BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

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

STAFF'S POST-HEARING BRIEF

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

Introduction

Kansas City Power and Light Company (KCPL) filed its tariffs seeking a general rate increase on February 1, 2006. The tariffs, effective eleven months later on January 1, 2007, seek a revenue increase of $57 million (11.5%) ($42 million in its reconciled case, Tr. 9:940). In its Application, KCPL explains that this is only the first of a series of rate cases called for in the Stipulation and Agreement approved by the Commission in Case No. EO-2005-0329 (hereinafter the "Regulatory Plan").

The Commission's statutory task in this case is to set just and reasonable rates. §§ 393.130, 393.140, RSMo. A "just and reasonable" rate is one that is fair to both the utility and its customers, *St. ex rel. Valley Sewage Co. v. Public Service Comm'n,* 515 S.W.2d 845, 850 (Mo. App., K.C.D. 1974); it is no more

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than is sufficient to “keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested.” *St. ex rel. Washington University et al. v. Public Service Comm'n,* 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925). Staff respectfully reminds the Commission that “the dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental.” *St. ex rel. Crown Coach Co. v. Public Service Comm'n,* 238 Mo. App. 287, ___, 179 S.W.2d 123, 126 (1944).

Ratemaking is a two-step process. The first step is the determination of the “revenue requirement,” that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors. *St. ex rel. Capital City Water Co. v. Missouri Public Service Comm'n,* 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993). The second step is the development of an equitable rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers in a way that reflects the cost of serving each class of customer.

Revenue requirement is usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. *Capital City Water Co., supra.* The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where:	RR	=	Revenue requirement;
	C	=	Cost of service including depreciation expense and taxes;
	V	=	Gross value of utility plant in service;
	D	=	Accumulated depreciation; and
	R	=	Overall rate of return or weighted cost of capital.

Empire, supra, Report & Order at 36.

Staff's Post-Hearing Brief, like its Supplemental Prehearing Brief, follows the order of issues established for the hearing. Staff incorporates herein by reference its Supplemental Prehearing Brief, filed herein on October 13, 2006 (Item 272 on the EFIS Docket Sheet). Staff urges the Commission to resolve the many issues submitted to it for resolution in the case as recommended by Staff in order to achieve just and reasonable rates that will survive scrutiny on appeal.

Argument

A. Cost of Service:

Revenue requirement consists of two components; the first of these is Cost of Service. This rate case is unusual in that it includes a large number of accounting issues, that is, disagreements about just what expenses to include in KCPL's Cost of Service. In general, Staff notes that KCPL, faced with a difficult period of construction in the near future, has taken positions calculated to maximize its revenue flow. In some instances, KCPL has taken positions that are unprecedented, such as recommending that unamortized non-recurring expenses be included in rate base so that it will earn a return on them. Rather than be beguiled by these suggestions, Staff urges that the Commission consider that KCPL has enjoyed a position of over-earning for the last twenty years. This company deserves no sympathy; its construction risk is adequately and appropriately controlled by the mechanism of the Regulatory Plan Additional Amortizations.

1. Incentive Compensation:

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

Although Staff allowed 65% of the Incentive Compensation paid by KCPL in Cost of Service, KCPL wants it all (Tr. 5:173). Staff disallowed 35% of the bonuses paid by KCPL, about $3 million in Incentive Compensation awards (*Id.*). Staff only excluded awards that KCPL paid either for maximizing shareholder wealth or for reasons so vague that a ratepayer benefit could not be identified (Tr. 5:179).[1]

Staff allowed KCPL's bonuses insofar as they were demonstrably tied to the promotion of safe and adequate services (Tr. 5:173, 184). Staff's disallowances reflect prior Commission practice as is shown by the citations to prior Commission decisions set out in Staff's Supplemental Prehearing Brief. Based on its questions at hearing, KCPL evidently believes that the disallowed bonuses should nonetheless be absorbed by the ratepayers simply because KCPL is just such a darn good company:

> Q. (by Mr. Steiner):
>
> When you were looking at whether to approve KCPL's incentive plan in rates, did you look at factors such as KCPL's reliability as compared to other companies, their

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[1] Staff also made a disallowance to reflect the fact that KCPL had not charged any of its bonuses to Construction Work in Progress (Tr. 5:179).

level of customer service as compared to other companies?

Did you look at benchmarks with other companies?

(Tr. 5:169-170).

As Staff witness Harris explained in his pre-filed testimony and at the hearing, Incentive Compensation that is tied to wealth maximization can have an unintended but very real side effect of *reducing* customer service and maintenance (Tr. 5:173, 175; Harris Surrebuttal at 4). In such a case, it would be doubly inappropriate to require the ratepayers to fund the bonuses. Additionally, KCPL has *already* been rewarded for its operating efficiency by twenty years of overearnings:

Q. (by Mr. Thompson):

And to the extent that this company has earned revenues in excess of its authorized level, isn't that a reward for the very efficiencies that have resulted in that increased earning?

A. (by witness Harris):

Yes, it's been a very rich reward.

(Tr. 5:186).

Finally, it is noteworthy that KCPL paid bonuses to its employees for achieving GPE's financial goals, not KCPL's (Tr. 5:180-181). GPE's performance was driven by that of its unregulated asset, Strategic Energy (Tr. 5:180). As Staff witness Harris testified:

And one of Staff's driving positions in this case is that

> it's unfair to hold captive Missouri ratepayers to an EPS and to an incentive plan that's funded based solely on unregulated operations that have nothing to do with providing electric service to Missouri.
>
> (Tr. 5:181).

For these reasons, Staff urges the Commission to disallow 35% of KCPL's Incentive Compensation expense as recommended by Staff.

2. Pensions:

Settled.

3. Hawthorn 5:

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

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

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

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

At hearing KCPL Controller Lori Wright testified that KCPL does not manage its cash in a way that it would establish a separate fund for insurance proceeds, invest those funds on a short-term basis and borrow money to pay its other bills. Insurance proceeds go into a general corporate cash account just like other funds it receives and KCPL manages its total cash requirements on a total cash basis. She testified that if KCPL had been required to use the Hawthorn 5 insurance proceeds for the reconstruction of Hawthorn 5, while it had replacement power and other costs to pay, it is likely that KCPL would have had to sought a rate increase or consider financing. (Vol. 5, Tr. 195-200).

It would be best at this stage to recall the dates of other events that indicate that (i) just prior to the catastrophic explosion of the Hawthorn 5 boiler on February 17, 1999, KCPL was in an excess earnings/revenues situation and had entered into a nonunanimous Stipulation And Agreement to reduce rates, and (ii) prior to, at the time of and after the Hawthorn 5 boiler explosion KCPL and Western Resources, Inc. had a joint merger application pending before this Commission. On January 26, 1999, less than a month before the Hawthorn 5 boiler explosion, the Staff, Public Counsel and KCPL filed a nonunanimous Stipulation And Agreement in Case No. ER-99-313 and Case No. EM-97-515 providing for a 3.2% or $15 million reduction of KCPL's annual Missouri electric revenues exclusive of license, occupation, franchise, gross receipts or other similar fees and taxes. On April 13, 1999, the Commission issued an Order Denying Intervention And Approving Stipulation And Agreement. *Re Kansas City Power & Light Company*, 8 Mo.P.S.C.3d 113, Case No. ER-99-313, Order Denying Intervention And Approving Stipulation And Agreement (1999). On July 20, 1999, KCPL, Western Resources, Inc., the Staff, Public Counsel, and the Missouri Department of Natural Resources filed a nonunanimous Stipulation And Agreement that subject to the conditions and modifications set forth in the nonunanimous Stipulation And Agreement the merger of KCPL and Western Resources and the creation of Westar Energy, Inc. (Westar) is not detrimental to the public interest and the Commission should approve the same. *Re Western Resources, In. and Kansas City Power & Light Company*, 8 Mo.P.S.C.3d 306, Case No. EM-97-515, Order Approving Stipulation And Agreement (September 2, 1999). Of course, the KCPL-Western Resources merger was never consummated.

Ms. Wright asserted that the Uniform System of Accounts (USOA) definition of “property retired” required KCPL to retire Hawthorn 5 property and record the insurance proceeds to be recorded as salvage as a credit to Account 108. (Vol. 5, Tr. 196-97). Mr. Williams was asked to read into the record the definition from the Uniform System of Accounts (USOA) of “property retired,” which is defined therein as follows: “Property retired as applied to electric plant means property which has been removed, sold, abandoned, destroyed or which for any cause has been withdrawn from service.” (Vol. 5, Tr. 208). Mr. Williams noted that contrary to the FERC definition, Hawthorn 5 was not withdrawn from service, it was rebuilt, and it now produces in excess of 60 megawatts more than it did at the time of the explosion in 1999. (*Id*. at 209, 225).

4. Ice Storm Costs:

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

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

5. EEI Dues:

Settled.

6. Severance Costs:

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

Although KCPL proposes to include a normalized amount for severance costs in rates, Staff recommends that the Commission include no severance costs in KCPL's cost of service. KCPL has now removed the severance payments made to two Great Plains Energy (GPE) executive officers who left the Company in 2005 from its proposed rates (Tr. 5:237), but the company still seeks recovery of some "normalized" cost of service expense in this case. However, all the evidence in the case points to the fact that only KCPL’s shareholders, not its ratepayers, benefit from the severance payments. For example, KCPL seeks to recover the severance costs associated with a high-level corporate officer who was employed by KCPL for less than 36 months and for GPE’s former CEO’s $1.2 million severance payment (Tr. 5:238).

Severance costs that create a customer benefit, such as lower payroll costs, occur infrequently. Such costs are created primarily through major employee downsizings or corporate reorganizations resulting from a merger that created merger savings. Although KCPL may pay some level of severance costs each year, none of KCPL's severance payments during the relevant period provided any benefit to its customers through a reduction in costs. Quite the opposite -- KCPL's payment will actually cause a detriment to customers by increasing cost of service if the Commission allows recovery of these non-benefit severance payments.

Even KCPL has determined that its severance costs incurred in 2005 is not a normal cost of doing business, as it did not hold its management responsible for these expenses. Specifically, the company excluded these expenses from the earnings per share calculation that determines KCPL's management's incentive compensation payment (Tr. 5:239). By seeking recovery of its 2005 severance payments, KCPL is asking its customers to be responsible for these costs, even though it does not consider them in its EPS calculations. The Commission should reject KCPL's proposal.

7. Bad Debts:

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

Staff and KCPL reached an agreement on the treatment of Bad Debts for the normalized, annualized Test Year. KCPL wants to apply that agreed percentage to whatever revenue requirement the Commission grants in this rate case. Staff objects because, as Staff witness Kim Bolin testified, there is no demonstrable correlation between the level of retail sales and the percentage of bad debts (Tr. 5:262, 263):

> A. (by Staff witness Bolin):
>
> . . . The retail sales may increase from one year to the next, but the bad debt expense may decrease from one year to the next.

(Tr. 5:262).

A. (by Staff witness Bolin):

> . . . From the year 2001 to 2002, retail sales increased by 1.78 percent. In the same year, the net write-offs decreased by 36.55 percent from the previous year.

(Tr. 5:264 and Ex. 144).

For this reason, Staff prays that the Commission will treat Bad Debts as recommended by Staff.

8. Fuel & Purchased Power Expense

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

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

[DENNY FREY]

9. Surface Transportation Board Litigation:

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

This issue concerns litigation costs. Staff believes that KCPL's efforts to pursue this complaint case are in the best interests of KCPL's customers. Therefore, Staff believes the costs should be allowed. However, because these costs are not normal and recurring costs associated with providing utility service, they are subject to special treatment.

Staff recommends that all incremental costs related to the STB case incurred in 2005, and in 2006 through June, be treated as a regulatory asset and amortized to expense over five years beginning in January 2007, the month when rates from this case will likely go into effect. Staff also recommends that all incremental, non-employee labor costs related to this litigation be deferred as a regulatory asset up to the month when the case is resolved. At that point, Staff believes it is appropriate for these costs to be amortized over five years. If the litigation results in a refund, the refund offset any existing balance of the regulatory asset, with the remainder used to offset fuel costs in future rate cases.

10. SO2 Premiums:

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

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

KCPL, Staff and OPC were all signatories to the Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329, but now disagree on the proper interpretation of one of its terms. The question is whether the entire paragraph pertaining to SO_2 premium treatment expires on December 31, 2006, or whether the annual limitation on the charges to the Missouri jurisdictional portion of Account 254 for SO_2 premiums remains capped at $400,000 after that date.

The dispute stems from the implications of the sentence, “But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually” in the Regulatory Plan Stipulation and

Agreement. Staff and KCPL believe that all requirements set forth in the paragraph expire December 31, 2006; OPC argues that only the requirement to record lower sulfur coal premiums in Account 254 expires at that time and the limitation on charges to the Missouri jurisdictional portion of Account 254 in the subsequent sentence remain in effect after that date.

In its *Report and Order* approving the Stipulation and Agreement, the Commission stated “[t]he Stipulation is a contract among the Signatory Parties, who will be obligated to carry out its terms if approved by the Commission,” citing to the Stipulation and Agreement itself at Section III.B.10.f at 53. *Report and Order* at 34. The cardinal rule in the interpretation of a contract is to ascertain the intention of the parties from the contract itself and to give effect to that intention. When the language of a contract is plain, there can be no construction because there is nothing to construe. *J.E. Hathman, Inc. v. Sigma Alpha Epsilon Club,* 491 S.W.2d 261 (Mo. banc 1973). The Commission "cannot 'enforce, construe nor annul' contracts, nor can it enter a money judgment." *Wilshire Constr. Co. v. Union Elec. Co.*, 463 S.W.2d 903, 905 (Mo.1971) (quoting *May Dep't Stores Co. v. Union Elec. Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 49 (Mo.1937)). The Regulatory Plan Stipulation and Agreement is not the type of contract referred to by these courts, however; rather, it is effectively incorporated into a Commission Report and Order. Although the Stipulation and Agreement was entered into and approved in settlement of a prior Commission case, Missouri courts have held that the Commission has the authority to use its discretion in new matters. The Commission’s “supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of an utility are always subject to change to meet changing conditions, as the commission, in its discretion, may deem to be in the public interest." *State ex rel Jackson County v. Pub. Serv. Comm'n,* 532 S.W.2d 20, 29-30 (Mo. banc 1975).

From Staff's perspective, the primary clause in the paragraph contains the expiration date for the entire paragraph – January 1, 2007.[2] In construing a contract, the words used are given their ordinary and common sense meaning and will not be construed to include meanings to which they would not be applied by most people. *Rhoden Investment Co., Inc. v. Sears, Roebuck & Co.*, 499 S.W.2d 375 (Mo. 1973); *Willman v. Beheler*, 499 S.W.2d 770 (Mo. 1973). In this case, the question is whether the word at the beginning of the next sentence ("but") is tantamount to "however," or whether it should be construed as the equivalent of "and" and thus be subordinate to the prior sentence. Staff believes the subsequent sentence is a continuation of the previous sentence's concepts and is thus subject to expiration and that the word "but" serves as a transition. In contrast, OPC suggests that the sentence creates a separate, ongoing limitation of $400,000 in the charges that can be booked to Account 254. To reach this interpretation, it may have been more reasonable and clear to have the sentence start with "In" rather than "But", eliminating the transition that implies the expiration date applies to the entire paragraph.

[2] That sentence 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 proportionate cost of such premiums in Account 254."

In light of the ambiguity in the paragraph in question, the Commission explored the intentions of the signatory parties in the present case as well. The Commission heard testimony regarding the parties' intentions, not unlike a court that has resorted to extrinsic evidence to determine intent when a contract's terms are ambiguous. A contract provision is ambiguous when its terms are susceptible to more than one meaning, so that reasonable persons may fairly and honestly differ in their construction of the terms. *Missouri Rental and Leasing, Inc. v. Walker*, 14 S.W.3d 638, 640 (Mo. App., E.D. 2000). The test is whether the disputed language, in the context of the entire agreement, is reasonably susceptible of more than one construction, giving the words their plain meaning as understood by a reasonably average person. *Speedie Food Mart, Inc. v. Taylor*, 809 S.W.2d 126, 129 (Mo. App., E.D. 1991). Witnesses on behalf of Staff and KCPL appeared and provided testimony regarding the intentions underlying their agreement. Testifying on behalf of KCPL, William Edward Blunk stated, "Staff and Company both view that the Stipulation & Agreement provision on this will end December 31, 2006, and there is no provision for 2007." (Tr. 6:376) The Company agrees with Staff that it is appropriate to record all the Company's coal sulfur premiums in Account 254, regulatory liability. (Tr. 377)

Mr. Blunk testified that:

> It's my understanding that this expires [December 31, 2006], because a few lines above that it says, to the extent that KCPL pays premiums for lower sulfur coal up until January 1, 2007, it will then do all that charging the 400,000 to 254. So we read that as up until January 1, 2007, we can charge $400,000 a year, but as of midnight December 31st, 2006, we can no longer charge under the

> provisions in the Stipulation & Agreement for coal sulfur premiums. (Tr. 6:378-79).

When asked what the phrase “but in no event” meant to him, Mr. Blunk replied that “[i]t means that as long as it is applicable, then it can't happen. But I also read that that is [sic] expired on January 1, 2007.” (Tr. 6:379)

On behalf of Staff, Mr. Hyneman testified when asked how he understood the phase “but in no event shall exceed $400,000 a year”:

> Now, my understanding in the context of this paragraph in the Stipulation, that in no event up through December 31st of 2006 will KCPL charge to its fuel -- or to its regulatory liability more than $400,000 on a Missouri jurisdictional basis. (Tr. 6:384).

Given this testimony and the reasonable construction of the sentences that the sentence beginning with the word “but” follows on the heels of the previous sentence and bears the same expiration, Staff recommends that the Commission reach the conclusion that all the SO_2–related provisions, and specifically the limitation of $400,000 to be charged to the Missouri jurisdictional portion of Account 254, expire at midnight on December 31, 2006.

11. Injuries and Damages:

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

This issue concerns the amount of expenses for injuries and damages that are included in KCPL’s test year cost of service. These are the costs of work-related injuries to persons and damages to property. The difference between Staff’s position and KCPL’s position amounts to $585,151.

KCPL wants to use a figure based on the accrual method of accounting; Staff wants to use a three-year average of actual cash payments (Tr. 6:298).[3] Staff's position is that the use of a figure drawn from KCPL's accrual methodology would overstate this expense item in KCPL's cost of service. Under the accrual system, when an incident is reported, an *estimate* of the value of the liability is booked (Tr. 6:290-291). An estimate, as KCPL's witness Lori Wright admitted, is nothing more than a guess (Tr. 6:291). Ms. Wright testified that, measured over a three-year period, KCPL's estimated and accrued liabilities *exceeded* the amounts actually paid out by 10% (Tr. 6:292-293, 304). Thus, the testimony offered by KCPL's own expert witness *confirms* Staff's position that this item would be overstated if based on an accrual methodology. Using Staff's figure, KCPL will collect in rates the amount that it can expect to actually pay out (Tr. 6:306). For this reason, Staff urges the Commission to resolve this issue as recommended by Staff.

12. Rate Case Expense:

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

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

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

This issue concerns the treatment of Rate Case Expense. The reasonable costs incurred by a utility in presenting a rate case are generally recoverable in rates. However, because rate cases do not occur every year, the

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[3] Generally-accepted accounting principles require the use of the accrual method for producing financial reports; ratemaking, however, is based on cash accounting. Tr. 6:303-304.

question then is how much of the expense should be included in rates on an annual basis?

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

13. Corporate Projects and Strategic Initiatives:

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

KCPL's position on corporate projects and strategic initiatives is nothing short of outrageous. Staff recommended that the test year expenses be deferred and expensed over five year, although the complete disallowance of these costs would have been justified (Tr. 6:322, 328). KCPL, in a display of *chutzpah* that defies rational explanation, wants the unamortized balance to be included in rate base so that it will earn a return on it as though it was a generating plant (Tr. 6:313-314). This Commission has simply never allowed such treatment of a cost of this nature (Tr. 6:323).

KCPL's original position was that the cost of these projects simply all be expensed in the test year (Tr. 6:316). However, as these costs are not recurring (Tr. 6:316, 322), that treatment would actually artificially and improperly inflate KCPL's earnings for future years, providing a windfall for shareholders at the expense of the ratepayers (Tr. 6:323). KCPL's original position constitutes another example of its greed.

Staff is willing to allow KCPL to recover these training expenses over a reasonable period of time because Staff *assumes* that KCPL would not incur such costs unless there was a potential of benefits to the ratepayers (Tr. 6:319-320, 322). However, the reality is that no benefit to ratepayers from these projects has ever been demonstrated. Perhaps Staff should change its position on this issue and recommend a complete disallowance.

14. Payroll, Including A&G Salaries:

Settled.

15. Other Benefits:

Settled.

16. Maintenance Expense:

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

The issue concerns the amount of non-payroll maintenance expenses to be included in cost of service for recovery in rates. KCPL believes that the test year expenses should be indexed with Handy-Whitman and forecasted forward (Tr. 6:412). Staff, on the other hand, proposes a six-year rolling average of normalized maintenance expenses. Staff opposes KCPL's contention that maintenance expenses should reflect "escalated dollars."

KCPL drew its escalation factors from the Handy-Whitman Index, which is commonly used in the construction industry (Tr. 6:413). However, the Handy-Whitman is primarily based on labor costs. KCPL's maintenance expenses do not include any labor costs. Therefore, the Commission should reject KCPL's position on this issue.

17. Property Taxes:

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

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

The use of estimations and projections improperly exposes ratepayers to paying more than is necessary to cover KCPL's cost of service.

18. Decommissioning Expense:

Settled.

19. True-up:

Staff will treat this issue in its Post-Hearing Reply Brief.

20. Regulatory Plan Additional Amortizations:

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

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

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

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

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

A. General:

A further indication of KCPL being in an excess earnings situation even while constructing Iatan 2 is not illogical or extreme by the Staff is the fact that the Signatory Parties to the KCPL Regulatory Plan Stipulation And Agreement built into the agreement a bar to a Signatory Party filing a rate decrease case, or rate increase case, that would effectuate a change in rates prior to January 1, 2007. Paragraphs III.B.1.b and III.B.2.a state as follow:

> **b. Current Rate Levels**
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> KCPL, Staff, Public Counsel and the other Signatory Parties have agreed that, based upon the agreements and commitments contained herein, KCPL's current rates should be maintained at current levels through December 31, 2006, as specified in Paragraph III.B.2 "Rate Moratorium" below.
>
> . . . .
>
> **RATE MORATORIUM**
>
> a. The Signatory Parties to this Agreement (excluding the Office of the Attorney General) agree not to request, or encourage or assist in any request for, (i) a general increase or decrease in KCPL's Missouri retail electric rates, or (ii) rate credits or rate refunds respecting KCPL's Missouri retail electric rates, that would become effective for service rendered prior to January 1, 2007.

(Ex. 143, pp. 7, 28). Mr. Traxler noted that in KCPL's 1985 rate increase case, which reflected in-service, rate base recognition of the Wolf Creek nuclear generating unit, the Staff determined that KCPL's cost of service, not reflecting in-service, rate base recognition of Wolf Creek, showed KCPL collecting excess earnings/revenues from its Missouri retail ratepayers. The excess cost of service / excess revenue requirement portion of the Staff's case was overwhelmed by the size of the rate increase resulting from rate base recognition of Wolf Creek with construction having been completed and the unit having attained in-service (fully operational and used for service) status. (Ex. 163, Traxler True-Up Direct, p. 7).

KCPL witness Michael W. Cline states that "KCP&L supports the additional amortization mechanism, but not as a -- a substitute for fair ratemaking." (Vol. 11, Tr. 1087). He continued on to state:

> . . . It's an augmentation to fair, reasonable, just rate setting as an accommodation, as a means, you know, to give us the opportunity to achieve our CreditMetrics and maintain our credit quality during the period of construction of this plan.

(*Id.* at 1087-88.). The Staff has never suggested anything to the contrary. The Staff believes the record shows that KCPL's principal response to the Staff's case both in general and in specific is rather than acknowledge that the Staff's positions are based on what the Staff believes are legitimate ratemaking principles, different from KCPL's, is to demonize the Staff's positions asserting that the Staff is seeking to use the additional amortizations provision of the KCPL Regulatory Plan Stipulation And Agreement as a way to provide KCPL the dollars necessary to meet its cost of service revenue requirement on the cheap.

The additional amortization in the Staff's case is a fallout to whatever the numbers generate based upon what the Staff contends are appropriate positions on each particular issue, including return on equity, independent of any

Regulatory Plan Additional Amortization calculation. The Staff in no instance is proposing (i) an adjustment, (ii) a level of recovery or (iii) no recovery based on the presence of in essence a "safety net" provided by the additional amortizations mechanism to provide a cheaper form of recovery, by an offset to ratebase, to give KCPL the opportunity to maintain its credit metrics at a level to preserve the investment grade rating of KCPL's debt. (Vol. 11, Tr. 1199-1200, 1193-94).

Mr. Traxler testified that it is the Staff's position that, under the KCPL Regulatory Plan Stipulation And Agreement, rate of return, depreciation, and each and every other issue in the case is to be decided on its own merits without any consideration for the provision of Regulatory Plan Additional Amortizations and only after the Commission has decided each and every issue in the case on its own particular merits should the provision for Regulatory Plan Additional Amortizations be applied. Mr. Traxler similarly testified that under the KCPL Regulatory Plan Stipulation And Agreement KCPL's rate of return and depreciation rates should not be increased in lieu of correctly applying the terms of the KCPL Regulatory Plan Stipulation And Agreement:

> [Mills]: And, in fact, doesn't the Regulatory Plan require that ROE depreciation -- all the other ratemaking questions being decided first, and then the amortization is determined after that?
>
> [Traxler]: Yes. The language is clear in that the expectation on the revenue requirement under traditional rate of return approach is to be done first without any consideration for Regulatory Plan amortization.
>
> [Mills]: And didn't KCPL sign that agreement?
>
> [Traxler]: Yes, they did.

> [Mills]: Didn't this exercise that you went through with Mr. Fischer on the easel and then the two exhibits that he provided and were admitted into the record [Ex. 51 and Ex. 52], doesn't that run counter to the way the agreement is set out in that they determine ROE sort of as a tradeoff for amortization, and depreciation as a tradeoff for amortization?
>
> [Traxler]: My characterization of the exercise I went through with Mr. Fischer was nothing more than the cash impact of different scenarios, not whether or not any of those changes are -- should be recommended. It's just, he asked me questions about what's the cash impact, assuming A or B, and that's the answer he received.
>
> [Mills]: So you wouldn't recommend that the Commission take into account that that sort of mathematical calculation, the tradeoffs that you illustrated, when they're trying to decide what the proper ROE is?
>
> [Traxler]: Well, I think that the fair rate of return should be done completely independent of the Regulatory Plan amortization. No additional ROE should be allowed simply to allow the company to avoid Regulatory Plan amortization.
>
> [Mills]: And the same with depreciation and other issues in the case?
>
> [Traxler]: I would agree, yes.

(Vol. 11, Tr. 1188-89, 1179).

For a while in this proceeding, KCPL's case was showing a traditional revenue requirement of approximately $52 million for KCPL and no Regulatory Plan Amortization, and the Staff's case was showing excessive earnings / revenues by KCPL of $34 million, a Regulatory Plan Amortization of $86, and thus a revenue requirement for KCPL of approximately $52 million. These numbers have changed, but while these numbers were the amounts being used by KCPL and the Staff respectively, the following colloquy occurred between Mr. Fischer and Mr. Traxler:

> [Fischer]: . . . So, in other words, if we're just considering the immediate rate increase to the customers that will come out of this case, then wouldn't it be correct to conclude that it doesn't matter whether the Commission accepts the company's ROE recommendation or the Staff's recommendation; the ultimate rate increase is still going to be almost $52 million?
>
> [Traxler]: Well, I wouldn't agree that it doesn't matter.
>
> [Fischer]: Okay.
>
> [Traxler]: I certainly disagree with that proposition.

(*Id.* at 1149). Regardless of how close in aggregate dollars the Staff's case and KCPL's case have been, it has always been true that it is highly significant whether the Commission accepts the Staff's derivation of KCPL's revenue requirement or KCPL's derivation of KCPL's revenue requirement.

Respecting KCPL Exhibit Nos. 51 and 52, even though the last line of each exhibit contains a line that states that the rate increase remains the same whether KCPL or the Staff wins the return on equity issue (Ex. No. 51) or the depreciation issue (Ex. No. 52), in all rate cases after year 1, rates will be higher for ratepayers if the regulatory plan additional amortization is eliminated by KCPL's higher return on equity and KCPL's higher depreciation rates. Mr. Traxler indicated that his disagreement relates in particular to the years after the initial year of additional amortizations when ratepayers would benefit from lower rates as a result of the reduction to rate base provided in the years subsequent to year 1 under the terms of the KCPL Regulatory Plan Stipulation And Agreement. (*Id.* at 1149, 1197; Ex. 136, Traxler Surrebuttal, pp. 15-22).

Mr. Traxler testified that the actual Regulatory Plan Additional Amortization number will not be known until the Commission makes a decision on each of the issues. Once that is done the actual Regulatory Plan Additional Amortization number can be calculated. That number is derivative of the Commissioners' decisions on all of the other issues. (Vol. 9, Tr. 858-59).

In these proceedings KCPL witnesses have sought to place on the Commission the sole responsibility for the business profile / credit rating of KCPL by S&P when the S&P ratings reports indicate that GPE's energy marketing and power supply coordination nonregulated subsidiary, Strategic Energy, plays a major factor in KCPL's business profile / credit rating. Strategic Energy serves approximately 8,900 commercial and industrial customers in nine (9) states. (Ex. 145, p. 2). Mr. Giles testified that in a conference call, on July 18, 2006 or thereabout, arranged by KCPL, Mr. Richard Cortright of S&P "did indicate that at some point in the past, the Strategic Energy business may have had an impact on that risk or that ranking." (Vol. 9, Tr. 762).

Just several days after KCPL filed the KCPL Regulatory Plan Stipulation And Agreement on March 28, 2005, S&P issued an April 1, 2005 Ratings Direct – Research Update that states in relevant part as follows:

> Standard & Poor's considers the proposed regulatory plan as providing an adequate framework for rate relief both during and after the construction period. . . .
>
> . . . .
>
> . . . The company has consistently demonstrated the strategic value of maintaining a well-performing fleet of coal plants, which has allowed it to offer below average retail rates and earn significant margins from sales into the wholesale power market. . . .

(Ex. 149, p. 1).

. . . .

> Strategic Energy, while still secondary to KCPL in importance, remains a significant component of Great Plains' credit profile. The outlook also assumes that Strategic Energy will continue to deliver steady returns and operating cash flow, while conservatively managing operating, credit, and market risks as it expands sales volumes to counter pressure on gross margins due to high gas and power prices and heavy competition with both incumbent utilities and retail energy marketers. Standard & Poor's expects Strategic Energy's market environment to remain challenging for the near future.
>
> Rate relief, timely equity offerings, and sound project execution at KCPL will be the primary drivers of Great Plains' consolidated financial performance and credit quality, assuming steady performance at Strategic Energy. . . .

(*Id.* at 2-3). This April 1, 2005 S&P Research Update, Exhibit 149 in this case, was attached as Schedule MWC-6 to the direct testimony of KCPL witness Michael W. Cline in Case No. EO-2005-0329.

Attached as Schedule MWC-1 to the direct testimony of KCPL witness Michael W. Cline in Case No. EO-2005-0329 was the S&P Ratings Direct – New Business Profile Scores Assigned for U.S. Utility and Power Companies: Financial Guidelines Revised. (Ex. 150). The June 2, 2004 S&P document identifies the key financial guidelines as funds from operations (FFO) interest coverage, FFO to total debt and total debt to total capital. Said document also states that these metrics are only guidelines and that S&P uses in its ratings process a wide array of financial ratios that do not have published guidelines:

> . . . It is important to emphasize that these metrics are only guidelines associated with expectations for various rating levels. Although credit ratio analysis is an important part of the ratings process, these statistics are by no means the only critical financial measures that Standard & Poor's uses in its analytical process. We also analyze a wide array of financial ratios that do not have published guidelines for each rating category.

(Ex. 150, p. 3). United States Department of Energy witness Dr. J. Randall Woolridge testified that this was his understanding and observation respecting the S&P rating process:

> [Dottheim]: Kansas City Power & Light is presently triple B rated by Standard and Poor's?
>
> [Woolridge]: Yes.
>
> [Dottheim]: And triple B rating is investment grade?
>
> [Woolridge]: Yes.
>
> [Dottheim]: Dr. Woolridge, is it a certainty that Standard and Poor's would downgrade Kansas City Power & Light if it did not meet the triple B metrics?
>
> [Woolridge]: No.
>
> [Dottheim]: Well, could you please explain that?
>
> [Woolridge]: I mean, companies on an ongoing basis don't meet the metrics for the ratings they achieve. And, in fact, if you read any of the S&P documentation or those of Moody's, they'll say these are not strict guidelines. These are simply metrics they look at. And they're very insistent to indicate that these are not the strict guidelines that some people think they are.
>
> I've been involved in several cases where commissions have set things based off of the S&P metrics. And the thing is, first of all, these metrics are broad ranges. Second of all, if you look at Moody's, their range -- their metrics tend to be much more lenient in terms of what their ranges they look at to achieve a certain bond rating.
>
> But they are not strict guidelines. And, I mean, that's kind of my observation from looking at these things over the years. But all you have to do is read the S&P documentation on their ratios and that's the first thing they tell you, they're not strict guidelines.

(Vol. 12, Tr. 1328-29).

The August 1, 2006 S&P Ratings Direct – Research Report on Kansas City Power & Light Co. states in relevant part as follows:

> **Major Rating Factors**
>
> . . . .
>
> Weaknesses:
>
> . . . .
>
> - The relatively much weaker business risk profile of Strategic Energy, Great Plains Energy's largest unregulated subsidiary, relative to KCPL.

(Ex.. 145, p. 2).

> . . . .
>
> **Rationale**
>
> . . . .
>
> The company's seasonal surplus capacity and relatively low production costs have enabled it to achieve strong levels of offsystem sales over the past several years, although surplus sales volumes are expected to decline as the company's load requirements grow. . . .
>
> Strategic Energy's business position, which is significantly weaker compared to KCPL, is characterized by the high degree of competition in the competitive supply industry, high supplier concentration, and moderate exposure to speculative-grader counterparties, although positions with these companies are adequately collateralized overall. Strategic Energy's cash flow and earnings declined in 2005 due to difficult market price conditions and heavy competition, but the retail marketer has adhered to conservative operating and risk management practices, including the innovative use of receivable lock boxes to reduce supplier collateral requirements.

(*Id.* at 3.).

> **Outlook**
>
> . . . .
>
> Exceptionally strong regulatory support, project execution, and debt reduction could lead to an improved outlook. In contrast, failure to obtain adequate rate relief or a fuel cost recovery mechanism by

> 2007 or rapid growth or poor risk management at Strategic Energy could have negative implications.

(*Id.* at 4.).

KCPL's effort to characterize the Regulatory Plan as having no benefit for KCPL's shareholders drew the direct inquiry of one of the Commissioners, causing KCPL's rate of return witness to modulate his portion of KCPL's orchestrated attack:

> [Hadaway]: . . . So I -- I'm not sure that I see a reduction at all in the risk to shareholders from that plan. Certainly it is a constructive plan, it is a good thing for trying to get this plant built as cheaply as possible for your constituents and the company's customers, but -- but it focuses mostly on fixed income securities.
>
> [Commissioner Clayton]: So it's your testimony that the result of the workshops associated with the regulatory plan that's been approved, the workshop, the case, the Stipulation and Agreement, the order approving that Stipulation and Agreement from this Commission did absolutely nothing to reduce the amount of risk that KCP&L faces in the marketplace?
>
> [Hadaway]: Well, Mr. Commissioner, please -- I didn't intend to say that at all.
>
> [Commissioner Clayton]: That's okay. I want to be clear, so feel free to elaborate.
>
> [Hadaway]: Certainly with respect to maintaining the company's bond ratings and its access to capital, the plan is an excellent and a hard piece of work that all the parties did together. The details of how all of it works are things that other people here know much, much more about than I do. But from my reading of the plan back in late 2005 when it was sent to me when we were preparing the initial Direct Testimony, there is not much in the plan that addresses the shareholders' position. Certainly if the bond rating of the company is maintained, it's better to have an investment-grade bond rating from the shareholders' perspective than it is a non-investment-grade bond rating. But you don't have additional amortizations that directly say that an ROE of this level or that level should be adjusted to account for those things, like you do the S&P metrics for the bonds.

(Vol. 12, Tr. 1306-07).

Mr. Traxler testified that there are benefits to shareholders, not just securities holders, from KCPL maintaining investment grade status for its debt:

> [Dottheim]: Mr. Traxler, are there -- you've been asked about the Regulatory Plan metrics and KCPL maintaining an investment-grade status. Are there benefits only to debt investors from KCPL maintaining its investment-grade credit rating through the Regulatory Plan additional amortizations?
>
> [Traxler]: No. There's a benefit to both shareholders and bondholders from maintaining an investment-grade credit rating.
>
> [Dottheim]: Could you explain that?
>
> [Traxler]: Well, number one, it's -- you know, it's just common sense that an investment rate -- grade credit rating is seen more favorable by equity investors than one that doesn't have an investment-grade credit rating. And secondly, because of the amortization, there are two CreditMetrics that are -- that are required for consideration under the Regulatory Plan amortization. One of those is the funds available from operations as a percentage of interest, interest coverage ratio. Any informed investor is going to find it favorable if the cash -- if that metric is higher than what's required for the bond indenture. . . .

(Vol. 11, Tr. 1197-98).

B. Off-Balance Sheet Obligations:

On this issue, KCPL and the Staff are aligned on the same side and Public Counsel is on the other side of the issue. Mr. Traxler explained in his direct testimony that he used a discount rate of 6.1% for KCPL’s off balance sheet obligations, which are operating leases and purchased power capacity contracts. He testified that he utilized a 6.1% discount rate to determine the present value of KCPL’s operating lease and purchased power capacity contracts rather than the 10% discount rate originally provided to him by KCPL due to information in an

August 1, 2006 S&P research report for Great Plains Energy, Inc. (GPE) (Ex. 134, Traxler Direct, p. 18). There are two versions of the S&P document to which Mr. Traxler referred. One version is Exhibit 146 and the other version is Exhibit 147. Both Exhibit 146 and Exhibit 147 state in part on page 4 of 6: "The present value of the company's operating leases is treated as a debt equivalent and determined using a 6.1% discount rate, which is Standard & Poor's estimate of the company's average cost of debt in 2005."

There is at least one sentence different between Exhibit 146 and 147, the two different versions of the August 1, 2006 S&P research report for GPE. Exhibit 146 states in part on page 4 of 6:

> . . . As of Jan. 1, 2006, Standard & Poor's had assigned a **risk factor of 30%** to KCPL's take-and-pay contracts, which translates into a debt equivalent of $24.7 million. Risk factors are subject to change, which could affect the level of debt imputation ascribed to purchased power obligations. [Emphasis added].

Exhibit 146 states in part on page 4 of 6:

> . . . As of Jan. 1, 2006, Standard & Poor's had assigned a **risk factor of 50%** to KCPL's take-and-pay contracts, which translates into a debt equivalent of $24.7 million. Risk factors are subject to change, which could affect the level of debt imputation ascribed to purchased power obligations. [Emphasis added].

Mr. Traxler related that he contacted S&P by e-mail on October 18, 2006 to verify the 30% risk factor number and received a response that the 30% risk factor in the original August 1, 2006 S&P research report was in error and he was sent a "corrected copy" of the August 1, 2006 S&P research report showing a 50% risk factor for KCPL off balance sheet obligations. (Ex. 147, p. 4). Mr. Traxler was also sent by S&P a copy of a May 8, 2003 S&P research report entitled "Buy

Versus Build" Debt Aspects Of Purchased Power Agreements, which indicates that a 50% risk factor is used by S&P when the purchased power capacity contracts are for three years or longer. For the true-up, Mr. Traxler changed the risk factor in the Staff's case for KCPL's purchased power capacity contracts from 30% to 50%. (Ex. 163, Traxler True-Up Direct, p. 15).

The following colloquy between Mr. Traxler and Mr. Mills indicates the bounds of the Staff's thinking, position and understanding to date in this area:

> [Mills]: Does the Regulatory Plan require us to use the same discount rate that Standard & Poor's uses?
>
> [Traxler]: I believe that the -- from the Staff's perspective, I think that the obligation to meet the CreditMetrics required by the rating agencies also includes an obligation to make those calculations consistent with the way the rating agencies make those calculations. So, the answer is yes.
>
> [Mills]: Do you think that's a requirement in the Regulatory Plan?
>
> [Traxler]: I believe -- I believe -- I believe it's an obligation. Once you accept the obligation of the parties to maintain cash flow based on those CreditMetrics, then it just follows, in our view, that the rating agencies are the ones who are calculating the CreditMetrics, so the calculation has to be consistent.
>
> [Mills]: If the rating agencies change the way they calculate those CreditMetrics, does the Regulatory Plan require us to follow along with those changes?
>
> [Traxler]: If I recall, I believe the language is such that, with regard to any change, that the parties will work together and attempt to reflect those changes. I think that's my recollection of what that language is in the Stipulation and Agreement.
>
> [Mills]: It doesn't, to use your word, obligate us to automatically follow those changes that the rating agencies make?
>
> [Traxler]: I don't think it does. If there's a significant change, no, I don't think it does.

> [Mills]: And your belief that we have an obligation to use the same discount rate for off-balance sheet obligations is based -- is that based on specific language in the agreement, or is it based on your view that the agreement, as a whole, requires us to try to follow their methods?
>
> [Traxler]: It's based on -- from our perspective, it's based on an obligation to make those calculations consistent with the way the rating agencies make those calculations. And I don't consider this to be, you know, a significant change in the way that the ratios are calculated.
>
> [Mills]: And if we were to look through the Regulatory Plan Stipulation and Agreement and search for how -- specifically how to calculate the discount rate for off-balance sheet obligations, we wouldn't find any specific language on that point, would we?
>
> [Traxler]: You are correct.
>
> [Mills]: And the same is true for the risk factor to be applied to those?
>
> [Traxler]: You are correct.

(Vol. 11, Tr. 1184-86).

The last sentence in the first paragraph on page 20 of the KCPL Regulatory Plan Stipulation And Agreement states as follows in Section III.B.1.i. Additional Amortizations To Maintain Financial Ratios: “If these ratio guidelines or ranges are changed or modified before June 1, 2010, the Signatory Parties will work together to determine the appropriate values for these ratios, including the use of the last published ranges for these ratios.”

21. Weather Normalization/Customer Growth:

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

This issue focuses on the question whether KCPL’s Large Power customer class is sufficiently weather sensitive to warrant weather normalization.

The Staff takes the position that it should not be weather normalized for a number of reasons, including:

a) The class is more influenced by seasonal fluctuations than by day-to-day weather such as are seen in other customer classes.

b) Although some customers within the class exhibit weather sensitivity, the overall effect within the class is small enough to be within the margin of error of the weather sensitivity modeling.

c) Weather normalization of customer usage would require weather normalization of class revenues, which would be very difficult, if not impossible to do correctly.

d) The customers in this class are annualized individually.

(Lange Surrebuttal, Ex. 121, p. 2, ln. 3-14).

Schedule 1 attached to Staff witness Shawn Lange's surrebuttal testimony demonstrates the lack of day-to-day weather sensitivity of the Large Power class relative to the Residential class, for example. If a class is not weather sensitive, its load versus temperature curve will be relatively flat. On the other hand, a weather sensitive class, such as Residential, will be deeply sloped in a V shape. The Large Power class loads increase somewhat with temperature in the summer; however, the Staff attributes that to sensitivity to seasonal changes in weather, as opposed to day-to-day fluctuations. (Lange Surrebuttal, Ex. 121, p. 3, ln.18 – p. 4, ln. 7). There should be no adjustment for seasonal sensitivities because, by definition, they *are* normal*; i.e.*, they occur every year. (Lange Surrebuttal, Ex. 121, p. 3, ln. 6-10*)*.

KCPL believes that the Large Power class ought to be weather normalized. The Company's witness, Dr. George M. McCollister, treated this class in the same manner as he treated KCPL's other customer classes, including a weather normalization step. He did not consider the variation in customer types and the large usages of the customers in this class. (McCollister Direct, Ex. 28). Using a data plot from the work papers supporting the direct testimony of Staff witness Shawn Lange, Dr. McCollister filed rebuttal testimony in which he claims, contrary to the Staff's position, that the Large Power class exhibits considerable weather sensitivity. (McCollister Rebuttal, Ex. 29, p. 2, ln. 1-12; Sched. GMM-4). Dr. McCollister further claims that his view is supported by a statistical regression analysis that produced a "t-statistic" for the temperature variable of 17.7, indicating significance. Dr. McCollister states that any t-statistic of greater than 2 is significant. (McCollister Rebuttal, Ex. 29, p. 3, ln. 1-4). In response, however, Mr. Lange was able to show significance (t-statistic of 2.095 [absolute value]) merely by incorporating 365 random values into KCPL's regression model. It is thus important to consider a number of statistical measures and a reasonableness check of the variables by an analyst when developing a model. (Lange Surrebuttal, Ex. 121, p. 4, ln. 21 – p. 5, ln 7).

This issue boils down to the fact that the Company and the Staff took two totally different approaches to test year adjustments of the Large Power class. KCPL treated the class as a mass of customers, just as it treated, for example, the Residential class. The method involves weather normalization of class usage followed by the application of a customer growth factor. (McCollister Direct, Ex.

28, p. 5, ln. 14-20). Using the same approach it uses for the other electric utilities in the state, the Staff annualized each customer in the Large Power class individually, based on a review of the particular customer's actual monthly usage during the test year. (Bolin Direct, Ex. 106, p. 9, ln. 21-23). These two wholly different approaches do not lend themselves to mixing. (Tr. 492, ln. 3-8).

The Staff believes that its long-standing approach to test year adjustments is to be preferred in this instance. The Large Power class consists of a relatively low number of customers, both industrial and commercial, that are engaged in various disparate businesses (*e.g.*, hotels, office buildings, manufacturing, hospitals, etc). As such, the "average" customer really does not exist, and there will be considerable variation in how and when the various members of the class demand electricity. Application of an average growth factor under these circumstances is therefore necessarily suspect. (Lange Surrebuttal, Ex. 121, p. 1, ln. 26-28; p. 2, ln. 23 – p. 3, ln 4). Accordingly, it makes sense to analyze each of the customers individually, particularly when, as here, the day-to-day weather sensitivity is low or non-existent. Other factors that have greater impact on the class usage then take precedence, including seasonal sensitivity, and other considerations such as erratic load level, facility expansions, unscheduled maintenance outages, and market forces. (Bolin Direct, Ex. 106, p. 10, ln. 2-7).

For the foregoing reasons, neither weather normalization nor the application of a growth factor is appropriate for KCPL's Large Power class.

22. Jurisdictional Allocations:

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

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

This issue addresses the question of which coincident peak ("CP") methodology more appropriately models how the fixed generation and transmission-related costs (a.k.a. demand costs) should be allocated to the three jurisdictions---Missouri, Kansas and FERC Wholesale. The Staff's position is that a four coincident peak ("4 CP") methodology most accurately reflects the distinct four-month summer peaking nature of the system demand experienced by KCPL and that these costs should be allocated based on the four coincident peak 4 CP methodology. (Maloney Direct, Ex. 123, pp. 6-8). The Commission approved the 4 CP methodology based on KCPL's recommendation in the last litigated rate case, and up to until very recently, KCPL has used the 4 CP methodology in its annual earnings surveillance reports. (Maloney Surrebuttal, Ex. 124, p. 5 line 21-23). In contrast, KCPL is proposing a twelve coincident peak ("12 CP") allocation methodology. (Frerking Direct, p. 6) The 12 CP allocation method would allocate more plant investment and costs to the Missouri jurisdiction and less to Kansas. (Featherstone Rebuttal Ex. 114, p. 15, ln. 19-23). Praxair, Inc. and Missouri Industrial Energy Consumers support Staff's recommendation of a 4 CP demand allocation methodology. (Brubaker Rebuttal, Ex. 603, p. 4, ln. 11-14). As the following discussion demonstrates, the Staff's recommendation, which is amply supported by the record evidence in this proceeding, should be adopted.

In contrast to KCPL, the Staff conducted an independent analysis of the Company's operating characteristics in order to arrive at its recommendation of a 4 CP demand allocation methodology. KCPL's monthly load pattern is consistent with that of a distinct four-month summer peaking utility. The Company experiences high peak demand in the summer months of June through September and significantly lower demand in the remaining eight months. (Maloney Direct, Ex. 122, pp. 6-8; Maloney Rebuttal, Ex. 123, Sched. 2, pp. 1-7; Brubaker, Rebuttal, Ex. 603, p. 2, ln. 23 – p. 3, ln. 1). On the other hand, a 12 CP utility exhibits a relatively flat load curve with relatively low statistical variation in peak demand on a month-to-month basis. (Maloney Rebuttal, Ex. 123, p. 2, ln. 1-4).

Strong quantitative support for the Staff's position that KCPL is a 4 CP utility is provided by the results of four mathematical system demand tests, which have been used by the Federal Energy Regulatory Commission ("FERC") to assist in the determination of the appropriate allocation methodology for various utilities. Staff witness Erin Maloney applied each of these system demand tests to actual load data for each of the past seven years (1999 through the test year of 2005). The results overwhelmingly support the Staff's position. In fact, every single one of the twenty-eight system demand test results (4 tests x 7 years) fell within the range of outcomes for which the FERC has determined that the company in question was a 4 CP utility. (Maloney Rebuttal, Ex. 123, p. 3; Sched. 1 and 2).

In his rebuttal testimony, KCPL witness Frerking suggests that KCPL is like The Empire District Electric Company ("Empire"), for which Staff witness Maloney recommended use of a 12 CP allocation methodology in that utility's pending general rate increase proceeding (Case No. ER-2006-0315), and that therefore, she should have determined that KCPL is likewise a 12 CP utility. Mr. Frerking's assertion is based on the operating realities referred to in the following quote taken from "A Guide to FERC Regulation and Ratemaking of Electric Utilities and Other Power Suppliers" used by staff witness Maloney in her analyses of the Empire and KCPL cases: "…it is necessary to consider the full range of a company's operating realities including, **in addition to system demand**, scheduled maintenance, unscheduled outages, diversity, reserve requirements, and off-system sales commitments." (emphasis added). (Frerking Rebuttal, Ex. 10, p. 5, ln. 10-13). KCPL witness Don A. Frerking states that consideration of these operating realities, particularly the year-round planning, the scheduled maintenance and the off-system sales commitments, leads to a determination that KCPL, like Empire, is a 12 CP utility. (Frerking Rebuttal, Ex. 10, pp. 6-8). The claim is not persuasive. First of all, Mr. Frerking essentially ignored system demand, which is the primary operating reality to be considered in the analysis. Furthermore, the mere assertion that the Company performs maintenance and engages in off-system sales during times of reduced load, and that its planning process takes into account all hours of the year, is hardly sufficient to demonstrate the appropriateness of a 12 CP methodology. On cross-examination, Mr. Frerking ventured that all electric utilities would do this. (Tr. 581, ln. 17 – 582, ln. 9).

Contrary to the Company's suggestion, KCPL and Empire are very different utilities. In comparing KCPL with Empire, the key operating reality leading to the Staff's 4 CP recommendation for KCPL, as opposed to its 12 CP recommendation for Empire, is the fact that Empire's winter peaks are higher in relation to its summer peaks than is the case with KCPL. The gas distribution system in Empire's more rural service area is less well-developed than the one in KCPL's service area. As a result, saturation of electric heating is much higher in Empire's service area than in KCPL's, which accounts for the substantially higher load for Empire than for KCPL during the winter months. (Maloney, Surebuttal, Ex. 124, p. 4, ln 7-10). On cross-examination, Mr. Frerking acknowledged the difference in load patterns between the two utilities. (Tr. 585, ln. 6 – 586, ln. 3, Frerking, Rebuttal, Ex. 10, Schedule DAF-7 page 30 of 30). In addition, Empire's higher winter load dictates a narrower time frame during which Empire is able to perform scheduled maintenance. (Maloney Surrebuttal, Ex. 124, p. 4, ln. 11-16). Thus, scheduled maintenance causes a more dramatic reduction in effective capacity in the off-peak months in the case of Empire, with the result being a more levelized utilization of available capacity throughout the year.

Apparently, it was not until Staff witness Maloney filed testimony in this proceeding that Mr. Frerking became aware of the system demand tests, which overwhelmingly support the Staff's position. (Tr. 575, ln. 7-22). Upon learning about these system demand tests, Mr. Frerking made a wholly inappropriate modification to Ms. Maloney's analytical approach in an attempt to produce results indicating that KCPL is a 12 CP utility. Specifically, Mr. Frerking incorporated non-firm off-system sales ("spot market sales") into the system demand tests used by Staff witness Maloney in her analyses. However, in order to do this, Mr. Frerking had to use energy numbers (MWhs) instead of the monthly coincident peak demand figures (MWs) contemplated by the system demand tests. At page 7 of his rebuttal testimony (Ex. 10, ln. 5-7), Mr. Frerking explains: "Since there are no load requirements for off-system sales, I have *attempted* to quantify the effect of the off-system sales on the FERC tests by using total MWh sales, including off-system MWh sales, in the FERC tests." (emphasis added). (Frerking, Rebuttal, Ex. 10, p.7 ln 5-7).

Mr. Frerking's "attempt," although creative, is nonetheless completely inapposite. The whole point of jurisdictional demand allocation is to allocate plant-related (capacity-related) costs to the jurisdictions causing those costs. Accordingly, as a matter of common sense, it seems certain that the FERC, in identifying off-system sales *commitments* as an operating reality, was referring to capacity (firm) sales contracts, which include a demand charge to reflect the fact that the purchaser is buying capacity. In other words, a part of the generating plant is *committed* or dedicated to fulfilling that contract. (Maloney, Surrebuttal, Ex. 124, p. 4 ln. 18 – p. 5 ln. 2). Conversely, because plant is not dedicated to support non-firm off-system sales, there is no associated demand charge. (Tr. 588, ln. 22 – 589, ln. 14; 702, ln. 6-10). Instead, non-firm off-system sales are billed strictly as an energy charge, which properly reflects the variable costs being recovered in these transactions; *i.e.*, fuel and purchased power costs.

In addition to having to use different units in his calculations due to the use of energy instead of demand, Mr. Frerking acknowledged on cross-examination that “the off-system sales, those under contract, would be more of a commitment than non-firm.. . .” (Tr. 587, ln. 6-7), and that there’s not a requirement to make non-firm off-system sales. (Tr. 588, ln. 5-9). Nonetheless, Mr. Frerking was not dissuaded from including non-firm off-system sales as “commitments” in his system demand test calculations in an attempt to produce results suggesting that KCPL is a 12 CP utility. The Commission should not be persuaded by Mr. Frerking’s convoluted, misleading and erroneous attempt to bolster “demand” on KCPL’s plant capacity in the off-peak months. Non-firm off-system sales, with which no demand charge is associated, should play no role in determining the appropriate jurisdictional demand allocation methodology for a utility. (Maloney Surrebuttal, Ex. 124, p. 5, lines 7-17).

In contrast to the Staff’s analytical approach, and apart from KCPL’s misguided attempt to incorporate off-system sales in the system demand tests (addressed above), the Company offers no quantitative rationale for its proposal to change to a 12 CP allocation methodology. In fact, the Staff can find no reference to the highly important monthly coincident peak demands in the Company’s considerations concerning an appropriate methodology for allocating demand-related costs. KCPL barely mentions the 12 CP methodology in its direct case. Mr. Frerking simply states: “The Demand allocator is a 12-month average of the coincident peak demands for the Missouri and Kansas jurisdictional customers and the firm wholesale FERC jurisdictional customers." (Frerking Direct, Ex. 9, p. 6, ln. 4-6).

KCPL and the Staff reached agreement that a 4 CP methodology would be used back in the early to mid 1980s, in Case No. ER-83-49. The Commission subsequently ordered, based on KCPL's recommendation, that a 4 CP allocation methodology was appropriate in the "Wolf Creek Case". (Case No. EO-85-185). (Featherstone Rebuttal, Ex. 114, p. 7, ln. 24 – p. 8, ln. 5). Since that time, KCPL has submitted, pursuant to the Report And Order in the Wolf Creek Case (Featherstone Surrebuttal 115*,* p. 9, ln. 16-17), earnings surveillance reports to the Staff and other parties to previous rate cases. (Featherstone Rebuttal, Ex. 114, p. 15, ln. 9-11). Up until and including the report for the year 2004, the earnings reports were based on a 4 CP jurisdictional demand allocation methodology. It was not until the 2005 earnings report that KCPL switched to the 12 CP methodology.[4] The Company has presented no evidence to suggest that

[4] The Staff would also note that the Company's switch to a 12 CP methodology in its 2005 earnings report is not consistent with a Commission-approved agreement in the "Wolf Creek Case" (Case No. EO-85-185). In the Wolf Creek Case, which was decided approximately 20 years ago, the Commission authorized a 4 CP methodology for KCPL, reflecting a position taken by the Company. (Tr. 589, ln. 15 – 59, ln. 2). Attached as part of KCPL's response to Staff Data Request No. 518 was a document entitled Joint Recommendation Of Alterations To Kansas City Power & Light Company's Phase-In Plan Rates (Joint Recommendation"), which document was signed by KCPL and the Staff, among other parties. The Joint Recommendation, which received Commission approval in the Wolf Creek Case, states in relevant part in paragraph 4: "The cost of service reports shall be based upon the Commission's Report and Order in the most recent rate or complaint case respecting KCPL." As KCPL witness Frerking acknowledged, the operative "most recent rate or complaint case respecting KCPL" is the Wolf Creek Case back in 1985. (Tr. 590, ln. 20 – 592, ln. 9). The Company did not provide the Staff or any other party with notification of its intention to make the change. (Featherstone Surrebuttal, Ex. 115, p. 9, ln. 8-14; TR. 596, ln. 16 – 597, ln. 3). Given that this Commission authorized the 4 CP methodology for the cost of service reports in the Wolf Creek Case, in preparing its 2005 earnings report, KCPL failed to comply with the Commission's order, as tacitly admitted by Mr. Frerking. (Tr. 595, ln 17-21; 594, ln. 5-15).

a significant change in KCPL's load profile has prompted the switch. Indeed, there was no significant change in KCPL's monthly peak demand between 2004 and 2005 that would warrant such a change. (Maloney Surrebuttal, Ex. 124, p. 5, ln. 18 – p. 6, ln. 5). In fact, the record contains no evidence of such a change dating back to the mid 1980s.

KCPL's glancing treatment of its proposed switch to a 12 CP methodology reflects the fact that its proposal is primarily driven by the desire to be consistent with its 12 CP proposal filed in its current rate case in Kansas. KCPL had agreed to use the 12 CP method in Kansas in that state's regulatory plan approved by the Kansas Corporation Commission ("KCC") in the summer of 2005 (Tr. 578, ln. 16-21), before KCPL developed its rate cases filed in both states. Mr. Frerking performed no independent analysis to determine the appropriate demand allocation methodology. Instead, he followed the direction of management to go with the 12 CP methodology. Mr. Frerking acknowledged this in oral testimony. (Tr. 576, ln. 23 – 577, ln. 19; 600, ln. 9-15). Thus, although he filed direct testimony proposing the 12 CP methodology, the reality is that Mr. Frerking was simply acting at the behest of management in an effort to implement a policy decision.

The record indicates that the Company's rate case in Kansas has been resolved, pending the approval of the KCC, via a "black box" settlement. (Tr. 643, ln. 14-24). Consequently, even if this Commission were to decide that a 12 CP methodology is appropriate for KCPL, it would not be possible to determine, in dollar terms, whether that vaunted consistency between Kansas and Missouri will have been achieved. In essence, the Company's concern about consistency has, in dollar terms, been nullified by the black box settlement in Kansas.

For all of the foregoing reasons, this Commission should reject the Company's proposal to switch to a 12 CP methodology for allocating KCPL's jurisdictional demand costs, and instead authorize the continued use of the 4 CP methodology.

23-A. Off-system Sales:

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

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

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

Staff witness Steve M. Traxler testified that the Staff made the determination, after looking at recent years' experience, the last three or four years, including the 12 months through September 2006, that KCPL's 2005 level of off-system sales net margin is representative of what KCPL will experience for the period the rates from this case will be in effect. He testified that the Staff's number is conservative, and he responded to a question from the Bench that the Staff's recommendation accounts for the risk of off-system sales net margin. He stated that the Staff traditionally has not accepted budgeted information for purposes of setting rates, especially an item as difficult to forecast as off-system sales net margin. He testified that the Staff's recommended amount is $16 million less than what KCPL experienced for the 12 months ending September 2006. (Vol. 9, Tr. 838-42, 855-56).

KCPL witness Michael W. Cline testified that as the Additional Amortizations provision was being developed for the KCPL Regulatory Plan, it was submitted by KCPL to the Standard & Poor's Rating Evaluation Service. In fact, Mr. Cline addressed this process in his direct testimony in Case No. EO-2005-0329, and attached to his testimony in the KCPL Regulatory Plan case, responses received by KCPL from the S&P Rating Evaluation Service. It is further indication that KCPL's off-system sales net margin proposal is not in keeping with the KCPL Regulatory Plan Stipulation And Agreement that as important as the response of the S&P Rating Evaluation Service was to KCPL, its off-system sales net margin proposal was not among the items submitted by KCPL to S&P. If KCPL had conceived the scheme by then, it certainly did not present it to the participants who it was seeking to engage in the Regulatory Plan as Signatory Parties. It certainly was not presented to the Staff until a prefiling phone call a few days before KCPL filed on February 1, 2006 its first of four possible annual rate increase cases. (Vol. 11, Tr. 1076-77; Vol. 9, Tr. 772).

KCPL seeks to distinguish itself as being unique in Missouri in having approximately 50% of its earnings attributable to the wholesale market. (Ex. 4, Giles Rebuttal, p. 4; Vol. 9, Tr. 755-56). Public Counsel witness Ryan Kind testified that the revenue number that KCPL witness Mr. Giles used for AmerenUE was significantly understated in what should be expected on a going forward basis for AmerenUE in large part because of the termination of the Union

Electric Company – Central Illinois Public Service Company – Ameren Generating Company Joint Dispatch Agreement (JDA). Under the JDA, AmerrenUE was making sales to its affiliates at incremental cost instead of at market value. With the termination of the JDA, AmerenUE will be able to make similar sales at market price instead of at incremental costs. (Vol. 9, Tr. 913-14).

KCPL is not asking out of the Regulatory Plan. To the contrary, since it wants to continue with the benefits of the Regulatory Plan, it must do things such as attempt to finesse the language respecting off-system sales net margin, invent the unused energy allocator methodology and hope that the parties that were signatories to the Regulatory Plan Stipulation And Agreement do not themselves seek recourse because KCPL has violated the terms of the Regulatory Plan. As noted by KCPL several times during the evidentiary proceedings, the Western District Court of Appeals might in essence let KCPL out of the Regulatory Plan in the Sierra Club's and the Concerned Citizens of Platte County's appeal of the Commission's authorization of the KCPL Regulatory Plan in Case No. EO-2005-0329. KCPL is very much actively defending the Commission's Regulatory Plan Report And Order on judicial review. An interesting question which hopefully will not have to be addressed is what might be the position of various of the non-KCPL Signatory Parties if the present Regulatory Plan meets a judicial demise.

Despite the not inconsiderable efforts of KCPL witnesses and KCPL attorneys, the Staff is steadfast, as are other parties, that KCPL's off-system sales net margin adjustment is a violation of the KCPL Regulatory Plan Stipulation And Agreement. Colloquies between (i) Counsel for KCPL and Staff witness Traxler and (ii) the Public Counsel and KCPL witness Giles are illuminating:

> [Zobrist]: **. . .** Can we lay to rest the debate and agree that what KCPL is proposing to share is the risk and not sharing any profits or margins with customers?
>
> [Traxler]: Certainly not, we can't agree with that.
>
> [Zobrist]: Okay.
>
> [Traxler]: That's not -- not the company's proposal.
>
> [Zobrist]: All right. So you view the company's proposal as going beyond the sharing of risks?
>
> [Traxler]: **. . . .** This is an assignment of profit for off-system sales in lieu of the additional recommendation for ROE.

(Vol. 9, Tr. 847-48).

> [Mills]: . . . If in the year that rates in this case are expected to be in effect, the year of 2007, if you earn Y amount from off-system sales, but the Commission has accepted your proposal to only include X in determining rates in this case, KCPL would retain all earnings from off-system sales between X and Y; is that not correct?
>
> [Giles]: Well, I'm not sure what you mean by retain, but as we -- as I discussed earlier and have testified to before, we would have an additional return on equity as a result of making those additional off-system sales.
>
> [Mills]: Additional earnings, correct?
>
> [Giles]: Additional earnings and additional return on equity.
>
> [Mills]: And are these cash earnings?
>
> [Giles]: These are cash earnings.
>
> [Mills]: Okay.
>
> [Giles]: And I'm glad you pointed that out. It's a very critical piece of the equation.

> [Mills]: And you propose no mechanism in this case that would allow any of those earnings to flow back to ratepayers; is that correct?
>
> [Giles]: We –
>
> [Judge Pridgin]: Is that correct, Mr. Giles?
>
> [Giles]: Yes.

(Vol. 9, Tr. 751-52). Mr. Giles agreed that KCPL's setting of its revenue requirement at a level of off-system sales for which there is a 75% likelihood that KCPL's off-system sales will actually be higher is a subjective use of the analysis performed by Mr. Michael M. Schnitzer as a consultant to KCPL. (Vol. 9, Tr. 768).

In his direct testimony, Mr. Giles states that a significant upside exists for KCPL from the off-system sales market and that "KCPL intends to account for this potential earnings increase in some manner in this proceeding, given the Company's proposed risk sharing of off-system sales. . . . A number of alternatives exist in this proceeding to account for the potential upside to the Company of the increased off-system sales margins." (Ex. 3, Giles Direct, p. 3). Mr. Giles testified at hearing: "We have not made a specific proposal in terms of testimony, anything direct in this case. I had anticipated making those proposals in settlement discussions." (Vol. 9. Tr. 771).

It would appear that by Mr. Giles' own testimony, KCPL thought it could address its violation of the KCPL Regulatory Plan Stipulation And Agreement in its settlement negotiations with the parties. As a last resort, there was the possibility of Mr. Giles making proposals from the witness stand. (Vol. 9, Tr. 791, 827-30). The Commission has rules in general on the filing of direct testimony in general rate increase cases, 4 CSR 240-2.065(1), and specific rules on the filing of direct, rebuttal and surrebuttal testimony, 4 CSR 240-2.130(7) and (8), with which KCPL did not comply. KCPL should not be permitted to game the system and to violate due process to top all of its other conduct. In his rebuttal testimony at page 10, lines 7-10 and in his surrebuttal testimony at page 4, lines 14-17, Mr. Giles makes a KCPL alternative rate of return proposal to KCPL's off-system sales net margin proposal that does not appear in KCPL direct testimony, the KCPL issue list or the KCPL prehearing brief. (Vol. 9, Tr. 769-71).

Mr. Giles asserted on October 23, 2006 that KCPL had not proposed alternatives alluded to in his direct testimony because "we couldn't get past the huge difference between the Staff and the company in cash earnings versus amortization. Staff's case is a $52 million rate increase, all amortization. The company's case is a $55 million with no amortization." (Vol. 9, Tr. 798). Mr. Giles failed to mention that on that very same day, KCPL filed in Case No. ER-2006-0314 a summary of adjustments based on KCPL's September 30, 2006 update for the September 30, 2006 true-up that showed KCPL, by its own calculations, requiring a $12.1 million additional amortization. (KCPL sought to make this filing in EFIS on Saturday, October 21, 2006, but it is shown as having been made on Monday, October 23, 2006.). In the true-up direct testimony filed by KCPL witness Timothy M. Rush on November 7, 2006, Mr. Rush states at page 2 that KCPL's current revenue deficiency based on the true-up through September 30, 2006 is $55,360,000, based on an earnings deficiency of

$42,210,000 and an amortization amount of $13,150,000. (Ex. 54, Rush True-Up Direct, p. 2).

Mr. Traxler testified at the principal hearings on October 23, 2006 that he expected because of approximately $200 million of additional plant in rate base as a result of the true-up period that the Staff's $34 million in excess earnings traditional cost of service revenue requirement finding would decrease, i.e., go to $15-$20 million in excess earnings, and the Staff's Regulatory Plan Additional Amortizations number would go from the $86 million to $52 million. (Vol. 9, Tr. 866-67). For example, the Direct Testimonies of Staff witnesses Cary Featherstone and David Elliott both indicate that the 100 megawatts (MW) of wind generation being constructed at the Spearville Wind Generation Facility for KCPL that was not complete as of June 30, 2006 was expected to be complete by the true-up date of September 30, 2006 and would be addressed in the Staff's true-up filing. (Ex. 113, Featherstone Direct, p. 32; Ex. 112, Elliott Direct, p. 9).

Mr. Giles' characterization in his direct testimony of KCPL's proposal as a risk sharing is curious in light of his surrebuttal testimony and testimony at hearing that based on the KCPL Regulatory Plan Stipulation And Agreement, "KCPL could not propose a sharing of off-system sales profit." (Ex. 5, Giles Surrebuttal, p. 2; Vol. 9, Tr. 768-69). This explanation is merely an example of the tortured rationale KCPL must construct to defend its proposals as not violating the KCPL Regulatory Plan Stipulation And Agreement. (Vol. 9, Tr. 805-06).

Mr. Giles testified in his rebuttal testimony and at the evidentiary hearings that none of the rate of return witnesses account for the risk of the off-system sales market contributing approximately 50% of KCPL's earnings. (Ex. 4, Giles Rebuttal, pp. 7, 11; Vol. 9, Tr. 748). At the evidentiary hearing, Mr. Giles asserted that neither the discounted cash flow (DCF) methodology (DCF) or the capital asset pricing model (CAPM) methodology account for the risk of the off-system sales market. (Vol. 9, Tr. 748, 792-93, 805, 813, 829-30). Missouri case law, *State ex rel. Union Electric Co. v. Public Serv. Comm'n*, 765 S.W.2d 618 (Mo.App. W.D. 1988), is against KCPL on Mr. Gile's argument.

In July 1973, Union Electric Company (UE) announced its decision to build Callaway I and II nuclear generating units and UE subsequently obtained the Commission's authorization to construct, operate and maintain these two nuclear generating units, which were planned as a single project. 765 S.W.2d at 619, 624. In October 1981, UE announced its decision to cancel construction of Callaway II. On December 3, 1982, UE filed with the Commission proposed tariffs, among other things, to increase retail electric rates to recover UE's approximately $106 million investment in the cancelled Callaway II nuclear generating unit. 765 S.W.2d at 619.

Respecting the cancellation of Callaway II, the Commission first disallowed recovery of the partial construction and cancellation costs of the abandoned Callaway II unit on the basis that the terms of Proposition One, Section 393.135, precluded the Commission from allowing recovery of any amount from ratepayers relating to abandoned construction. In the first appellate court decision respecting UE's effort to recover in rates the costs associated with the abandoned Callaway II unit, the Missouri Supreme Court held that Proposition One, Section 393.135, did not have the purpose, and did not have the effect, of divesting the Commission of the authority to make any allowance for the costs of abandoned generating plant construction. The Court based its conclusion on "the established practice of allowing such charges, absent a statutory command to the contrary, and on the absence from Proposition One of explicit language dealing with abandoned construction." The case was remanded to the Commission for further proceedings. 687 S.W.2d at 168.

After further proceedings on the remanded issues, the Commission again rejected recovery in rates of the construction and cancellation costs of Callaway II. The Commission held that UE's shareholders had already been compensated for some of their loss through the rates of return in prior UE cases. 765 S.W.2d at 621. Among other things, the Commission determined that UE shareholders had received some compensation for the risk of their investment in UE which included a risk of cancellation of Callaway II. The Court held that the Commission's decision to treat the cancellation costs as an expense outside the rate base and different from normal or extraordinary operating expenses was well within its discretion to determine what items should be included as normal or extraordinary operating expenses and was supported by competent and substantial evidence. 765 S.W.2d at 623.

The Western District Court of Appeals stated: "The increased costs of the project and the eventual cancellation of Callaway II were risks taken into account by stockholders who invested in Union Electric." 765 S.W.2d at 624. The Court further stated as follows:

> . . . we believe that the Commission properly performed its duty which is to balance the interest of the ratepayers with that of the shareholders. The Commission must insure just and reasonable rates. To determine whether the rates were just and reasonable, we must consider whether the order could reasonably be expected to maintain financial integrity, attract necessary capital, fairly compensate investors for the risk they assume, and protect relevant public interest. *See Union Electric Company v. Federal Energy Regulatory Commission*, 668 F.2d 389, 392 (8th Cir. 1981). We believe the action of the Commission meets these requirements.

765 S.W.2d at 625.

Exhibit 149, the S&P April 1, 2005 Ratings Direct – Research Update on KCPL, is evidence that the details of the KCPL Regulatory Plan Stipulation And Agreement were known to the investment community and published by S&P almost immediately after the KCPL Regulatory Plan Stipulation And Agreement was filed with the Commission on March 28, 2005.

Furthermore, as the Commissioners are aware from Case No. EO-2005-0329, KCPL and St. Joseph Light & Power Company (SJLP), in Case No. 17,895, obtained on November 14, 1973 from the Commission certificates of convenience and necessity to construct four (4) generating units as the Iatan Steam Electric Generating Station. Although only Iatan 1 has been constructed in entirety, some facilities comprising or accommodating the later units that were to be built were constructed at the time of the construction of Iatan 1. These facilities are referred to as "common plant" and were the subject of a ratemaking issue in the individual Iatan 1 cases before the Commission. The costs of Iatan common plant have been and continue to be recovered in rates by KCPL. *Re Kansas City Power & Light Co.*, Case Nos. ER-81-42, et al., 24 Mo.P.S.C.(N.S.) 386, 408-11 (1981).[5]

23-B. Unused Energy Allocator:

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

The Staff recommends that the Commission continue to authorize use of the energy allocator for revenues from non-firm off-system sales of energy, including the margin component thereof. This is the time-tested and widely accepted method for allocating such revenues in this state because it is appropriate for allocating revenues and associated costs that are purely variable with the amount of energy sold. (Featherstone Surrebuttal, Ex. 115, p. 6, ln. 14-17; Tr. 702, ln. 11-17)

KCPL sprang a surprise in this case by proposing a brand new approach to allocating the margin component of non-firm off-system (or, "spot market") sales to the Missouri retail, Kansas retail and FERC wholesale jurisdictions served by the Company. KCPL calls its new mechanism the Unused Energy Allocator[6]. The Staff opposes the Company's proposal, which would shift some

[5] A ratemaking issue regarding the recovery in rates of the costs of common plant respecting the eventual four (4) unit Jeffrey Energy Center, owned in part by Missouri Public Service Company, now an operating division of Aquila and constructed on a site in Kansas, required judicial determination in *State ex rel. Missouri Pub. Serv. Co. v. Public Serv. Comm'n*, 627 S.W.2d 882 (Mo.App. 1981). The court found that the common facilities were in full use during the test year and §393.135 was not applicable although only the first of four (4) units was constructed. 627 S.W.2d at 889-90.

[6] The name of the Company's proposed allocator is misleading, as arguably "unused energy" is a contradiction in terms. Company witness Don A. Frerking suggested an alternative label; *i.e.*, the "adjusted demand allocator." (Tr. 673, ln. 1-2).

$4.4 million in revenues from KCPL's Missouri jurisdiction to its Kansas jurisdiction (Featherstone Surrebuttal, Ex. 115, p. 5, ln. 14-17). All other parties that have weighed in on this issue---*i.e.*, the Office of the Public Counsel, Praxair, Inc, Missouri Industrial Energy Consumers, and the US Department of Energy-Kansas City Plant---argue strongly in support of the traditional energy allocation mechanism, as proposed by the Staff.

KCPL has not litigated a rate case in Missouri for some 20 years---the last such case being the "Wolf Creek Case " (Case No. EO-85-185). (Tr. 592, ln. 10-24). The energy allocator was used for off-system sales by both the Company and the Staff in that case. Since the Wolf Creek Case, the Company has submitted earnings surveillance reports at least annually, and up until its submission for 2005, those reports have reflected the allocation of the margin component of non-firm off-system sales revenues in the same manner as Staff is recommending in the instant proceeding; *i.e.*, based on the relative amount of energy (kilowatt-hours) consumed in each of the three jurisdictions[7]. (Tr. 647, ln. 8-12; 655, ln. 20 -656, ln. 9; Maloney Direct, Ex. 122, p. 10, ln. 12 – p. 11, ln. 22). Both the use of the 12 CP method and unused energy allocation method for off-system sales had a significant impact on KCPL's regulated earnings for 2005 as identified in the 2005 surveillance report, resulting in an overall reduction from

[7] As was the case with KCPL's switch in this proceeding to a 12 CP allocation methodology, the Company did not provide the Staff with advance notification of its intention to alter its computation of earnings by allocating non-firm off-system sales margins on the basis of its unused energy allocator. (Featherstone Surrebuttal, Ex. 115, p. 9, ln. 9-11).

10.328% to 9.321% (Tr. 653) [8]. As was the case with KCPL's switch in this proceeding to a 12 CP allocation methodology, the Company did not provide the Staff with advance notification of its intention to alter its computation of earnings by allocating non-firm off-system sales margins on the basis of its unused energy allocator. (Featherstone Surrebuttal, Ex. 115, p. 9, ln. 9-11).

The unused energy allocator is the brainchild of KCPL witness Don A. Frerking. (Tr. 660, ln. 19 – 661, ln. 9). As such, there is absolutely no precedent for its use. A discussion of this mechanism cannot be found anywhere in the technical literature, including textbooks and learned treatises. Prior to KCPL's proposal of the unused energy allocator in the instant case and in its general rate increase case currently pending before the Kansas Corporation Commission ("KCC"), it had not been adopted or even proposed in any other jurisdiction. (Featherstone Rebuttal, Ex. 114, p. 5, ln. 12-12; p. 6, ln. 13-23; Tr. 661, ln. 10 – 662, ln. 18).

According to Mr. Frerking, he was prompted to consider the matter of allocation of off-system sales margins because KCPL has just recently begun separating out the margin component of non-firm off-system sales. (Tr. 661, ln. 3-6; Giles Surrebuttal, Ex. 5, p. 5, ln. 13). The Staff disputes this claim. The evidence indicates that the Company and the Staff were in the business of determining the cost of off-system sales as far back as the early 1980s rate cases. For example, at page 28 of its Report And Order in Case No. ER-82066,

[8] At the Staff's request, the Company re-ran its 2005 earnings surveillance report as it had for some two decades before---*i.e.*, using both the 4 CP demand allocator and the energy allocator for spot market off-system sales margin---and the return on equity for Missouri jurisdictional operations increased about 100 basis points, from 9.321% to 10.328. (Tr. 653, ln 14-21; 654, ln. 23 – 655, ln. 10).

a KCPL rate case, the Commission states: "10,000 barrels of the 32,000 barrels used in the first three months of 1982 were, *as admitted by the company*, used for interchange [off-system] sales." (emphasis added). (Tr. 658, ln. 7-9). On page 30 of the same Report And Order, the Commission states: As concerns interchange sales and purchases, Staff priced interchange sales from KCPL's system using 1982 fuel prices and the cost of interchange purchases using 1981 prices. The Company does not appear to protest Staff's pricing of interchange sales but uses it as evidence that Staff has been inconsistent in the treatment of interchange sales and purchases." (Tr. 659, ln. 14-20). Given that calculations of off-system sales costs were being made and the revenues from off-system sales were known, obviously the resultant margin was available. (Tr. 657, ln. 19 – 659, ln. 20).

A primary concern is the underlying philosophy implied by utilization of the unused energy allocator. Specifically, the allocator operates to reward the lower load factor of KCPL's Kansas retail jurisdiction by allocating a greater percentage of the profit from non-firm off-system sales to that jurisdiction[9]. (Mantle Rebuttal, Ex. 125, p. 4, ln. 13-14). Load Factor is defined as average energy usage divided by peak demand. The higher the load factor, the closer the average load is to peak demand. (Mantle Rebuttal, Ex. 125, p. 3, ln.10-13). The lower load factor of KCPL's Kansas jurisdiction causes the Company to build higher energy cost combustion turbines, which provide KCPL with less opportunity to make off-system sales. In KCPL's recent Regulatory plan case (Case NO. EO-2005-

[9] The same can be said of the FERC wholesale jurisdiction relative to Missouri retail. However, since the major dollar impact centers overwhelmingly on the Missouri-Kansas situation, the discussion will be limited to that.

0329), some $14 million in expenditures was authorized for demand response programs that should result in increasing KCPL's load factor, and hence, reducing KCPL's need to acquire higher energy cost combustion turbines. (Tr. 700, ln. 21 – 701, ln. 8). Yet, KCPL proposes to allocate a greater proportion of the off-system sales margin to the lower load factor Kansas jurisdiction. Thus, use of the unused energy allocator creates a possible disincentive to implement projects aimed at increasing load factor (Tr. 701, ln. 10-20).

Furthermore, application of the unused energy allocator ignores the fact that, thanks to Missouri's higher load factor, Kansas is already benefiting to a greater extent than Missouri from a lower overall cost of energy. Under KCPL's fuel costing system, all three of the jurisdictions served by the Company---Missouri, Kansas, and FERC wholesale---share equally in the production cost of energy. (Featherstone Rebuttal, Ex. 114, p. 9, ln. 23 – p. 12, ln. 16). Costs are determined for KCPL's electric generating system through a "joint dispatching" process simulated in KCPL's production cost model. This total dispatching approach produces the lowest overall fuel (and purchased power) cost for KCPL. However, because Missouri has a higher load factor, as it has since the early 1980s (Featherstone Rebuttal, Ex. 114, p. 9, ln. 20-22), the Company is able to build more base load capacity, with its lower fuel cost, than if KCPL's overall load factor was that of Kansas. (Mantle Rebuttal, Ex. 125, p. 7, ln. 14-16). As a result, the system average cost of energy is lower than Kansas' contribution thereto, and higher than Missouri's. (Featherstone Rebuttal, Ex. 114, p. 16, ln.

19 – p. 17, ln. 10). Therefore, Kansas benefits more from the sharing of overall KCPL system energy costs than Missouri.

The Company's proposal also ignores another implication of the fact that Missouri's higher load factor permits KCPL to build more low-fuel-cost base load capacity, to wit: If KCPL were serving only its Missouri jurisdiction, the Company would be able to sell electricity in the spot market at a more attractive price and thus have greater opportunity to engage in off-system sales than if it were serving only its Kansas jurisdiction. (Featherstone Surrebuttal, Ex. 115, p.18, ln. 12-15; Mantle Rebuttal, p. 7, ln. 16-20).

In addition, the Company's unused energy allocator takes its basis from the demand factor. (Frerking Rebuttal, Ex. 10, ln. 3-10). This is inappropriate since the off-system sales revenues, expenses, and ultimately margins, have nothing to do with the demand factor methodology. No fixed costs, which is what the demand factor is intended to allocate, are assigned or identified with the non firm off-system sales. While the demand factor is used to allocate the fixed costs (or demand charges) portion of capacity sale contracts, the energy allocator is used to allocate the energy sales portion of the firm capacity sales contracts. The energy allocator is used to allocate the fuel costs and purchased power costs, which are variable costs of the production and purchase of electricity. The only costs assigned to non firm off-system sales is the fuel and purchased power costs-- the variable costs-- hence the appropriateness of using the energy allocator. This is consistent with the way KCPL itself allocates the costs relating to the energy portion of firm capacity contracts--- using the energy allocator. The reason is simple-- the energy allocator is used to allocate variable costs of fuel and purchased power costs relating to retail sales. Using the same rationale, the energy allocator is equally appropriate to use as the allocation factor for both energy of firm (as KCPL does) and non firm off-system sales. The demand based unused energy allocator should not be used to allocate off-system sales -- either energy from firm capacity sale contracts or non firm off-system sales. Because plant is not dedicated to support non-firm off-system sales, there is no associated demand charge. (Tr. 588, ln. 22 – 589, ln. 14; 702, ln. 3-24; Featherstone Surrebuttal, Ex. 115, ln. 7-23).

As noted earlier, the effect of the unused energy allocator would be to shift some $4.4 million of off-system sales revenues from Missouri's customers to those in Kansas. If the Commission were to authorize the unused energy allocator along with KCPL's proposed 12 CP demand allocator, KCPL's Missouri customers would be required to pay 53.82% of the plant costs, but they would receive only 51.55% of the non-firm off-system sales margin. On the other hand, Kansas, with its lower load factor, would be paying for 45.30% of the cost of the Company's production and transmission facilities while receiving 47.61% of the off-system sales profit. (Featherstone Surrebuttal, Ex. 115, p. 4, ln. 21-23; p. 17).

Given the dollar impact, it is not difficult to understand why the KCC Staff did not oppose KCPL's introduction of its unused energy allocator in the Kansas rate proceeding. Clearly, it is unfair to punish Missouri for its favorable contribution to KCPL's cost of energy by using it as a basis for shifting part of

Missouri's rightful share of KCPL's non-firm off-system sales margin to Kansas. (Featherstone Rebuttal, Ex. 114, p. 5, ln. 20-23).

In addition to the unfair and unreasonable impact of a change to the proposed unused energy allocator, the calculation itself is flawed. In his rebuttal testimony, Mr. Frerking corrected the calculation of his unused energy allocator. "Unused Energy" is calculated for each jurisdiction by subtracting the jurisdiction's energy used from some measure of its available capacity, dubbed "Available Energy." The percentage of the total unused energy is then calculated for each jurisdiction to produce the unused energy allocator. Mr. Frerking corrected his calculation by substituting total available capacity for the average of 12 coincident peak loads. The correction caused the measure of total available capacity to increase from 2,652 MWs to 4,389 MWs, or more than 65%. The total available capacity was then spread to the jurisdictions according to the proposed 12 CP jurisdictional allocation methodology, and each was again multiplied by the number of hours in the year (8760) to arrive at Available Energy for each jurisdiction. The net effect of the correction at least resulted in the allocation of a majority of off-system sales margin to Missouri, as has historically been the case. (Frerking Rebuttal, Ex. 10, Sch. DAF-6, pp. 1-2). Prior to the correction, the Company's Missouri customers would have adversely affected due to the change to the unused energy allocator to the tune of about $8 million. The correction reduced that blow to a "mere" $4.4 million.[10] (Featherstone Surrebuttal, Ex. 115, p.5, ln. 12-17).

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[10] Following the modification or correction, KCPL's calculation of Missouri's share of the non-firm off-system sales margins increased from 46.97% to 51.55%. This compares to Staff's calculated

This dramatic correction could be considered a modification to an evolving mechanism. Mr. Frerking himself regards the unused energy allocator as something of a work in progress. (Tr. 672, ln. 7-13). In fact, he expressed a willingness to entertain suggestions as to how to improve it. (Tr. 671, ln. 15-20) Given the existence of the energy allocator, a venerable allocation mechanism that has been continually endorsed by this Commission and is widely accepted in this state, it makes no sense to adopt an alternative mechanism that is apparently still in its development stage, for the purpose of achieving an unfair and inappropriate objective.

Another deficiency of the unused energy allocator is the fact that calculated amount of unused energy is overstated. Prior to Mr. Frerking's correction, the total "unused Energy" related to non-firm off-system sales calculated using KCPL's theory for the 2005 test year was 7,545,659 MWh, but the actual amount of energy sold off-system was only 4,468,707 MWh. (Maloney Rebuttal, p. 4, ln. 22 – p. 5, ln. 2). The great disparity, which would only increase as a result of the correction discussed above, results from the fact that the market has something to say about how much energy KCPL can sell from its available capacity. As Staff witness Cary Featherstone states in prefiled testimony:

> Much of the excess capacity available during the off-peak season would be combustion turbines. While these peaking units have low capital costs, they have very high fuel costs to operate the unit. Since fuel is the only cost component beside purchased power costs that is identified for off-system sales, these high fuel costs would not allow many sales transactions to occur. Kansas, with its

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share for Missouri of 56.68%, based on the conventionally used energy allocator. (Featherstone Surrebuttal, Ex. 115, p.5, ln. 3-11).

> heavy concentration of residential load causing the poor load factor, would have a need for more peaking units than Missouri. Yet, much of the time of the year, these peaking units would not be economic to generate electricity that a buyer would be willing to pay—and thus, the Available Capacity would remain idle.

(Featherstone Surrebuttal, Ex. 115, p. 19, ln. 10-17).

Furthermore, KCPL did not allocate all of the margins from its off-system energy sales in a consistent manner. Its unused energy allocator was applied only to non-firm off-system sales. Revenues (and hence the margin component thereof) from sales of energy under KCPL's firm (or, "capacity") contracts continue to be allocated using the same methodology recommended by the Staff, and historically used by both Company and Staff for both firm and no-firm off-system energy sales (57.12% to Missouri and 41.96% to Kansas). By contrast, the Staff employed a consistent approach, allocating 56.68% of both firm and non-firm off system energy revenues (including margin) and associated costs to Missouri, along with 53.46% of the demand cost of firm off-system sales. (Featherstone Rebuttal, Ex. 114, p. 14, ln. 4 – p. 15, ln. 1).

Finally, it is the Staff's position that KCPL's proposal to remove from Missouri a portion of off-system sales revenues to which it is entitled is not consistent with the Commission-approved Stipulation And Agreement in KCPL's regulatory plan case, Case No. EO-2005-0329. In pertinent part, the Report And Order in that case states at page 18-19:

> Under the terms of the Stipulation, KCPL agrees that off-system energy and capacity sales and related costs will continue to be treated "above the line" for ratemaking purposes. **KCPL will not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case**. KCPL agrees that it will not argue that these

> revenues and associated expenses should be excluded from the ratemaking process. During the hearing, KCPL also stipulated that it would agree to this ratemaking treatment for off-system sales as long as the Iatan 2 costs were included in rate base.

(emphasis added).

Thus, in the very first case KCPL filed under the regulatory plan Stipulation And Agreement, the Company has proposed a mechanism, the unused energy allocator, that is not in keeping with the letter and intent of its Commission-approved agreement. (Featherstone Rebuttal, Ex. 114, p. 19, ln. 5 – p. 20, ln. 3).

For all of the foregoing reasons, the Commission should reject this never-before-used and apparently still "developing" mechanism for allocating spot market sales margin, in favor of the traditionally used, widely accepted and Commission-endorsed energy allocation methodology.

24. Depreciation:

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

This is one of the larger issues in terms of the amount of money involved. Staff has proposed depreciation rates that will decrease the annual depreciation expense realized by KCPL from $65 million to $55 million, based upon Staff's Depreciation Study using current methods and techniques. KCPL, on the other hand, contends that the Regulatory Plan Stipulation and Agreement approved in Case No. EO-2005-0329 requires that KCPL's depreciation rates not be changed in this case but rather be implemented as set out in Appendix G to that Stipulation and Agreement (Tr. 7:494, 500, 506, 510). Nonetheless, KCPL's expert witness, Don Frerking, admitted on the stand that the Regulatory Plan Stipulation and Agreement specifically and expressly authorizes parties to propose changes to KCPL's depreciation rates in this case (Tr. 7:494-495, 510-511).

Frerking criticized certain aspects of Staff's Depreciation Study, including "the estimates of the lives on generating units, the cost of removal and salvage calculations, and some of the curve matching on transmission and distribution accounts" (Tr. 7:495 *and see* 7:506-507, 515). But, Frerking admitted that KCPL has no plans to retire any of its present generating units (Tr. 7:518-519). With respect to the service lives of generation units, the Commission stated as follows in its recent *Report & Order* in Case No. ER-2004-0570, *In the Matter of the Empire District Electric Company:*

> The record shows that generation plants tend to remain in service indefinitely under present conditions and that this is likely to continue to be the case in the future. For these reasons, the Commission will reject the reduced service lives sponsored by Empire in favor of the longer lives produced through the use of Iowa Curves as advocated by Staff and Public Counsel.

Report & Order, at 50. Staff considers the above to be a policy statement by the Commission and has consequently applied the methodology approved in that case to KCPL in the present case (Tr. 7:498).

With respect to the cost of removal and salvage calculations, Frerking admitted on the stand that KCPL's FERC Form 1 for the years 2003 through 2005 show a positive net salvage position (Tr. 7:497). He noted, accurately, that Staff's salvage calculation in this case does *not* involve the net salvage methodology firmly rejected by this Commission in the above-cited *Empire* decision (Tr. 7:516-517). He also admitted, with respect to curve-matching, that two different engineers might reach different conclusions in matching Iowa curves to data sets because it is a matter of judgment (Tr. 7:495-496, 507).

KCPL's true objection to Staff's recommendation is that the Regulatory Plan Additional Amortizations will necessarily be larger if KCPL's Commission-approved depreciation rates are lower (Tr. 7:503-504, 506, 511). The Additional Amortizations are a form of accelerated depreciation in which KCPL trades rate base for additional cash flow; one effect is a reduction of rates in future cases because there will be less rate base on which a return may be earned (Tr. 7:504-505). KCPL simply wants to keep its rate base *and* to have its cash flow too. For these reasons, Staff urges the Commission to accept its recommended depreciation rates.

B. Rate of Return:

The Commission must afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service. *St. ex rel. Utility Consumers Council, Inc. v. Public Service Comm'n*, 585 S.W.2d 41, 49 (Mo. banc 1979). Missouri Courts have said, "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment." *St. ex rel. Missouri Public Service Co. v. Fraas,* 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

The rate of return is used to calculate the second component of the Company's revenue requirement. The first component is the utility's prudent operating and maintenance expenses, discussed above in the Cost of Service section of Staff's brief. The second component is an amount calculated by multiplying the value of the utility's depreciated assets by a rate of return. For any utility, its fair rate of return is simply its composite cost of capital. *In the Matter of Empire District Electric Co.,* Case No. ER-2004-0570 (*Report & Order,* issued March 10, 2005), p. 37.

The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

25. Cost of Capital:

What is the appropriate capital structure?

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

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

a. What is the appropriate capital structure?

According to the True-up Testimony of Staff's expert witness, Matt Barnes, KCPL's (actually, GPE's) capital structure and embedded cost of debt as of September 30, 2006, was as follows (Barnes True-up Direct, 1-2, and Schedules 1-3):[11]

[11] Using Staff's mid-point ROE recommendation.

	Proportion:	Embedded Cost:	Weighted Cost:
Long Term Debt	44.79%	**____%**	**____%**
Preferred Stock	1.53%	**____%**	**____%**
Common Equity	53.69%	9.37%	5.03%
	100.01%		7.88%

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

The Commission has commented on the difficulty of estimating the cost of common equity, also termed the return on common equity or ROE. *In the Matter of Missouri Gas Energy,* 12 Mo.P.S.C.3d 581, 591 (2004). In its *Empire Report & Order, supra,* already often cited herein, the Commission set out a detailed discussion of this process. Perhaps most importantly, the Commission noted that "In the final analysis, it is not the method employed, but the result reached, that is important. The Constitution 'does not bind ratemaking bodies to the service of any single formula or combination of formulas.'" *Empire, supra,* at 41. The Commission's discretion extends to selecting the methodology or methodologies to be used. *Id.,* at n. 52.

In the two cases cited above, the Commission turned to "benchmarking" to establish the basis parameters of a just and reasonable ROE. This is the "zone of reasonableness" defined in *Missouri Gas Energy,* 12 Mo.P.S.C.3d at 593, and referred to with approval in *Empire, supra,* at 45. The record in this case shows that the national average for the third quarter of 2006 was 10.06% and the zone of reasonableness thus extends from 9.06% to 11.06% (Tr. 12:1241-1242). KCPL's own analyst, Dr. Hadaway, testified that this use of the national average as a test of reasonableness was acceptable (Tr.

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12:1271). As the chart below shows, the recommendations made by Woolridge, Barnes and Baudino fall within this zone of reasonableness, while that of Dr, Hadaway does not.

Staff expert witness Matt Barnes recommends a cost of common equity in the range of 9.32% to 9.42%, with a mid-point of 9.37%, resulting in a fair and reasonable rate of return of 7.85% to 7.90% for KCPL's Missouri jurisdictional electric utility rate base. (Barnes True-up Direct, pp. 1-2, and Schedules 1-3.) Barnes' recommendations are in line with those of expert witnesses Baudino (for OPC) and Woolridge (for USDOE) (Tr. 11:1091), a fact that vitiates the effort devoted by KCPL to impeaching Mr. Barnes (*see* Tr. 9:959 *and following*) – if he is so unqualified, then how did he come up with results comparable to those of the eminently qualified Baudino and Woolridge? How is it that Hadaway's own results with the traditional constant-growth DCF model are essentially identical? (Tr. 12:1259, 1319).

	USDOE	**Staff**	**OPC**	**KCPL**
ROE:	9.0	9.32 - 9.42	9.9	11.5

It is the recommendation offered by Dr. Hadaway for KCPL that is strikingly different from those of the other analysts, not that of Mr. Barnes. Hadaway's recommendation of 11.5, first of all, includes a 50 basis-point "adder" that will be discussed in the next subsection of this brief. Dr. Hadaway's analytical methods yielded a result of 11.0, not 11.5. Second, the other analysts uniformly criticize Hadaway's methods and results. Baudino calls Hadaway's recommendation "overstated" (Tr. 11:1095). In fact, Hadaway testified that his recommendations typically range from 11.0 to 11.5, which values are consistently *higher* than the average ROEs awarded by state regulatory commissions (Tr. 12:1319-1320). Hadaway admitted that, using the traditional constant-growth DCF model, he obtained a range of 9.3% to 9.4% for his comparable group, a range "almost exactly the same" as that obtained by Staff expert witness Matt Barnes (Tr. 12:1259, 1287). Hadaway also admitted that his use of the DCF model did not accord with *Hope* and *Bluefield* (Tr. 12:1261).

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

KCPL has recommended a plethora of "adders" to protect it from purportedly unique varieties of risk and to reward it for especially good achievement. Dr. Hadaway proposes a 50-basis-point "adder" to reflect KCPL's purportedly unique construction risk (Tr. 9:948-949; 12:1248-1249, 1272; 13:1408). Mr. Giles proposes a highly confidential "adder" to reflect KCPL's unique level of dependence on off-system sales (Tr. 9:933-934; 13:1408). Mr. Camfield – in exchange for $160,000 of remuneration (Tr. 13:1404-1405) -- proposes an "adder" of 50 to 100 basis points just because KCPL is such a darn good company (Tr. 13:1405, 1412-1413, 1415). Camfield admitted that his 50 to 100-basis-point "adder" is intended to be "pancaked" on top of the 50-basis-poiunt "adder" proposed by Hadaway (Tr. 13:1414). The reality is that *none* of these artificial inflators of KCPL's ROE are appropriate or necessary. Indeed, the Commission would do well to review the oft-quoted passages from the guiding decisions of the United States Supreme Court, which contain no mention of "adders" and which suggest that any such devices are improper.[12]

OPC's expert, Baudino, testified that he considered KCPL's construction risk and did not think that a specific "adder" was required (Tr. 11:1122). KCPL is not unique in its participation in the unregulated, wholesale market (Tr. 11:1123). The elements of risk that KCPL cites to justify various "adders," as well as its comparatively good performance history, are actually part of the overall company profile and so are already taken into account (Tr. 11:1117-1118). By using a comparable group with similar bond ratings to the subject company, all such elements are taken into account (Tr. 11:1119, 1120). Additionally, KCPL has failed to take other compensating factors into account (Tr. 11:1118). For example, the Regulatory Plan certainly tends to mitigate KCPL's other risks (Tr. 11:1123). Consequently, "adders" such as KCPL seeks are inappropriate (Tr. 11:1120). KCPL witness Hadaway, for example, testified that he did not know whether off-system sales margin risk was significant or not (Tr. 12:1275).

This Commission has, in the past, made both upward and downward rate-of-return adjustments (Tr. 11:1127). Hadaway testified that "subtracters" wewre every bit as appropriate as "adders" (Tr. 12:1276). Hadaway agreed, for example, that blowing up the Hawthorn 5 generating station might support a "subtracter" for poor performance (Tr. 12:1277-1278). Camfield, although characterizing the Hawthorn 5 explosion as "largely a random event that any electric service provider could experience" (Tr. 13:1416), was unable to

[12] *Fed. Power Comm'n v. Hope Nat. Gas Co.,* 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia,* 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

enumerate even a single other electric utility that had managed to destroy one of its generating stations by a catastrophic explosion (Tr. 13:1417-1418).

As recently as 2005, in the frequently-cited *Empire Report & Order, supra,* the Commission approved a 30-basis-point “adder” for risk. However, that “adder” was specifically awarded to reflect and counter a recent credit-rating-downgrade of Empire; KCPL has not suffered any similar downgrade (Tr. 9:953, 973). The Commission stated in *Empire:*

> In addition to the comparative analysis discussed above, *Hope* and *Bluefield* also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk. The evidence is unrefuted that Empire's credit rating has been downgraded. The evidence also shows that Empire's access to capital has been correspondingly impaired – Empire must pay higher rates to borrow money. Its earnings per share have declined and it has not been able to realize the return on equity of 10.0% authorized in its last rate case. These facts are significant objective indicators that Empire's rates have been too low and must be increased.

Empire, supra, at 45. This Commission has recently rejected “adders” as a regulatory tool:

> [A] rate of return adder is inappropriate in concept and unworkable in practice. Conceptually, the Commission must determine a just and reasonable rate of return for the utility that it regulates. To then tack an additional percentage to the rate of return as a reward for efficiency means that the company would be receiving a rate of return that is higher than the just and reasonable rate. In essence, the Commission would be making a gift to the company from the ratepayer’s pocket. Obviously, that is not acceptable.

*In the Matter of Missouri Gas Energy, supra,*12 Mo.P.S.C.3d at 598.

For these reasons, Staff urges the Commission (1) to adopt Staff's proposed capital structure, (2) to adopt Staff's proposed ROE, and (3) to reject all proposals to adjust the ROE either up or down.

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

26. Class Cost-of-Service:

Settled.

27. Rate Design:

Settled.

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

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

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

KCPL's existing General Service All-electric Rate Schedule provides a discount to qualifying customers. This issue concerns possible changes to that rate schedule.

a. Expansion of the General Service All-electric Rate Schedule:

Staff does not oppose expansion of the all-electric rate schedules or increasing the all-electric winter rate by an additional 5% as proposed by KCPL.

b. Elimination or Restriction of the General Service All-electric Rate Schedule:

The Staff opposes eliminating the existing general service all-electric rate schedules at this time because no one has performed a cost analysis or studied the customer impacts if they were eliminated; however, the Staff is willing to study eliminating them in the context of a comprehensive CCOS and rate design investigation and/or a cost-effectiveness study of the Affordability, Energy Efficiency and Demand Response programs. (Pyatte Rebuttal, p. 17.)

D. Customer Programs:

29. Weatherization Program:

Staff has no position on these issues.

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

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served on all of the parties of record or their representatives as set out on the attached service list on this **17th day of November, 2006**, either by hand delivery, electronic mail, facsimile transmission, or First Class United States Mail, postage prepaid.

/s/ Kevin A. Thompson