BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

POST-HEARING BRIEF OF
KANSAS CITY POWER & LIGHT COMPANY

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TABLE OF CONTENTS

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Kansas City Power & Light Company ("KCPL" or "Company") respectfully submits its Post-Hearing Brief in accordance with the Commission's Order Setting Procedural Schedule issued on March 29, 2006. KCPL will address the issues filed by the parties on October 6, 2006, but will address the most significant issues first.

A. Executive Summary

For the past two decades KCPL has provided its customers with low rates, high productivity and excellent service. Committed to continuing this record of performance, KCPL proposed an ambitious plan to expand and improve its operations after an extensive and unprecedented workshop process that engaged all of its stakeholders, including Staff and the Office of the Public Counsel.[1] Pursuant to the Regulatory Plan ("Plan") approved by the Commission as part of the 2005 Stipulation and Agreement ("Stipulation"),[2] KCPL has begun a series of infrastructure and customer enhancement projects valued at $1.3 billion.

However, the risks inherent in that Plan require this Commission to issue an order in this rate case that grants necessary increases in revenue and sets a rate of return that will permit KCPL to remain financially healthy. The Commission must specifically address two factors that

[1] In re the Future Supply, Delivery and Pricing of the Electric Service Provided by Kansas City Power & Light Co., No. EW-2004-0594 (Mo. P.S.C.).
[2] Report and Order, In re Proposed Regulatory Plan of Kansas City Power & Light Co., No. EO-2005-0329 (Mo. P.S.C., July 28, 2005).

are unique to KCPL among Missouri electric utilities: (1) The Company's multi-million dollar construction projects, including the coal-fired Iatan 2 unit, new wind generation, and numerous environmental upgrades, which will require KCPL to generate sufficient cash earnings to meet credit ratios; and (2) the risk and uncertainty of wholesale off-system sales.

Unlike other electric companies that are regulated by this Commission, approximately 50% of KCPL's earnings today come from the volatile off-system sales market. (Tr. 755-756). Because the price of energy in this market is mainly driven by the price of natural gas, KCPL faces additional risks, as well as difficulty in accurately predicting the level of off-system sales margins. (Tr. 457-58, 839, 885-87, 919, 20).

When natural gas prices fall, as they have in recent months, KCPL will be unable to sell as much electricity and will have smaller margins in the off-system sales market. As a result, there are less earnings from off-system sales and KCPL's total earnings will decline. Since these margins are included in the Revenue Requirement calculation, declining off-system sales margins will also affect the revenue that must be recovered from the Company's ratepayers if KCPL is to earn its authorized rate of return.

KCPL witness Michael Schnitzer provided the Commission a basis for assessing this risk. His uncontested analysis set forth the expected ranges of KCPL's 2007 off-system sales and the probability of those sales being realized. The Commission should rely upon Mr. Schnitzer's analysis as it considers KCPL's increased risk. As discussed in more detail below, the record contains the necessary evidence for the Commission to set rates for off-system sales at the 25% point which results in a sharing of risk, or creating a regulatory liability and regulatory asset that eliminates the risk altogether.

Regarding cost of capital, the Company is seeking a Return on Equity ("ROE") of 11.50% in this case. This ROE includes a 50 basis point adder that KCPL witness Dr. Sam

Hadaway testified accounts for the substantial construction risks faced by KCPL. The ROE in this case should be set at this level to generate the necessary cash earnings for the Company to be able to finance its construction projects, while minimizing the need for other mechanisms like the Regulatory "Additional Amortizations" that were approved by the Commission in the Stipulation. KCPL's requested ROE in this case is just one-half of a percentage point higher than what this Commission found in March 2005 to be reasonable in Empire's electric rate proceeding (Case No. ER-2004-0570). If the risks outlined above are not properly assessed by the Commission in this case, the sure result will be a financial downgrade to the Company which will trigger more uncertainty and greater costs, all to the detriment of customers. Given KCPL's exemplary record of performance over the past decade, as described in the testimony of Robert Camfield combined with the substantial construction risk faced by KCPL, the Commission should authorize an ROE of 11.50% so that its history of top-of-the-industry productivity can continue.

Moreover, the ROE should be set at this level to generate the necessary cash earnings for the Company, while minimizing the need for other mechanisms like the Additional Amortizations permitted by the Stipulation. The Additional Amortizations (which act like accelerated depreciation and, therefore, an eventual off-set to rate base) are intended to be used as a last resort to maintain KCPL's credit ratios in the event that its earnings, as determined in general rate cases like this proceeding, fail to satisfy certain financial ratios. See Stipulation, § III.B.1.i at 19.

Instead of establishing an ROE at the levels recommended by Staff, Public Counsel and the Department of Energy, and having to backstop the Company's cash flows by implementing a substantial Additional Amortization, the Commission should establish an ROE at 11.5% and accept KCPL's other accounting adjustments. If this were done, there would be less need for an

Additional Amortization to meet the minimum financial metrics to maintain KCPL's bond rating at investment grade. In addition, there would be sufficient cash earnings to attract equity investors. On the other hand, if the Commission rejects KCPL's ROE recommendation or adopts the accounting adjustments proposed by other parties, there will be a need for a much larger Additional Amortization.

Despite the large number of issues in this case, the Company's future will be determined by the Commission's decision on how much of the rate increase will come from real cash earnings and how much will come from the Regulatory Plan Additional Amortization. Acceptance of the Company's positions is critical to KCPL's ability to successfully complete the projects called for by the Regulatory Plan that this Commission approved in the Stipulation.

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

Staff's proposed revenue requirement increase, on the other hand, is entirely due to Additional Amortizations. As explained by Staff witness Traxler, the Staff's overall revenue requirement recommendation at the conclusion of the true-up proceeding is a positive $27 million. (Tr. 1658). Staff is now recommending that the Commission adopt a <u>negative</u> $28 million under Staff's traditional ratemaking case (Ex. 164, p. 13), and a $55 million Additional Amortization to meet KCPL's credit metrics. (Tr. 1658).

Focusing only on the overall level of revenue requirements, the $27 million Staff vs. $55.8 million KCPL, without considering the underlying components would misrepresent the significance of the differences between the two positions.

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

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

B. Revenue Requirement

1. Cost of Capital

a. What is the appropriate capital structure?

The parties have essentially agreed to KCPL's requested capital structure. The Commission's Order should reflect the following percentages, which are contained in the True-Up Direct Testimony of Matthew Barnes at page 2 and which reflects KCPL's most recent publicly disclosed figures:

KCPL Requested Capital Structure	
Debt	44.79%
Preferred Stock	1.53%
Common Equity	53.69%
Total	100.00%

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

KCPL's cost of capital witness Dr. Sam Hadaway recommended an ROE of 11.5%, consisting of a base of 11.0% plus a 50 basis point adder to account for the significant construction risks faced by the Company. As Schedule 1 to his Direct Testimony demonstrated, KCPL's construction program will almost double its plant in service (by 95%), compared to the average utility's rate case increase of 56%. (Tr. 1305; Ex. 33, Sch. SCH-1).

Dr. Hadaway used the traditional discounted cash flow (DCF) methodology to arrive at his ROE recommendation. Because the "constant growth" DCF model yielded extremely low rates, not reflected in ROE's issued by other utility commissions, as well as when compared with other methodologies like the capital asset pricing model (CAPM), Dr. Hadaway used a GDP (gross domestic product) growth model. (Tr. 1282-87). Mr. Baudino, the ROE expert for Public Counsel, conceded that GDP growth models have been used by experts in other proceedings in their DCF analysis. (Tr. 1096).

In carrying out his DCF analysis, Dr. Hadaway used a peer group of 24 companies. In accord with the Supreme Court's directive in Bluefield Waterworks & Improvmt. Co. v. PSC, 262 U.S. 679, 692 (1923), he mainly used companies in the Midwest (e.g., Ameren, Empire, AEP, Alliant, Westar, Xcel Energy, Vectren [Southern Indiana Gas & Electric Co.], and FirstEnergy). However, to make certain that the sample was representative of the entire country, he also used utilities in other regions (e.g., Southern Company, Progress Energy, Pinnacle West, Hawaiian Electric, N-Star and Consolidated Edison). DOE's expert Dr. Woolridge accepted Dr. Hadaway's peer group without question. (Tr. 1343). Mr. Baudino used a similar peer group of 21 companies. (Tr. 1093).

However, in stark contrast to all of the other experts in the case, Staff's Matthew Barnes used only five companies: Southern Company (Atlanta); Pinnacle West [Arizona Public Service]

(Phoenix); IDACORP [Idaho Power] (Boise); Puget Energy (Seattle), and Hawaiian Electric (Honolulu). While the other cost of capital experts utilized several of these companies in their peer group, none of them relied exclusively upon these five non-Midwestern companies to develop a DCF analysis pertinent to KCPL.

The most significant difference between Dr. Hadaway's analysis and those of the other experts is his explicit recognition of the construction risks facing KCPL by adding 50 basis points to his preliminary 11.0% ROE figure. That risk was ignored by the other experts who simplistically argued that such risks was accounted for in their analysis "generally." (Tr. 1112 (Baudino); 977 (Barnes); 1340 (Woolridge)).

Moreover, on cross-examination each of the experts opposing Dr. Hadaway acknowledged that the factors they considered as providing comfort to KCPL were uncertain. They acknowledged that the 2005 Stipulation and Agreement was still under attack in the courts. (Tr. 974 (Barnes); 1113-14 (Baudino)). Mr. Baudino acknowledged that the Commission's approval of the Stipulation did not cause Standard & Poor's or any other credit rating agency to raise KCPL's debt rating. (Tr. 1114). Accord, (Tr. 953 (Cline)). Mr. Barnes did not dispute that five of the intervenors in this case (Department of Energy, AARP, Wal-Mart, Jackson County and Trigen) did not sign the Stipulation and were free to attack any aspect of KCPL's Regulatory Plan. (Tr. 975). Finally, Dr. Woolridge acknowledged that the effects of the 2003 dividend tax cut legislation were uncertain and, at least, subject to strong differences of opinion as far as whether it lowered the cost of capital to companies like KCPL. (Tr. 1137, 1346-47). In fact, a 2005 study authored by the Federal Reserve Board's Divisions of Research & Statistics and

Monetary Affairs "found little measurable effect of the dividend tax cut on aggregate U.S. stock valuations …." [3]

Based upon a fair review of the evidence, it is clear that Dr. Hadaway's recommendation of an 11.5% return on equity should be accepted by the Commission, given current economic conditions and the construction program upon which KCPL has embarked.

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

Mr. Robert Camfield of Christensen Energy Consulting presented a detailed analysis assessing KCPL's performance for a 10-year period, 1994-2004. His analysis, which was not contested by any other parties' witness, led to his opinion that KCPL was among the best performing electric utilities in the United States. (Tr. 1412).

Testifying that the Commission could justify adding 50 to 100 basis points to the return on equity figure that it otherwise arrived at (Tr. 1413), Mr. Camfield specifically stated that it was not the Company's recommendation that this be done (Tr. 1406). Consistent with testimony presented by KCPL's President William Downey (Tr. 150), KCPL is requesting that its excellent performance be used as part of the Commission's rationale in accepting Dr. Hadaway's ROE recommendation of 11.5%. (Tr. 1413).

The only rebuttal to Mr. Camfield was provided by Staff, whose witness Deborah Bernsen simply stated that a utility's performance is difficult to measure and that performance metrics are difficult to establish. (Tr. 1130-34). However, she offered no specific criticism of the Camfield study or the metrics. Mr. Camfield's data were taken from industry-wide statistics compiled by the Federal Energy Regulatory Commission, the U.S. Department of Energy's

[3] See Ex. 53 at 7. "Thus, during the key period where the actual form of the tax cut took shape and was adopted, the S&P 500 did not outperform a comparably broad index of European equities." Id. at 5.

Energy Information Administration, and J.D. Power & Associates, and used to compare KCPL to a broad group of 55 U.S. utilities, a peer group of 17 utilities, and a geographically contiguous group of 6 utilities. (Ex. 36, pp.12-14; Sched. RJC-1).

Ms. Bernsen did state that this Commission routinely used performance measures to set rates in the early 1980's (Tr. 1127-29) which was a period of significant generation plant construction. See J. Bonbright, A. Danielsen, D. Kamerschen, Principles of Public Utility Rates at 262 (1988). As KCPL and other Missouri utilities begin to construct new plant, it is an appropriate time for the Commission to examine principles of performance-based ratemaking. Many other commissions have utilized performance in setting rates. See In re IPS Electric, Div. of Iowa Public Serv. Co., 134 PUR4th 1, 1992 WL 207221 at 10 (Iowa Util. Bd., 1992)(added 30 basis points, recognizing that "extraordinary management efficiency has resulted in tangible financial benefit to ratepayers"); In re Appalachian Power Co., 123 PUR4th 447, 1991 WL 501852 at 10 (Va. Corp. Comm'n, 1991)("outstanding generation unit performance justifies setting rates authorizing it to earn at the top of its return-on-equity range"); Pennsylvania Public Util. Comm'n v. West Penn Power Co., 119 PUR4th 110, 1990 WL 488813 at 77 (Pa. P.U.C., 1990) (utility's "outstanding record of promoting efficient operations" and "cost containment" justified an additional 25 basis points to ROE). If the Commission finds it appropriate to use risk as a basis to increase return on equity, as it did in Empire's 2005 case, it should also consider the extensive performance evidence in this case as part of its rationale in setting the return on equity.

Although Staff never disputed the findings of Mr. Camfield in either direct, rebuttal or surrebuttal testimony, it raised the 1999 Hawthorn Unit 5 explosion during its cross-examination of him, apparently in a last minute attempt to impeach his opinions. Mr. Camfield replied that all of his statistics covered the period of the Hawthorn explosion and its outage. (Tr. 1416). Indeed, KCPL's high ranking among U.S. utilities is even more impressive in light of the Hawthorn 5 outage.

More importantly, it should be recognized that none of the cases brought before the Commission found that KCPL had engaged in negligent or imprudent conduct. On two occasions, this Commission soundly rejected the allegations of GST in a fully litigated complaint case. See GS Technology Operating Co. v. Kansas City Power & Light Co., Case No. EC-99-533, Report and Order (Mo. P.S.C., July 13, 2000), rev'd, 116 S.W.3d 680 (Mo. App. 2003), on remand, Report and Order on Remand (Mo. P.S.C., Dec. 2, 2004). In both cases the Commission stated: "GST has failed to show that the explosion at the Hawthorn station resulted from imprudence on the part of Kansas City Power & Light Company." See Report and Order on Remand at 3. Finally, in its review of the Stipulation and Agreement which Staff entered into with KCPL, the Commission approved Staff's finding that KCPL's conduct was not imprudent. See In re Kansas City Power & Light Co. regarding an Incident at the Hawthorn Station on Feb. 17, 1999, Case No. ES-99-581 (Mo. P.S.C., July 12, 2001)("Staff concludes that, at the time of the explosion, KCPL's safety and operating procedures were adequate and none of its employees deviated substantially from those procedures."). The Commission has taken official notice of these decisions in this docket. (Tr. 1422).

Ironically, attached to the Direct Testimony of Staff witness Phillip K. Williams is Schedule 3-9, which confirms that KCPL recovered many millions of dollars in insurance proceeds and subrogation claims. (Ex. 139, pp.3-4). As Staff acknowledged, the subrogation claims were based upon KCPL's actions brought in the courts against other potentially responsible parties and which resulted in a substantial recovery for the Company. Clearly, Staff's reference to the Hawthorn 5 explosion and outage is a red herring.

2. Off-System Sales

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

KCPL relies to a greater degree upon revenue and earnings from off-system sales than any other utility in Missouri. As KCPL's Chris Giles testified, over 18% of KCPL's revenues and almost 50% of its earnings come from sales in the wholesale electricity markets. (Tr. 755-56). Historically, other Missouri utilities, including Ameren derive less than 10% of their revenues from such off-system sales. (Tr. 756, 823). Most experts testifying at the hearing agreed that KCPL faced substantial risks in the volatile wholesale electricity market and acknowledged that it was difficult to predict accurately the level of off-system sales margins, particularly because its prices are mainly driven by the price of natural gas. (Tr. 457-58 (R. Smith); 839 (Traxler); 885-87 (Dittmer); 919-20 (Brubaker)).[4] Yet, 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)).

To give the Commission a basis for assessing this risk to KCPL as it sets retail rates, KCPL presented the testimony of the NorthBridge Group's Michael Schnitzer. His probabilistic analysis of the expected ranges of KCPL's off-system sales in 2007 provided a range of sales figures and the probability of those sales being reached. None of the other parties' experts on this issue disagreed with Mr. Schnitzer's analysis or offered a counter-analysis. (Tr. 917-18 (Brubaker); 459-61 (Smith); 885 (Dittmer)). Staff made no attempt to dispute the Northbridge forward-looking analysis. Instead, Staff rejected the analysis in its entirety, relying on a

[4] Ryan Kind of the Office of the Public Counsel did not have an opinion whether the risks that KCPL faced in the wholesale market were more or less than the risks in the retail market where revenue is derived from rates. See Tr. 908-10.

traditional historical model that ignored data analyzing the future volatility of wholesale markets. (Tr. 838-39 (Traxler)).

Given the general consensus that the wholesale market poses problematic risks and is volatile, KCPL recommended that the Commission set rates for off-system sales at the 25% point. Such rates would recognize that KCPL has a 75% chance in 2007 of achieving such sales, and a 25% chance that it would not. Setting rates at the 25% point would require KCPL to bear the risk that margins in 2007 would be below this level because this level of off-system sales would be built into the rate structure. Any profit from such sales exceeding the 25% point would be retained by the Company as a means of increasing the Company's opportunity to earn the ROE set in this case given the risk and uncertainty of this market. This is consistent with the Stipulation's Section III(B)(1)(j). As Mr. Giles testified at the hearing:

> "All off-system sales are still above the line. It's just a matter of whether you treat them as a risk-adjusted off-system sales level … [given that] we don't know what level of off-system sales we will have in 2007." (Tr. 788).

As an alternative, KCPL suggested in its pre-filed testimony that the Commission could set rates with off-system sales predicted at the 50% point, but that given the Company would only have a 50:50 chance of achieving such margins, 9.57 basis points should be added to the return on equity for each $1 million of margin included in the revenue requirement for these sales between the 25% and 50% points. (Tr. 745-55 (Giles)); (Ex. 4, pp.6-7). This is an alternative means of directly recognizing the risk of this market, and setting the appropriate ROE level.

Responding to the concern that setting rates at the 25% point of expected off-system sales would unfairly benefit the Company, Mr. Giles testified that KCPL was willing to accept a more "symmetrical proposition." (Tr. 792). He proposed that the Commission set rates at the 25%

point, but that it order KCPL to book as a regulatory liability any amounts that exceeded that level. Such amounts would then flow back to customers in the next rate case. Id. Conversely, if KCPL failed to achieve sales at the 25% level, the difference would be booked as a regulatory asset and be reflected when new rates are set. Id. This eliminates the risk of this market to the Company and demonstrates that KCPL is not in violation of the Stipulation And Agreement, given KCPL is indifferent to the elimination of the risk or an appropriate sharing of the risk. (Ex. 3).

Adoption of such a mechanism to set rates for off-system sales margin would not require any specific adjustment of the Commission's return on equity decision. However, it would account for the expected volatility in these sales, as recognized in certain highly confidential figures presented in evidence to the Commission. Those figures demonstrated that while the level of KCPL revenues was roughly the same in 2004 and 2005, the amount of those sales and the prices at which power was sold were radically different. (Ex. 32, pp.5-6); (Tr. 841 (Traxler)). Such volatility has continued through September 2006. (Tr. 147 (Downey)).

Two arguments were raised in opposition to KCPL's proposal. First, 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. They argued that setting rates at any other point would harm ratepayers and give the Company an undue advantage. However, as KCPL pointed out, it is only asking that customers share to some degree the risk that KCPL would not reach the 50:50 point. The likelihood of not reaching the 50:50 point would have severe consequences to have sufficient cash to meet the credit metrics and diminish the opportunity for KCPL to realize the ROE established in this case.

The second argument advanced against the KCPL proposal is that it would violate the Stipulation because KCPL and the other parties agreed that any revenue from off-system sales would be counted "above the line." KCPL has made clear its adherence to that provision, recognizing that all such sales will be considered above the line. (Tr. 788 (Giles)). However, there is nothing in the Stipulation which requires that off-system sales revenue be included in rates on a normalized or historical basis, or that prohibits the use of a risk-based analysis that would set projected sales only at a 25:75 point. Moreover, the proposal set forth by Mr. Giles in his Direct Testimony at 28, as well as in his oral testimony before the Commission makes clear that KCPL is willing to accept a result or outcome that recognizes the elimination of, or a sharing of the risk of this market.

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

As explained by KCPL witnesses Chris Giles and Don Frerking, KCPL proposes to allocate its margins, or profits, from off-system sales among its Missouri retail, Kansas retail and FERC wholesale jurisdictions using an unused energy allocation methodology. KCPL has never before sought to allocate separately its off-system sales margins among its jurisdictions. (Ex. 5, p.5).

Although KCPL has allocated total off-system sales revenues on an energy basis since its last litigated rate case, "because off-system sales margins have increased so dramatically, it is no longer appropriate to allocate between jurisdictions based on kwh." (Ex. 4, p.10). As acknowledged by Staff witness Cary Featherstone, KCPL's past allocations of off-system sales revenues do not dictate how the Commission must treat KCPL's proposal concerning the allocation of margins in the instant case. (Tr. 694).

KCPL's unused energy allocation methodology "is calculated by subtracting the actual energy usage from the 'available energy.' The available energy is defined as the average of the 12 coincident peak demands multiplied by the total hours in the test period." (Ex. 9, pp.7-8).

The rationale behind the unused energy allocation methodology was to develop "an allocation methodology that correlates with the unused capacity that enables the Company to make the off-system sales" that result in the margins at issue. (Ex. 4, p.10). It is generally acknowledged that KCPL's Missouri jurisdiction has a higher load factor than its Kansas jurisdiction. (Tr. 695). As explained by Mr. Giles, Missouri's higher load factor means that

> more generation capacity is available and unused in Kansas than Missouri. This unused capacity is allocated to the Kansas jurisdiction on a coincident peak basis. This, the allocation of off-system sales should reflect the unused capacity that Kansas customers are paying for in their rates. It represents an equitable allocation between the two jurisdictions. To do otherwise places a greater burden on Kansas customers for unused capacity without the corresponding benefit of the sales of that unused capacity into the off-system market. (Ex. 4, pp.10-11).

Although a number of the parties object to KCPL's proposal to use the unused energy allocation methodology to allocate off-system sales margins, none of the parties dispute the correctness of the rationale or intent behind the methodology. Instead, the parties simply argue either (i) that KCPL has allocated off-system sales revenues on an energy basis in the past and so therefore should also allocate margins on that basis going forward (Ex. 114, pp.7-8), or (ii) that the unused energy allocation methodology proposed by KCPL is overly simplistic (Ex. 603, p.5). It has also been noted that KCPL witness Don Frerking has not previously developed such an allocation methodology. None of these assertions substantively address whether the unused energy allocation methodology is more appropriate than the energy allocation methodology proposed by Staff and other parties.

KCPL's unused energy allocation methodology represents a more equitable means of allocating KCPL's off-system sales margins. As Staff witness Cary Featherstone 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's proposed unused energy allocation methodology is based upon a demand allocation methodology, and results in an allocation that is closer to the allocation of generation plant costs than Staff's proposal to use an energy allocation methodology. (Tr. 698-99). The Commission should allocate KCPL's off-system sales margins using KCPL's proposed unused energy allocation methodology.

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

The Stipulation does not bar or otherwise restrict the Commission from setting OSS revenues for ratemaking purposes on the basis of the testimony of Mr. Schnitzer and Mr. Giles.

The Stipulation states that OSS will "continue to be treated above the line for ratemaking purposes." KCPL's proposal does not change that. The Company agreed not to propose "any adjustment that would remove any portion" of OSS from its revenue requirement determination in a rate case, and agreed not to argue that OSS revenues and expenses should be excluded from the ratemaking process. See Stipulation, § III.B.1.j at 22. KCPL's proposal is consistent with each of those pledges.

KCPL asks the Commission to determine the appropriate level of OSS margins to include in the revenue requirement, based upon the NorthBridge probabilistic analysis of OSS margins which is uncontroverted. While the Commission could award KCPL a basis-point adder to mitigate the risks of the competitive wholesale market, the Company believes that its recommended level of OSS margins, as adjusted at the True-Up proceeding, is the best solution. It is a lawful element of the Company's Experimental Regulatory Plan approved in the Stipulation, and is supported by long-standing Missouri case law which has upheld experimental ratemaking provisions. See Union Elec. Co. v. PSC, 136 S.W.3d 146, 152 (Mo. App. 2004); State ex rel. Laclede Gas Co. v. PSC, 535 S.W.2d 561, 567 (Mo. App. 1976).

d. Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders?

Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?

KCPL does not propose sharing OSS margins with customers, which would be contrary to the intent and spirit of the Stipulation's Section III.B.1.j at 22.

The mechanism proposed by the Company, described above and detailed at length in the testimony of Chris B. Giles, calls for the Commission to eliminate 25% of the risk of OSS margins from the volatile competitive wholesale electric markets.

3. Regulatory Plan Additional Amortizations

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

KCPL has presented evidence justifying a rate increase of approximately 11.5% ($55.8 million) and an ROE of 11.50% based upon a capital structure of 53.81% equity. The use of the Additional Amortizations mechanism will result in an addition to KCPL's cost of service in a rate case when the projected cash flows resulting from the Company's Missouri jurisdictional operations, as determined by the Commission, fail to meet the low end of the top third of the BBB range. (Ex. 143 and Appendix E-1, Stipulation and Agreement in Case No. EO-2005-0329). That is the only circumstance in which the Amortizations come into play.

Further, as Mr. Cline explained in rebuttal and surrebuttal, because the Amortizations ensure that KCPL maintains target levels for certain key credit metrics, they primarily benefit bondholders and other creditors. They do not address the concerns of equity investors who focus on KCPL's ability to generate earnings over time. (Ex. 24, pp.3-4; Ex. 25, pp.3-4).

Gross-Up of Additional Amortizations for Income Tax Purposes

KCPL, Staff, and other parties expect to file a Non-Unanimous Stipulation And Agreement Regarding Regulatory Plan Additional Amortization ("Amortization Stipulation") which will resolve virtually all of the issues (with the exception of the risk factor issue discussed below) with regard to the mechanics of calculating the Additional Amortization, including the methodology used to calculate the quantification of any income tax impacts associated with the Regulatory Plan Additional Amortizations in this case. 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).

As explained in the Rebuttal and Surrebuttal Testimony of Robert W. Hriszko, a tax managing director in the Chicago office of PricewaterhouseCoopers LLP, it is essential to KCPL that the Commission recognizes the implications of the tax effects of the Additional Amortizations. Otherwise, the cash flow benefits of the amortizations in the Stipulation will not be realized. (Exs. 26 and 27).

For book purposes, the Amortizations are included in gross revenues with an offsetting accelerated depreciation/amortization expense. This results in no change to KCPL's net operating income. For tax purposes, however, the Amortizations are includable in gross taxable income under Internal Revenue Code Section 61. However, there will be no offsetting tax deduction. This results in an increase in current taxes payable that is equal to KCPL's current federal and state tax rate times the total Amortizations allowed. In order to receive the proper amount of cash to meet the credit ratios, KCPL must be allowed to gross-up for income taxes any Additional Amortizations cash-flows that are allowed. For example, if additional cash flows of $1,000 were required to meet the ratios, KCPL should collect $1,538 from ratepayers as a result of the income tax (assuming a 35% corporate federal income tax rate) that would be due. This

Additional Amortization would permit KCPL to increase its cash flow by $1,000.[5] (Ex. 26, pp.3-4). The actual amount of the gross-up for income taxes will be directly related to any Additional Amortizations approved by the Commission. (Ex. 4, pp.14-16). This amount will be determined at the conclusion of the case when the Commission establishes the level of the Company's revenue requirement, including Return on Common Equity.

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

KCPL and Staff agree that the risk factor that should be used in calculating the Regulatory Plan additional amortizations for off-balance sheet purchased power agreements should be a 50% risk factor that is required and used by Standard & Poor's in its analysis of KCPL's debt.[6]

In KCPL's responses to Staff Data Request Nos. 0444 and 0510, KCPL has provided information to the parties that Standard & Poor's applies a risk factor of 50% to KCPL's long-term purchased power contracts when calculating the Company's credit metrics. (Ex. 25, p.6). Since the very purpose of the Regulatory Plan Additional Amortization mechanism is to ensure that the Company achieves targeted levels for S&P–published credit metrics, the Company believes it is critical to use the same risk factor that is used by Standard & Poor's. If the

[5] Under the above example, in order for KCPL to increase cash flow by $1,000, it would have to collect $1,538 because income taxes would be due on the additional revenue. For illustration purposes, Mr. Hriszko disregarded state income taxes and used the federal income tax rate of 35%.

Additional Revenue	$1,538
Tax at 35%	<538>
Cash Available to KCPL	$1,000

(Ex. 26, pp.3-4).

[6] Staff initially took the position that the Commission should authorize a 30% risk factor for this purpose. However, during the course of the hearings, Staff introduced corrected information from Standard & Poor's that indicated that "As of January 1, 2006, Standard & Poor's had assigned a risk factor of 50 percent" to KCPL. (Tr. 764)(Ex. 147, See also Ex Nos. 151 and 152). Based upon this information, Mr. Traxler testified that Staff now supports the use of a 50% risk factor. (Tr. 1392). Additional testimony is expected to be elicited on the Staff updated position during the True-Up hearings.

Commission were to adopt a lower risk factor, the amortization would be determined using a lower level of debt than the level of debt actually used by S&P in determining the Company's credit ratios. As KCPL witness Michael Cline explained, "this, in turn, would result in the Company failing to meet the thresholds that S&P established. . . S&P's position must be accepted as a given in light of what the amortization mechanism is designed to accomplish." (Ex. 25, p.6).

Public Counsel witness Trippensee, however, has asserted that only a 10% risk factor should be used for this purpose. (Ex. 213, pp.3-4; Tr. 1214-16). Mr. Trippensee explained his position as follows:

> It is Public Counsel's <u>belief</u> that the lowest risk factor available within the rating agency methodology should be utilized to determine the debt-equivalent value of each off-balance sheet obligation included in the calculation of the amortization. KCPL is a regulated entity provided service to Missourians as a monopoly provider of electric service. Any risk associated with a loss of market share for the services provided, loss of revenue streams, or this Commission's obligation to provide KCPL with an opportunity to earn a reasonable rate of return (i.e. all expense supported by revenue including a reasonable return) is minimal. Thus, the Public Counsel recommends that the risk factor to apply be 10%. (Ex. 213, pp.4-5) (emphasis added).

Public Counsel's "belief" is not a sufficient reason to jeopardize the efficacy of the Regulatory Amortization when S&P has clearly stated, and Staff has accepted, that this bond rating agency will use a 50% risk factor in evaluating KCPL's off balance sheet obligations. There is no competent and substantial evidence in the record to support the use of a 10% risk factor in this proceeding. For these reasons, KCPL requests that the Commission accept the position of Staff and KCPL that a 50% risk factor be utilized in this calculation.

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

KCPL, Staff, and other parties expect to file an Amortization Stipulation in which they will agree that any Regulatory Plan Additional Amortization that is provided to KCPL pursuant to that Stipulation and Agreement will be used as a reduction to rate base for the longer of (a) at least ten (10) years following the effective date of the July 28, 2005 Report And Order in Case No. EO-2006-0329 or (b) until the investment in the plant in service accounts to which the Regulatory Plan additional amortizations are ultimately assigned by the Commission is retired.

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

See discussion below.

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

KCPL, Staff, and other parties expect to file an Amortization Stipulation in which they will agree that the additional amortization calculation based upon the revenue requirement resulting from the true-up in this case will reflect an allocation of Great Plain Energy, Inc.'s (GPE's)/KCPL's capital structure to Missouri electric operations. This allocation will exclude the impact of the operations of GPE/KCPL not related to KCPL's Missouri electric operations. (Amortization Stipulation, pp.1-2). These parties have agreed in concept that the calculated amount of any Regulatory Plan additional amortizations during KCPL's Regulatory Plan will reflect an allocation of GPE's/KCPL's total company capital structure to its Missouri jurisdictional retail electric operations. GPE's/KCPL's Missouri jurisdictional allocated capital structure will be calculated by synchronizing the capital structure component ratios with the amount of its Missouri jurisdictional electric rate base plus any net balance sheet investment in electric operations it incurs in serving Missouri retail electric customers that is not reflected in its rate base. This synchronization will be effectuated by applying the debt and equity capital ratio percentages from GPE's/KCPL's total company capital structure to the sum of Missouri jurisdictional rate base plus the additional net balance sheet investment incurred to serve Missouri jurisdictional electric operations.

4. <u>Incentive Compensation</u>

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

KCPL's incentive compensation plan consists of four annual plans (an Officer Plan for Company executives; a ValueLink Plan for management employees; a PMG plan for management employees in the power sales and services department; a Rewards incentive plan for bargaining unit employees) and a long term incentive plan for Company executives. (Ex. 6, p.5). The Staff has included the majority of KCPL's incentive compensation plan costs in the Company's cost of service. (Ex. 117, p.5). Staff opposes KCPL's recovery in rates of incentive plan costs that are based on earnings per share (EPS) on the theory that incentive compensation that is tied to financial goals primarily benefits Shareholders and has the potential to be achieved at the expense of customer service. (Ex. 117, p.2, 4; Tr. 173, 174).

Although Staff's disallowance theory is based on the premise that financial performance may be improved at the expense of customer service when incentive compensation is tied to EPS, Staff does not provide any hard evidence to support this theory. Staff witness Harris admitted that he didn't look at KCPL's customer service, reliability or operational performance benchmarks when evaluating KCPL's incentive compensation plan. (Tr. 170).

Instead, Mr. Harris uses a hypothetical example to illustrate his concern. According to Mr. Harris, a utility might be tempted to reduce costs by delaying planned maintenance on generating units, reducing payroll by eliminating customer service representatives or cut back on the level of tree trimming maintenance. These reductions in costs, according to Mr. Harris would improve financial performance but harm customers. (Ex. 117, p. 4). While Staff's hypothetical examples may have some hypothetical merit, they ignore KCPL's superior performance as demonstrated by KCPL witness Robert J. Camfield. KCPL has obtained a very high level of performance from the perspective of retail customers over recent years. (Ex. 36, p.20-21). Staff's concerns regarding the potential for financial performance at the expense of customer service are not warranted.

Not only did Staff not investigate the facts in order to test its theory, Staff witness Harris admitted that KCPL is providing safe and reliable electric service to its customers. (Tr. 171). Mr. Harris also admitted that Staff could file a complaint to address customer service problems if they occurred. (Tr. 175). In summary, Staff's disallowance theory is not supported in the record nor did Staff attempt to test its theory.

In contrast to Staff's untested theory, KCPL's incentive compensation plan is based on the market reality that the Company must offer incentive compensation in order to attract and retain superior employees. (Ex. 6, p.6). The use of incentive compensation plans is so pervasive in the utility industry and in general industry that KCPL would be placed at a competitive disadvantage in the marketplace for which it competes for talent if it did not offer incentive compensation plans. (Id.)

KCPL's entire incentive compensation plan is consistent with ratepayer interests. As explained in the rebuttal testimony of KCPL witness David Cross, incentive compensation based on EPS is proper because a financially sound and stable company provides a direct benefit to all stakeholders including, employees, customers shareholders and the community which KCPL operates. (Ex. 6, p.3).

Mr. Cross explains the customer benefits from KCPL achieving its financial benefits on pages 3-5 at his rebuttal testimony. These benefits include:

1) KCPL must provide a market competitive compensation plan to attract and retain highly qualified and experienced employees. It is to the benefit of the customers to provide a competitive salary package, including incentives, to build a strong management team and a team of highly qualified employees who are driven to provide high levels of customer service and who deliver safe and reliable electric service. If KCPL fails to hire highly qualified people, the Company's operations would most certainly suffer which would have a direct impact on customers.

2) Because of KCPL's solid financial performance from an earnings perspective, it is in a position to undertake the Comprehensive Energy Plan, directly benefiting the customers and the community. The Plan will supply predictable, low-cost, clean and efficient energy to meet the needs of the growing Kansas City area for years to come, and maintain the region's ability to retain and create jobs through continued economic growth. The Plan also reduces the potential that KCPL will have to rely on the volatile wholesale energy market to meet future demand.

3) Customers benefit when the Company is strong financially as the Company is able to raise the capital needed to fund the ongoing construction projects associated with the Comprehensive Energy Plan. A solid financial foundation means that the Company receives more favorable rates on capital, reducing the overall costs that ultimately get charged to customers.

4) A utility can only deliver strong financial success through strong operational performance. In effect, by measuring financial performance you are measuring operational performance. Many utilities that have built their incentive plans based on financial performance because there is the explicit recognition that such measures reflect the performance of a wide range of operations. One common set of financial measures provides a simple incentive structure while reflecting the kind of operational performance that KCPL customers want.

Another Staff adjustment is the disallowance of the 20% payout for incentive plan individual goals because it alleges that defined goals were not identified by KCPL. (Ex. 117, p.5). KCPL submits that the record does contain these defined goals. KCPL believes that individual performance is a key component of the Company's compensation philosophy. The individual performance piece of KCPL's incentive compensation plan allows the Company to recognize and reward the outstanding performance of its officers and employees. (Ex. 6, p.12). Moreover, the individual goals provides motivation for KCPL executives and employees to achieve financial and operational goals. (Id.)

While the 2005 Officer Plan had no formal objectives for the individual component, KCPL provided evidence of how officers earned this piece of incentive compensation. Members of KCPL's Board of Directors determined if the Officers demonstrated a commitment to achieving divisional operational goals, created a winning culture, contributed to the Comprehensive Energy Plan and were committed to the community. (Id., p.13). Factors such as creating a winning culture create an environment where the employee is encouraged to provide a high level of customer service and promotes teamwork and innovative thinking while maintaining reliable electric service. (Id.)

For the ValueLink plan, the objectives used to pay the individual performance piece are very well defined. (Id., p.13). An employee's year end performance rating is directly linked to the award the employee receives for the individual performance component. (Id.) As shown in Schedule DC-1 and DC-2 to KCPL witness David Cross's rebuttal testimony, an employee's performance is assessed annually against predetermined and specific individual performance goals and core Company competencies. (Id.) Management does have some discretion in determining individual awards. However, management must generally follow a set of published guidelines (see schedule DC-3) to ensure that the approximate target level of individual incentive is achieved. (Id., p.14). The individual performance component is linked to specific performance measures for key operational and customer goals. The individual performance component has defined goals that benefit customers as well as shareholders, and therefore the costs for the individual performance piece of the incentive compensation plan should not be disallowed. (Id., p.14).

Staff also disallowed KCPL's long-term incentive plan (LTIP) because the awards were based on financially driven goals such as EPS; the awards were made with stock and therefore required no cash outlay and the belief that KCPL is asking ratepayers to pay double for KCPL's financial results for 2005 and 2006. (Ex. 116, p.13).

LTIP is the most prominent element of executive compensation and makes up to 60% of an executive's total compensation. (Id., p.15). Virtually all regulated utilities recognize the need for LTIP as a necessary cost of doing business. (Id.) If LTIP is excluded, the Company will be at a competitive disadvantage in its ability to attract and retain high caliber executive talent. (Id.)

KCPL reiterates its earlier comments regarding financial goals. The application of financial metrics in any incentive plan is beneficial for a number of reasons: strong financial performance can best be achieved in a utility environment by strong operational performance. (Id.) The fact that the LTIP is paid in stock, not cash, does not mean that there is no expense to an equity grant in today's corporate environment. (Id.) Finally, there may have been a double payment but this was only because there was no equity payment in 2004. (Id., p.16). The reason for the missed payment year was the development of a new LTIP. KCPL had to ensure that the new LTIP was reasonable and appropriate for both customers and stockholders and therefore did not rush the 2004 plan. (Id.)

5. Pensions

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

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

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

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

6. Hawthorn 5

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

Background

On February 17, 1999 an explosion destroyed KCPL's Hawthorn 5 generating unit. KCPL received insurance proceeds stemming from this loss beginning in 1999 and continuing through 2005. Some of the insurance proceeds were not received until after construction was complete. (Tr. 201). Under the terms of the insurance policies there were no restrictions regarding how KCPL could use the proceeds. (Tr. 216, 221-222). KCPL used the insurance proceeds to fund normal day-to-day operations of the Company, which includes capital and operations and maintenance activities. (Tr. 219). KCPL used the insurance proceeds to pay normal expenses such as payroll, fuel and for replacement power (due to the loss of Hawthorn 5). (Tr. 195). KCPL accounted for the insurance proceeds as salvage and recorded the proceeds to FERC Account 108, Accumulated Provision for Depreciation as required by the Uniform System of Accounts (USOA) (Ex. 8, p.2).

KCPL began rebuilding Hawthorn 5 in 1999. As with any major construction project, KCPL was permitted to capitalize and recover the carrying costs it incurs through the calculation of an AFUDC rate. The AFUDC mechanism provides utility investors a return on its capital investment during the construction cycle. (Ex. 139, p.42). KCPL calculated the AFUDC rate in accordance with the USOA. The unit was completed and began serving customers in 2001.

Staff did not inform KCPL that it had an issue with KCPL's accounting treatment of the insurance proceeds or the calculation of the AFUDC rate until this rate case. (Tr. 217). Staff maintains that KCPL should have segregated the insurance proceeds from its other funds and used those proceeds to partially fund the construction of Hawthorn 5. Staff's recalculation of the AFUDC rate used the insurance proceeds as the first source of construction funds. (Ex. 139, p.40). Staff's recalculation not only ignores KCPL's cash management reality but also the USOA.

<u>The USOA determines how insurance proceeds are booked</u>.

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.35). Account 108-B of the USOA states:

> At the time of retirement of depreciable electric utility plant, this account shall be charged with the book cost of the <u>property retired</u> and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance. (Ex. 139, p.39, emphasis supplied).

Staff witness Williams believes that "the USOA did not take into consideration a catastrophic event such as what happened at Hawthorn 5 in which an existing plant that had been in service for approximately 30 years was destroyed and essentially rebuilt resulting in a new plant after construction was completed." (Ex. 139, p.39).

In contrast to Staff's unsupported belief that Account 108 does not apply to property that has been destroyed, KCPL relied on the unambiguous language of the USOA. "Property Retired", as applied to electric plant, means property that has been removed, sold, abandoned, <u>destroyed, or which for any cause has been withdrawn from service</u>. (18 CFR Pt. 101, Definitions (28), emphasis supplied). Thus, the definition specifically addresses the Hawthorn 5 situation and also would cover any situation where an existing generation unit is withdrawn from service and rebuilt.

Staff attempts to bolster its flawed interpretation of the USOA by reporting parts of a conversation it had with two FERC employees. However, Staff witness Williams admitted on the stand that the two FERC employees that spoke to Staff did not provide an official FERC opinion. (Tr. 212). Nor did Staff witness Williams speak to those employees' supervisor to check on the accurateness of the conversation. (Tr. 211, 215).

Even this unofficial "opinion" of a FERC lower level employee doesn't say that KCPL improperly interpreted the USOA. Staff quotes FERC employee Okrak as saying that "he had seen instances of equipment failures and that he had also heard in the past where some utilities had treated the proceeds from insurance recoveries as a reduction to plant-in service directly." Mr. Okrak indicated that in those instances, "the FERC Audit Staff did not make an issue of this treatment." (Ex. 140, p.9). Note that Mr. Okrak doesn't even have first-hand experience with this issue. Nor did Mr. Okrak say that utilities that treated the insurance proceeds as salvage, as KCPL did, were in violation of the USOA.

Staff believes that KCPL should have sought a waiver or letter ruling from FERC. (Ex. 140, p.10). But why would KCPL seek a letter ruling to deviate from accounting rules which were clear on their face? Moreover, since KCPL knew it was following FERC's accounting rules, how was it supposed to know that Staff had a different interpretation of the rules? The Company was unaware of Staff's position until this rate case. Staff's contention that KCPL should have sought a waiver of the USOC rules is unrealistic.

The Commission Should Follow The USOA

Staff witness Williams admits that the USOA sets forth the guidelines for the proper booking of funds received from insurance proceeds but then argues that due to the extraordinary nature of the Hawthorn 5 explosion and rebuild, simply following the USOA is not enough. (Ex.

140, p.10). This is the basis for Staff's "last gasp" argument that the Commission does not have to follow the USOA for ratemaking purposes.

The Staff is asking the Commission to do something out of the ordinary by not following the USOA. (Tr. 222). Staff admitted that it has no authority to ask the Commission not to follow the established USOA rules. (Tr. 223). Staff also admitted that it has no support that for its contention that the insurance proceeds had to be used to fund the Hawthorn 5 construction costs. (Tr. 221-222).

Staff cites 4 C.S.R. 240-20.030(4). This rule does allow the Commission flexibility in setting rates. However, caution should be exercised when deviating from the USOA. The Staff believes the circumstances surrounding the Hawthorn 5 construction provides the support needed for deviating from the USOA. (Ex. 140, p.11-12) However, Staff's five reasons do not support the Commission taking this drastic action.

Staff's first three reasons deal with the insurance payments that KCPL received. Staff asserts that the funds were to be used for construction costs and cover replacement power costs. As demonstrated above, the insurance proceeds were treated as other cash proceeds and used to fund day-to-day operations of the Company, including the purchase of replacement power. Moreover, there was no restriction that the insurance proceeds had to be used to rebuild Hawthorn 5. Next, Staff believes that KCPL could have filed with the Commission an accounting authority order (AAO) to account for the extraordinary replacement power costs if the Company believed it was warranted. Again, KCPL had no idea at the time it was paying replacement power costs that the Staff would take a position contrary to the USOA and therefore, KCPL had no reason to contemplate the filing of an AAO.

The Staff's last argument is that KCPL was in an over-earning situation at the time of the explosion, so that costs incurred by Company resulting from the explosion were made up either by the over-earnings prior to the explosion or that occurred once the unit was back in service. (Ex. 140, p.12). The Staff makes no attempt at quantifying its position except by stating that KCPL has had an opportunity to recoup much of the profits lost during the time of Hawthorn 5 reconstruction. (Ex. 140, p.21). The Commission should not make an adjustment based on the past earnings of the Company, due to the prohibition against retroactive ratemaking. Retroactive ratemaking occurs when rates are set to recover for past deficiencies or to refund past excesses. See, State ex rel Utility Consumers Council of Missouri v. PSC, 585 S.W.2d 41, 59 (Mo. banc. 1979).

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

Staff's AFUDC calculation used the insurance proceeds received prior to and during construction as the first source of construction funds. (Ex. 139, p.40). As can be seen in Staff witness Williams exhibit (Ex. 13, Sched. 2-3), Staff subtracts the insurance proceeds from the cumulative construction costs in its recalculation of AFUDC. This is contrary to the AFUDC formula found in the USOA which uses the average balance in construction work in progress. (18 C.F.R. 101, Electric Plant Instructions (17)). Unlike Staff's AFUDC calculation, KCPL calculated AFUDC according to the USOA. The base used to calculate AFUDC represents the cost to construct the assets and that base is not overstated because the insurance proceeds were recorded in account 108, pursuant to the USOA. (KCPL Prehearing Brief, p.4).

Staff AFUDC recalculation assumes that the insurance proceeds were available to fund the reconstruction. (Ex. 139, p.45). In fact, the insurance proceeds were managed by KCPL just as it does any other funds that it receives. KCPL did not establish a separate fund for the insurance proceeds to be used to fund Hawthorn 5 construction. Instead the insurance proceeds went into the general corporate cash account and used to pay whatever needs the company had.

(Tr. 195-196). It would not have made sense to segregate the funds in account that was designated to pay for Hawthorn 5 construction expenditures because at the same time the Company would have been faced with paying replacement power costs and other expenses which it did not have the funds to pay. (Tr. 196). KCPL spent approximately $162 million in unreimbursed purchase power costs from the time Hawthorn 5 went down until the unit was back in service and approximately $10 million in removal costs. (Ex. 8, p. 3-4). Had the Company held back the insurance proceeds and only used them to pay for Hawthorn 5 construction costs, it may have had to seek a rate increase at that time. (Tr. 196).

Staff's contention that the insurance proceeds needed to be used only for Hawthorn 5 construction costs rests on its mistaken assumption that the insurance proceeds were somehow "earmarked" for Hawthorn 5 construction use. In fact, there was no restriction on the use of the funds by KCPL. (Tr. 201).

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

See discussion below.

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

Staff's recording of insurance proceeds as a credit to construction results in an understatement of AFUDC, gross plant, depreciation expense and accumulated depreciation. (Ex. 8, p.2). Staff maintains that the gross plant value is overstated because the insurance proceeds were booked to the depreciation reserve and because of the way KCPL calculated AFUDC reflected in its books. (Ex. 140, pp.13-14). Both of these reasons do not have merit.

As shown earlier, KCPL was required by the USOA to account for the insurance proceeds as salvage. Since the proceeds are reflected in the depreciation reserve as salvage, they reduce the net plant investment that reduces the allowed return on rate base. (Ex. 8, pp. 4-5). Staff agrees that due to KCPL's booking to salvage customers receive the benefit of reduced net plant resulting in lower depreciation expense and lower return of this investment. (Ex. 139, p.41). Staff also admits that any potential overstatement due to this issue is addressed by KCPL either by a manual adjustment or a reduced depreciation rate. (Ex. 140, p.14).

The second reason given by Staff for the alleged overstatement is Staff's recalculation of AFUDC based on its theory that the insurance proceeds eliminated the need to finance much of the Hawthorn 5 construction costs. As shown earlier, the insurance funds were used for day-to-day operations, including the purchase of replacement power. Staff's adjustment assumes that the insurance funds eliminated the need to finance the majority of Hawthorn 5 construction costs. (Ex. 140, p.15). However, this assumption does not reflect KCPL's cash management practices.

Staff's assumption regarding insurance proceeds was examined by Commissioner Murray's questions to KCPL witness Lori Wright.

> Q. In reading the Staff's Supplemental Prehearing Brief, there was a statement made by the Staff that KCP&L's customers should not be required to pay the carrying costs for the funds used during construction that were covered by insurance proceeds. <u>My question is were the funds received in time to avoid carrying costs</u>?
>
> A. What happened was we received the funds and the company doesn't necessarily segregate its cash per se for different uses. Those funds weren't restricted in any way for construction costs. So the company received the proceeds and they managed those proceeds just like they do any other funds it receives. And on a daily basis they look at the funds that are available, the sources of funds that it has and the requirements for cash, and they match them up.
>
> Okay. So it wasn't necessarily such that the company -- the company doesn't manage its cash in a way that it would establish a separate fund and have those monies sitting there invested and receiving interest at a short-term investment rate, while at the same time it would be borrowing money to pay other bills that it has to pay, such as bills for, you know, payroll cost, fuel replacement power and those sorts of things.

> Q. Okay. So when the insurance proceeds were received, what did KCP&L do with them?
>
> A. They went into their general corporate cash account, just like any other funds it receives, and it manages its total cash requirements on a total KCP&L basis. It doesn't segregate them at all. So it was used to pay whatever bills or needs the company had at the time. (Tr. 194-196).

Unless the Commission determines that Staff's unproven assumption that insurance proceeds financed the Hawthorn 5 construction is correct, there is no overstatement of plant due to improper AFUDC calculation and no adjustment to KCPL's books and records is appropriate.

7. Ice Storm Costs

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

On January 30 and 31, 2002, a severe ice storm hit KCPL's system, depositing up to two inches of ice on trees, lines and equipment and causing unprecedented damage and destruction to the Company's facilities. In order to restore service as quickly as possible to the over 305,000 customers that had lost electric service, KCPL used hundreds of outside utility, contractor and tree trimming crews. (See, Order Granting Accounting Authority Order, Case No. EU-2002-1048 (2002)) KCPL filed for an Accounting Authority Order (AAO) due to the unusual expenses related to the ice storm.

The Commission granted the AAO and allowed the ice storm costs to be deferred until January 31, 2007. The Commission reserved the right to consider in a future rate case the ratemaking treatment of the deferred costs. KCPL's position is that there should be a twelve month amortization as the Commission authorized the AAO until January 31, 2007. Staff advocates a seven month amortization as that is what is left between the true up date (June 30, 2006) and January 31, 2007. (Tr. 232-233)

The Department of Energy (DOE) alleges that because the robust nature of KCPL's earnings from 2002 through 2005, KCPL has already recovered the costs from Missouri ratepayers. DOE admits that the earnings that it believes that KCPL made are unaudited and have not been normalized. (Ex. 803, p.23). Further, DOE recognizes that in none of these years was a complaint case seeking rate reductions ever brought against KCPL despite several investigations. (Tr. 899).

KCPL submits that there is nothing special about the fact that the amortization ends the first month in 2007. The fact remains that the ice storm costs won't be fully amortized until the end of January 2007 and that the ice storm amortization costs occurred during the test year. There are other increased costs which will begin outside the test year; such as wage increases, which KCPL will not be able to recognize in rates. DOE should not be allowed to "cherry pick" ice storm costs and remove them from KCPL's cost of service.

8. <u>EEI Dues</u>

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

KCPL believes that this issue has been settled.

9. <u>Severance Costs</u>

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

KCPL incurs severance costs each year. (Ex. 8, p.9). In fact, over the last five years, the Company has averaged severance payments of $1,320,463. (Tr. 247). Severance payments are necessary due to changing job requirements, reorganizations and downsizing. As the Company continues to position its employees in order to implement its corporate strategies, severance costs will continue to be incurred. (Ex. 8, p.9). KCPL believes that $897,024 be included in its cost of service for severance costs which is less than its five year average of severance payments and is representative of its ongoing level of severance costs. (Ex. 8, p. 10).

Staff disallowed all severance costs based on three reasons; 1) severance costs are not a recurring cost of providing electric service; 2) severance payments do not provide a benefit to ratepayers and 3) KCPL has likely recovered its past severance costs through regulatory lag. (Ex. 119, p.3). None of Staff's rationale are supported by the record.

First, KCPL has in fact incurred severance costs in each of the last five years. Staff Witness Hyneman admitted on the stand that for the period 2001 through 2005, KCPL made severance payments of $354,596 (2001), $1,128,482 (2002), $2,047,356 (2003), $688,219 (2004), $2,383,662 (2005). (Tr. 247). Staff's assertion that severance costs are not recurring is not supported by the facts established in this case.

Staff's next point is that only shareholders benefit from severance payments. As noted in Mr. Hyneman's surrebuttal testimony, KCPL uses severance agreements to extinguish all potential claims an employee may have had against the Company. (Ex. 119, p.10). Mr. Hyneman then jumps to the conclusion that regulated customers should not pay for protection against claims of improper conduct on the part of KCPL management. (Id.) In fact, as Commissioner Murray recognized in her questioning of Mr. Hyneman on this issue, this exculpatory language is normal for a severance agreement. (Tr. 252). The fact that all future claims are extinguished protects a company from defending frivolous lawsuits. Staff witness Hyneman admitted that not all lawsuits have merit and all lawsuits that are filed must be defended by the Company. (Tr. 244). Severance payments are a way to cap a company's exposure to legal fees and other costs of litigation. Ratepayers benefit from a company not expending dollars on legal costs and not having its employees distracted by litigation. Staff's assertion that ratepayers receive no benefits from severance payments is not supported by the record.

Staff's hypothetical regulatory lag argument also falls short as it does not recognize the reality of KCPL's situation. Staff asserts that after an employee is terminated, KCPL recovers the amount of severance paid to the employee since it rates are based on having that employee on the payroll. (Ex. 119, p.9). What Staff's hypothetical ignores is the typical situation where the terminated employee is replaced by another employee at the same level of salary and benefits. Staff witness Hyneman admitted that KCPL would not benefit from regulatory lag if another employee fills the vacated position. (Tr. 245-246). Moreover, Staff witness Hyneman noted in his testimony that KCPL is in a hiring mode and recognized that the employees terminated by KCPL in 2006 are expected to be replaced by new employees. (Ex. 119, p.4). Because the record shows that terminated employees will likely be replaced on the payroll by KCPL, Staff's regulatory lag argument fails.

KCPL's position is supported by the fact that severance payments are a regular occurrence for KCPL. The Commission should recognize this reality and adopt KCPL's severance cost amount which is significantly less than KCPL's five-year average of KCPL's actual severance payments.

10. <u>Bad Debts</u>

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

KCPL witnesses Lori Wright and Don A. Frerking, and Staff Witness Kimberly Bolin explained that KCPL and Staff agreed to normalize KCPL's annual bad debt expense by applying a bad debt write-off percentage factor to KCPL's Missouri jurisdictional revenue. (Ex No. 7, p.13; Ex No. 11, p. 15; Tr. 261). Specifically, Staff and KCPL agreed to apply a 0.61 percent bad debt write-off factor to KCPL's Missouri jurisdictional revenue. (Tr. 260). The only issue between KCPL and Staff is whether to apply that factor to the Missouri jurisdictional revenue determined by the Commission in this case to be just and reasonable, or to apply that factor to a previous estimate of KCPL's revenue requirement. The Commission should apply the agreed upon factor to the actual Missouri jurisdictional revenue that the Commission determines in this case to be appropriate for KCPL.

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. Mr. Frerking explained that because any change in KCPL's Missouri jurisdictional revenue will result in a corresponding change to KCPL's annualized bad debt expense, Staff's position understates the bad debt expense that KCPL will experience should the Commission increase its revenue requirement. (Ex No. 11, p. 15). The Commission should apply the 0.61 percent bad debt write-off factor agreed upon by KCPL and Staff to whatever Missouri jurisdictional revenues that the Commission determines to be just and reasonable as a result of this proceeding.

11. <u>Fuel & Purchased Power Expense</u>

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

KCPL witness Burton L. Crawford described the method used by KCPL for normalizing the test year fuel and purchase power expense in this proceeding. (Ex. 15, pp.12-16). As explained by Mr. Crawford, the proper method for normalizing the test year fuel and purchased power expense is to normalize and annualize the system peak and energy, the market price of purchased power, the prices paid for fuel, generating system maintenance and forced outages, and available generating resources. After determining the appropriate normalized and annualized values, an accurate production cost computer modeling tool is used to develop the appropriate generation and purchase power levels and resulting fuel and purchased power expenses. KCPL used the MIDAS™ model for its production cost model. (Id. at 12).

The Staff used a similar process for developing its fuel and purchase power expenses. Staff witness Charles R. Hyneman describes in his Direct Testimony how the Staff calculated the fuel and purchased power expense that should be included in KCPL's revenue requirement. The Staff computed the fuel expense using prices and quantities incurred by KCPL through June 30, 2006. This process included using fuel prices for nuclear, coal, including freight, natural gas, including natural gas transportation costs and oil. (Ex. 118, pp.3-20). The Staff's fuel prices were provided to Staff witness Leon Bender as inputs for the Staff's fuel models. Staff witness Curt Wells of the Energy Department, and Staff witness Kimberly K. Bolin of the Auditing Department, developed normalized and annualized sales through June 30, 2006. (Exs. 106 and 141).

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

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

As explained by Staff witness Hyneman, the Staff methodology used a weighted average natural gas price that was based upon KCPL's actual gas purchases over the 18-month period from January 2005 through June 2006. (Ex. 118, pp.13-14). Public Counsel witness Ralph C. Smith asserted that "[p]rices for natural gas used by KCPL should be updated to reflect a known and measurable change as of June 30, 2006. The June 30, 2006, NYMEX price should be substituted for the six-day average from December 27, 2005 through January 3, 2006 that was used by KCPL." (Ex. 210, pp.33). During the hearings, Mr. Smith testified that his concerns regarding natural gas prices would be alleviated if the natural gas prices included in the case were trued-up.(Tr. 454). Since KCPL and Staff intend to true-up the price of natural gas as a part of the true-up proceeding, KCPL does not believe there continues to be an issue that needs to be resolved by the Commission. (Tr. 360-61).

12. Surface Transportation Board Litigation

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

This issue relates to the accounting treatment of the litigation costs associated with a rate complaint that KCPL initiated on October 12, 2005, with the Surface Transportation Board (STB) against the Union Pacific (UP) railroad, KCPL's sole source of rail service from Southern Powder River Basin in Wyoming to KCPL's Montrose Station. In that rate complaint, KCPL charged that UP's rates for the movement of coal from origins in the Powder River Basin of Wyoming to KCPL's Montrose Generating Station were unreasonably high. The STB is the exclusive forum available for contesting rates for railroad services.

KCPL estimated that potential freight cost savings could be substantial if it were successful in the STB Complaint proceeding. (Ex. 13, p.3). Staff also believes that KCPL's efforts to pursue this complaint case and keep fuel costs as low as possible are in the best interests of KCPL's customers. (Ex. 118, pp.22-23). However, since these litigation costs are not considered normal and recurring expenses by Staff, Staff recommends that they be deferred and amortized over a period of years. 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).

Public Counsel witness Ralph C. Smith, on the other hand, recommends that the Commission deny recovery on all of these litigation costs. However, as an alternative position, Mr. Smith also recommends that if the Commission decides to include the costs in the Company revenue requirement, "at minimum the costs of the STB complaint should be spread over a representative period, such as five years or longer, that reflects the relative infrequency of such cases and the future period benefited from the expenditure." (Ex. 210, p.24) (Tr. 453).

During the hearings, Mr. Smith also testified that it is in the best interests of KCPL's customers for KCPL to take actions to keep fuel costs as low as possible, including the transportation costs related to the delivery of coal. (Tr. 451-52). He also candidly admitted that the Surface Transportation Board is the exclusive forum available for contesting rates for railroad service. (Tr. 452).

KCPL respectfully requests that the Commission accept the KCPL/Staff position (and Public Counsel's alternative position) and treat these litigation costs as a regulatory asset and spread the costs over five years. Any refund received by KCPL as a result of this litigation 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. This is a reasonable and appropriate treatment of these costs, and would continue to give regulated public utilities the regulatory signal that they should pursue prudent strategies to lower transportation costs, including appropriate litigation before the STB.

13. <u>SO_2 Premiums</u>

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

See discussion below.

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

KCPL and Staff are in agreement that KCPL should be required to charge all of its coal SO_2 (i.e., sulfur) premiums against the regulatory liability in Account 254, Regulatory Liability, after January 1, 2007. (Ex. 14, p.4) (Tr. 376). KCPL believes that this accounting treatment is consistent with the following provision contained in the Stipulation And Agreement approved in Case No. EO-2005-0329:

> KCPL currently purchases coal from vendors under contracts that indicated nominal sulfur content. To the extent that coal supplied has a lower sulfur content than specified in the contract, KCPL may pay a premium over the contract price. The opportunity to burn coal with lower sulfur content is both advantageous to the environment and reduces the number of SO_2 emission allowances that must be used. To the extent that KCPL pays premiums for lower sulfur coal up until January 1, 2007, it will determine the portion of such premiums that apply to retail sales and will record the proportionate cost of such premiums in Account 254. But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually. The portion of premiums applicable to retail will be determined monthly based on the system-wide percentage of MWh's from coal generation used for retail sales versus wholesale sales as computed by the hourly energy costing model. This system-wide percentage will be applied to premiums invoiced during the same period. (Ex. 143, pp.9-10).

Public Counsel witness Ryan Kind has a different position on this issue, however. According to his Rebuttal Testimony, he believes that the coal sulfur premium provision of the

Stipulation referenced above that caps through the end of 2007. (Ex. 204, pp.4-5) This interpretation of the Stipulation, however, is incorrect.

The Stipulation states: "To the extent that KCPL pays premiums for lower sulfur coal up until January 1, 2007, it will determine the portion of such premiums that apply to retail sales and will record the proportional cost of such premiums in Account 254." (Ex. 143, § III.B.1.d, p.10) (emphasis added).

By its own terms, this provision of the Stipulation expires at midnight on January 1, 2007. It is simply not applicable to coal premiums incurred in 2007. As a result, the Commission should reject the position of the Public Counsel on this issue.

Secondly, while Public Counsel agrees that it is appropriate to adjust Account 254 for coal sulfur premiums, Public Counsel witness Kind initially assumed that the $400,000 annual limit should be spread over twelve months commencing with the effective date of the Order approving the Stipulation. According to Mr. Kind's original interpretation that appeared in his pre-filed direct testimony, the $400,000 annual limit should be interpreted as twelve consecutive monthly limits of $33,333.33. (Ex. 204, pp.4-5) However, during the hearings, Mr. Kind apparently revised his original interpretation, and instead changed his testimony to state that "the annual amount of SO_2 premiums that could be reflected in Account 254 in this case should be $400,000." (Tr. 391-92). This revised interpretation is now consistent with the positions of KCPL and Staff on the annual cap for 2005 and 2006. However, Mr. Kind's interpretation of the applicability of this provision beyond January 1, 2007 continues to be an issue to be resolved by the Commission.

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

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

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

KCPL's test year costs, including injuries and damages, are calculated using the accrual method of accounting. Injuries and damages consist of insurance premium expense, cash payments to third parties for damages and medical services and accruals for estimated contingencies. (Staff Pre-Hearing Brief, p.26). For injuries and damages expense, Staff reflects insurance and related premiums using the accrual method. However, for the remainder of the injuries and damages expense, Staff proposed to use a three year average of cash payments. KCPL believes that all of its injuries and damages expense be recovered using the accrual method of accounting, which is consistent with the way that the Company records and keeps its books for other items recovered in its cost of service. (Tr. 290).

Staff's cash basis proposal for part of KCPL's injuries and damages expense is not only inconsistent with the way that KCPL records its cost of service expenses, it is also inconsistent with Staff's own cash working capital calculation. Staff witness Williams produced the cash working capital analysis which is designed to reflect the amount of cash necessary for KCPL to pay the day-to-day expenses incurred to provide service to its customers. (Ex. 139, p.15).

The cash working capital study uses a lead/lag analysis to determine the number of days the Company has to make payments after receiving the goods or services from a vendor and is compared with the number of days it takes KCPL to receive payment from customers for electric service. (<u>Id</u>., p.16). According to Staff witness Williams, for injuries and damages, there is a 185-day lag between the date of an accident and KCPL's damages payment to the individuals involved in the accident. (Tr. 297). Ratepayers get the benefit of a lag since any lag adds to a negative cash working capital value. A negative cash working capital value means that in the aggregate, ratepayers have provided the cash working capital to the Company during the test year. (Ex. 139, p.30). Ratepayers are compensated for the cash working capital they provide through a reduction to rate base. (Id.)

The cash working capital study is made up of many estimates. KCPL only has a problem with the injuries and damages expense lag of 185 days because of Staff's proposal to treat part of the injuries and damages expense on a cash basis. For if KCPL's rates are to be set based on a cash basis of accounting, this would mean that there is a zero lag regarding injuries and damages expenses. (Tr. 294). Staff is recommending a cash basis be used for setting rates. (Tr. 302). Staff is also setting rates with its cash working capital study. This study recognized that there is a 185-day lag between the date of the occurrence of the accident and the date of payment due to the accident. (Ex. 139, p.25). There is an inconsistency between these two rate setting procedures.

Staff can't have it both ways. It is inconsistent and unfair to the Company to claim that on the one hand, injuries and damages expense should be treated for ratemaking purposes on a cash basis, while at the same time giving ratepayers the benefit of a 185 day lag between the time of an injuries and damages occurrence (an accident) and the date that KCPL makes payment to the individual involved in the accident.

KCPL recommends that the Commission use the accrual method for accounting for injuries and damages as it better reflects actual experience and is consistent with the cash working capital study. If the Commission accepts Staff's proposal then the Commission should order that the cash working capital study reflect a zero expense lag for injuries and damages.

15. Rate Case Expense

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

See discussion below.

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

See discussion below.

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

Unlike the issue of rate case expense in an ordinary rate case filed by a utility, this issue needs to be understood in the context of the Company's Regulatory Plan Stipulation, which spells out the timing of KCPL's future rate cases. KCPL is obligated to file a rate case in 2009 and has the option to file a rate case in 2007 and 2008. (Ex. 143, p.29). KCPL witness Giles indicated at the hearing that KCPL would file a rate case in February of 2007. (Tr. 828). Given the unprecedented level of future rate case activity, KCPL amortized rate case expense over two years. The Staff used a three year amortization period because, as Staff witness Harris explained at the hearing that the Regulatory Plan requires a rate case filing in three years. (Tr. 312). Both Staff and KCPL positions on this issue recognize that it is appropriate to recognize in rates the unusual level of rate case expense that KCPL will incur over the next five years.

OPC, on the other hand, argues in its prehearing brief (it has no witness on this issue) that since rate case expenses don't occur every year, the amount should be normalized. OPC believes that rate case expense is a "classic example of the type of expense that is typically normalized." (OPC Prehearing Brief, p.3). As set forth in the Regulatory Plan, KCPL's future level of rate case expense is neither classic or typical. KCPL's two year amortization of rate case expense is the best reflection of the rate case expenses that KCPL will incur in the future.

In the past, the Commission has allowed a two-year amortization of rate case expense when it is likely that the utility will file another rate case within two years. See, In the matter of

St. Joseph Light & Power Company, Case No. HR-94-177, 3 Mo. P.S.C. 3d 207 (1994). This is the exact situation in this case and the Commission should follow its earlier decision.

16. Corporate Projects and Strategic Initiatives

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

KCPL has undertaken several companywide initiatives to develop and implement its corporate strategy. KCPL proposed that the costs associated with the projects should be included in the test year cost of service. (Tr. 316). For two of these projects (Leadership Development (LED-LDI) and Corporate Development/Planning (CORPDP-KCPL)), Staff decided to combine the test year cost (payments made to outside consultants) of the projects with the 2006 costs of the projects and amortized this amount to expense over a five-year period. (Ex. 119, p.12). KCPL believes that these amounts should be included in rate base. (Tr. 313).

Staff had a dilemma, it could either disallow the expenses or allow the company to recover costs in the future. (Tr. 325). Because Staff recognizes that it is probable that these projects will provide future benefits, its decision not to allow these projects into rate base raises contradictions. Staff Witness Hyneman indicates that in order for an item to go into rate base, it must be an asset. According to Mr. Hyneman, the projects do not meet the definition of an asset because they do not meet the "probable future economic benefit" test of an asset and are not "used and useful". (Ex. 119, pp.13-14). However, Mr. Vesely, another Staff witness on this issue noted in his testimony that the projects will provide benefits over a future period. (Ex. 137, p.8).

In order to keep these projects out of rate base, Staff must contradict itself and take illogical positions. Witness Hyneman believes that the costs incurred for these two projects were incurred with the intention to improve the effectiveness and leadership skills of Company management. (Ex. 119, p.15). Mr. Hyneman then argued that as there was no evidence that KCPL's management lacked leadership skills, there was no management problem that needed to be addressed by the projects and therefore no probable future economic benefits. (Ex. 119, pp.14-15).

However, Staff Witness Vesely indicates that the projects were not solely aimed at improvements to management. Project LED-LDI involved a corporate-wide workforce evaluation and skills assessment. (Ex. 137, p.10, emphasis added). The Company made a complete evaluation of substantially all of it's employees and effectively "raised the bar" on expected employee performance. (Ex. 137, p.10). Staff Witness Vesely also describes the scope of the CORPD-KCPL project as beyond the scope of improving KCPL's management team since the project was designed to create the "Delivery System of the Future" by "partnering with customers to dynamically manage load shape, demand response and efficiency programs, system automation and monitoring." (Id. at p.11). Thus, witness Hyneman's rationale that the projects do not provide probable economic benefits because KCPL's management did not need improvement is contradicted by the fact that the programs are companywide and seek improvement beyond that of KCPL's management team.

Staff's position that the projects are not needed to provide service ignores the fact that a company must always seek improvement. Staff witness Hyneman admitted that a utility even with an outstanding level of performance cannot rest on its laurels, it must always seek continuous improvement through a training program. (Tr. 315-316). Thus, the projects which Staff admits are basically related to training (Tr. 317). are in fact "used and useful". The projects are what Staff believes should be a normal undertaking for a utility providing service in Missouri.

Staff has determined that the projects in question will provide future benefits, that they go beyond improving management skills, and that even though KCPL's performance was superior, continuous improvement training programs are the normal undertakings of a utility. The programs therefore meet Staff's own criteria for inclusion into rate base.

17. Payroll, Including A&G Salaries

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

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

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

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

18. Other Benefits

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

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

19. Maintenance Expense

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

Staff witness William Harris sponsors adjustments regarding the normalization of maintenance expense for both production and distribution. Mr. Harris recommends adjusting the 2005 test year level of maintenance expense to represent a normalized level of maintenance based upon an historical analysis of actual costs. He originally used a six-year average of actual maintenance expenses for years 2000 through 2005 to reflect production and distribution costs. (Ex. 116, pp.18-21).

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

Production Expense

Since the filing of his original direct testimony, Mr. Harris has proposed the use of a two-year average for steam production maintenance normalization. Unfortunately, this adjustment appears to state actual non-labor operations and maintenance as "In-Year$'s" and does not express costs as a common value. As explained by KCPL witness Dana Crawford, 2004 costs should be escalated to like-year dollars to match the test year and take into account the impacts of market inflation/escalation to indicate all figures in "test-year dollars," (i.e., 2005 dollars). (Ex. 17, pp.2-3) In contrast, KCPL's approach applied historic cost escalations based on the Handy-Whitman Index, which is a nation-wide database, recognized throughout the United States as an industry standard for documenting changes in historic costs. According to the Handy-Whitman Index, price increases for bulk materials, labor and other costs associated with maintenance of industrial equipment have increased between 2004 and 2005. For non-labor O & M, these increases have been 5.08 percent. (Id.)

Because KCPL sees this trend continuing with no apparent reduction in demand over the foreseeable future, KCPL requests that the Commission view historic costs on the basis of today's costs. Using Mr. Harris' two-year average for steam production adjusted to 2005 dollars, this results in a positive adjustment of $626,656 above Staff's recommended level for production maintenance expenses. (Id. at 3). KCPL would respectfully request that this modest increase in production maintenance expenses be approved in this case.

Distribution Expenses

Mr. Harris recommends a reduction of $1,877,784 in distribution maintenance expenses from the test year level of $21,629,071, based upon the use of a six-year average of actual maintenance expenses for the years 2000 through 2005.

For the same reasons that his analysis of production expenses is flawed, the Commission should reject his adjustment on distribution expenses below the 2005 test year level. As explained in the Rebuttal Testimony of John R. Marshall, Mr. Harris' analysis does not take into account the time value of money, and the escalation in maintenance for distribution equipment that has occurred. Mr. Marshall recommends that the normalized adjustment should be calculated by utilizing the Handy-Whitman index to the test year dollars. This results in an increased normalized adjustment above Mr. Harris' calculation of $1,150,331 for distribution maintenance expense. (Ex. 19, pp.2-3).

In addition, KCPL will be absorbing an additional operations and maintenance impact ("O & M") of approximately $2 million a year resulting from the Asset Management Inventory and System Assessment Project discussed by Mr. Marshall. A reduction in the distribution maintenance expenses could make it more difficult for KCPL to implement the Inventory and System Assessment Project, as well as the other projects associated with the Asset Management Plan. (Id.).

For these reasons, KCPL respectfully requests that the Commission decline to accept Mr. Harris' normalization of maintenance expenses for distribution expenses, and instead adopt the recommendations of KCPL witness Marshall related to the level of distribution maintenance expenses to be included in rates in this case.

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

20. <u>Property Taxes</u>

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

Yes. Property taxes should 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.

In the Stipulation And Agreement approved in Case No. EO-2005-0329, p.30, the Signatory Parties agreed to the following provision related to the true-up in this case:

> **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. <u>On or about October 21, 2006, KCPL will file in a true-up</u>

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. (emphasis added)

Although property taxes were clearly on the list of items that the parties, including KCPL, Staff, and Public Counsel, agreed would be trued-up in the true-up proceeding in this 2006 rate case, Staff has apparently decided that it will not update its case for the most recent known and measurable information related to property taxes. (Tr. 423).:

[Fischer]: Q. And as I understand the testimony earlier, the Staff does not intend to true-up property taxes?

[Williams]: A. No, sir. We haven't trued up property taxes as a Staff probably since the early 1990s.

Instead, the Staff has adopted an ad hoc approach which results in fewer property tax dollars being included in revenue requirement than KCPL is expected to pay in the first year the new rates are in effect.

Staff witness Phil Williams sponsored an adjustment which increases the actual test year property taxes expensed of $54,284,956 by $1,684,275[7] to annualize the property tax amount based upon December 2005 plant balances. (Ex. 139, pp.48-49; Accounting Schedule 10-24, Adjustment S-81). According to Mr. Williams, Staff examined the actual amounts of property tax payments made by KCPL for the years 2001-2005. Mr. Williams developed "a relationship"

[7] On October 12, 2006, Staff filed a Motion For Leave To File Supplemental Surrebuttal Testimony of Staff Witness Phil Williams. In the attachment to the motion, there was a revised Schedule 1-1 which lowered the Staff's proposed adjustment to the test year levels to $1,480,759. (Tr. 422) It is unclear to KCPL from the transcripts whether the Supplemental Surrebuttal Testimony was offered by Staff or otherwise included in the record of this case. (Tr. 417-23)

of actual property tax payments to the level of property at January 2 for each of those years. The "relationship" was then applied to the plant in service balance at the end of the test year, December 31, 2005, to calculate an annualized property tax amount in this case. (Ex. 139, pp.48) (Tr. 419). However, Mr. Williams made no attempt to include the most recent tax levies and property tax assessments in his calculation, even though these values are known and measurable at the end of the test year because utilizing Staff's method apparently the result would be the same. (Tr. 419).

As explained in the Rebuttal Testimony of KCPL witness Shannon Green, Jr., KCPL appreciates Staff's efforts to adjust test year 2005 property tax expense to an annualized level. However, Staff's adjustment does not reasonably reflect the increased property tax expense that KCPL will incur in 2006 and thereafter. (Ex. 20, pp.2-7). In particular, Staff's adjustment does not reflect known and measurable changes to the property taxes that will be paid by KCPL in 2006, nor does it reflect the additional property taxes due to the applicable plant additions during 2006. (Id.)

Staff's adjustment does not fully reflect the following known and measurable changes:

> 1. KCPL's property assessments in 2006 have increased. An adjustment is needed to reflect the increased property assessments by county;
>
> 2. The tax levy rates in 2006 are increasing. An adjustment is needed to reflect the 2006 increases in the actual 2005 tax levy rates[8];
>
> 3. Payments In Lieu of Property Taxes (PILOTs) will be paid on the Wind Generation Facility. An adjustment is needed to reflect the PILOTs on the Wind Generation Facility.

[8] For example, on August 14, 2006, the Board of Education of USD #244 approved a 2.5 mill levy increase for 2006, raising KCPL's 2006 projected property taxes by $500,316. Other tax levy increases will be known by the true-up proceeding, and are expected to be approximately $660,293 based upon a three-year historical trending factor of levy rate increases for total KCPL property of 1.18%. (Ex. 20, pp.5).

KCPL respectfully requests the Commission to allow recovery of known and measurable increases in its property tax expense amounting to $4,689,563. This annualized adjustment to KCPL's 2005 test year property tax expense exceeds Staff's recommended original adjustment of $1,684,275 by $3,005,288.

The following adjustments should be included in the Company's revenue requirement in this proceeding:

				Adjustments
1)	Use of Actual 2006 Assessed Property Values			$1,890,810
2)	Use of Increased 2006 Tax Levies			1,159,227
3)	Annualized property taxes on 2006 Plant Additions			
	a)	Estimated plant additions (January 1 to September 30, 2006, excluding wind generation facility)	$1,309,526	
	b)	Payments In Lieu of Property Taxes	330,000	
				1,639,526
	Known and Measurable Increases in Property Taxes			$ 4,689,563
	Minus Staff Annualization Adjustment			$1,684,275
	Requested Adjustment to Staff case			$3,005,288

In his Surrebuttal Testimony, Staff witness Phillip K. Williams argues that such changes are not "known and measurable" since tax levy rates may decrease at the same time that property assessed values increase. (Ex. 140, pp.26-27). He suggests that: "Staff has seen in the past when reviewing historical property tax data at other utilities that many times when the assessed values are increased the corresponding tax levy rates are adjusted downward to keep the property tax levels revenue neutral." (Id.) He also argues that the Commission should ignore the known and measurable changes in the property taxes, and PILOTs on the wind generation facility since "KCPL's proposed level of property tax expense violates the test year and the true-up period in this case." (Id. at 31).

Apparently, Staff would have the Commission ignore known and measurable changes in property assessments and tax levies in the hope that tax authorities will lower tax levies in the future "to keep the property tax levels revenue neutral." (Id. at 25). The Commission should reject this approach. KCPL respectfully requests that the Commission incorporate into the revenue requirement in this proceeding the known and measurable changes in property assessments and tax levies, based upon the information known at this time, as updated in the true-up proceeding.

Secondly, KCPL would disagree with Staff that KCPL's proposed adjustments should exclude the PILOTs on the wind generation facility that has been recently completed. The true-up proceeding will incorporate the addition of the wind generation facility into KCPL's revenue requirement. It would be unreasonable to incorporate the plant in service related to the wind generation facility, but refuse to recognize the PILOTs on that same investment.

In summary, KCPL respectfully requests that the Commission adopt its proposed adjustments to Staff's property tax annualization and thereby reflect the known and measurable 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. KCPL will update its property tax adjustment during the true-up proceeding to file the most recent information available, including tax levies, property assessed values, and the PILOTs on wind generation facilities. KCPL's proposed method is consistent with the provisions of the Stipulation And Agreement in Case No. EO-2005-0329 which requires a true-up of property taxes in this case.

The use of the most recent information available is a preferred method of dealing with the known and measurable changes related to property taxes rather than the Staff's ad hoc approach of developing a "relationship" between past property taxes paid and property values at the end of the test year. KCPL respectfully requests that the Commission adopt its more straight forward adjustment, as updated for known and measurable changes, in the true-up proceeding.

21. Decommissioning Expense

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

KCPL, Staff, and other parties expect to file a Non-Unanimous Stipulation And Agreement regarding KCPL's decommissioning expense, which fully resolves this issue. The parties have agreed to reduce the expense as suggested by KCPL witness Don A. Frerking, who explained that the Commission should reduce the expense to reflect the longer expected life of the Wolf Creek Nuclear Generating Station ("Wolf Creek"). (Ex. 9, pp.25-31). Specifically, Mr. Frerking recommended that the annual funding level for the Missouri jurisdictional component to KCPL's trust fund for the decommissioning of Wolf Creek be set at $1,281,264. (Id., p.25). No party presented evidence questioning KCPL's decommissioning cost estimate of $517,601,292 (in 2005 dollars); nor did any party present evidence questioning KCPL's cost escalation rate of 4.40 percent. The sole issue is whether Wolf Creek will have a 40-year life or a 60-year life.

The Wolf Creek Nuclear Operating Corporation submitted an application to the U.S. Nuclear Regulatory Commission ("NRC") on October 4, 2006, requesting that the NRC grant a 20-year extension to the license to operate the Wolf Creek Generating Station. The current annual accruals are based upon the plant's existing 40-year operating license. If the NRC grants the requested license extension the assumed plant life will increase to 60 years. The parties to the Stipulation and Agreement in Case No. EO-2005-0329 agreed to use a 60-year life for Wolf

Creek for depreciation purposes, and Staff assumed in its depreciation analysis that Wolf Creek has a 60-year life. (Ex. 131, p.9). The annual accrual should reflect the longer expected life of Wolf Creek.

22. True-up

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

The parties to this proceeding have filed their Direct and Rebuttal Testimony in the true-up proceeding. KCPL believes it is unnecessary for the Commission to address what elements of cost of service and rate base should be updated at this issue at this time. Any issues between the parties will be dealt with in the true-up proceeding which is scheduled to commence on November 16, 2006.

23. Weather Normalization/Customer Growth

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

In its case, KCPL adjusts the revenue received from several customer classes to a weather normalized level. Staff performs the same adjustment, only not for the Large Power (LP) class. Staff witness Lange believes that the LP class is not significantly weather sensitive and therefore Staff makes only an annualization adjustment to the LP class on a customer-by-customer basis. (Ex. 121, p.2)

The weather sensitivity of the LP class is demonstrated in the rebuttal testimony of KCPL witness Dr. George McCollister. The LP class consists of both industrial and commercial customers. The commercial customers include hospitals, college campuses, hotels, casinos, shopping malls and office buildings. (Ex. 29, p.2). These kind of customers have substantial air conditioning loads that vary with outdoor temperature. (Id.) The average daily load of LP customers is very weather sensitive. Typical weekday loads are approximately 250 MWs up to about 55 degrees and then rise steadily with temperature, reaching about 300 MWs at 80 degrees. (Ex. 29, p.2). KCPL witness McCollister verified the weather sensitivity of the LP customers using statistical regression analysis. This analysis showed a statistically significant relationship between the temperature and the LP customer load. (Ex. 29, p.3).

Staff recognizes that there is a small increase in usage in the summer for the LP class but believes that this increase is due to the season, not day-to-day weather fluctuations.(Ex. 121, p.4.) When responding to Commissioner Murray's questions, Staff witness Lange indicated that seasonal sensitivity are things such as market conditions, industrial cycles and electric motors running more efficiently in the colder months. (Tr. 490). But nowhere in his testimony does witness Lange explain the effect of market conditions or industrial cycles on the LP classes usage of electricity, except to say that seasonal sensitivities correspond to the industry of which each customer is a part. (Ex. 121, p.3). Moreover, witness Lange could not explain at the hearing the impact of motors running more efficiently in cooler weather would have on the variation in LP usage. (Tr. 490-491).

KCPL submits that the Commission need not try to understand Staff's "seasonal sensitivity" theory or evaluate the impact of the efficiency of electric motors on LP class usage levels during the winter. All that is needed is to recognize the commonsense notion (supported by the Staff and KCPL testimony) that LP customers' (such as hospitals, schools, hotels and office buildings) loads will increase with temperature. Once it does this, the Commission must recognize the superiority of KCPL's weather normalization position.

24. <u>Jurisdictional Allocations</u>

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

KCPL witness Don A. Frerking explained why it is appropriate to allocate KCPL's generation and transmission costs among its Missouri, Kansas and FERC jurisdictions on a 12-month average coincident-peak demand allocation ("12 CP") basis. (Ex. 10, pp.6-8; Ex. 11, pp.2-7). Specifically, Mr. Frerking explained that

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

No party presented evidence refuting the operating realities of KCPL's system as described by Mr. Frerking. Praxiar witness Maurice Brubaker simply observes that KCPL appears to have summer peaks that would support the use of the 4 CP Demand allocation methodology. (Ex. 603, pp.3-4). Staff witness Erin L. Maloney relies upon an analysis described by FERC in Carolina Power & Light Co., 4 FERC ¶ 61,107 (1978) ("Carolina Power"), but only applies the arithmetical portion of that analysis, which appears to support use of the 4 CP Demand allocation methodology, while ignoring the portion of the analysis that pertains to thee operating realities of KCPL's system, which supports the use of the 12 CP Demand allocation methodology. (Ex. 122, pp.7-8).

Ms. Maloney acknowledged that she applied the same FERC analysis in KCPL's case as she did in Empire's pending rate case in Docket No. ER-2006-0315. (Tr. 603). In her testimony in the Empire rate case, Ms. Maloney summarizes the FERC analysis as follows:

> Q: Are there any other factors [in addition to the three arithmetical calculations] to consider in determining the appropriate allocation methodology?
>
> A: Yes. These FERC tests are part of a larger set of factors historically utilized by the FERC in its determination of which coincident peak methodology should be used in electric utility cases. In [Carolina Power], for example, the

> FERC states: "…it is necessary to consider the full range of the company's operating realities including, in addition to system demand, scheduled maintenance, unscheduled outages, diversity, reserve requirements, and off-system sales commitments. In the adoption of the 12 CP methodology, FERC has cited these operating realities, all of which affect a utility's effective capacity, as important to its determination.
>
> (Ex. 10, Schedule DAF-7, p.9).

In concluding in this case that a 4 CP methodology is appropriate for KCPL, Ms. Maloney only references the "arithmetical calculations" of the FERC analysis. (Ex. 122, p.7-8). She ignores KCPL's "operating realities," yet, she acknowledges that "in addition to the quantitative tests, the three [she] performed, it's also necessary to look at the list of operating realities." (Tr. 604). She further acknowledged that nothing in the analysis indicated the one should disregard the utility's operating realities if the arithmetical calculations turned out a particular way. (Tr. 605). KCPL experiences the same operating realities (as quoted above from Mr. Frerking's testimony) as those experienced by Empire, which Ms. Maloney cited in support of adopting a 12 CP allocation methodology for Empire. (Tr. 605-606). The Commission should consider the operating realities of KCPL's system when determining what demand allocation methodology is most appropriate.

KCPL's uncontested operating realties support the use of the 12 CP Demand allocation methodology. KCPL's capacity planning process takes into account all the hours of the year, not just the peak hour or any seasonal peaks. In addition, KCPL utilizes periods of the year, typically in the spring and fall, with lower retail and FERC jurisdictional wholesale peak loads to perform necessary maintenance on its generating facilities and to pursue off-system sales while still maintaining adequate reserve margins. All of these operating and capacity planning realities indicate that the 12 CP methodology is more appropriate than simply relying on the summer month peaks. (Ex. 11, pp.3-4; Ex. 10, pp.5-7).

Both of KCPL's other jurisdictions, *i.e.*, Kansas and the Federal Energy Regulatory Commission, use the 12 CP demand allocation methodology for KCPL. (Ex. 10, p.8). As explained by Mr. Frerking, "if consistent allocation methodologies are not utilized in the Company's various jurisdictions, the result will be over- or under-recovery of the Company's prudently incurred costs." (Id.)

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

As explained by KCPL witness Don A. Frerking, KCPL recommends allocating A&G costs among jurisdictions using a number of methods depending on the cause of the costs. (Ex. 9, p.10). Specifically, KCPL recommends allocating salaries, employee benefit, and injuries and damages expenses based on the ratio of the allocated sum of the labor portion of the production, transmission, distribution, customer, and sales expenses described previously. KCPL recommends directly assigning the regulatory expenses to the jurisdiction of their origin. KCPL recommends allocating property insurance expenses based on the allocation of total plant. KCPL recommends allocating general plant maintenance and fleet expenses based on the allocation of the plant with which they are associated. KCPL recommends allocating general advertising expenses using the Customer allocator. Lastly, KCPL recommends allocating the remainder of the A&G expenses using the Energy allocator.

25. Depreciation

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

The Commission should reject Staff's proposal to decrease KCPL's depreciation expense. As explained by KCPL witness Don A. Frerking, Appendix G of the Regulatory Plan Stipulation and Agreement in Case No. EO-2005-3029, which was executed and approved by the Commission just last year, provided the depreciation rates that KCPL believed were to be used in this rate case. (Ex. 10, p.15). KCPL chose not to submit a depreciation study in this case based upon this belief. (Id.)

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. (Id., pp.16-18). Staff also presumes that certain generation-related assets have an indefinite life, which is factually inaccurate and skews the results of Staff's study. Staff also made errors in its retirement curve matching. (Id., pp.18-19). Moreover, Staff's calculation of net salvage rates is also mathematically and analytically incorrect. (Id., pp.19-20).

Staff's depreciation study is too significantly flawed to be relied upon as the basis for setting a reasonable level of depreciation expense. KCPL supports using the depreciation rates negotiated and agreed to by the parties to the Regulatory Plan Stipulation and Agreement and approved by this Commission last year. In the event that Commission decides not to use the depreciation rates contained in Appendix G of the Regulatory Plan Stipulation and Agreement, it should use KCPL's most recent depreciation study, which it submitted on March 31, 2005. KCPL's study does not contain the flaws in Staff's study and it was conducted recently enough in time to be relevant to this case.

Changing KCPL's depreciation rates would be unlikely to change the rates the Commission establishes in this case. The credit ratio amortization mechanism established in the Regulatory Plan Stipulation and Agreement provides for additional amortization expense, if necessary, to provide cash to maintain adequate credit metrics during the term of the Regulatory Plan. As Mr. Frerking explained, "from 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). The Regulatory Plan Stipulation and Agreement contemplates that the accumulated amortization can be re-directed to specific plant accounts to be determined at a later time. It would be more appropriate to defer any revision to depreciation rates until the conclusion of the Regulatory Plan when the total accumulated amortization related to the Regulatory Plan is known.

The Commission should disregard Staff's depreciation study as flawed and refrain from revising the depreciation rates of KCPL's assets until the conclusion of the Regulatory Plan. If the Commission decides to revise KCPL's depreciation rates, the Commission should use the results of the depreciation study KCPL submitted to the Commission on March 31, 2005.

C. Class Cost-of-Service and Rate Design

1. Class Cost-of-Service

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

See discussion below.

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

See discussion below.

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

See discussion below.

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

See discussion below.

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

See discussion below.

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

See discussion below.

2. <u>Rate Design</u>

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

See discussion below.

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

See discussion below.

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

See discussion below.

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

See discussion below.

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

See discussion below.

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

On November 9, 2006, a Stipulation And Agreement Regarding Class Cost-Of-Service And Rate Design Issues ("Rate Design Stipulation") was filed by the parties to this proceeding which contained a comprehensive settlement of the class cost of service and rate design issues. The following parties have either signed the Stipulation And Agreement or otherwise have expressed no objection to the provisions of the proposed settlement within seven days of the filing of the settlement agreement:

Commission Staff
The Office of the Public Counsel
Praxair
The United States Department of Energy (which also represents the Federal Executive Agencies that take electric service from KCPL)
Wal-Mart Stores East, LP
Ford Motor Company
Missouri Industrial Energy Consumers
The City of Kansas City, Missouri
Jackson County, Missouri
W. Bill Dias
Kansas City Power & Light Company
The Empire District Electric Company
Aquila, Inc.
Missouri Gas Energy

Under the proposed settlement, the Signatories have agreed to overall company rate revenue neutral interclass changes in class revenue responsibilities that have the effect of increasing current residential customer class rates by about 2.00%; decreasing current small, medium and large general service class rates by about 0.45%; decreasing current large power service class rates by about 2.54% and making no change to current lighting class rates as more particularly described in attached Appendix A of the Unanimous Stipulation And Agreement.

The Signatories agreed to the provisions of Appendix A, all of which are designed to implement overall company revenue neutral changes in class revenue responsibilities. In particular, the Signatories have agreed that the class rate revenue responsibilities to be used as the base for implementing any overall increase in revenues the Commission orders in this case are the dollar amounts shown in the table between items (4) and (5) on the line labeled "Post-Shifted Class Rate Revenues" contained in Appendix A to the Rate Design Stipulation.

The Signatories further agreed that new rates should be developed based on the "Post-Shifted Class Rate Revenues," and then each rate element of those rates will be factored up by multiplying them by the sum of one plus the result of dividing any overall increase in company revenue requirement the Commission orders in this case by total KCPL Missouri revenue at present rates as trued-up to generate final rates from this case.

KCPL respectfully requests that the Commission adopt in total the provisions of the Rate Design Stipulation as a fair and reasonable resolution of the hotly contested class cost of service and rate design issues in this proceeding. With such a diverse group of customer representatives, including Staff and Public Counsel, in agreement, it is appropriate for the Commission to adopt their proposed settlement and find that the rates resulting from the implementation of the provisions of the Rate Design Stipulation are just and reasonable.

3. Availability of General Service Space-Heating Rate Discounts

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

KCPL and the other Signatory Parties to the Rate Design Stipulation are proposing to increase the general service space hearing and all-electric winter energy rate by 5 percentage points more than each class' general application rates. (Ex. 21, pp.4-5; Rate Design Stipulation, Appendix A, paragraph 12).[9]

KCPL is also proposing to expand the qualifications provision to establish electric heating as the primary heating sources, rather than the requirement that the customer qualification is all-electric. KCPL is proposing this change to tailor its tariffs to meet customer needs. For example, KCPL's current tariff requires a customer to be all-electric in order to

[9] Trigen-Kansas City Energy Corporation ("Trigen") has also stated that "KCPL's proposal to increase the all-electric winter energy rate an additional 5% may be a step in the right direction. . ." (Trigen Prehearing Brief at 8). However, Trigen has taken the position that the increase should be "significantly greater than 5%. (Id.)

qualify. This means that all of the customer's energy consuming equipment, including water heating and space heating, must be all electric. As explained by KCPL witness Tim Rush, this precludes customers that wish to install solar equipment or other supplemental heating energy sources from qualifying. It also precludes customer from having natural gas cooking, water heating or other minor energy sources. KCPL believes that expansion of the tariff will give customers more choice and a better means for equipment utilization. (Ex. 22, pp.4-5).

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

Yes. KCPL has service charges within each rate schedule that vary based on the size of the customer. KCPL recommends that those service charges be deleted where KCPL does not have customers or where the customer usage characteristics are such that they should be on another rate schedule. These latter two changes are essentially clean-up and simplification changes from the rate design case in 1996.

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

In this proceeding, Trigen-Kansas City Energy Corporation has proposed eliminating or otherwise restricting the KCPL general service all-electric rate schedules. (Ex. 701 and 702). For the reasons stated below, this proposal should be rejected.

As Staff counsel Nathan Williams pointed out during cross-examination, Trigen's interest in this issue is due to Trigen's <u>role as a competitor of KCPL</u>:

> [Williams]: Q. Let me ask it this way: Is Trigen's interest in the particular issues dealing with the availability of general service space-hearting rate discounts in this case due to Trigen's role as a competitor with KCPL?

[Herz]: A. I would – I would believe so. (Tr. 1036).

Trigen operates a district steam-heating system that primarily serves commercial and industrial customer in the Kansas City, Missouri downtown area. (Tr. 1039). As Mr. Joseph A. Herz candidly admitted during cross-examination, he is participating in this proceeding representing Trigen's interests and not as a representative of any of KCPL's customers in this proceeding. (Tr. 1039).

KCPL's general service rate design has been in place for many years with the approval of the Commission. KCPL participated in an extensive CCOS study and rate design case in 1996. At that time, rates were established based on the CCOS, and rate design changes were made that changed the overall price structure. The rates maintained the price differential between customers with electric heating that were in place prior to the rate design case. (Ex. 22, pp.4-5).

Unfortunately, Mr. Herz did not participate in that extensive rate design case. (Tr. 1045). He also testified that he had not read the testimony of any of the parties in that case. (Tr. 1045-46). Unlike many of the other parties to this case, Mr. Herz did not conduct a cost of service study in this proceeding. (Tr. 1046) However, he in essence is trying to unwind all the work that was done in the last rate design case because he believes that a cost of service study of the type that he requested was not performed in the context of this case. (Ex. 22, p.5). Perhaps more importantly, Mr. Herz has not calculated the rate impact of his recommendations on KCPL's customers in the downtown area. (Tr. 1046).

It would be inappropriate and unreasonable to eliminate or otherwise restrict the existing KCPL general service all-electric rate schedules based upon the arguments of a competitor like Trigen-Kansas City Energy Corporation. A diverse number of customer representatives have carefully studied KCPL's cost of service studies and rate design proposals in this case, and have reached a Unanimous Stipulation And Agreement that resolves the cost of service and rate design issues. The Commission should adopt their recommendations in total, and not mandate a change in the proposed tariffs by accepting Trigen's recommendations in this case.

D. Customer Programs

1. Weatherization Program

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

As explained by KCPL witness Sue Nathan, at a meeting held September 20, 2006, the Customer Program Advisory Group ("CPAG"), which includes Mr. Jackson of the City of Kansas City, Missouri, discussed whether the weatherization program should be modified so that KCPL's Call Center will refer customers to the program. (Ex. 42, p.8-9).

At that time, the participants discussed the various ways KCPL could refer customers to this program. KCPL agreed to develop a list of its customers who receive third party assistance in paying their bills and who meet KCPL's usage and customer eligibility guidelines. KCPL agreed to inform those customers of the availability of the program. (Id.). KCPL's action fully addresses the parties' concerns regarding this issue. The Commission should not direct any further action by KCPL.

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

As explained by KCPL witness Sue Nathan, LIHEAP is administered through the Department of Social Services ("DSS"). Therefore, DSS is responsible for any changes in the current referral procedures. (Ex. 42, p.9). However, as further explained by Ms. Nathan during the evidentiary hearing in this case, KCPL "would be happy to cooperate and work with other people in the state to make this program referral and process be more efficient." (Tr. 1437). Notwithstanding the merits of modifying DSS's LIHEAP referral procedures as recommended by Mr. Jackson of the City of Kansas City, Missouri, doing so is beyond the scope of this rate case. Consequently, the Commission's should not direct any action by KCPL concerning the referral of LIHEAP recipients to the weatherization program.

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

The parties to the Regulatory Plan Stipulation and Agreement carefully negotiated and agreed to the energy efficiency, demand response and affordability programs that are set forth for consideration in that agreement. The members of the CPAG continue to consider and evaluate programs.

Although the details of what Mr. Dias intends for the Commission to require of KCPL as part of an "Energy Conservation Program" continues to be unclear, KCPL understands Mr. Dias to be requesting that the Commission compel KCPL to utilize a service he or his company is providing. (Ex. 42, pp.4-5). It become clear at the evidentiary hearing, however, that Mr. Dias is not seeking to have the costs of his proposed "Energy Conservation Program" included in KCPL's rates. Mr. Dias seeks to have KCPL's shareholders bear the cost of KCPL's participation in his proposed program. (Tr. 1535). As such, Mr. Dias's request for relief is beyond the scope of this rate case and is also beyond the scope of the Commission's jurisdictional authority. The Commission should not direct KCPL to participate in Mr. Dias's "Energy Conservation Program."

WHEREFORE, for the reasons stated herein, Kansas City Power & Light Company respectfully requests that the Commission order that adopts its recommendations in this case.

Respectfully submitted,

/s/ Karl Zobrist

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 17th day of November, 2006, to all counsel of record.

/s/ Karl Zobrist
Karl Zobrist