BEFORE THE PUBLIC SERVICE COMMISSION
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**

STAFF'S POST-HEARING REPLY BRIEF AND TRUE-UP BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through the Commission's General Counsel, and for its Post-Hearing Reply Brief, states as follows:

Argument

A. Cost of Service:

1. Incentive Compensation:

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

KCPL admits that Staff has allowed the majority of its incentive compensation expense in cost of service and seeks only to disallow (1) that portion that is tied to Earnings Per Share (EPS) and (2) that portion awarded for undefined reasons (*KCPL's Initial Post-Hearing Brief,* at 22, 24).[1]

As for the EPS-dependent portion, KCPL complains that Staff has advanced no evidence to support its contention that higher EPS may be obtained at the expense customer service. KCPL points to the extremely expensive --

[1] Hereinafter "*KCPL Brief.*"

$160,000! – testimony of its expert, Robert Camfield, who testified that KCPL is performing better than many other electric utilities. KCPL also points to the testimony of its other expert witness, David Cross, who testified that KCPL must use incentive compensation in order to attract and retain qualified employees and that the EPS-based bonuses indeed serve ratepayer interests.

With regard to the portion awarded for undefined reasons, KCPL *admits* in its brief that the program lacked defined standards: "While the 2005 Officer Plan had no formal objectives for the individual component" (*KCPL Brief,* at 25). KCPL then goes on to claim, despite the evidence to the contrary, that it did too have standards for its individual awards.

Staff has simply applied prior decisions of this Commission in determining whether or not to allow KCPL's various incentive compensation programs into cost of service. The Commission has disallowed incentive compensation in the past where the goals were either ill-defined or tied primarily to shareholder wealth maximization. *In the Matter of Union Electric Company,* 29 Mo.P.S.C. (N.S.) 313, 325 (*Report & Order,* 1987) ("an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the incentive plan."); *In the Matter of Southern Union Company, doing business as Missouri Gas Energy,* 5 Mo.P.S.C.3d 437, 458 (*Report & Order,* 1997) ("The Commission finds that the costs of MGE's incentive compensation program should not be included in MGE's revenue requirement **because the incentive compensation program is driven at least primarily, if not solely, by the goal of shareholder wealth**

maximization, and it is not significantly driven by the interests of ratepayers.") (*emphasis added*); *In the Matter of Southern Union Company, doing business as Missouri Gas Energy,* 12 Mo.P.S.C.3d 581, 606-7 (*Report & Order,* 2004):

> The Commission agrees with Staff and Public Counsel that the financial incentive portions of the incentive compensation plan should not be recovered in rates. Those financial incentives seek to reward the company's employees for making their best efforts to improve the company's bottom line. Improvements to the company's bottom line chiefly benefit the company's shareholders, not its ratepayers. Indeed some actions that might benefit a company's bottom line, such as a large rate increase, or the elimination of customer service personnel, might have an adverse effect on ratepayers. If the company wants to have an incentive compensation plan that rewards its employees for achieving financial goals that chiefly benefits shareholders, it is welcome to do so. However, the shareholders that benefit from that plan should pay the costs of that plan. The portion of the incentive compensation plan relating to the company's financial goals will be excluded from the company's cost of service revenue requirement.

Finally, KCPL offers long term equity compensation (i.e., GPE stock) as incentive compensation for executives. Staff proposes to exclude these awards because (1) they were primarily tied to achieving of financial goals, including the performance of GPE's unregulated subsidiary; (2) they were funded with equity rather than cash; and (3) there is a double award for 2005 and 2006. Additionally, the equity incentives are tied to a "change in control" provision intended to assist in resisting hostile takeovers and to provide a "golden parachute" to management. There is no benefit to ratepayers. The Commission has previously disallowed awards based on achieving the goals of an unregulated parent and unregulated affiliates. For example, in *In the Matter of*

Southwestern Bell Telephone Company, 29 Mo.P.S.C. (N.S.) 607, 627 (*Report & Order,* 1989), the Commission stated:

> [T]he results of the parent corporation, unregulated subsidiaries, and non-Missouri portions of SWB, are only remotely related to the quality of service or the performance of SWB in the State of Missouri. Achieving the goals of SBC [the parent company] and unregulated subsidiaries is too remote to be a justifiable cost of service for Missouri ratepayers. Accordingly, the Staff's proposed disallowances in the senior management's long-term and short term incentive plans . . . should be adopted.

Similarly, in *In the Matter of Southwestern Bell Telephone Company,* 2 Mo.P.S.C.3d 479, 531-2 (*Report & Order,* 1993), the Commission stated:

> The structure of the plan provides an implicit incentive for participants to try to increase SBC's stock price. This in turn could encourage senior managers to spend a greater percentage of time on non-regulated companies and discourage time and effort spent on Missouri operations . . . . The likelihood of SBC managers emphasizing whatever they perceive will cause the market to react favorably to SBC stock, including giving priority to unregulated subsidiaries, further convinces the Commission that Missouri ratepayers should not fund the long-term incentives.

In conclusion, Staff states that the Commission is not bound by the decisions of prior Commissions and may choose to allow bonuses in this case that prior Commissions would not have allowed. However, the Commission should know that its Staff regards every Commission decision as a statement of policy to be implemented in the future. Whatever resolution of this issue the Commission selects should express the policy that the Commission wishes its auditors to follow from now on.

2. Pensions:

Settled.

3. Hawthorn 5:

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

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?

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?

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

The Staff's principal brief on the Hawthorn 5 issues appears in the Staff's Supplemental Prehearing Brief.

KCPL's Initial Post-Hearing Brief makes reference a number of times to KCPL's cash management practice of commingling cash in a single general corporate cash account out of which it paid its daily requirements for cash for payroll, fuel, replacement power, capital, operations and maintenance. Nowhere does KCPL cite this activity as being anything other than a practice of KCPL. (KCPL's Initial Post-Hearing Brief, pp. 27, 28, 30, 31, 32, 33, 34). Nowhere does KCPL cite this cash management practice as being a requirement imposed on KCPL by statute, rule or regulation which KCPL could not alter.

KCPL asserts at page 28 of its Initial Post-Hearing Brief that there is no support for Staff witness Phil Williams' position that USOA Account 108 does not apply to the Hawthorn 5 rebuild situation. Besides Mr. Williams' noting that Hawthorn 5 was rebuilt rather than being withdrawn from service, KCPL's witness Robert J. Camfield of Christensen Associates Energy Consulting provides support for the Staff's position that the Hawthorn 5 situation was unique. Mr. Camfield was hired by KCPL to assess the utility performance of KCPL in providing electric service to retail consumers over recent years and to report his findings to the Commission. He has worked as an economist as a member of the staff of the Michigan and New Hampshire Public Service Commissions and for the Southern Company before joining Laurits R. Christensen Associates, Inc. in 1994. (Ex. 36, Camfield Direct, pp. 1-3). Mr. Camfield testified that the Hawthorn 5 catastrophic boiler explosion was "largely a random event that any electric service provider could experience" and that in the last 20 years, six (6) other electric service providers have experienced such an event. When on the witness stand, he was asked to enumerate the six (6) other electric service providers that he was thinking of, he could not name a single one that was comparable to the KCPL Hawthorn 5 situation. (Vol. 13, Tr. 1416-18). Regarding KCPL's support that Account 108 applies to the Hawthorn 5 rebuild, KCPL could only cite what it characterized as "the unambiguous language of the USOA" definition of "property retired." (18 CFR Pt. 101, Definitions (28)).

The Staff can cite to the Commission no authority for what the Staff is proposing other than the Commission's own rule and Missouri case law, which the Staff has previously cited to the Commission in Mr. Williams' testimony and the Staff's Prehearing Brief: 4 CSR240-20.030 and *State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 645 S.W.2d 44, 53-54 (Mo.App. 1982) and *Union Electric Co. v. Public Serv. Comm'n*, 136 S.W.3d 146 (Mo.App. W.D. 2004).

KCPL incorrectly states at page 28 of its Initial Post-Hearing Brief that "Staff's main contention is that KCPL should have booked the insurance recoveries received before and during the reconstruction to plant in service as a direct offset to the cost of reconstruction. (Ex. 139, p. 40)." This was not the Staff's main concern as indicated in the Surrebuttal Testimony of Mr. Williams:

> Q. What is the difference between the treatments that KCPL and Staff have given Hawthorn 5 reconstruction costs?
>
> A. One difference relates to how KCPL treated the recoveries from both insurance and lawsuit settlements relating to the Hawthorn 5 reconstruction costs as an increase to the accumulated depreciation reserve. Staff believes that these recoveries should have been used to reduce plant-in-in-service, FERC Account 101. . . .
>
> . . . .
>
> Q. Is there another difference between KCPL and Staff relating to Hawthorn 5 costs?
>
> A. Yes. The major difference between KCPL and Staff is how the Company calculated the amount of allowance for funds used during construction (AFDC).
>
> Q. Does the accounting treatment of the recoveries have anything to do with the AFDC issue that exists between the Company and Staff?
>
> A. No. . . .

(Ex. 140, Williams Surrebuttal, pp. 3-4)[2].

---

[2] Q. Does the fact that KCPL treated the receipt of insurance recoveries and lawsuit settlements as an increase to accumulated depreciation reserve, affect the re-computed AFDC amount?

A. No. The two issues addressed in this testimony are separate and distinct. While it makes a much more straight-forward solution if the amounts of the insurance proceeds and lawsuit settlements were used to reduce plant in service instead of increasing the reserve, the treatment of booking recoveries to the depreciation reserve does not affect the recalculation Staff is making to the AFDC amount that should be included in rates consumers are charged.

At page 31 of its Initial Post-Hearing Brief, KCPL raises the charge against the Staff of retroactive ratemaking. The Staff first raised this issue in the Surrebuttal Testimony of Mr. Williams regarding KCPL's treatment of replacement power and cost of removal relative to AFDC:

> A. . . . To suggest, as Ms. Wright has done in her rebuttal testimony (page 3, line 21), that the cash flow impacts of the amounts expended for replacement power not covered by insurance and cost of removal of the destroyed equipment at Hawthorn 5 should be considered in the AFDC analysis is simply wrong. Without authorization from the Commission, KCPL is not able to defer amounts of this magnitude. Any consideration of these costs is long past the appropriate time frame. To do otherwise would be nothing short of retroactive ratemaking, i.e., the recovery, or attempted recovery, of costs from periods, in this situation from the years 1999 to 2001.
>
> . . . .
>
> . . . what the Company has done through its calculation of AFDC is charge the ratepayer a financing charge for the purchase of replacement power during the time that Hawthorn 5 was out of service. This is a form of retroactive ratemaking that can be seen in Ms. Wright's assertion that Staff omits several important factors in its cash flow analysis.

(Ex. 140, Williams Surrebuttal, pp. 17-18). Mr. Williams testified that (i) replacement power is an operating expense, not a capital expense, which KCPL chose only to insure for in the amount of $5 million and (ii) KCPL had been recovering in rates cost of removal for Hawthorn 5 for over 30 years. (*Id*. at 17-19).

4. Ice Storm Costs:

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

(Ex. 139, Williams Direct, p. 44).

This issue was raised by the United States Department of Energy, National Nuclear Security Agency (USDOE) and Staff has no position on the issue.

5. EEI Dues:

Settled.

6. Severance Costs:

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

Staff sees no need to add to its previous arguments on this issue.

7. Bad Debts:

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 wants to determine the allowance for uncollectibles to include in cost of service by multiplying the revenue requirement set by the Commission in this case by the agreed Bad Debt factor of 0.61 percent (*KCPL Brief,* at 38). KCPL whines that "Staff's position not only requires the use of an inaccurate surrogate revenue requirement figure, but also defies the common sense understanding that increased rates will have an adverse impact of KCPL's bad debt expense" (*id.*). Actually, what "defies the common sense understanding that increased rates will have an adverse impact of KCPL's bad debt expense" is not Staff's position, but reality.

Staff witness Kim Bolin testified, "[f]rom the year 2001 to 2002, retail sales increased by 1.78 percent. In the same year, the net write-offs decreased by 36.55 percent from the previous year." (Tr. 5:264 and Ex. 144). It may be counter-intuitive, but it’s reality! Staff urges the Commission to reject KCPL’s position on this issue, which contradicts the hard evidence of actual experience, and resolve this issue as Staff recommends.

8. Fuel & Purchased Power Expense

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

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?

In its Post-Hearing Brief, filed November 17, 2006, the Staff neglected to include a statement indicating that it did not believe it has an issue with KCPL concerning the amount of fuel and purchased power expense to be included in cost of service. The Staff apologizes for the inadvertent error. The Staff would note, however, that at page 23 of its October 13, 2006, Supplemental Prehearing Brief, which was incorporated into its Post-Hearing Brief, the Staff stated its understanding that, while not agreeing to the Staff's methodology for arriving at its recommendation for fuel and purchased power expense, KCPL had agreed to the Staff's recommended amount, subject to true-up. KCPL's Initial Post-Hearing Brief (pp. 38-40) confirms that Staff's understanding is correct, and that as a result, there is no issue between the Staff and KCPL regarding the amount of fuel and purchased power expense to be included in cost of service in this proceeding.

9. Surface Transportation Board Litigation:

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?*

KCPL states: "KCPL accepts Staff's recommendation on this issue. (Ex. 13, p.3). Both KCPL witness Ed Blunk and Staff witness Charles Hyneman now recommend that the Commission treat the 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 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)" (*KCPL Brief,* at 40-41).

10. SO2 Premiums:

How should SO2 premiums related to lower-sulfur coal be recorded for book and ratemaking purposes?

What parameters does the Commission-approved Stipulation & Agreement in Case No. EO-2005-0329 impose on the treatment of SO2 premiums in this case?

Staff sees no need to add to its previous arguments on this issue.

11. Injuries and Damages:

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

KCPL insists that the Commission require the ratepayers to loan it an unnecessary and unsupported amount of cash with respect to certain small liabilities that accrue about six months before they are finally paid. KCPL is required to accrue the estimated value of each of these liabilities when the incident occurs (Tr. 6:290-291). About 185 days later, KCPL pays out (*KCPL Brief,* at 44-45). The important point is that **the final pay-out is generally *less***

than the amount originally accrued: KCPL's witness, Lori Wright, testified that, measured over a three-year period, KCPL's estimated and accrued liabilities ***exceeded*** the amounts actually paid out by 10% (Tr. 6:292-293, 304). This is the evidentiary finding that should form the keystone of the Commission's resolution of this issue.

12. Rate Case Expense:

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

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?

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

KCPL proposes that actual rate case expense by deferred and amortized over two years (Tr. 6:307). Staff, on the other hand, proposes to normalize rate case expenses over three years (Tr. 6:310). Three years is the appropriate interval because KCPL is not required to file another rate case until the end of its Regulatory Plan (Tr. 6:312). Staff urges the Commission to adopt its recommendation.

13. Corporate Projects and Strategic Initiatives:

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?

The best KCPL can come up with on this issue is: "In order to keep these projects out of rate base, Staff must contradict itself and take illogical positions" (*KCPL Brief,* at 47). What, one wonders, is illogical about refusing to require Missouri working families to pay *interest* to KCPL on its unamortized rate case expense? This Commission has simply never allowed such treatment of a cost of this nature (Tr. 6:323).

14. Payroll, Including A&G Salaries:

Settled.

15. Other Benefits:

Settled.

16. Maintenance Expense:

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

KCPL continues to insist that its normalized test year production maintenance expenses be inflated by 5.08 percent, representing the application of the Handy-Whitman Index (*KCPL Brief,* at 50). KCPL seeks the same treatment for distribution maintenance expenses, although Staff's audit shows that ratepayers a due a *reduction* on those costs (*KCPL Brief,* at 51). The Commission will recall that Staff witness Harris testified that use of the Handy-Whitman escalator is inappropriate because KCPL's costs *exclude* labor costs.

17. Property Taxes:

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 sees no need to update its arguments as already propounded on this issue.

18. Decommissioning Expense:

Settled.

19. True-up:

EMPLOYEE LEVELS (True-Up Issue)

Employee levels is a true-up issue. There is only true-up direct testimony and true-up rebuttal testimony. There are no Prehearing Briefs on this issue nor does this issue appear in the Initial Post-Hearing Briefs filed on November 22, 2006.

KCPL's true-up payroll cost annualization includes $6.3 million for 113 positions for individuals who were not employed by KCPL or on the KCPL payroll register as of the September 30, 2006 true-up cutoff date agreed to for purposes of this case. The Staff is opposed to the revenue requirement cost of service recognition of employee additions expected to occur after the September 30, 2006 true-up date as proposed by KCPL for the reasons explained below. The instant case is now unique if for no other reason than due to the fact there is a contested true-up issue.

Section III.B.3.a.(i) of the KCPL Regulatory Plan Stipulation And Agreement approved by the Commission in Case No. EO-2005-0329 contained the following language:

> **a. RATE FILING # 1 (2006 RATE CASE)**
>
> (i) <u>Schedule.</u> Rate schedules with an effective date of January 1, 2007 will be filed with the Commission on February 1, 2006. The test year will be based upon a historic test year ending December 31, 2005, (initially filed with nine (9) months actual and three (3) months budget data), with updates for known and measurable changes, as of June 30, 2006, and with a true-up through September 30, 2006. On or about October 21, 2006, KCPL will file in a true-up proceeding a reconciliation as of September 30, 2006. The specific list of items to be included in the true-up proceeding shall be mutually agreed upon between KCPL

> and the Signatory Parties, or ordered by the Commission during the course of the rate case. However, the Signatory Parties anticipate that the true-up items will include, but not necessarily be limited to, revenues including off-system sales, fuel prices and purchased power costs, payroll and payroll related benefits, plant-in-service, property taxes, depreciation and other items typically included in true-up proceedings before the Commission.

On February 3, 2006, the Commission issued an Order And Notice in which among other things it directed the Staff, Public Counsel and any person or entity seeking intervention to indicate by March 6, 2006 concurrence in the recommended test year and true-up filings or recommend alternatives. On March 6, 2006, the Staff filed Staff's Response To Commission Order Respecting Test Year, Update And True-Up in which the Staff recommended to the Commission issuance of an Order consistent with the terms of the KCPL Regulatory Plan Stipulation And Agreement approved by the Commission in Case No. EO-2005-0329. On March 29, 2006 in Case No. ER-2006-0314 the Commission issued an Order Setting Procedural Schedule.

Staff witness Mr. Traxler testified that the driver for the true-up date of September 30, 2006 was the projected in-service date of KCPL's $85 million, approximately 100 megawatt (MW), wind generation facility at Spearville, Kansas. (Ex. 163, Traxler True-Up Direct, pp. 10, 17; KCPL witness Timothy M. Rush, at page 7 of his True-Up Direct Testimony, Exhibit 54, verifies that the timing of KCPL's rate case is to coincide with the in-service date of the Spearville wind generation project.). The intent of the September 30, 2006 true-up date is to allow KCPL, and other parties, the opportunity to determine KCPL's revenue requirement cost of service as close as reasonably possible to the January 1, 2007 operation-of-law date.

Mr. Traxler explained in his Direct True-Up Testimony that a "known and measurable" date, which is not the same thing as the "true-up date," is established in any major rate case for the purpose of reflecting changes in revenue requirement cost of service as close to the Staff's direct filing, August 8, 2006 in this case, as possible. The known and measurable date agreed to for this case, as previously noted, is June 30, 2006. Mr. Traxler further explained that a "true-up date" is only recommended in special circumstances when a utility has a significant revenue requirement cost of service increase, which will not occur in time to be reflected in the Staff's direct filing, but will occur on a date prior to the operation-of-law date which provides the Staff sufficient time to update its revenue requirement cost of service calculation to reflect the significant cost of service increase, as well as all other material changes, which represent a matching of rate base, cost of capital, revenues and expenses, as of the true-up date. If all appropriate cost of service components are not measured at the same point in time, a distortion is reflected in the revenue requirement determination and the rates as a consequence are not just and reasonable. A true-up date is ultimately of great benefit to the utility because of the opportunity for the new rates established to be based upon the most current "matching" of the utility's revenue requirement cost of service components – rate base, cost of capital, revenue and expenses – as reasonably possible to the operation-of-law date. Even though the rates that are being set by the Commission are for a future period, both procedural requirements and staffing needs respecting other Commission cases do not permit the operation-of-law date to be used as the true-up cut-off date. (Ex. 163, Traxler True-Up Direct, pp. 10-12).

If the Commission decides to accept KCPL's proposal, then it should recognize that it is adopting an anomaly to the "true-up" concept rather than attempt to rationalize why KCPL's 113 unfilled employee positions at the true-up cutoff date is actually consistent with the true-up concept it has long applied. *See Re St. Louis County Water Co.*, Case No. WR-91-361, Order Establishing Test Year, pp. 2-3 (September 6, 1991) (Unpublished).

Mr. Traxler testified that early in the Staff's audit of KCPL in this case, Staff audit supervisor Cary Featherstone in discussions with Mr. Rush, KCPL's Director of Regulatory Affairs, related that only individuals actually employed and on the KCPL payroll as of September 30, 2006 would be considered by the Staff for revenue requirement cost of service recognition in this case. The Staff's position on calculating payroll based on actual employee levels is long standing, having been consistently applied by the Staff for decades. (Ex. 163, Traxler True-Up Direct, pp. 9-10). Mr. Traxler stated that the Staff is treating the true-up of KCPL employee levels and salaries consistent with the way that employee levels and salaries have been handled in any case in which he has been involved in with regard to a true-up report or a known and measurable date, i.e., the employee levels and salaries are those as of the true-up report or a known and measurable date. (Vol. 15, Tr. 1662).

Mr. Traxler explained at the true-up hearing that the Staff had no expectation that it would encounter in this case at the true-up stage a budgeted employee level of 113 people: "it was a complete surprise to us." (*Id*. at 1665). He noted that as a consequence the Staff's ability to deal with the issue, such as conduct discovery, was limited. Mr. Traxler repeated his statement: "This was a complete surprise to the Staff that we were going to be dealing with this issue." (*Id*.). More than two weeks after surrebuttal testimony was filed on October 6, 2006, KCPL provided its first true-up information regarding this matter. Two true-up documents were provided by KCPL: (i) a summary of adjustments based on KCPL's September 30, 2006 update for the September 30, 2006 true-up and (ii) Missouri revenue requirement, 2005 updated test year, including known and measurable to September 30, 2006 for the true-up. KCPL sought to file these documents in EFIS on Saturday, October 21, 2006, but EFIS shows the filing as having been made on Monday, October 23, 2006. The October 21, 2006 cover letter from Counsel for KCPL states, in part: "These documents are being provided for use in KCPL's true-up proceeding in this case." Counsel for KCPL also on October 21, 2006, e-mailed these documents to counsel of record in Case No. ER-2006-0314.

KCPL witness Lora Cheatum, Vice President, Administrative Services, who had not filed testimony previously in the case filed True-Up Rebuttal Testimony, Exhibit 56, explaining at pages 3-4 that in addition to initiating a workforce realignment program in 2005 that resulted in approximately 118 employees leaving KCPL on March 31, 2006 (a number of these positions were eliminated), KCPL added 176 employees between May and September 2006 and terminated/retired 120 employees between May and September 2006, and 50 KCPL employees retired in late August/early September 2006. She explained that since KCPL has many employees who either currently qualify for retirement benefits or will qualify for such benefits within the next couple of years, and due to the particular specifics of the present structure of KCPL's retirement plan, it is likely that the pattern of late August/early September retirements seen this year will recur in subsequent years. (Ex. 56, Cheatum True-Up Rebuttal, p. 5).

She also argued that although their start dates will occur after September 30, 2006, "104 of the employees whose employment with KCPL [Mr. Traxler] questions not only received written offers of employment from KCPL, but also that each of them executed a letter of acceptance of employment prior to September 30, 2006," and their salaries are known and measurable because that was part of the acceptance of employment with KCPL. (Ex. 56, Cheatum True-Up Rebuttal, p. 2).

Mr. Rush attached to his True-Up Direct Testimony, Exhibit 54, a graph, Schedule TMR-4, entitled "Historical Employee Levels," which he characterized as "a graph demonstrating the swings that have been experienced for the last several years," but only showing the months from January 2005 to October 2006. (Ex. 54, Rush True-Up Direct, p. 10). On cross-examination, he acknowledged that although "offers extended" are only shown on Schedule TMR-4 for the months September and October 2006, there would have been offers extended in almost all, if not all, of the other months on his Schedule TMR-4, and that could have been shown, but that was not shown. (Vol. 15, Tr. 1614-15).

Mr. Rush noted that at September 30, 2006, KCPL had 2,110 full time equivalent employees excluding the 113 positions at issue. He stated that hires for these 113 positions "will be reporting at job sites throughout October and November. Since September 30th, and up through November 6th, the Company has brought on board 66 of the 113 employees, an additional 10 employees have a specified start date, and 29 employees are pending awaiting final clearance on the medical and background checks. Also, 8 of those employees declined the job after they had accepted. . . . All of the positions will be filled by the time rates go into effect." (Ex. 54, Rush True-Up Direct, p. 10).

KCPL's assertion that all of the 113 positions for which individuals were not actually in the employ of KCPL or on KCPL's payroll register on September 30, 2006, will be filled by the time that rates from this case go into effect on January 1, 2007 is not acceptable to the Staff and it should not be acceptable to the Commission. Of course, the accuracy of KCPL's assertion will not be known and measurable for some time and that is not the concept of a true-up that the Signatory Parties to the KCPL Regulatory Plan Stipulation And Agreement and the parties to this case approved by concurring in the test year, know and measurable update and true-up in the KCPL Regulatory Plan Stipulation And Agreement. Agreeing to a true-up cutoff date of September 30, 2006 does not mean that the signatory parties have agreed to a change or changes to KCPL's revenue requirement cost of service subsequent to September 30, 2006 just because the change is or the changes are expected to occur prior to the January

1, 2007 operation-of-law date.

Mr. Traxler attached to his True-Up Rebuttal Testimony, Schedule SMT-1, which is also attached hereto. Schedule SMT-1 summarizes the status of the 113 employee positions as of September 30, 2006 and November 1, 2006 based on KCPL's response to Staff Data Request No. 556 and KCPL's true-up payroll workpapers. The Staff also issued Staff Data Request No. 557 to identify existing employees, as of September 30, 2006, who subsequently left the employment of KCPL by November 1, 2006. Mr. Traxler's Schedule SMT-1 does not reflect that seven (7) KCPL employees retired or were terminated subsequent to the September 30, 2006 true-up date and prior to the November 7, 2006 True-Up Direct Testimony filing date. Among other things, Schedule SMT-1 identifies various categories of possible KCPL employees. (Ex. 164, Traxler True-Up Rebuttal, pp. 4, 7, 10).

Mr. Traxler provided additional information as to why resolution of this issue would not be just a simple matter of moving the September 30, 2006 cutoff to a later date, for example, November 1, 2006. He explained that there would need to be a proper matching of cost of capital, rate base, revenues and other expenses at November 1, 2006 in order to prevent a distortion and rates that are not just and reasonable. Mr. Traxler provided the example of additional revenue from customer growth. KCPL's updated cost of service calculation provided in July 2006 did not reflect any additional revenue. KCPL assumed no customer growth between June 30, 2006 and September 30, 2006. The Staff's calculation of Missouri jurisdictional revenue at September 30, 2006 is $2.8 million higher than the level calculated for June 30, 2006. KCPL has made no attempt to consider any additional revenue from customer growth after September 30, 2006. Such additional revenue would offset the cost of additional employees. (Ex. 164, Traxler True-Up Rebuttal, pp. 7-8).

Mr. Traxler provided another example of the need to match rate base, cost of capital, revenues and expenses for the true-up period. KCPL's Missouri jurisdictional accumulated depreciation and amortization reserve will increase approximately $16.5 million between September 30, 2006 and January 1, 2007. If KCPL's Missouri jurisdictional plant additions are less than $16.5 million between September 30, 2006 and January 1, 2007, KCPL's rate base will be lower at January 1, 2007 than at September 30, 2007 and so will its Missouri jurisdictional revenue requirement relative to these items. (Ex. 164, Traxler True-Up Rebuttal, p. 8).

20. Regulatory Plan Additional Amortizations:

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?

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

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

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

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

The Staff expects to be entering into a stipulation and agreement with at least KCPL and Public Counsel regarding the Regulatory Plan Additional Amortization issues except for the off-balance sheet obligations risk factor issue, which is an issue between the Public Counsel on the one side and the Staff and KCPL on the other side. Nonetheless, there are differences between the Staff and KCPL regarding how they characterize each other's and their own positions regarding the Regulatory Plan Additional Amortizations. The Staff addressed these items in its Supplemental Pre-Hearing Brief filed on October 13, 2006 and in its Initial Post-Hearing Brief filed on November 17, 2006, which incorporated by reference the Supplemental Pre-Hearing Brief. The Staff will respond below to some statements made by KCPL in its Initial Post-Hearing Brief that deserve a response.

Gross-Up Of Taxes – Calculation Of Book Depreciation

At page 18 of its Initial Post-Hearing Brief, KCPL states: "KCPL, Staff, and other parties are in agreement that the Additional Amortizations related to the Regulatory Plan should include an amount reflecting a gross-up for income tax purposes. (Ex. 136, pp. 13-14; Ex. 214, pp. 2-3)." The Staff does not concur with KCPL's characterization of the change in the Staff's position on the gross-up issue. When KCPL (or The Empire District Electric Company) refers to a gross-up for income tax purposes, the Staff believes each is referring to a gross-up for current income tax purposes. Mr. Traxler does not explain the Staff's change in position as an increase or gross-up in recognition of current income tax. Exhibit 136 is Mr. Traxler's Surrebuttal Testimony. A review of pages 13 to 14 of Exhibit 136 reveals that the Staff determined that its calculation of the book depreciation necessary to provide the cash flow required for the rating agency credit metrics under the Regulatory Plan Additional Amortization was inadequate. The Staff therefore increased book depreciation and explained that this increase in book depreciation entailed a corresponding increase in the straight line tax depreciation deduction used in calculating deferred income tax. An increase in book depreciation does not result in an increase in current income tax in the revenue requirement cost of service calculation. Thus, rather than its change in position involving a gross-up for income tax purposes, the Staff's change in positions involves an increase in book depreciation and a corresponding reduction to deferred income tax expense.

Off-Balance Sheet Obligations

Operating Leases & Purchased Power Capacity Contracts[3] - Risk Factor & Discount Rate

Commissioner Murray asked Staff witness Traxler for the quantification of the difference between a 10% discount rate initially used by KCPL and a 6.1% discount rate used by Mr. Traxler, which Public Counsel witness Russell W. Trippensee testified he concurred in. (Ex. 134, Traxler Direct, p. 18; Ex. 213, Trippensee Rebuttal, p. 4). Mr. Traxler calculated that the 6.1% discount rate increased the Regulatory Plan additional amortization by approximately $4 million over the 10% discount rate. (Exs. 151 and 152; Vol. 13, Tr. 1395).

Public Counsel in its Initial Post-Hearing Brief at pages 12-13 asserts that the Staff's position on the discount rate is not consistent with S&P because S&P

---

[3] Mr. Traxler testified that S&P takes a conservative approach for these items involving obligations of greater than one year that otherwise would be treated as expenses for financial reporting purposes. He explained that they are treated as fixed obligations requiring additional debt coverage. (Vol. 13, Tr. 1399).

uses a 10% discount rate. Mr. Traxler's Direct Testimony, Exhibit 134, clearly states at page 18 that he chose to be consistent with S&P's position rather than with KCPL's position:

> . . . In response to Staff Data Request No. 444.1, KCPL provided the necessary Off Balance Sheet Obligations with a discount rate assumption of 10% for Operating Leases and Purchase Power Capacity Contracts. I rejected the 10% discount rate assumption based upon data included in an August 1 2006, research bulletin from Standard & Poors for Great Plains Energy (GPE). Standard & Poors indicated that a 6.1% discount rate was used to determine the present value of KCPL's Operating Lease and Purchase Power Capacity Contract obligations. Since Standard & Poors is responsible for the GPE/KCPL credit rating, its recommended discount rate should be given consideration.

Exhibit 145, page 4 of 6, Exhibit 146, page 4 of 6, and Exhibit 147, page 4 of 6 indeed show that S&P uses a 6.1% discount rate.

Further, although the Staff changed its position, after surrebuttal testimony had been filed, based on information received from S&P on October 18, 2006, from a position that the risk factor for KCPL's purchased power capacity contracts should be 30% to a position that the risk factor for KCPL's purchased power capacity contracts should be 50%, the Surrebuttal Testimony of KCPL witness Michael W. Cline, filed on October 6, 2006, states that Mr. Trippensee's 10% risk factor position is without merit because S&P applies a risk factor of 50% to KCPL's long-term purchased power contracts when calculating KCPL's credit metrics. (Ex. 25, Cline Surrebuttal, p. 6). Mr. Cline's October 6, 2006 Surrebuttal Testimony relates that KCPL supplied this information to the Staff about S&P applying a 50% risk factor in response to Staff Data Request Nos. 444 and 510 and notes that S&P's May 2003 white paper on the topic was part of KCPL's response to Staff Data Request No. 510. (*Id.*). Mr. Traxler indicated that if the original August 1, 2006 S&P report had correctly indicated that the risk factor applied by S&P was 50% rather than the incorrect 30%, the Staff would have used a risk factor of 50% from the start. (Vol. 13, Tr. 1392-93; Ex. 163, Traxler True-Up Direct, p. 15).

Contrary to Mr. Trippensee's allegations in his True-Up Rebuttal Testimony, Exhibit 220, at pages 2-3, and Public Counsel's intimation in its Initial Post-Hearing Brief at page 13, the Commission would not defer its regulatory authority to S&P nor abdicate its ratemaking role to S&P for the Commission to adopt a 50% risk factor. (Remember that Mr. Trippensee has adopted the 6.1% discount rate.) Mr. Traxler characterized the 6.1% discount rate and the 50% risk factor as assumptions used in the calculation of the two agreed to credit metrics: (i) funds from operations (FFO) interest coverage (FFO 3.8 times interest), and (ii) funds from operations (FFO) as a percentage of average total debt (FFO 25% of average total debt).[4] Mr. Traxler testified that the two credit metrics have not changed but the discount rate assumption changed from 10% to 6.1% and the risk factor was corrected from 30% to 50%. (Vol. 13, Tr. 1401). The Staff discussed in its Initial Post-Hearing Brief the provision in the Regulatory Plan Stipulation And Agreement which addresses changes in the credit metrics.

The Staff anticipates that it will file in the next few days the True-Up Reconciliation / Reconcilement.

[4] There is a third credit metric, (iii) total debt to total capitalization, which was to be addressed in KCPL's financing application case, subsequent to the Regulatory Plan case, EO-2005-0329.

21. Weather Normalization/Customer Growth:

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

In its Initial Post-Hearing Brief, the Company criticizes Staff witness Shawn Lange for not having addressed in greater detail the effects of seasonal sensitivities on electricity usage within the Large Power customer class. (*KCPL Brief,* p. 59). Because these seasonal effects are regular, and hence normal, it is not appropriate to normalize them (Lange Surrebuttal, Ex. 121, p. 3, ln. 6-10); hence, there is no need to launch a major, detailed, expensive study in an attempt to specify their impact.

The Staff and KCPL disagree as to the extent of day-to-day weather sensitivity of the Large Power ("LP") customer class. Using the same approach he employed for the Company's other customer classes, KCPL witness Dr. George M. McCollister treated the LP class in the aggregate, by developing a day-to-day weather adjustment and subsequently applying a growth factor. (McCollister Direct, Ex. 28, p. 5, ln. 14-20).

The Staff takes the position that, while some of the LP customers exhibit some day-to-day weather sensitivity, the overall effect is small. (Lange Surrebuttal, Ex. 121, p. 2, ln. 9-12). Staff witness Lange's testimony presented graphical evidence showing how the electricity usage of the Residential class, a truly weather sensitive class, varies with temperature to produce a distinct V-shaped curve, while the LP curve is quite flat by comparison. (Lange Surrebuttal, Ex. 121, p. 3, ln. 17 – p. 4, ln. 7; Sch. 1). Further, in contrast to, for example, the Residential class, which is large and quite homogeneous with respect to its consumption of electricity, the LP class contains a relatively low number of large customers engaged in disparate businesses (*e.g.*, hotels, office buildings, manufacturing, hospitals, etc.) with heterogeneous electricity usage patterns. (Lange Surrebuttal, Ex. 121, p. 2, ln. 23 – p. 3, ln. 2).

Under the circumstances, the Staff believes it is more appropriate to analyze each LP customer individually for a whole host of considerations uniquely applicable to the particular customer---*e.g.*, erratic load level, facility expansions, unscheduled maintenance outages, and market forces (Bolin Direct, Ex. 106, p. 10, ln. 5-7).---than it is to lump them together and apply an analytical technique much more suitable to a large and homogeneous customer class such as Residential. This is the same approach that the Staff uses for the other electric utilities in Missouri (Bolin, Direct, Ex. 106, p. 9, ln. 21-23).

For the reasons stated herein and in its Post-Hearing Brief filed November 17, 2006, the weather normalization/customer growth approach is not appropriate for adjusting electricity usage and revenues associated with KCPL's Large Power class. The Staff recommends that the Commission adopt the Staff's individualized approach to annualizing said usage and revenues.

22. Jurisdictional Allocations:

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

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

KCPL's assertion in its Initial Post-Hearing Brief (p. 60) that "[n]o party presented evidence refuting the operating realities of KCPL's system as described by Mr. Frerking," is untrue and otherwise misleading. To a considerable extent, there was nothing to dispute. While all of a utility's operating realities should be considered in determining whether, for example, a 4 CP or a 12 CP allocation methodology is appropriate, the mere assertion by Mr. Frerking that the Company performs scheduled maintenance during normally down periods and that it plans its capacity on a year-round basis provides precious little support for the proposition that KCPL is a 12 CP utility. In fact, Mr. Frerking opined at the hearing that all electric utilities operate in the same manner as KCPL with respect to maintenance and capacity planning. (Tr. 581, ln. 17 – 582, ln. 9).

Nonetheless, in her prefiled testimony, Staff witness Erin Maloney did take issue with Mr. Frerking's passing references to KCPL's operating realities. Ms. Maloney distinguished the operating realities experienced by KCPL from those of The Empire District Electric Company ("Empire"), which, as KCPL pointed out, Ms. Maloney had determined was a 12 CP utility in Empire's currently pending rate increase proceeding (Case No. ER-2006-0315). The main difference is that Empire is a dual peaking utility, with peaks both in the summer and, because of the high saturation of space heating in Empire's service territory, in the winter. In addition, and as a consequence of its relatively high winter load, Empire has a much smaller window in which to perform scheduled maintenance, a reality which has a levelizing effect on utilization of available capacity throughout the year. (Maloney Surrebuttal, Ex. 124, p. 4, ln. 11-16).

Mr. Frerking did perform some quantitative analysis with respect to another operating reality identified by the FERC; *i.e.*, the so-called off-system sales "commitments," which he interpreted as including non-firm off-system sales. Staff witness Maloney took issue with this, as well. Specifically, she disputed Mr. Frerking's inclusion of spot market sales, which have nothing to do with fixed costs. She noted that in order to include non-firm off-system sales, he had to use energy units (kilowatt-hours) rather than the demand units (kilowatts). Ms. Maloney further stated that Mr. Frerking's attempt to include energy sales in a methodology used for analyzing system demand and the jurisdictional allocation of fixed costs made no sense and was a "totally incorrect application of the system demand tests" (Maloney Surrebuttal, Ex. 124, p. 5, ln. 7-17).

While attempting to focus the Commission's attention on unsupported statements and flawed analysis regarding other operating realities, KCPL essentially ignores the "elephant in the room," which is system demand itself. The FERC pointed out the need "to consider the full range of a utility's operating realities ***in addition*** to system demand." (Frerking Rebuttal, Ex. 10, p. 5, ln. 10-12). In other words, system demand is the obvious operating reality to consider because it is the most important. In KCPL's case, the results of the four quantitative system demand tests performed by Staff witness Maloney for a period of seven years, up to and including the 2005 test year, unanimously support her conclusion that KCPL is a 4 CP utility. The evidence offered by KCPL concerning other operating realities is clearly insufficient to overcome this overwhelming evidence that KCPL is a 4 CP utility.

Despite his valiant attempt, subsequent to the filing of the Company's case-in-chief, to fashion some additional rationale for KCPL's proposed switch from a 4 CP to a 12 CP demand allocation methodology, as Mr. Frerking admits (Tr. 577, ln. 13-19; 600, ln. 11-13), the primary driver for the proposal was the Company's policy decision to seek consistency with its rate case filing in Kansas. In that case, the 12 CP methodology was proposed pursuant to a prior agreement as part of KCPL's Kansas regulatory plan stipulation and agreement. (Tr. 578, ln. 19-21). This is not a basis upon which to authorize a shift to an inappropriate 12 CP demand allocation methodology in this state, to the considerable detriment of KCPL's Missouri customers. Moreover, assuming that KCPL's settlement of its rate case in Kansas is approved by the Kansas Corporation Commission, the Company's desire for consistency will have been rendered moot by the "black box" nature of that settlement.

For the reasons stated herein, as well in the Staff's Post-Hearing Brief filed November 17, 2006, the Commission should reject the Company's proposal to switch to a 12 CP methodology for allocating KCPL's jurisdictional demand costs, and instead authorize the continued use of the 4 CP methodology.

23-A. Off-system Sales:

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

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?

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?*

KCPL makes much of the other parties' lack of attack on Mr. Schnitzer's testimony. KCPL chose a construct or scheme for its adjustment and then found a consultant, Mr. Schnitzer, to construct a continuum. The continuum developed by Mr. Schnitzer is not the key to KCPL's position in any sense. From the selection of the 25th percentile to the violation of the Regulatory Plan Stipulation And Agreement, the truly significant points to KCPL's off-system sales net margin position are set by Mr. Giles, not by Mr. Schnitzer.[5] KCPL does not dare suggest that the other parties did not (i) disagree with Mr. Giles' analysis or (ii) offer counter-analysis. The other parties do not need to challenge Mr. Schnitzer's testimony in order to dismantle Mr. Giles' testimony.

KCPL asserts at page 11 of its Initial Post-Hearting Brief that "none of the other parties to this case have taken into account these off-system sales risks in recommending a return on equity. (Tr. 792-93, 829-30 (Giles))." KCPL attempts to present off-system sales net margin as a new and unique issue. If it were, then the Signatory Parties to the Regulatory Plan Stipulation And Agreement would not have had the foresight to address it in the Regulatory Plan Stipulation And Agreement in the manner that they did. The Staff will not be so presumptuous as to speak on behalf of the Public Counsel, DOE, or Praxair / Explorer Pipeline, although the Staff is certain that their responses are similar to the Staff's, that the record reflects the Staff's disagreement with KCPL's

[5] The case law in Missouri is clear. Mr. Schniter's testimony does not need to be refuted in order for the Commission to lawfully disbelieve it. *State ex rel. Rice v. Public Serv. Comm'n*, 220 S.W.2d 61, 65 (Mo. banc 1949).

contention. The Staff noted *State ex rel. Union Electric Co. v. Public Serv. Comm'n*, 765 S.W.2d 618 (Mo.App. W.D. 1988) in its Initial Post-Hearing Brief regarding the scope of factors considered by the Commission's DCF analysis and would further note that Staff and the Commission in general have always been mindful of the forward looking and uncertain nature of ratemaking. As the Western District Court of Appeals stated in *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo.App. W.D. 1981) in rejecting Missouri Public Service Company's plea for an attrition factor proposed by the utility to address the risk of inflation:

> It is no answer to the foregoing duty to say that a forecast as to future inflation is merely speculative. Despite that hazard, the Commission must make an intelligent forecast with respect to the future period for which it is setting the rate; rate making is by necessity a predictive science. *State v. N.J. Bell Tel. Co.*, 30 N.J. 16, 152 A.2d 35 (1959).

The Court noted that to address the inflation problem the Commission used "a test year which was adjusted to take into account known and measurable future changes. That concept was implemented by the holding of what the Commission denominates as 'a true-up hearing.'" 627 S.W.2d at 886.

In the paragraph at the bottom of page 12 and at the top of page 13 of KCPL's Initial Post-Hearing Brief, KCPL proposes to the Commission an alternative off-system sales net margin proposal briefly outlined at the evidentiary hearing by Mr. Giles. The proposal has no signatories to it other than its originator KCPL. KCPL was free to present this proposal to the other parties to the case but chose not to do so. Should the Commission adopt KCPL's proposal without signatory or nonobjecting parties, one or more parties might challenge the proposal on any number of grounds, including retroactive ratemaking and denial of due process.

The mere fact that the Commission has the general authority to permit experiments does not mean that the Commission may authorize unlawful experiments or may unlawfully authorize experiments. *Re Empire District Electric Co.*, Case No. EO-97-491, 6 Mo.P.S.C.3d 510, Report And Order (1997); *State ex rel. Southwestern Bell Tel. Co. v. Brown*, 795 S.W.2d 385 (Mo. banc !990); *State ex rel. Missouri Cable Telecomm. Ass'n v. Public Serv. Comm'n*, 929 S.W.2d 768 (Mo.App. W.D. 1996). The Commission's Report And Order in the 1997 Empire case states that the case involves two proposed tariffs: one referred to as the pilot open access transmission (POAS) tariff and the other referred to as the residential and small commercial competitive market research project. The Commission found that (i) the POAS tariff violated Section 393.106 RSMo and (ii) since the residential and small commercial competitive market research project required neither tariffs nor variance from Commission rules, it would be inappropriate for the Commission to approve or disapprove the residential and small commercial competitive market research project.

KCPL incorrectly states in the second sentence of the second full paragraph at page 13 of its Initial Post-Hearing Brief that "opponents argued that if the Northbridge analysis were used, rates should be set at the 50% point so that the Company would have only a 50:50 chance of achieving such sales." The Staff did not in any fashion argue that if the NorthBridge analysis is used, rates should be set at the 50% level. The Staff included in its cost of service revenue requirement case KCPL's actual 2005 off-system sales net margin level, which is $9 million lower than the off-system sales net margin level proposed by various other parties in the case. (Ex. 134, Traxler Direct, p. 23; Ex. 135, Traxler Rebuttal, pp. 3-4).

KCPL updated its off-system sales net margin position for data through June 30, 2006 and trued-up its off-system sales net margin position for data through September 30, 2006. (Ex. 4, Giles Rebuttal, p. 5; Ex. 54, Rush True-Up Direct, p. 3). As a result of Mr. Rush's True-Up Direct Testimony and KCPL's True-Up Direct workpapers, KCPL's recommended 25th percentile off-system sales net margin level is $28 million less than KCPL's actual level for the test year 2005 (Staff's recommended level for setting rates for 2007) and $26 million less than KCPL's actual off-system sales net margin level for the 12 months ending October 31, 2006. (Ex. 164, Traxler True-Up Rebuttal, p. 11)

Finally, having read the dismissive approach that KCPL takes even in its Initial Post Hearing Brief to its violation of the Regulatory Plan Stipulation And Agreement on off-system sales net margin, the Staff requests guidance from the Commission. In the future, if a utility such as KCPL flagrantly, or even cleverly, materially violates a major element of an agreement approved by the Commission, should the Staff, in order to indicate the seriousness of the matter, file with the Commission a complaint against the utility, or proceed as the Staff has done in this case and merely allege a violation?

23-B. Unused Energy Allocator:

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

KCPL alleges in its Initial Post-Hearing Brief ("KCPL Brief") that "none of the parties dispute the correctness of the rationale or intent behind the methodology"; that none of the assertions raised by other parties in opposition to the Company's proposal "substantively address whether the unused energy allocation methodology is more appropriate than the energy allocation methodology proposed by Staff and other parties." (KCPL Brief, p. 15). The allegation is patently false. As set forth in the Staff's Post-Hearing Brief, the record clearly contains substantive criticisms raised by the Staff. Chief among them is the flawed philosophical premise of the methodology. The unused energy methodology operates to allocate a larger share of the profit from non-firm off-system ("spot market") sales to Kansas, owing to that state's greater proportion of unused capacity. (Giles Surrebuttal, p. 5, ln 24 - p. 6, ln. 3). The proposed methodology thus rewards the jurisdiction with the lower load factor (Kansas), while punishing Missouri for its higher load factor. (Mantle Rebuttal, Ex. 125, p. 4, ln. 13-14). Since the margins from spot market sales result from the relatively low-cost generation profile---*i.e.*, including a higher percentage of base load capacity---made possible by Missouri's higher load factor, this is clearly unfair to KCPL's Missouri customers. (Staff's Post-Hearing Brief, pp. 59-60). In addition, such a methodology creates a possible disincentive for the future implementation of programs aimed at increasing load factor, and hence, the ability to produce and sell electricity at an attractive price. (Tr. 701, ln. 10-20).

Additionally, KCPL witness Don A. Frerking states that "the basis of the unused energy allocator is a demand allocator applied to the available capacity."[6] (Tr 688, ln. 3-5). He also acknowledges that no dedicated plant is assigned to non-firm off-system sales. (Tr. 588, ln. 22 – 589, ln. 7). As Staff witness Cary Featherstone testified at the hearing: "And, in fact, because the off-system sales, non-firm component of off-system sales have no dedicated plant facilities, transmission facilities, there's no relationship between these revenue dollars and fixed costs." (Tr. 702, ln. 6-10). Since the spot market customer is not buying capacity, it is illogical to use the unused energy allocator, which is rooted in demand allocation methodology, when no fixed costs are being assigned to these spot market sales.

Spot market sales are purely energy sales, and the price to the customer includes (in addition to profit) only KCPL's variable costs (*i.e.,* fuel and purchased power). (Tr. 702, ln. 11-17; Featherstone Surrebuttal, Ex. 115, p. 7, ln. 3-6). Thus, it is appropriate to allocate to the jurisdictions the entire amount of the revenues (including the profit) from the sale of energy on the basis of the relative amount of energy consumed (*i.e*., using the energy allocator). It is not surprising, therefore, that the energy allocator enjoys wide acceptance in this state, and has been repeatedly authorized by this Commission. (Featherstone Surrebuttal, Ex. 115, p. 7, ln. 7-16).

KCPL used the traditional energy allocator methodology for jurisdictional allocations of its non-firm off-system sales margins in its earnings surveillance reports for almost two decades following the Wolf Creek case, until the 2005

---

[6] Mr. Frerking even suggested an alternative label for his allocator; *i.e.*, the "adjusted demand allocator." (Tr. 673, ln. 1-2).

report. (Featherstone Surrebuttal, Ex. 115, p. 7, ln. 21-22). At that point, KCPL apparently concluded that some threshold had been crossed beyond which it was no longer acceptable to use the energy allocator for this purpose, either in its 2005 surveillance report or in the instant case. The Company explains that the allocation of off-system sales margins has increased so dramatically that it is no longer appropriate to allocate such margins on energy usage. (KCPL Brief at 14; Giles Surrebuttal, Ex. 5, p. 5, ln. 13-19). On the contrary, the allocation of off-system sales margins based on an energy allocator is not simply a handy technique that was acceptable for use while the margin component was a relatively small part of total off-system sales revenue[7]. As shown above and in Staff's Post-Hearing Brief, the evidence demonstrates that the traditional energy allocator methodology is the appropriate basis for allocation of spot market sales margins *regardless* of the dollar amounts of those margins.

KCPL claims that Staff "acknowledges, 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 Brief, p. 15). However, the Staff made that assertion *in the context* of the Company's unused energy allocator. The exchange during cross-examination of Staff witness Featherstone was as follows:

> Q. Are you suggesting that it's inequitable for Kansas to receive a greater share of off-system sales margins than its share of generation plant costs?

---

[7] In prefiled testimony, KCPL witness Chris B. Giles states: "Unlike previous cases, margins are now identifiable, and thus should be allocated separately from fuel cost. However, the evidence indicates that the margin has been "identifiable" for more than 20 years. (Staff's Post-Hearing Brief, pp. 58-59).

> A. Under the company's unused energy allocator proposal, yes.
>
> Q. But you're comparing off-system sales margins to generation plant costs?
>
> A. In this instance, I'm saying that the Kansas jurisdiction paying the lower plant cost is receiving a greater share of revenues from off-system sales.

(Tr. 697, ln. 18 – 698, ln. 3).

In other words, using KCPL's proposed methodology, the unused energy allocator, which is rooted in demand allocation methodology, assigns a larger share of spot market sales margins to Kansas than that state's share of demand charges. The Staff continues to maintain, however, that the unused energy allocator should be rejected as inappropriate for jurisdictional allocation of profits associated with non-firm off-system sales (*i.e.*, revenues minus the variable fuel and purchased power component of those revenues). The Staff's recommended allocation percentage for these margins to Missouri retail is 56.68%, which is the same percentage allocated to Missouri customers for the cost of the energy that produces those margins. (Maloney Direct, Ex. 122, p. 10, ln. 114; Featherstone Rebuttal, Ex. 114, p. 14, ln. 20-22).

Assuming that KCPL has not changed its mind again regarding the calculation of its proposed unused energy allocator and reverted to its earlier approach, the KCPL Brief erroneously states the manner in which the allocator is calculated. Quoting the direct testimony of its witness, Mr. Frerking, KCPL states: "The available energy is defined as the average of the 12 coincident peak demands multiplied by the total hours in the test period." (KCPL brief, p. 14). However, in his rebuttal testimony, Mr. Frerking changed the calculation by substituting total available capacity for the average of 12 coincident peak loads. The revision, which increased the measure of total available capacity by 65% (from 2,652 MWs to 4,389 MWs), shifted back to KCPL's Missouri jurisdiction some $3.6 million of the approximately $8.0 million originally at issue. (Frerking Rebuttal, Ex. 10, Sch. DAF-6, pp. 1-2). Mr. Frerking refers to this change as a "correction." The Staff sees it differently. Changing "two plus two equals five" to "two plus two equals four," for example, is a correction. However, in this instance, KCPL did not simply "correct" calculations regarding its unused energy allocation factor; it effectively changed its methodology and approach to the whole of the calculation in Mr. Frerking's rebuttal testimony, and the impact of that change was obviously substantial. Such a significant revision to a brand new concept, even after KCPL had filed its case-in-chief, and in light of Mr. Frerking's expressed willingness to consider suggestions for improving the proposed mechanism (Tr. 671, ln. 15-20), indicates that the unused energy allocator is, at the present time, essentially a work in progress.

Although, as KCPL points out, the Commission is free to authorize a new allocation mechanism in this proceeding (KCPL Brief, p. 14), there should be a compelling reason to do so. In this instance, it simply makes no sense to discard the traditionally used energy allocator, a time-tested allocation mechanism, in favor of a still-evolving alternative mechanism that is based on a flawed rationale, and that adversely affects the Company's Missouri ratepayers.

For the reasons stated herein, and in the Staff's Post-hearing Brief filed November 17, 2006, the Staff recommends that the Commission reject KCPL's proposed unused energy allocator methodology, and instead order the continued use of the traditional energy allocator methodology for allocating margins from non-firm off-system sales.

24. Depreciation:

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

KCPL states, “KCPL chose not to submit a depreciation study in this case based upon this belief” (*KCPL Brief,* at 63).[8] That was its choice. Staff, however, *did* perform and submit a depreciation study as the Regulatory Plan expressly permits (Tr. 7:494-495, 510-511). KCPL’s first point, which is the equivalent of a runny-nosed first-grader shouting “Not fair! Not fair!,” is equally undeserving of serious attention.

KCPL states (*KCPL Brief,* at 63):

> The Commission should not adopt Staff’s depreciation study because it contains a number of significant flaws. As explained by Mr. Frerking, Staff’s depreciation study contains errors in the lifespan analysis and the related interim retirements for the generation accounts. Staff also presumes that certain generation-related assets have an indefinite life, which is factually inaccurate and skews the results of Staff’s study. Staff also made errors in its retirement curve matching. Moreover, Staff’s calculation of net salvage rates is also mathematically and analytically incorrect. (*Internal citations omitted*).

Staff has fully rebutted Mr. Frerking’s rather desperate assaults on Ms. Schad’s depreciation study in both its Supplemental Pre-hearing Brief and in its Initial Post Hearing Brief and those points need not be repeated here. KCPL’s *real* issue with Staff’s depreciation study is this: “As Mr. Frerking explained, ‘from

[8] That is, that the current depreciation rates, as set out in Appendix G to the Regulatory Plan, would be continued in force.

a practical standpoint any adjustment to depreciation rates would necessitate an equal and offsetting adjustment to amortization expense to maintain equivalent cash flow.' (Ex. 10, p.15)." (*KCPL Brief,* at 63). In other words, "aw, gosh, you'll just have to give it back to us as Regulatory Plan Additional Amortizations!" That's true, but, in the latter case, the ratepayers will enjoy the prospect of seeing KCPL's rate base diminish correspondingly.

Staff urges the Commission to adopt its recommendations as to depreciation.

25. Cost of Capital:

What is the appropriate capital structure?

What is the appropriate return on common equity (ROE)?

Should ROE be adjusted either upwards or downwards to reflect increased or decreased risk or company performance? If so, what adjustment should be made?

This is perhaps the single most important issue facing the Commission in this case. KCPL faces a challenging period in which it will nearly double its rate base. KCPL is, understandably, concerned in view of the myriad risks that it will face during that period. However, the Commission must not lose sight of the fact that it has already considered that situation and its attendant risks and sensibly provided for it in the Regulatory Plan approved in Case No. EO-2005-0329.

Aware that the Commission might do exactly that, KCPL has come armed with testimony about other risks. Mr. Giles and Mr. Schnitzer testified about the risk KCPL faces with respect to off-system sales. The bottom may fall out of that market, they say. Who, exactly, required KCPL to develop this over-dependence on off-system sales revenue? That was a *management* decision and *management* will either reap the rewards for its perspicacity or pay the price for its foolishness. Why must the ratepayers provide the Company with a safety net? What KCPL seeks is nothing less than a guarantee by the ratepayers of its earnings per share. Such a guarantee is inappropriate and unlawful and should not be countenanced.

Nor does KCPL stop with risk – there's also quality. Mr. Camfield testified about the general excellence of KCPL's performance and urges the Commission to reward the Company with an "adder." The reality is that KCPL has not initiated a rate case for twenty years because it has been consistently over-earning throughout that period. Those earnings have already rewarded KCPL for its efficiency.

a. What is the appropriate capital structure?

KCPL concurs in the capital structure presented by Staff in its Initial Post-Hearing Brief, supported by the testimony of Matt Barnes (Barnes True-up Direct, 1-2, and Schedules 1-3) (*KCPL Brief,* at 5).

b. What is the appropriate return on common equity (ROE)?

KCPL pretty much says it all in its brief when it admits that its ROE expert, Dr. Sam Hadaway, used a two-stage Discounted Cash Flow (DCF) model with the Gross Domestic Product (GDP) as his growth factor "[b]ecause the 'constant growth' DCF model yielded extremely low rates" (*KCPL Brief,* at 6). In other words, as is the invariable practice of these overpaid, "hired-gun" expert witnesses, Hadaway found a way to reach the results his client wanted. The

Commission should discard Hadaway's purchased testimony and look instead to the strikingly consistent results reached by the other ROE witnesses in this case: Barnes, Woolridge and Baudino.

The Commission has two navigation points in this fog: first, the "zone of reasonableness" defined in *Missouri Gas Energy,* 12 Mo.P.S.C.3d 581, 593 (2004), and referred to with approval in *Empire District Electric Company,* Case No. ER-2004-0570 (*Report & Order,* issued March 10, 2005) at 45. That zone extends 100 basis points to either side of the national average, which, for the third quarter of 2006, was 10.06% on the present record (Tr. 12:1241-1242). Thus, the zone of reasonableness extends from 9.06% to 11.06%. Hadaway's result, less the "adder" that he recommends, falls within the zone at 11.00 (*KCPL Brief,* at 7).

The second navigation point available to the Commission is the remarkably consistent range of analytical results produced by Barnes, Woolridge and Baudino, using time-honored methods:

	USDOE	**Staff**	**OPC**
ROE:	9.00	9.32 - 9.42	9.90

These three witnesses define a 90-basis point range, from 9.00 to 9.90. This range is essentially synonymous with the lower half of the zone of reasonableness discussed above.

c. Should ROE be adjusted either upwards or downwards to reflect increased or decreased risk or company performance? If so, what adjustment should be made?

KCPL offered three different witnesses to support various “adders”: Dr. Hadaway proposed an “adder” of 50 basis points to account for construction risk; Chris Giles proposed an “adder” of 9.57 basis points per million dollars of Regulatory Plan Additional Amortizations and/or each $1 million of margin included in the revenue requirement for these sales between the 25% and 50% points (55 x 9.57 = 526.35) to reflect off-system sales risk (*KCPL Brief,* at 12); and Robert Camfield proposed an “adder” of 50 to 100 basis points as some sort of absurd “attaboy” to reflect KCPL’s “exceptional” performance – a performance that included the destruction of KCPL’s Hawthorn 5 plant because the control room toilet was allowed to overflow.[9]

With respect to construction risk, the Commission has already considered it and provided for it through the Regulatory Plan. There should be no further discussion of the matter. If the Regulatory Plan is struck down by the courts, KCPL can always come back and ask for a higher ROE at that time, but that is not the situation now.

As for the off-system sales risk, that aspect of KCPL’s case is truly outrageous – an “adder” of 526 basis points![10] Perhaps the Commission should apply a 50-to-100-basis-point “subtracter” to reflect the Company’s astonishing gall in seeking a guarantee from the ratepayers for the profits it’s been earning

[9] KCPL suggests that Staff’s reference to the Hawthorn 5 incident is a “red herring” because the Commission has twice concluded that KCPL was not at fault for the explosion. (*KCPL’s Initial Post-Hearing Brief* at 9-10.) Staff raised the point only to demonstrate that Mr. Camfield’s celebrated metrics do not tell the whole story. Staff is unaware that either this Commission or any court has ever concluded that the toilet clog that initiated the bizarre train of events that resulted in the destruction of Hawthorn 5 was the fault of anyone other than an employee of KCPL.

[10] Based on KCPL’s explanation of the size of the Regulatory Plan Additional Amortizations required under Staff’s case; *see KCPL Brief,* at 5.

on its unregulated off-system sales. It's difficult to imagine that an appellate court would sustain such a distasteful exercise in ratemaking. What happens, for instance, if the notably volatile natural gas market moves in such a way that KCPL makes money hand-over-fist through off-system sales?

Finally, there is Camfield's extremely expensive testimony in support of a "darn good company" "adder." It is noteworthy that, while KCPL offered this testimony, it did not even include Camfield's "adder" in its ROE request. Contrary to KCPL's assertion in its brief (*KCPL's Initial Post-Hearing Brief* at 8), Staff presented the testimony of Deborah Bernsen in contraversion of Camfield's testimony. The gist of her testimony, which KCPL seems to have missed, is that Camfield's study is nothing more than a lot of expensive hot air. And, in any event, KCPL has *already* been rewarded for its outstanding performance by twenty years of over earning.

In its initial post-hearing brief, Staff reminded the Commission of its determination, in *Missouri Gas Energy,* 12 Mo.P.S.C.3d at 598, that "a rate of return adder is inappropriate in concept and unworkable in practice." Staff urges the Commission to let itself be guided by that sensible principle.

C. Class Cost-of-Service and Rate Design:

26. Class Cost-of-Service:

Settled.

27. Rate Design:

Settled.

28. Availability of General Service Space-Heating Rate Discounts:

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?

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?

Staff sees no need to add to its previous arguments on this issue.

D. Customer Programs:

29. Weatherization Program:

Staff has no position on these issues.

WHEREFORE, the Commission's Staff prays that the Commission will accept its position on each contested issue and set just and reasonable rates in this matter as Staff has recommended.

Respectfully submitted,

/s/ Kevin A. Thompson
KEVIN A. THOMPSON
General Counsel
Mo. Bar No. 36288

/s/ Steve Dottheim
STEVE DOTTHEIM
Chief Deputy General Counsel
Mo. Bar No. 29149

/s/ Dennis L. Frey
DENNIS L. FREY
Senior Counsel

Mo. Bar No. 44697

/s/ David A. Meyer______
DAVID A. MEYER
Senior Counsel
Mo. Bar No. 46620

Attorneys for the Staff of the Missouri Public Service Commission
P.O. Box 360
Jefferson City, Missouri 65102
573-751-6514 (voice)
573-751-7489 (voice)
573-751-8700 (voice)
573-751-8706 (voice)
573-526-6969 (FAX)
kevin.thompson@psc.mo.gov
steven.dottheim@psc.mo.gov

Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served on all of the parties of record or their representatives as set out on the attached service list on this **27th day of November, 2006**, either by hand delivery, electronic mail, facsimile transmission, or First Class United States Mail, postage prepaid.

/s/ Kevin A. Thompson