Heating Rate Discounts

a. In this case, should the qualification provision of the existing general service all-electric rate schedules be expanded as proposed by KCPL, and the all-electric winter energy rate increased an additional 5%, to make rate discounts available to existing and future customers who are not all-electric customers?

See discussion below.

b. Should KCPL's proposed changes to the General Service customer charge be implemented?

See discussion below.

c. Should the existing general service all-electric rate schedules and the separately metered space heating provisions of KCPL's standard general service tariffs be (1) eliminated; or (2) restricted to existing customers only until there is a comprehensive class cost of service study and/or cost-effectiveness study which analyzes and supports such tariffs and provisions as well as KCPL's Affordability, Energy Efficiency and Demand Response programs?

In its Post Hearing Brief, Staff stated that it "does not oppose the expansion of the all-electric rate schedules or increasing the all-electric winter rate by an additional 5% proposed by KCPL." (Staff Br., pp.75-76). In addition, Staff went on record opposing the elimination of "the general service all-electric rate schedules at this time because no one has performed a cost analysis or studied the customer impacts if they were eliminated." (Id.) As a result, KCPL and Staff are in agreement on these issues.

KCPL believes that it has already adequately addressed the arguments of Trigen-Kansas City Energy Corporation, and no further response is required at this time.

For the reasons stated in KCPL's Post-Hearing Brief, KCPL respectfully requests that the Commission adopt the Stipulation And Agreement Regarding Class Cost-Of-Service And Rate Design Issues ("Rate Design Stipulation") which was filed on November 9, 2006, and contained a comprehensive settlement of the class cost of service and rate design issues. A diverse number of customer representatives have carefully studied KCPL's cost of service studies and rate design proposals in this case, and have reached a Unanimous Stipulation And Agreement that resolves the cost of service and rate design issues. As explained in KCPL's Post-Hearing Brief, the Commission should adopt their recommendations in total, and not mandate a change in the proposed tariffs by accepting any of Trigen's recommendations in this case.

D. <u>Customer Programs</u>

1. <u>Weatherization Program</u>

a. Should the weatherization program be modified so that KCPL's Call Center will refer customers to the program?

This issue has been resolved. Please see the discussion provided below.

b. Should LIHEAP recipients be directed to the weatherization program and be required to participate in it?

The City of Kansas City, Missouri ("KCMO") raised these weatherization program issues in the pre-filed testimony of its witness Mr. Robert Jackson (Ex. 501). As KCMO explained in its post-hearing brief, "the issues raised by Mr. Jackson have substantively resolved and an order of the Commission addressing Mr. Jackson's recommendations will not be required." (KCMO Br., p.5). The Missouri Department of Natural Resources ("MDNR") concurs that these issues have been resolved. (MDNR Br., p.2). No other party has taken a position or presented evidence concerning these issues. As such, the Commission should not direct any further action by KCPL concerning either the referral by KCPL's call center of customers to the weatherization program or the referral of LIHEAP recipients to the weatherization program. There is no competent and substantial evidence in the record that would support further action.

c. Should KCPL participate in an "Energy Conservation Program" that will provide consultation, weatherization materials and installation? If so, should the cost of the program to be underwritten by KCPL and charged to the customer?

Mr. Dias raises a number of issues in his Post-Hearing Brief that are not properly before the Commission. The Commission should disregard any issues raised by Mr. Dias that are not in response to the issues provided in the List of Issues in this proceeding, *i.e.*, whether KCPL should "participate in an 'Energy Conservation Program'" and whether the cost of such a program should "be underwritten by KCPL and charged to the customer." The other issues Mr. Dias's raises in his brief are not on the List of Issues agreed to by the parties in this proceeding.

Mr. Dias makes numerous references in his Post-Hearing Brief to the Baptist Ministers Union, his company, and the "community" (an undefined term used frequently by Mr. Dias in his brief). (<u>See, e.g.</u>, Dias Br., p.45. "The **<u>community</u>** wants to have **<u>my</u>** **<u>company</u>** authorized as a third-party pay agent under the terms and conditions that would provide energy conservation, weatherization." (emphasis added)). To the extent Mr. Dias represents or purports to represent the interests of anyone other than himself in this proceeding, he is engaging in the unauthorized practice of law. Consequently, the Commission should deny any requests for relief that Mr. Dias makes on behalf of the Baptist Ministers Union, his company, or the "community."

In addition, Mr. Dias's requests for relief are beyond the statutory authority of the Commission for two distinct reasons. First, Mr. Dias requests that the Commission direct KCPL to enter into a contractual agreement with Mr. Dias's company (See, e.g., Dias Br., pp.11-17; 25-35). Deciding with whom to contract is a fundamental management decision of the company, which is beyond the Commission's statutory authority. Second, Mr. Dias requests that the Commission direct KCPL to use its shareholders' money to underwrite the costs of his proposed programs (Dias Br., p.59). Dictating KCPL's use of shareholder funds is similarly beyond the Commission's statutory authority, as well as beyond the scope of this rate case. The Commission like all administrative agencies is constrained by the authority granted to it by statute. Curdt v. Missouri Clean Water Comm'n, 586 S.W.2d 58, 59 (Mo. App. E.D. 1979). The Commission does not have the requisite statutory authority to grant Mr. Dias the relief he seeks.

Even if it were within the Commission's authority to grant Mr. Dias's requested relief, it would be bad policy to do so. KCPL carefully evaluates its contractors, typically using a formal request for proposal program to ensure that the most qualified and efficient contractor gets the job. Mr. Dias would have the Commission circumvent those procedures and direct KCPL to contract with Mr. Dias, his company, or his appointed weatherization contractors. KCPL does and should carefully evaluate the credentials and costs of its contractors. It would be bad policy for the Commission to circumvent that process.

Even if the Commission were to entirely disregard all of the foregoing reasons for denying Mr. Dias's requested relief, the fact remains that there is inadequate evidence in the record to support the adoption of Mr. Dias's "Energy Conservation Program" or any of his other proposed programs. KCPL has asserted that it does not have sufficient information to evaluate Mr. Dias's proposed programs, (Tr., p.1505), and the record in this proceeding is similarly devoid of such detailed information. There is no competent and substantial evidence in the record that supports that Mr. Dias's proposed programs are in the public interest. There is similarly no evidence in the record to support Mr. Dias's requests concerning rate reductions for churches.

Mr. Dias also misconstrues the purpose of the Customer Program Advisory Group ("CPAG"). CPAG is simply an advisory group to KCPL. (Tr., p.1568). The CPAG does not approve programs or dictate policy to KCPL; nor is it the sole means for KCPL to consider customer programs. CPAG is a creature of the Stipulation and Agreement in Case No. EO-2005-0329 and is therefore limited to the signatories of that agreement, but as demonstrated by Mr. Dias, the CPAG is not the sole means to present customer program ideas to KCPL. Mr. Dias was able to present his ideas to KCPL at the highest levels of KCPL's management. (Tr., p.1451). Mr. Dias's issue is not one of access to KCPL to present ideas. Instead, his issues stem from the fact that KCPL declined to adopt his ideas or to use his company's services.

The Commission should not direct KCPL to participate in Mr. Dias's "Energy Conservation Program." The Commission should also deny Mr. Dias's other requests for relief. First, Mr. Dias's requests for relief are not on his personal behalf, but instead are on behalf of his company (or, at best, are on behalf of the Baptist Ministers Union or the "community"). Mr. Dias's requests and the representation of those groups constitute the unauthorized practice of law. Second, Mr. Dias wants KCPL's shareholders to fund his programs, which is beyond the scope of this rate case and is also beyond the scope of the Commission's jurisdictional authority. Third, it is also beyond the Commission's statutory authority to dictate to KCPL with whom it must contract. This is a fundamental management decision of the company. Fourth, it would be bad policy to direct KCPL to circumvent its own due diligence procedures, *e.g.*, the request for proposal process, when evaluating potential contractors. Finally, even if the Commission were to disregard all of the above, the evidentiary record in this case does not support granting Mr.

Dias the relief he seeks. There is no competent and substantial evidence in the record that would indicate that Mr. Dias's proposed programs are in the public interest. For all of these reasons, the Commission should deny Mr. Dias the relief he seeks.

Respectfully submitted,

/s/ Karl Zobrist

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 27th day of November, 2006, to all counsel of record.

/s/ Karl Zobrist
Karl Zobrist