Exhibit No.:
Issues: *Straight Line Tax Depreciation; Deferred Income Tax; FAS 106 OPEB; FAS 87 Pension Cost; Regulatory Plan Amortization; Off-System Sales*
Witness: *Steve M. Traxler*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Direct Testimony*
Case No.: *ER-2006-0314*
Date Testimony Prepared: *August 8, 2006*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

STEVE M. TRAXLER

KANSAS CITY POWER AND LIGHT COMPANY

CASE NO. ER-2006-0314

Jefferson City, Missouri
August 2006

****Denotes Highly Confidential Information****

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & 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

AFFIDAVIT OF STEVE M. TRAXLER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Steve M. Traxler, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 31 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Steve M. Traxler

Subscribed and sworn to before me this 7th day of August 2006.

TONI M. CHARLTON NOTARY SEAL STATE OF MISSOURI NOTARY PUBLIC

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

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DIRECT TESTIMONY

OF

STEVE M. TRAXLER

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2006-0314

Q. What is your name and business address?

A. Steve M. Traxler, Fletcher Daniels State Office Building, Room G 8, 615 East 13th Street, Kansas City, Missouri 64106.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor for the Missouri Public Service Commission (Commission).

Q. What is your educational background?

A. I graduated from Missouri Valley College at Marshall, Missouri, in 1974 with a Bachelor of Science degree in Business Administration with a major in Accounting.

Q. Please describe your employment history.

A. I was employed as an accountant with Rival Manufacturing Company in Kansas City from June 1974 to May 1977. I was employed as a Regulatory Auditor with the Missouri Public Service Commission from June 1977 to January 1983. I was employed by United Telephone Company as a Regulatory Accountant from February 1983 to May 1986. In June 1986, I began my employment with Dittmer, Brosch & Associates (DBA) in Lee's Summit, Missouri, as a regulatory consultant. I left DBA in April 1988. I was self-employed from May 1988 to December 1989. I came back to the Commission in December 1989. My current position is a Regulatory Auditor V with the Commission's Auditing Department.

Q. What is the nature of your current duties at the Commission?

A. I am responsible for assisting in the audits and examinations of the books and records of utility companies operating within the state of Missouri.

Q. Have you previously testified before this Commission?

A. Yes, I have. A list of cases in which I have filed testimony is shown on Schedule 1 of this direct testimony.

Q. Have you filed testimony in rate proceedings involving a regulated utility company in any jurisdictions besides Missouri?

A. Yes, I have also filed testimony in Kansas, Minnesota, Arizona, Indiana, Iowa and Mississippi.

Q. To which of the Kansas City Power & Light Co.'s (KCPL) operations are you directing your testimony?

A. This testimony addresses the electric operations of KCPL in Missouri.

Q. What are your principal areas of responsibility in Case No. ER-2006-0314?

A. As one of the Regulatory Auditor V's assigned to this case, I have oversight responsibility regarding areas assigned to other auditors on this case, an Application to increase rates filed by KCPL. In addition, my direct testimony will address the specific areas listed below:

(1) Income Tax-Straight Line Tax Depreciation

(2) Income Tax

(3) FAS 87 – Pension Cost

(4) FAS 106 – Other Post Retirement Employee Benefit Costs (OPEB)

(5) Additional Amortization – Regulatory Plan

(6) Interchange Sales Margin

Q. What knowledge, skill, experience, training, or education do you have with regard to the areas you have been assigned?

A. I have approximately 30 years of experience in utility regulation. My experience includes 23 years with the Missouri Commission, four years with United Telephone Company of Kansas and three years as a regulatory consultant with the former Dittmer Brosch and Associates. I have provided expert testimony on regulatory matters in six other state jurisdictions. For most of my career, I have had responsibility for supervising other auditors on major rate cases. With specific regard to my areas in this case, I have presented expert testimony on these issues in prior cases and have had responsibility for providing training on these areas for the Commission's Auditing Department.

EXECUTIVE SUMMARY

Q. In summary, what does your testimony cover?

A. My testimony addresses six primary areas:

1) Calculation of the tax deduction for book depreciation expense – straight - line tax depreciation.

Straight line tax depreciation is the tax deduction for book depreciation for a regulated utility. The deduction for straight line tax depreciation must reflect basis differences between the book basis and tax basis of depreciable plant. It must also match the proposed book depreciation rates used in calculating annualized book depreciation for rate recovery.

2) Calculation of current and deferred income tax.

The current and deferred income tax calculation reflects timing differences which result in a difference between pretax book accounting income and taxable income for IRS purposes. The deferred income tax component must also reflect the amortization of excess deferred taxes resulting from the reduction in the federal tax rate and the amortization of the investment tax credit (ITC) deferred prior to the 1986 Tax Reform Act.

3) Appropriate level of Financial Accounting Standard (FAS) 87 pension cost and related rate base assets to be included in cost of service in this case.

KCPL, the Staff, and other parties to the Stipulation and Agreement in KCPL's experimental regulatory plan docket, Case No. EO-2005-0329, reached an agreement for calculating pension cost under FAS 87 and a tracking mechanism to ensure that KCPL recovers all of its pension cost.

4) Appropriate level of FAS 106 Other Post Retirement Employee Benefits (OPEB) cost to be included in cost of service in this case.

The 2005 test year for FAS 106 cost was replaced by the 2006 cost provided by KCPL's actuarial firm.

5) Additional amortization requirement under the experimental regulatory plan agreement in Case No. EO-2005-0329. The Signatory Parties agreed to support an additional amortization amount to be added to KCPL's cost of service when the cash flows, resulting from the Commission's traditional cost of service approach, fail to meet the Funds from Operations Interest Coverage ratio and the Funds from

Operations as a Percentage of Average Total Debt ratio. My testimony addresses the Staff's benchmark analysis for these two financial ratios.

6) Under the terms of the Stipulation and Agreement in KCPL's regulatory plan docket, EO-2005-0329, KCPL agreed that off-system sales revenues and costs will continue to be treated "above the line" for ratemaking purposes. I will address the appropriate level to be included in cost of service in this case, ER 2006-0314.

STRAIGHT LINE TAX DEPRECIATION

Q. What is the relationship between book depreciation and straight-line tax depreciation?

A. Annualized book depreciation is a result of multiplying the plant investment at June 30, 2006, the end of the update period established in Case No. EO-2005-0329 for this proceeding, by the book depreciation rates being recommended by Staff witness Rosella L. Schad of the Engineering and Management Services Department. Straight line tax depreciation represents the tax deduction for book depreciation for a regulated utility for ratemaking purposes.

The IRS allows a regulated utility, like all corporations, to use an accelerated depreciation method in calculating its current income tax liability. However, with regard to a regulated utility, Congress intended for the additional cash flow (lower current income tax), resulting from an accelerated depreciation method, to be retained by the utility. As a result, under IRS rules for a regulated utility, the additional deduction resulting from the use of an accelerated depreciation method cannot be reflected in rates. Ratepayers receive the tax deduction for depreciation expense over the same period used for book accounting purposes.

For example, a 10 year book life for recognizing book depreciation is also used to calculate the tax deduction for setting rates – straight line tax depreciation.

Differences between book depreciation and the corresponding tax deduction – straight line tax depreciation, occur as a result of the following:

1) The plant cost on the financial books (book basis) includes capitalized costs which were taken as current tax deduction prior to the reform of the 1986 Tax Reform Act and

2) The book basis also includes the equity component of Allowance for Funds Under Construction (AFUDC) which is not deductible for tax purposes.

The tax basis of depreciable property is lower than the book basis for a utility primarily for these two reasons. Straight line tax depreciation is calculated by applying the book depreciation rate (10 year life = 10% annual rate) times the tax basis of the property.

Q. Can you provide an example to illustrate the book basis and tax basis difference and the relationship of book deprecation expense to the IRS tax depreciation and the tax deduction allowed for setting rates for regulated utility, straight line tax depreciation?

A. Yes. Attached as Schedule 2 attached to this direct testimony is an example to illustrate these relationships.

Q. Would you please explain Schedule 2?

A. Prior to the Tax Reform Act of 1986, interest, pension cost, property taxes and payroll taxes which were capitalized for financial accounting (included in the book basis) were treated as a current year deduction by the IRS. This resulted in a difference between the book basis and tax basis of the asset. Line 3 reflects the book basis of the asset, $10,000, which includes capitalized interest of $2,000. The tax basis of the asset of $8,000 on line 4 reflects that the $2,000 interest amount, line 2, was allowed as a current year deduction prior to 1986. Since 1986, the interest expense is capitalized for both financial accounting and IRS tax purposes which eliminated the difference between the book basis and tax basis of the asset.

Column A reflects the annual depreciation of the book basis over its 10 year life - $1,000 / year. Column B reflects the basis difference for interest expense. The IRS allowed the $2,000 interest expense as a tax deduction in year 1. For financial accounting the interest cost was capitalized and included in the book depreciation in Column A at $200/year.

Column C reflects the IRS tax depreciation deduction using an accelerated 20% rate (20% X $8,000), $1,600/year. At the end of year 5 the asset is fully depreciated for IRS tax purposes - $2,000 in year 1 for the interest cost and $1,600/ year in tax depreciation (years 1-5) for a total tax deduction of $10,000 at the end of year 5.

As stated previously, IRS rules don't allow State regulatory Commissions to reflect the additional depreciation deduction resulting from an accelerated method. For ratemaking purposes, the tax deduction for depreciation cannot be reflected in rates any quicker than the time period used in recognizing book depreciation for financial accounting – 10 years in our example. The straight line tax depreciation deduction for setting rates is reflected in Column D - $800/year (10% X $8,000) for 10 years. The ratepayer also received the $2,000 interest deduction in year 1 for a total deduction of $10,000 at the end of year 10.

Column E reflects the excess of the IRS tax deduction over the straight line deduction allowed for rates. The $800 difference results in positive deferred income taxes in years 1-5 (Column G). At the end of year 5, the Accumulated Deferred Tax balance in Column I reflects that ratepayers have paid $1,520 more in rates for income tax than the company's actual tax liability. Beginning in year 6 and continuing through year 10, the ratepayer continues to receive an $800/year tax deduction for ratemaking purposes. The utility's tax deduction is $0 for years 6-10 as reflected in Column C. In summary, ratepayers paid $1,520 more in income tax in years 1-5 than the utility actually paid to the IRS , however, in years 6 – 10, the ratepayers paid $1,520 less in rates for income tax than the utility's tax liability. This tax "timing difference" has reversed by year 10 as reflected in Column I, for year 10.

Q. How does the Staff compute the straight line tax deduction?

A. As reflected on Schedule 2, straight line tax depreciation is calculated by applying the book depreciation rate – 10% to the tax basis of the asset - $8,000 = $800/year. This result is the same if the tax basis to book basis ratio is applied to book depreciation as follows:

Book Depreciation Expense	$1,000
Tax Basis $8,000 / Book Basis $10,000 =	80%
Straight Line Tax Depreciation	$800 per year

This method is used by the Staff to make sure that the straight line tax depreciation deduction, used in a rate case, is tied directly to the "annualized" book deprecation expense reflected in the Staff's cost of service. A historical amount for straight line tax depreciation will not reflect a change in the book deprecation rates being recommended by the Staff or a full year's deduction for plant additions between the end of the test year and the known and measurable update period.

Q. Does an adjustment need to be made to the tax basis prior to calculating straight line tax depreciation for ratemaking purposes?

A. Yes. Retirements for vintage property depreciated under the Asset Depreciation Range (ADR) are not reflected in the tax basis until the entire vintage is fully depreciated. This results in a mismatch between the book basis and tax basis for these assets because the retirements are reflected in the book basis of depreciable property but not in the tax basis. Reducing the tax basis for ADR retirements eliminates this mismatch for calculating the straight line tax depreciation deduction.

Q. Does the Staff's method for computing straight line tax depreciation result in a corresponding tax deduction for all assets accruing book depreciation for rate recovery?

A. Yes. The Staff and KCPL use mass asset accounting rules under Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) for accruing depreciation expense for financial reporting and ratemaking purposes. Under mass asset accounting, individual assets, in a specific account, are not tracked for depreciation purposes. All assets in an account continue to accrue depreciation expense for accounting and ratemaking purposes until the entire account is fully depreciated. The Staff's method for calculating straight line tax depreciation results in a corresponding tax deduction for all assets accruing book depreciation for rate recovery. Ratepayers are entitled to a straight line tax deduction for all book deprecation included in rates.

<u>DEFERRED INCOME TAX AND AMORTIZATIONS</u>

Q. What does the term, deferred income tax, generally refer to with regard to calculating income tax expense for a regulated utility?

A. There are "timing differences" between when specific costs are reflected in determining pretax accounting income and when they are reflected in determining current year taxable income for the Internal Revenue Service (IRS). In calculating income tax for ratemaking purposes, timing differences can be reflected consistent with when they are reflected under IRS rules (flow through treatment) or they can be reflected consistent with when they are reflected in determining pretax income for financial accounting purposes (normalization treatment). When timing differences are normalized for ratemaking purposes, a deferred tax adjustment is used for the purpose of not reflecting the timing of cost recognition under IRS rules. Deferred taxes are reversed in subsequent years (Column E & G, Schedule 2, years 6-10) consistent with the timing for recognizing the related costs for financial reporting purposes in determining pretax operating income. The deferral of the difference between accelerated tax depreciation and straight line tax depreciation in Column E & G of Schedule 2 is an example of normalization treatment for a tax timing difference.

Q. Is normalization treatment required for using an accelerated depreciation method under IRS rules?

A. Yes. As previously stated, normalization treatment is required for an accelerated depreciation method for a regulated utility. The tax deduction for depreciation cannot be reflected for ratemaking purposes any quicker that the timing for recognizing book depreciation in rates. The Staff's method for calculating straight line tax depreciation complies with the IRS normalization requirements for a regulated utility. Staff adjustment S-89 reflects the deferred taxes resulting from normalizing the tax timing difference for accelerated tax depreciation.

Q. You mentioned previously that prior to the 1986 Tax Reform Act, there were tax timing differences for property taxes, interest, payroll taxes and pension cost. How were these timing differences reflected for ratemaking purposes prior to 1986?

A. Flow through treatment (current year deduction) was used for all Missouri utilities unless the utility could demonstrate the need for additional cash flow to meet interest coverage ratios. It is my understanding that KCPL received normalization treatment in rate cases prior to 1986 based upon a need for additional cash flow during significant construction activity related to new generation facilities.

Q. How are the normalized timing differences described in your last answer reflected for ratemaking purposes?

A. Timing differences which were reflected as a tax deduction in the current year, for current income tax to the IRS, were deferred (normalized) for ratemaking purposes. The tax deduction is reflected in rates by amortizing the deferred tax balance over the depreciable life of the property. Staff's income tax calculation for KCPL, in this current case, reflects the amortization of prior timing differences which were normalized in prior rate cases. Adjustment S-94 reflects an annual amortization of deferred taxes resulting from normalization treatment in prior cases.

Q. Does the Staff's income tax calculation also reflect an amortization of excess deferred taxes resulting from a reduction in the federal tax rate?

A. Yes. The 1986 Tax Reform Act reduced the federal tax rate for corporations from 46% to 34%. As a result all deferred taxes, previously reflected in rates, based upon an assumed 46% tax rate, were overstated. The IRS allowed a regulated utility to flow back (amortize) the excess deferred taxes over the approximate depreciable book life of the property. The Staff's income tax calculation, for KCPL in this current case, reflects an amortization of excess deferred taxes resulting from the reduction in the federal tax rate in

1986. Adjustment S-90 reflects an annual amortization of the excess deferred taxes resulting from the reduction in the federal tax rate.

Q. Does the Staff's income tax calculation also reflect an amortization of the investment tax credit?

A. Yes. Prior to the 1986 Tax Reform Act, a utility received a permanent tax credit for investing in new capital additions. For ratemaking purposes, the IRS allowed the utility to amortize (flow back to ratepayers) the investment tax credit over the approximate depreciable book life of the related property. Adjustment S-91 reflects an annual amortization of the deferred investment tax credit which was in effect prior to the 1986 Tax Reform Act.

Q. Is there a recent tax benefit for an electric utility resulting from the American Jobs Creation Act of 2004?

A. Yes. An additional tax deduction is available for income from qualified production facilities. In response to Staff Data Request No. 434, KCPL indicated that its tax deduction for 2006 is expected to be $2,531,000. The Staff's income tax calculation for KCPL, in this current case, reflects the Missouri jurisdictional share of the 2006 deduction.

OTHER POST RETIREMENT EMPLOYEE BENEFIT COSTS – FAS 106

Q. What is Financial Accounting Standard (FAS) 106?

A. FAS 106 is the Financial Accounting Standards Board (FASB) approved accrual accounting method used for financial statement recognition of annual Other Post-Retirement Employee Benefit (OPEB) costs.

Q. When was the FAS 106 accrual accounting method for OPEB costs adopted for ratemaking purposes?

A. House Bill 1405 (Section 386.315, RSMo), approved by the Missouri Legislature and signed into law by the Governor in 1994, required the adoption of FAS 106 for setting rates for OPEB costs. In Commission cases following the date that House Bill 1405 became law, the Staff began recommending the use of FAS 106 for determining ratemaking recovery for OPEB costs.

Q. What method was used for setting rates for OPEB costs before the effective date of Section 386.315, RSMo?

A. Prior to the effective date of Section 386,315, RSMo, rates were set on a "pay-as-you-go" or "cash" basis for OPEB costs. The utility's actual paid claims for OPEB cost, for current retirees, were included for recovery for ratemaking purposes.

Q. Does Section 386.315, RSMo, include a funding requirement as a prerequisite for the adoption of FAS 106 for ratemaking purposes?

A. Yes. The recognition of FAS 106 for ratemaking purposes is conditioned on a requirement that annual FAS 106 costs collected in rates be funded in a separate funding mechanism to be used solely for the payment of OPEB benefit costs to retirees. Paragraph 2 of Section 386.315 addresses the funding requirement:

> 2. A public utility which uses Financial Accounting Standard 106 shall be required to use an independent external funding mechanism that restricts disbursements only for qualified retiree benefits. In no event shall any funds remaining in such funding mechanism revert to the utility after all qualified benefits have been paid; rather, the funding mechanism shall include terms which require all funds to be used for employee or retiree benefits. This section shall not in any manner be construed to limit the authority of the commission to set rates for any service rendered or to be rendered that are just and reasonable pursuant to sections 392.240, 393.140 and 393.150, RSMo.

Q. Is KCPL currently in compliance with the funding requirement under Section 386.315, RSMo.?

A. Yes.

Q. Please explain Staff adjustments S- 78.7.

A. Adjustment S-78.7 adjusts KCPL's 2005 test year costs for FAS 106 to reflect the more current FAS 106 calculation for 2006.

PENSION COST - FAS 87

Q. What is Financial Accounting Standard (FAS) 87?

A. FAS 87 is the accrual accounting method for calculating pension cost for financial reporting purposes.

Q. Did the parties to KCPL's experimental regulatory plan case, Case No. EO-2005-0329, agree to a method under FAS 87 for calculating pension cost for ratemaking purposes?

A. Yes. Pages 10 – 15 of the Stipulation and Agreement address the method to be used under FAS 87 for calculating pension cost for ratemaking purposes. The Stipulation and Agreement also provides for a tracking mechanism intended to make KCPL whole when its actual pension cost exceeds the level being recovered in existing rates. Alternatively, if KCPL's pension cost drops below the level being collected in rates, the excess will be tracked and returned to ratepayers beginning in KCPL's next rate case.

Q. Does the Stipulation and Agreement reached in EO-2005-0329 address rate base recognition of a KCPL prepaid pension asset?

A. Yes. KCPL, like all major utilities in Missouri, recognized a negative pension cost under FAS 87 as a result of a well-funded pension plan and strong investment performance in the 1990's. Under FAS 87, a prepaid pension asset is recognized when FAS 87 pension cost is less than the cash contributions required under the Employee

Retirement Income Security Act (ERISA) of 1976. The pension cost agreement provides for rate base recognition of a prepaid pension asset of $ $34,694,918 (Missouri jurisdictional).

Q. Does the pension cost agreement address rate recovery of the prepaid pension asset?

A. Yes. The pension cost agreement requires KCPL to fund the FAS 87 cost being collected from ratepayers in rates. FAS 87 pension cost which exceeds the minimum funding requirement under ERISA is being used to pay down the prepaid pension asset. After the prepaid pension asset has been fully amortized in this fashion, KCPL is required to fund its annual FAS 87 cost in the same manner that Section 386.315, RSMo requires for FAS 106 cost collected in rates.

Q. What is the unrecovered balance of the prepaid pension asset reflected in the Staff's rate base?

A. The Staff's rate base includes an approximate balance of $21.4 million on a Missouri jurisdictional basis as of June 30, 2006. This amount will be updated through September 30, 2006 in the true up audit in this case.

Q. You mentioned previously that the pension settlement agreement tracks the difference between KCPL's actual pension cost under FAS 87 and the amount being collected in rates. How do KCPL's actual FAS 87 costs compare to the level recovered in rates?

A. The tracking mechanism under the pension cost agreement identified the FAS 87 pension cost included in existing rates to be $22,000,000 (Total Company). KCPL's actual FAS 87 cost since January 2005 has exceeded the level included in current rates by approximately $12.7 million (Missouri jurisdictional) through June 30, 2006. This amount will be updated through September 30, 2006 in the true up audit ordered for this case.

Q. Does the pension cost agreement in Case No. EO-2005-0329 address ratemaking treatment for the $12.7 million excess of KCPL's actual FAS 87 costs over the level recovered in existing rates?

A. Yes. The $12.7 million excess is recognized as a regulatory asset which is included in rate base and amortized over 5 years. If the reverse were true, a regulatory liability would have been used as an offset to rate base and amortized back to ratepayers over 5 years. The tracking mechanism treats the company and ratepayers in an equal fashion.

Q What is the purpose of adjustment S-78.3?

A. Adjustment S-78.3 adjusts the 2005 test year to reflect the 5 year amortization of the excess of KCPL's actual FAS 87 pension cost over the level recovered in rates since January of 2005.

Q. What is the purpose of adjustment S-78.4?

A. Adjustment S-78.4 adjusts the 2005 test year pension cost to reflect the 2006 level under FAS 87 as calculated by the Company's actuary.

REGULATORY PLAN AMORTIZATION

Q. What is the experimental regulatory plan amortization addressed in the Stipulation and Agreement in Case No. EO-2005-0329?

A. The Signatory Parties to the Stipulation and Agreement in Case No. EO-2005-0329 agreed that it is desirable for KCPL to maintain its debt at investment grade during the period of addressed in the agreement. The Signatory Parties agreed to support additional amortizations to maintain financial ratios:

> . . . As part of this commitment, the non-KCPL Signatory Parties agree to support the "Additional Amortizations to Maintain Financial

> Ratios", as defined in this section and related appendices, in KCPL general rate cases filed prior to June 1, 2010. . . . (page 19)
>
> The Signatory Parties agree to support an additional amortization amount added to KCPL's cost of service in a rate case when the projected cash flows resulting from KCPL's Missouri jurisdictional operations, as determined by the Commission, fail to meet or exceed the Missouri jurisdictional portion of the lower end of the top third of the BBB range shown in Appendix E, for the Funds from Operations Interest Coverage ratio and the Funds from Operations as a Percentage of Average Total Debt ratio. . . . (page 20)

This language requires a determination, in all rate cases between now and 2010, as to whether the cash flows, resulting from the revenue level recommended by the Staff's traditional cost of service, will be sufficient to meet the specified financial ratio range for two specific financial ratios identified in the above paragraph. Appendix F, attached to the Stipulation and Agreement, reflects the adjustment process that the Signatory Parties agreed to use for determining the Missouri jurisdictional amortization levels based upon Staff's recommended revenue level for setting rates in this case.

Q. Has the Staff performed the analysis to determine whether the annual revenue level recommended by the Staff in its cost of service calculation meets the benchmarks for the two financial ratios specified in the regulatory plan agreement?

A. Yes. Attached as Schedule 3 to this direct testimony is a copy of Attachment 1 to Appendix F from the Stipulation and Agreement in Case No. EO-2005-0329. The calculation is based upon the Staff's revenue requirement result and additional data supplied by KCPL in response to Staff Data Request Nos. 444 and 444.1.

Q. What additional data, supplied by KCPL, did you rely on for purposes of completing the financial ratio benchmark analysis?

A. The two financial ratios, Funds from Operations Interest Coverage and Funds From Operations as a Percentage of Average Total Debt, require additional balance sheet amounts and an assumed interest cost for each. These are referred to as Off Balance Sheet Obligations. For KCPL, these obligations include purchase power capacity contracts, operating lease agreements and accounts receivable sales. An assumed discount rate is used to determine the present value of these obligations with a corresponding interest cost being considered in the financial ratio calculations.

Q. Did you accept the discount rate assumption provided by KCPL for the Off Balance Sheet Obligations?

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

Q. What additional information was provided by KCPL to complete the financial ratio analysis?

A. The financial ratio analysis also considers short term debt and related interest expense. KCPL provide this data in response to Staff Data Request No. 441.

Q. Why is it critical that the Staff's revenue requirement determination and supporting cost of service calculation be used to benchmark the financial ratios agreed to in the experimental regulatory plan Stipulation and Agreement?

A. As a regulated electric utility, KCPL operates in the Kansas retail jurisdiction and the federal wholesale jurisdiction, in addition to operating in the Missouri retail jurisdiction. Also, KCPL is part of a holding company, GPE, which operates an unregulated business enterprise, Strategic Energy, which is an electricity provider in certain deregulated markets. The Stipulation and Agreement in Case No. EO-2005-0329 applies only to the Missouri jurisdiction of KCPL. Missouri ratepayers are not responsible for GPE's failure to meet the financial ratio benchmarks as a result of poor performance by KCPL's regulated Kansas jurisdiction or GPE's unregulated subsidiary, Strategic Energy. The additional amortization, if any, that is applicable from the financial ratio analysis in this proceeding should be based solely upon KCPL's Missouri jurisdictional operations.

Q. What are the results of the financial ratio benchmark analysis based upon the Staff's recommended revenue requirement resulting from Staff's cost of service determination?

A. The Staff's revenue requirement determination for KCPL based upon a traditional cost of service approach is an approximate revenue excess/earnings excess of $80 million based upon results as of June 30, 2006. This result does not consider the additional $107 million in Missouri jurisdictional plant expected to be in service by the September 30, 2006 true-up date ordered for this case, related depreciation expense and operations and maintenance expense. The amortization resulting from the financial ratio benchmark analysis will change with changes in the Staff's traditional revenue requirement result.

The financial ratio benchmark analysis generates a need for an additional amortization of approximately $75 million (excluding expected changes through September 30, 2006). It is the Staff's position in The Empire District Electric Company rate increase case, Case No. ER-2006-0315, and in this case that the additional amortization should not be grossed up for income taxes. For clarification then, assuming no change in the Staff's $80 million revenue excess/earnings excess determination, the additional $75 million amortization, to meet benchmark financial ratios, would offset all but $5 million of the Staff's recommended rate reduction of $80 million.

Thus, in lieu of a rate reduction under traditional ratemaking treatment, ratepayers would receive a $75 million rate base offset in KCPL's next rate case. This provision for a rate base offset appears throughout the KCPL experimental regulatory plan Stipulation and Agreement in Case No. EO-2005-0329 (see pages 18, 27, 32, 37 and 40 of the Stipulation and Agreement).

Q. Will the additional revenue requirement associated with plant additions from July through September 2006 reduce the amortization result from the financial ratio benchmark analysis?

A. Yes. An increase in the revenues/earnings from the traditional cost of service approach reduces the amount of the additional amortization needed to meet the financial ratio benchmarks.

Q. Does KCPL have an incentive to maximize revenue/earnings received under the traditional cost of service approach?

A. Yes. Under the Experimental Regulatory Plan Stipulation and Agreement, ratepayers receive a rate base offset for any amortization resulting from the financial ratio benchmark analysis. This lowers KCPL's revenue requirement in future rate cases. Alternatively, if KCPL prevails upon the Commission and obtains rate relief from the

Commission under traditional cost of service ratemaking treatment by the Commission adopting, for example, KCPL's proposed authorized rate of return and other of KCPL's revenue requirement proposals, thereby producing a positive, rather than a negative revenue requirement for KCPL, then the additional amortization mechanism is not activated and KCPL's rate base would not be reduced in KCPL's next rate case as a result of this rate case. Thus, KCPL has an incentive to maximize its requested return on equity, for the purpose of avoiding an amortization, resulting from the financial ratio benchmark analysis.

Q. You mentioned earlier that your financial ratio benchmark analysis resulted in an additional amortization of $75 million without consideration of any additional income tax. What are the income tax considerations related to the amortization generated by the credit ratio benchmark analysis?

A. The Staff considers the additional amortization to be a supplement to depreciation on KCPL's existing plant. A straight line tax depreciation deduction should be reflected consistent with the additional amortization in the Staff's cost of service determination. This treatment is consistent with the ratemaking treatment used for any increase in allowed depreciation expense.

Q. In fact, has the Staff used a similar "additional amortization" approach in addressing a prior excess earnings /revenue position for KCPL?

A. Yes. As part of a settlement of an earnings investigation of KCPL in Case No. EO-94-199, KCPL and the Staff agreed to an additional amortization of $3.5 million annually. In lieu of reducing KCPL's rates by an additional $3.5 million, KCPL was allowed to book an amortization of $3.5 million per year. This $3.5 million amortization has been treated as additional book depreciation with the accumulated balance being reflected as a reduction to rate base. A corresponding straight line tax depreciation deduction has been assumed in subsequent earnings/revenues investigations of KCPL.

Q. Does the Stipulation and Agreement in Case No. EO-2005-0329 express agreement among the parties as to whether any additional amortization to meet financial ratios should be grossed up for income tax?

A. No. The Stipulation and Agreement addresses this issue on page 21:

> … Additional taxes will be added to the amortization to the extent that the Commission finds such taxes to be appropriate …

This language indicates that the Commission may be required to make a decision on this issue.

Q. Does the Staff's filed revenue requirement include an estimated revenue requirement impact for plant additions and related costs through September 30, 2006?

A. Yes. The Staff has included an additional $20 million in revenue requirement related to expected plant additions and related expenses expected between June 30, 2006, and September 30, 2006.

Q. Does the financial ratio benchmark analysis discussed in this direct testimony address this estimated $20 million in revenue requirement for plant additions and related costs through September 30, 2006?

A. No, it does not. The Experimental Regulatory Plan amortization will be updated for all changes to the Staff's recommended revenue requirement which occur between June 30, 2006, and September 30, 2006.

OFF-SYSTEM SALES

Q. Has Staff included in this case, the net margin (profit) from off-system sales in the interchange market?

A. Yes. Staff has determined the level of off-system net margin that KCPL experienced during the 12 months ended December 31, 2005, (the test year used in this case) and included that amount in this case. The net margin includes both the sales revenue and related fuel and purchase power costs for resale.

Q. What are off-system sales?

A. Off-system sales relate to sales of electricity made at times when utilities have met all obligations to serve their native load customers and have excess energy to sell to other utilities. The off-system sale transactions occur between utilities resulting in profits (net margin) to the selling entity, in this case, KCPL.

Q. What levels of net margin from off-system sales has KCPL experienced over the last several years?

A. For the period 2001 through 2005 and budget for 2006 and 2007, KCPL experienced and projected the following levels of net margin (net profit) from off-system sales:

Year	**Dollars**	
2001	** __________ **	
2002	** __________ **	
2003	** __________ **	
2004	** __________ **	
2005	** __________ **	
2006	** ___________ **	Budget

2007 ** ___________ ** Budget

[Staff Data Request 99.1R and 234]

Q. Why is it appropriate to include the net margin from off-system sales in the current revenue requirement determination for KCPL?

A. The same generating facilities, equipment, and employee/personnel that are necessary to provide service to Missouri retail electric customers are also needed to make off-system sales. It is appropriate to include the net margin from off-system sales in this case because KCPL customers are paying for all costs associated with the facilities to produce electricity for the firm retail customers, i.e., native load customers. To the extent that other sales can be made using those same facilities, the customers should benefit from these sales. The off-system sales are made at a time when the generating facilities are not needed to serve the native load customers. Off-system sales represent an efficient utilization of the electric system that has been put in place to meet the native load customers' electricity needs. Off-system sales occur at a time when the production facilities and purchases are not needed for Missouri retail customers.

Q. Are all the costs of the plant investment and costs to provide off-system sales within the Missouri jurisdiction assigned or allocated to an electric utility's Missouri retail customers?

A. Yes. All of these costs are included in the overall revenue requirement calculation. Return of and on plant investment and equipment, material and supplies and prepayments, costs of fuel, payroll and payroll benefit costs, training and employee development costs to operate the power production and transmission facilities; all costs relating to the production and transmission dispatch centers including the building (office) costs, payroll and payroll benefit costs, employee development and training costs, computer and software costs are all assigned and allocated to the Missouri retail jurisdiction and included in customer rates.

Q. Does KCPL benefit from the net margin from off-system sales?

A. Yes. To the extent that there are increases in off-system sales that occur after rates are determined in any given proceeding, the Company will benefit from the growth and increase in net margins (off-system sales less fuel costs) throughout the period until rates are changed by the Commission in a general rate proceeding. Since KCPL has not had a rate case for over 20 years, the Company has directly benefited from the very significant increase in the off-system sales market since the mid-1990s. KCPL has experienced very significant growth to which it has directly benefited. Any sales over and above the level of sales at which rates were established goes directly to KCPL's earnings.

Q. Has the Commission recognized the benefits of including the net margin from off-system sales in the determination of revenue requirements in prior cases?

A. Yes. In a 1997 Aquila, Inc. (then UtiliCorp United, Inc.) rate case, Case No. ER-97-394, the Commission commented respecting the novel position that UtiliCorp proposed as follows: "UtiliCorp states that significant risk exists in the current UtiliCorp effort to enhance off-system sales and that there must be some incentive to UtilitCorp and its stockholders to aggressively pursue off-system sales. . . . To fairly compensate the UtiliCorp shareholders for assuming this risk, and as a future incentive, UtiliCorp is proposing to split the revenue derived from its test year sales on a 50/50 basis, including applying one-half of the total in revenue as an offset to rates while holding the other one-half out of revenue." The Commission stated, in part, as follows:

> The Commission finds the Staff provided competent and substantial evidence that all of the off-system sales revenue should be reflected in the test year revenue for the purposes of setting rates. The Staff is correct in stating that, since all of the costs of producing the off-system sales revenue were borne by the ratepayers, and since UtiliCorp has benefited from regulatory lag, the total amount of this revenue should be included in rates.
>
> The Commission adopts the adjustment proposed by the Staff.

Electrical corporations, other than in this just mentioned 1997Aquila case, and Staff in all cases that I am aware of dating back to the late 1970s have consistently included the net margin from off-system sales in the determination of revenue requirement.

Q. Did the KCPL Experimental Regulatory Plan address off-system sales?

A. Yes. KCPL specifically agreed to the inclusion of off-system sales in the ratemaking process. On July 27, 2005, a pleading was filed in Case No. EO-2005-0329 entitled Signatory Parties' Response to Order Directing Filing, which states in part as follows:

> KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process. KCPL agrees that all of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates.

In a separate pleading filed on July 27, 2005, Staff's and Public Counsel's Additional Response to Order Directing Filing, Staff and Public Counsel further state as follows with regard to the off-system sales issue:

> KCPL, pursuant to its commitment to explicitly address the term of the understanding among the Staff, Public Counsel and KCPL concerning the treatment above-the-line of off-system energy and capacity sales revenue and related costs, has added the following sentence to the paragraph on off-system sales in the Stipulation And Agreement filed

> March 28, 2005: "KCPL agrees that all of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates."

Q. Did the Commission address off-system sales in its Order approving KCPL's Regulatory Plan?

A. Yes. The Commission stated at page 18 of its Order in Case No. EO-2005-0329 regarding off-system sales the following:

> Under the terms of the Stipulation, KCPL agrees that off-system energy and capacity sales revenues 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 treatment for off-system sales as long as the Iatan 2 costs were included in KCPL's rate base. (Tr. 1037-38).[4]
>
> [4] Also in their July 26 Response to Order Directing Filing, the Signatory Parties memorialized KCPL's agreement that all of its off-system sales would be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in determining those rates, and amended Section III.B.1.j. of the Stipulation and Agreement.

Q. Did KCPL agree to amend the original language in the Stipulation and Agreement the Company signed on March 28, 2005, relating to off-system sales?

A. Yes. In the July 26 Response to Order Directing Filing, KCPL agreed to amend Section III.B.1.j. of the Stipulation and Agreement to include the language "that all of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates."

The original language included in the Stipulation and Agreement concerning the Experimental Regulatory Plan, appearing at page 22, stated:

> KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process.

Q. Did Kansas Commission include off-system sales in its Order approving KCPL's Regulatory Plan in Kansas?

A. Yes. The KCPL Regulatory Plan in Kansas is very similar to one agreed to in Missouri. In the Kansas Stipulation and Agreement, filed in Docket No. 04-KCPE-1025-GIE, off-system sales were agreed to be included in the ratemaking process by the signatory parties to KCPL's Kansas proceeding. In Appendix C attached to the Kansas Stipulation in that docket, the following appears regarding the rate treatment of off-system sales:

> The Parties also agree that profits from off-system sales should continue to be included above-the-line in the regulatory process during the term of the Five-Year Regulatory Plan. KCPL specifically agrees not to propose any adjustment or modification that would remove any portion of its off-system sales costs and revenues from being passed through the ECA mechanism. The specific details of the ECA mechanism will be determined in the 2006 rate proceeding.

Q. Do other state commissions recognize the importance of including off-system sales in the determination of rates?

A. Yes. In an UtiliCorp United Inc. rate application filed in Kansas on December 8, 2000, its West Plains Energy, Kansas (West Plains) division proposed an adjustment to remove a portion of off-system sales from above the line treatment through a 50/50 "sharing" mechanism before the Kansas State Corporation Commission (KCC) in Docket No. 01-WPEE-473-RTS. The KCC rejected this proposal stating:

> **<u>F. Sharing of Off-System Sales Margins</u>**

> 30. West Plains asks the Commission to reconsider its decision in Docket No. 99-WPEE-818-RTS to not allow West Plains to share in off-system sales margins. The Commission's decision was affirmed by the Kansas Court of Appeals in *UtiliCorp United, Inc. d/b/a West Plains Energy Kansas v. KCC,* slip op.85,716 (Kan.App.December 15, 2000). As discussed in Order Nos. 10 and 13 in Docket No. 99-WPEE-818-RTS, **the cost of off-system sales are borne entirely by the ratepayers, while the Applicant has enjoyed all of the benefits of the increased revenue.** If all of the costs are borne by the ratepayers, then **all of the benefits of increased revenues should be enjoyed by the ratepayers. The full measure of revenues and costs related to these sales should be reflected in the cost of service at test year levels.**

> 31. West Plains again asserts its proposed sharing mechanism provides incentive for West Plains to engage in off-system sales and compete in the marketplace. [Keith, Rebuttal at 17]. West Plains submits its proposed sharing mechanism is similar to the sharing mechanism allowed in another Commission proceeding, Docket No. 190,061-U. [Keith, Rebuttal at 17]. These arguments are the same arguments made by West Plains in Docket No. 99-WPEE-818-RTS. Consistent with the decision in Docket No. 99-WPEE-818-RTS, Staff made an adjustment to add back 50 percent of the sales margins that had been removed in the schedules filed by West Plains with its rate application.

> 32. The **Commission remains concerned about any sharing mechanism that allocates the sales margins where 100 percent of the costs are borne by the customers.** The Commission has not accepted a sharing mechanism, as proposed by West Plains, for any other electric public utility. The **Applicant has an incentive to continue making off-system sales because the Applicant would retain all profits exceeding the normalized level reflected in the Applicant's overall revenue requirement. The Commission finds no compelling argument has been advanced by the Applicant to justify the Commission's departure from the prior decision and**

> **adoption of a new policy regarding off-system sales. Staff's adjustment to off-system sales revenues is accepted.**
>
> [August 15, 2001 Order of KCC in Docket No. 01-WPEE-473-RTS, page 13-14; emphasis added]

Thus, UtiliCorp proposed a "sharing" mechanism in Kansas on two occasions and the KCC rejected the proposal in both instances.

Q. Have the net margins from off-system sales been reflected in the overall revenue requirement used to set rates in other electric utility rate cases in Missouri?

A. Yes. I have been involved in numerous electric rate increase cases, earnings/revenues review cases, and excess earnings/revenues complaint cases in my years of employment at the Commission involving KCPL, Aquila, Inc. and its predecessors UtiliCorp United, Inc. and Missouri Public Service Company, St. Joseph Power & Light Company and The Empire District Electric Company. I am also generally aware of similar regulatory activity respecting Union Electric Company, now d/b/a AmerenUE and Arkansas Power & Light Company, which sold most of its Missouri service territory to UE early last decade. The net margin from off-system sales have consistently been used by the Staff and accepted by the Commission to determine the overall revenue requirement of electrical corporations within the Commission's jurisdiction.

Q. Are off-system sales a part of the true-up process in this case?

A. Yes. At page 30 of the Stipulation and Agreement in Case No. EO-2006-0329, under paragraph a. Rate Filing # 1 (2006 Rate Case) the Signatory Parties anticipated that the true-up would include off-system sales:

> (i) <u>Schedule.</u> . . . The specific list of items to be included in the true-up proceeding shall be mutually agreed upon between KCPL and the Signatory Parties, or ordered by the Commission during the course of the rate case. However, the Signatory Parties anticipate that the true-up items will include, but not necessarily be limited to, revenues including

> off-system sales, fuel prices and purchased power costs, payroll and payroll related benefits, plant-in-service, property taxes, depreciation and other items typically included in true-up proceedings before the Commission.

In fact, this same language is used for each of the four rate cases contemplated in the KCPL Experimental Regulatory Plan.

Q. Does Staff intend to review KCPL's net margin from off-system sales as part of the true-up audit agreed to and directed for this case through September 30, 2006?

A. Yes. As stated previously, the Staff's direct filing reflects the net margin from off-system sales revenue and costs based upon the test year level, 2005. The Staff will revisit this position after reviewing actual data for the nine month period ending September 30, 2006.

Q. Does this conclude your direct testimony?

A. Yes, it does.

Steve M. Traxler

SUMMARY OF RATE CASE INVOLVEMENT

Year	Case No.	Utility	Type of Testimony	
1978	Case No. ER-78-29	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979	Case No. ER-79-60	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979		Elimination of Fuel Adjustment Clause Audits Due to Missouri Supreme Court Decision (all electric utilities)		
1980	Case No. ER-80-118	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1980	Case No. ER-80-53	St. Joseph Light & Power Company (electric)	Direct	Stipulated
1980	Case No. OR-80-54	St. Joseph Light & Power Company (transit)	Direct	Stipulated
1980	Case No. HR-80-55	St. Joseph & Power Company (industrial steam)	Direct	Stipulated
1980	Case No. TR-80-235	United Telephone Company of Missouri (telephone)	Direct Rebuttal	Contested
1981	Case No. TR-81-208	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1981	Case No. TR-81-302	United Telephone Company of Missouri (telephone)	Direct Rebuttal	Stipulated
1982	Case No. ER-82-66	Kansas City Power & Light Company	Rebuttal	Contested
1982	Case No. TR-82-199	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal	Contested
1982	Case No. ER-82-39	Missouri Public Service	Direct Rebuttal Surrebuttal	Contested
1990	Case No. GR-90-50	Kansas Power & Light - Gas Service Division (natural gas)	Direct	Stipulated

Year	Case No.	Utility	Type of Testimony	
1990	Case No. ER-90-101	UtiliCorp United Inc., Missouri Public Service Division (electric)	Direct Surrebuttal	Contested
1991	Case No. EM-91-213	Kansas Power & Light - Gas Service Division (natural gas)	Rebuttal	Contested
1993	Case Nos. ER-93-37	UtiliCorp United Inc. Missouri Public Service Division (electric)	Direct Rebuttal Surrebuttal	Stipulated
1993	Case No. ER-93-41	St. Joseph Light & Power Co.	Direct Rebuttal	Contested
1993	Case Nos. TC-93-224 and TO-93-192	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1993	Case No. TR-93-181	United Telephone Company of Missouri	Direct Surrebuttal	Contested
1993	Case No. GM-94-40	Western Resources, Inc. and Southern Union Company	Rebuttal	Stipulated
1994	Case Nos. ER-94-163 and HR-94-177	St. Joseph Light & Power Co.	Direct	Stipulated
1995	Case No. GR-95-160	United Cities Gas Co.	Direct	Contested
1995	Case No. ER-95-279	Empire Electric Co.	Direct	Stipulated
1996	Case No. GR-96-193	Laclede Gas Co.	Direct	Stipulated
1996	Case No. WR-96-263	St. Louis County Water	Direct Surrebuttal	Contested
1996	Case No. GR-96-285	Missouri Gas Energy	Direct Surrebuttal	Contested
1997	Case No. ER-97-394	UtiliCorp United Inc. Missouri Public Service (electric)	Direct Rebuttal Surrebuttal	Contested
1998	Case No. GR-98-374	Laclede Gas Company	Direct	Settled
1999	Case No. ER-99-247 Case No. EC-98-573	St. Joseph Light & Power Co.	Direct Rebuttal Serrebuttal	Settled
2000	Case No. EM-2000-292	UtiliCorp United Inc. and St. Joseph Light & Power Merger	Rebuttal	Contested

Year	Case No.	Utility	Type of Testimony	
2000	Case No. EM-2000-369	UtiliCorp United Inc. and Empire Electric Merger	Rebuttal	Contested
2000	Case No. EM-2000-369	UtiliCorp United Inc. and Empire Electric District Co.	Rebuttal	Contested
2001	Case No. TT-2001-328	Oregon Mutual Telephone Co.	Direct	Settled
2002	Case No. ER-2001-672	UtiliCorp United Inc.	Direct, Surrebuttal	Settled
2002	Case No. EC-2002-1	Union Electric Company d/b/a AmerenUE	Surrebuttal	Settled
2003	Case Nos. ER-2004-0034 and HR-2004-0024 (Consolidated)	Aquila, Inc., d/b/a Aquila Networks-MPS and Aquila Networks-L&P	Direct	Stipulated
2004	Case Nos. ER 2005-0436 HR 2005-0450	Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks-L&P	Direct Surrebuttal	Settled

LineNo.		
1	Asset Cost	$ 8,000
2	Interest Capitalized in Book Basis (Deducted in Current Year for IRS Tax)	$ 2,000
3	**Total Book Basis for Asset**	**$ 10,000**
4	**Tax Basis for Asset**	**$ 8,000**
5	Accelerated Tax Depreciation Rate - 5 years = 20%	
6	Book and Straight Line Tax Depreciation Rate - 10 years = 10%	

		Book Depreciation	Interest Deduction	Accelerated Tax Depreciation	Straight Line Tax Depreciation	Tax Deprec. to be Deferred	Effective Tax Rate	Deferred Tax Expense	Accumulated Deferred Income Tax
		(A)	(B)	(C)	(D)	(E) (C) - (D)	(F)	(G) (E) X (F)	(I)
7	Year 1	$1,000	$2,000	$1,600	$800	$800	38%	$304	$304
8	Year 2	$1,000	$0	$1,600	$800	$800	38%	$304	$608
9	Year 3	$1,000	$0	$1,600	$800	$800	38%	$304	$912
10	Year 4	$1,000	$0	$1,600	$800	$800	38%	$304	$1,216
11	Year 5	$1,000	$0	$1,600	$800	$800	38%	$304	$1,520
12	Year 6	$1,000	$0	$0	$800	($800)	38%	($304)	$1,216
13	Year 7	$1,000	$0	$0	$800	($800)	38%	($304)	$912
14	Year 8	$1,000	$0	$0	$800	($800)	38%	($304)	$608
15	Year 9	$1,000	$0	$0	$800	($800)	38%	($304)	$304
16	Year 10	$1,000	$0	$0	$800	($800)	38%	($304)	$0
17	Total	$10,000	$2,000	$8,000	$8,000	$0		$0	$0

Schedule 2

Attachment 1 to Appendix F

Information from the Company's annual Surveillance Report

Line			Total Company	Jurisdictional Allocation	Jurisdictional Adjustments	Jurisdictional Proforma
7	Rate Base		NA	1,042,994,653		
8	Jusrisdictional Allocator for Capital	Jurisdictional Rate Base / Total Company Rate Base		52.4%		
9						
10	Total Capital	Barnes Schedule 9	2,413,866,000	1,265,684,805	-	1,265,684,805
11	Equity	Barnes Schedule 9	1,229,711,000	644,785,803	-	644,785,803
12	Preferred	Barnes Schedule 9	39,000,000	20,449,233		20,449,233
13	Long-term Debt	Barnes Schedule 9	1,145,155,000	600,449,769		600,449,769
14	Cost of Debt	Barnes Schedule 10	5.86%	5.86%		5.86%
15	Interest Expense	Line 13 * Line 14	67,140,438	35,204,370	-	35,204,370
16						
17	Retail Sales Revenue	Staff Accounting Schedule 9-1 plus Revenue Requirement	0	409,331,276	75,230,678	484,561,954
18	Other Revenue	Staff Accounting Schedule 9-1	0	114,178,128		114,178,128
19	Operating Revenue	Staff Accounting Schedule 9-1	0	523,509,404	75,230,678	598,740,082
20						
21	Operating & Maintenance Expenses	Staff Accounting Schedule 9-3 - Less Customer Deposit Interest		329,489,042		329,489,042
22	Depreciation	Staff Accounting Schedule 9-3		51,472,027		51,472,027
23	Amortization	Staff Accounting Schedule 9-3		2,520,523	75,230,678	77,751,201
24	Interest on Customer Deposits					0
25	Taxes other than income taxes	Staff Accounting Schedule 9-3		35,453,227		35,453,227
26	Federal and State income taxes	Staff Accounting Schedule 9-4		25,098,392		25,098,392
27	Gains on disposition of plant			0		0
28	Total Electric Operating Expenses	Sum of Lines 21 to 27	0	444,033,211	75,230,678	519,263,889
29						
30	Operating Income	Staff Accounting Schedule 1-1 Line 3	0	79,476,193	0	79,476,193
31	less Interest Expense	- Line 15	-	(35,204,370)	-	(35,204,370)
32	Depreciation	Staff Accounting Schedule 9-3		51,472,027	-	51,472,027
33	Amortization	Staff Accounting Schedule 9-3		2,520,523	75,230,678	77,751,201
34	Deferred Taxes	Staff Accounting Schedule 9-4		10,976,162		10,976,162
35	Funds from Operations (FFO)	Sum of Lines 30 to 34	-	109,240,535	75,230,678	184,471,213
36						
37	Net Income	Line 30 + Line 31	-	44,271,823	-	44,271,823
38	Return on Equity	Line 37 / Line 11	0.0%	6.9%	0.0%	6.9%
39	Unadjusted Equity Ratio	Line 11 / Line 10	50.9%	50.9%	0.0%	50.9%

Additional financial information needed for the calculation of ratios

Line			Total Company	Jurisdictional Allocation	Jurisdictional Adjustments	Jurisdictional Proforma
43	Capitalized Lease Obligations	KCPL Trial Balance accts 227100 & 243100	2,314,096	1,213,371		1,213,371
44	Short-term Debt Balance	KCPL Trial Balance accts 231xxx	82,400,000	43,205,558		43,205,558
45	Short-term Debt Interest	KCPL T.B. accts 831014, 831015, 831016	5,681,983	2,979,287		2,979,287

Adjustments made by Rating Agencies for Off-Balance Sheet Obligations

Line			Total Company	Jurisdictional Allocation	Jurisdictional Adjustments	Jurisdictional Proforma
49	Debt Adjustments for Off-Balance Sheet Obligations					
50	Operating Lease Debt Equivalent	Present Value of Operating Lease Obligations discounted @ 6.1%	86,657,361	45,437,860		45,437,860
51	Purchase Power Debt Equivalent	Present Value of Purchase Power Obligations discounted @ 6.1%	20,739,514	10,874,542		10,874,542
52	Accounts Receivable Sale	KCPL Trial Balance account 142011	70,000,000	36,703,751		36,703,751
53	Total OBS Debt Adjustment	Sum of Lines 50 to 52	177,396,875	93,016,153	-	93,016,153
54						
55	Interest Adjustments for Off-Balance Sheet Obligations					
56	Present Value of Operating Leases	Line 50 * 6.10%	5,286,099	2,771,709	-	2,771,709
57	Purchase Power Debt Equivalent	Line 51 * 6.10%	1,265,110	663,347	-	663,347
58	Accounts Receivable Sale	Line 52 * 6.1%	4,270,000	2,238,929	-	2,238,929
59	Total OBS Interest Adjustment	Sum of Lines 56 to 58	10,821,209	5,673,985	-	5,673,985

Ratio Calculations

Line			Total Company	Jurisdictional Allocation	Jurisdictional Adjustments	Jurisdictional Proforma
63	Adjusted Interest Expense	Line 15 + Line 45 + Line 59	83,643,630	43,857,642	-	43,857,642
64	Adjusted Total Debt	Line13 + Line 43 + Line 44 + Line 53	1,407,265,971	737,884,852	-	737,884,852
65	Adjusted Total Capital	Line 10 + Line 43 + Line 44 + Line 53	2,675,976,971	1,403,119,887	-	1,403,119,887
66						
67	FFO Interest Coverage	(Line 35 + Line 63) / Line 63	1.00	3.49	1.72	5.21
68	FFO as a % of Average Total Debt	Line 35 / Line 64	0.0%	14.8%	10.2%	25.0%
69	Total Debt to Total Capital	Line 64 / Line 65	52.6%	52.6%	0.0%	52.6%

Changes required to meet ratio targets

Line			Total Company	Jurisdictional Allocation	Jurisdictional Adjustments	Jurisdictional Proforma
73	FFO Interest Coverage Target		3.80	3.80	0.00	3.80
74	FFO adjustment to meet target	(Line 73 - Line 67) * Line 63	234,202,164	13,560,863	(75,230,678)	(61,669,815)
75	Interest adjustment to meet target	Line 35 * (1 / (Line 73 - 1) - 1 / (Line 67 - 1))	#DIV/0!	(4,843,165)	26,868,099	22,024,934
76						
77	FFO as a % of Average Total Debt Target		25%	25%	0%	25%
78	FFO adjustment to meet target	(Line 77 - Line 68) * Line 64	351,816,493	75,230,678	(75,230,678)	-
79	Debt adjustment to meet target	Line 35 * (1 / Line 77 - 1 / Line 68)	#DIV/0!	(300,922,712)	300,922,712	-
80						
81	Total Debt to Total Capital Target		51%	51%	0%	51%
82	Debt adjustment to meet target	(Line 81 - Line 69) * Line 65	(42,517,716)	(22,293,709)	-	(22,293,709)
83	Total Capital adjustment to meet target	Line 64 / Line 81 - Line 65	83,368,070	43,713,155	-	43,713,155

Amortization and Revenue needed to meet targeted ratios

Line			Total Company	Jurisdictional Allocation	Jurisdictional Adjustments	Jurisdictional Proforma
87	FFO adjustment needed to meet target ratios	Maximum of Line 74 , Line 78 , or Zero	351,816,493	75,230,678	(75,230,678)	-
88	Effective income tax rate	Surveillance Report Schedule 7, Line 0370 / Line 0160	38.57%	38.64%	38.64%	38.64%
89	Deferred income taxes *	- Line 87 * Line 88 / (1 - Line 88)	(220,907,623)	(47,383,840)	47,383,840	-
90	Total amortization required for the FFO adjustment	Line 87 - Line 89	572,724,116	122,614,518	(122,614,518)	-
91						
92	Retail Sales Revenue Adjustment	Adjustment =Sum(Line 21 to Line 25)+Line 27-Line 18-Line 31+(Line 11*Line 38)/(1-Line 88)		409,331,276	75,230,678	484,561,954
93	Percent increase in retail sales revenue	Line 92 Jurisdictional Adjustments / Line 92 Jurisdictional			18.4%	

* Adjusted for known and measurable changes including changes related to new plant in-service

Schedule 3