

Exhibit No.:
Issue: Relief Requested
Witness: Terry Bassham
Type of Exhibit: Direct Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2006-____
Date Testimony Prepared: January 30, 2006

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2006-____

DIRECT TESTIMONY

OF

TERRY BASSHAM

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

**Kansas City, Missouri
January 2006**

*** [REDACTED] *** Designates that "Proprietary" Information has been Removed
Pursuant to the Standard Protective Order.

DIRECT TESTIMONY

OF

TERRY BASSHAM

Case No. ER-2006-_____

1 **Q: Please state your name and business address.**

2 A: My name is Terry Bassham. My business address is 1201 Walnut, Kansas City, Missouri
3 64106-2124.

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

5 A: I am employed by Kansas City Power & Light Company ("KCPL") as Chief Financial
6 Officer. KCPL is wholly owned by Great Plains Energy Inc. ("GPE"), where I am also
7 employed as Executive Vice President, Finance & Strategic Development, and Chief
8 Financial Officer.

9 **Q: What are your responsibilities?**

10 A: My responsibilities include the oversight of KCPL's finance and accounting departments.

11 **Q: Please describe your education, experience and employment history.**

12 A: I hold a Bachelor of Business Administration degree in Accounting from the University
13 of Texas at Arlington and a Juris Doctor degree from St. Mary's University School of
14 Law in San Antonio, Texas. I have held my current position at KCPL since April of
15 2005. Prior to that time, I was employed by El Paso Electric for nine years in various
16 positions including General Counsel, Chief Administrative Officer and Chief Financial
17 Officer. The remainder of my work career I worked as an attorney in the primary
18 practice of regulatory law.

1 **Q: Have you previously testified in a proceeding at the Missouri Public Service**
2 **Commission (“MPSC” or “Commission”) or before any other utility regulatory**
3 **agency?**

4 **A:** I have not previously testified before the MPSC. I have testified before the Federal
5 Energy Regulatory Commission, the Public Utility Commission of Texas, the New
6 Mexico Public Service Commission and various legislative committees of the Texas and
7 New Mexico legislatures.

8 **Q: What is the purpose of your testimony?**

9 **A:** The purpose of my testimony is to discuss certain KCPL financial information pertinent
10 to this rate case and to summarize the relief KCPL requests in this rate case.

11 **Q: What is the amount of the rate increase KCPL is requesting in this case?**

12 **A:** The amount of the rate increase is approximately 11.5% or \$55.8 million dollars based on
13 test year revenue of approximately \$487 million.

14 **I. REQUESTED RETURN ON EQUITY**

15 **Q: What return on equity does KCPL request in this case?**

16 **A:** KCPL requests a return on equity of 11.5% based upon GPE’s capital structure of
17 53.81% equity.

18 **Q: What is the basis for the requested 11.5% return on equity?**

19 **A:** KCPL bases its request for an 11.5% return on equity on a baseline cost of equity capital
20 of 11.0%, adjusted to reflect certain investor risks associated with the implementation of
21 KCPL’s Regulatory Plan. For example, as explained in the direct testimony of KCPL
22 witness Samuel Hadaway, the risk premium associated with the construction component

1 of KCPL's Regulatory Plan increases KCPL's cost of capital by approximately 50 basis
2 points.

3 **Q: Are there other justifications for a baseline return of equity greater than 11%?**

4 A: Yes, there are. A return level greater than the baseline 11.0% is also justified by KCPL's
5 utility performance, which has added substantial value to customers. KCPL provides its
6 retail customers with a very high level of service. As explained in the direct testimony of
7 KCPL witness Robert Camfield, of Christensen Associates Energy Consulting ("CA
8 Energy Consulting"), KCPL's high level of performance results in lower prices and
9 higher levels of productivity, resource utilization and service. Accordingly, KCPL
10 respectfully requests that the MPSC give consideration to KCPL's performance when
11 establishing a rate of return on equity in this proceeding.

12 **Q. Did KCPL calculate its rate increase request based upon a performance allowance?**

13 A: No. As I mention above, a rate of return on equity level of 11.5% is fully justified given
14 the risks associated with the extensive, fast-paced construction component of KCPL's
15 Regulatory Plan.

16 **Q: Why is it important that KCPL earn a return on equity of at least 11.5%?**

17 A: An 11.5% return on equity is required to protect KCPL's shareholders. The construction
18 component of KCPL's Regulatory Plan is vital to the region served by KCPL. KCPL's
19 ability to access the capital markets at reasonable costs is necessary for the timely
20 completion of that construction. Acquiring capital on reasonable terms requires that
21 KCPL's holding company, GPE, continue to maintain the value of its common stock. To
22 this end, a return on equity of at least 11.5% is necessary. GPE will issue a substantial
23 amount of equity during the five-year Regulatory Plan. A return on equity less than

1 11.5% would be costly to retail customers and the Company because it would not
2 adequately compensate shareholders for their investment risks.

3 **Q: Does an 11.5% return on equity adequately address the substantial risk of KCPL's**
4 **off-system sales in the wholesale market?**

5 A: No, it does not. The risk of the off-system sales in the wholesale market consists of
6 several components, including market price, volumetric risk associated with generation
7 variable cost, generation unit outages, coal supply availability, and weather, as well as the
8 uncertainty of retail sales growth. KCPL believes that the most appropriate management
9 of this risk is a sharing between KCPL and its customers. KCPL has requested to hold
10 the rate of return request to 11.5%, and distribute the off-system wholesale sales risk
11 between its customers and shareholders. This issue is discussed in greater detail in the
12 direct testimony of KCPL witness Michael Schnitzer.

13 **Q: How does KCPL propose to share the risk of off-system sales margins between**
14 **customers and investors?**

15 A: Based upon the analysis of Michael Schnitzer, KCPL included approximately **
16 of off-system sales margin in its test year revenue requirement. This level of
17 off-system sales margin is approximately ** less than KCPL has estimated
18 to be a 50% probability of achieving in 2007, the year in which the requested rates will
19 go into effect. By reducing the total dollar amount of off-system sales margins in base
20 rates, the risk of achieving that level of margin is appropriately reduced.

II. ADDITIONAL AMORTIZATION

Q: The Regulatory Plan Stipulation and Agreement discussed additional amortization to maintain financial ratios. Please explain the significance of this amortization and the maintenance of financial ratios for KCPL.

A: The signatory parties to the Regulatory Plan Stipulation and Agreement agreed that it is desirable that KCPL maintain its debt at an investment grade rating during the implementation period of its Regulatory Plan. The parties agreed to support the concept of “Additional Amortizations to Maintain Financial Ratios” (“Additional Amortization”) in KCPL general rate cases filed prior to June 1, 2010. The parties agreed that Additional Amortization would be an element in any KCPL’s rate case only when the Missouri jurisdictional revenue requirement in that case failed to satisfy certain financial ratios, as shown in Appendix E of the Regulatory Plan Stipulation and Agreement. This issue is discussed in greater detail in the direct testimony of KCPL witness Michael Cline.

Q: Why is it important for KCPL to maintain investment grade ratings during the implementation of the Regulatory Plan?

A: Maintaining high credit quality at KCPL is vital to debt and equity investors, banks, and rating agencies for three primary reasons. First, KCPL and GPE will rely extensively on capital markets to finance KCPL’s obligations under the Regulatory Plan. Investors will need to have confidence in KCPL’s credit strength and financial strength to feel comfortable making this capital available to KCPL on attractive terms, particularly given the number of investment alternatives otherwise available to them. Second, KCPL has a significant amount of debt subject to refinancing over the next five-year period. KCPL’s ability to refinance its debt efficiently and effectively will be heavily dependent on

1 bondholder and rating agency views of KCPL's creditworthiness. Finally, equity
2 investor views of KCPL's financial strength and credit quality will be a major influence
3 on the GPE stock (NYSE ticker: GXP) price for the next several years. Clearly, a
4 number of other factors will also impact the performance of GXP. However, because
5 KCPL constitutes a majority of GPE's core earnings and assets, assurance of KCPL's
6 continued strength is, and will remain, essential to GPE investors.

7 **Q: What is the purpose of the Additional Amortization?**

8 A: The fundamental purpose of the Additional Amortization is to ensure that KCPL achieves
9 an amount of Funds from Operations ("FFO") sufficient to sustain levels of certain
10 financial ratios above the low end of the top third of the range for BBB rated companies.
11 Specifically, KCPL will need to maintain at that level its FFO Interest Coverage ratio and
12 its FFO as a Percentage of Average Total Debt ratio. This issue is discussed in greater
13 detail in the direct testimony of Mr. Cline.

14 **Q: What is the actual amount of Additional Amortization for which KCPL is filing in**
15 **this rate case?**

16 A: Zero. Based on the components of KCPL's case, as described in the testimony of
17 numerous witnesses from the Company and experts testifying on the Company's behalf,
18 KCPL estimates that cash flow will be adequate to achieve the thresholds for the two key
19 financial ratios without the need for Additional Amortization. An Additional
20 Amortization may be required to achieve the thresholds, however, if the MPSC does not
21 approve or substantially modifies KCPL's requested rates.

1 **III. ACCOUNTING ORDERS AND OTHER RELIEF**

2 **Q: Is KCPL requesting the MPSC's approval of certain accounting orders as part of**
3 **this rate case?**

4 **A: Yes, it is. KCPL is requesting an accounting order with respect to the accrual level of the**
5 **Wolf Creek Nuclear Generating Station ("Wolf Creek") decommissioning trust fund and**
6 **with respect to pensions.**

7 *Wolf Creek Decommissioning Trust Fund Accrual*

8 **Q: Please summarize your recommendation regarding the appropriate funding level**
9 **for the Missouri jurisdictional component of KCPL's trust fund for**
10 **decommissioning Wolf Creek.**

11 **A: I recommend that the annual funding level for the Missouri jurisdictional component of**
12 **KCPL's trust fund for the decommissioning of Wolf Creek be set at \$1,281,264, as**
13 **shown in Schedule DAF-5 of the direct testimony of KCPL witness Don Frerking. This**
14 **funding level will begin in 2007 and continue at the same level through the first quarter**
15 **of 2045 unless it is changed in a future proceeding before the MPSC. This issue is**
16 **discussed in more detail in the direct testimony of KCPL witness Don Frerking.**

17 **Q: How does your recommended funding level compare to the existing funding level?**

18 **A: The existing annual funding level for the Missouri jurisdictional component of KCPL's**
19 **decommissioning trust fund is \$2,303,856. The recommended annual funding level of**
20 **\$1,281,264 is \$1,022,592 less than the existing annual funding level.**

21 **Q: What is meant by the term "tax qualification" as it relates to nuclear**
22 **decommissioning trust funds?**

1 A: A "tax-qualified" nuclear decommissioning trust fund is a fund that meets certain criteria
2 as defined in Section 468A of the Internal Revenue Code ("Section 468A"). Tax-
3 qualified nuclear decommissioning trust funds are afforded favorable tax treatment as
4 compared to non-qualified funds.

5 **Q: Did the Energy Policy Act of 2005 include any modifications to the special rules for**
6 **nuclear decommissioning and Section 468A?**

7 A: Yes, the Energy Policy Act of 2005 included a number of modifications to the special
8 rules for nuclear decommissioning. Among the modifications were amendments to
9 Section 468A which governs the tax qualification of nuclear decommissioning trust
10 funds. These amendments are effective for taxable years beginning after December 31,
11 2005.

12 **Q: What were the requirements for tax qualification under Section 468A prior to the**
13 **changes resulting from the Energy Policy Act of 2005?**

14 A: In order to ensure the continued tax qualification of the fund, any change in the funding
15 levels had to be filed with and approved by the Internal Revenue Service ("IRS"). The
16 IRS required a statement in an order of the state commission (a) approving the schedule
17 of decommissioning cost accruals; (b) finding that the decommissioning cost accruals
18 were included in cost of service and were included in rates for ratemaking purposes; and
19 (c) finding that the earnings rate assumed for the trust takes into consideration the tax rate
20 change and the removal of the investment restrictions resulting from the Energy Policy
21 Act of 1992.

22 **Q: How have the requirements for tax qualification changed as a result of the changes**
23 **to Section 468A?**

1 A: There is no longer a cost of service requirement for tax-qualified funds. Previously,
2 deposits into a tax-qualified fund were limited by the amount included in cost of service
3 for ratemaking purposes so long as that amount did not provide greater than level (front-
4 loaded) funding. Regarding the allowed level of funding into a tax-qualified fund, the
5 revised Section 468A only states that "the amount which a taxpayer may pay into the
6 Fund for any taxable year shall not exceed the ruling amount applicable to such taxable
7 year."

8 **Q: What was the rationale for the elimination of the cost of service requirement?**

9 A: The cost of service requirement was primarily eliminated to allow nuclear owners in
10 states that now have deregulated generation to maintain the tax-qualified status of their
11 trust funds in the absence of cost of service-based regulation.

12 **Q: How will the IRS determine the allowable level of funding to a tax-qualified fund if**
13 **it no longer has a state commission-ordered cost of service amount for**
14 **decommissioning funding upon which to rely?**

15 A: Because the elimination of the cost of service requirement has only recently become
16 effective it is not yet evident how the IRS will rule when it does not have state
17 commission-ordered funding amount.

18 **Q: Given the elimination of the cost of service requirement for tax-qualification of the**
19 **fund, what language would you request that the MPSC put in its order regarding**
20 **the amount of decommissioning funding in cost of service for ratemaking purposes?**

21 A: KCPL respectfully requests that the MPSC use the same language in the order approving
22 the decommissioning funding level that was required prior to the changes to
23 Section 468A. Because of the uncertainty at this time regarding potential IRS treatment,

1 use of the prior Section 468A language provides the greatest assurance of continued tax-
2 qualified decommissioning funding.

3 Pensions

4 **Q: What is the nature of the accounting order the Company requests regarding**
5 **pensions?**

6 **A:** The Company requests the Commission reaffirm its approval of the regulatory asset or
7 liability the Company records for the annual difference in Statement of Financial
8 Accounting Standards No. 87 ("FAS 87") pension expense recorded for financial
9 reporting purposes and the amount of FAS 87 pension expense calculated for ratemaking
10 purposes, as addressed in Section III.B.1.e.1 of the Regulatory Plan Stipulation and
11 Agreement. The Regulatory Plan Stipulation and Agreement provided no rate base
12 recognition for this regulatory asset or liability. As indicated in the Regulatory Plan
13 Stipulation and Agreement, any difference between the two methods is merely a timing
14 difference that will eventually be recovered, or refunded, through rates under the method
15 used in setting rates over the life of the pension plans.

16 The Company also requests the Commission reaffirm its approval of the regulatory asset
17 or liability the Company records for the annual difference in FAS 87 pension expense
18 calculated for ratemaking purposes and the level of pension expense built into rates for
19 that period, as addressed in Section III.B.1.e.6 of the Regulatory Plan Stipulation and
20 Agreement. The Regulatory Plan Stipulation and Agreement provided rate base
21 recognition for this regulatory asset or liability.

22 Unlike FAS 87, which allows for the delayed recognition in net periodic pension cost of
23 certain gains and losses, FAS 88 requires immediate recognition of certain gains and

1 losses arising from settlements and curtailments of defined benefit plans. The Company
2 requests Commission approval to set up a regulatory asset or liability to track the
3 difference in FAS 88 pension expense recorded for financial reporting purposes and the
4 level of FAS 88 expense built into rates. The regulatory asset or liability would be
5 applied as of the first day of the calendar year in which the rate and order are issued in
6 this case and would be included in rate base and amortized over five (5) years at the next
7 rate case.

8 **Q: Does that conclude your testimony?**


9 **A: Yes, it does.**

In the Matter of the Application of Kansas City
Power & Light Company to Modify Its Tariffs to
Begin the Implementation of Its Regulatory Plan

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

1. My name is Terry Bassham. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Chief Financial Officer.

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


Terry Bassham

Subscribed and sworn before me this 30th day of January 2006.

Nicol A. Loney
Notary Public

My commission expires: Feb. 4, 2007

