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 PREHEARING BRIEF

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

Introduction

Kansas City Power and Light Company (KCPL) filed its tariffs seeking a general rate increase, together with its direct testimony and other minimum filing requirements, on February 1, 2006. The tariffs, effective eleven months later on January 1, 2007, seek a revenue increase of $57 million (11.5%). 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").

Pursuant to the procedural schedule adopted by the Commission on March 29, 2006, the score of parties to this matter have filed three rounds of prepared testimony, participated in prehearing conferences and settlement discussions, attended local public hearings, and worked cooperatively to establish a list of issues and schedule of witnesses for the evidentiary hearing set to commence on October 16, 2007.

The Commission understands that just and reasonable rates are determined in a two-step analytical process. In the first step, the revenue requirement is calculated; that is, the amount of income required by the utility on an annual basis. This amount is simply the sum of its prudent operating and maintenance expenses plus a fair return on the depreciated value of the assets dedicated to the public service. The second step in determining just and reasonable rates is designing a rate plan whereby to collect the required revenue from the utility's customers. This step is driven by a Class Cost of Service Study in which the utility's cost of service is assigned by various means to the several customer classes. Customers are classed according to their consumption characteristics and rates are generally designed so that the revenue realized from each customer class will cover its cost of service.

Staff's prehearing brief follows the order of issues established for the upcoming hearing. Due to the large number of issues that the Commission must resolve – 29, many with multiple sub-parts – Staff's treatment of each issue in its prehearing brief is necessarily concise.

Argument

A. Revenue Requirement:

1. Incentive Compensation:

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

This issue concerns incentive compensation -- financial bonuses -- paid by KCPL to various of its employees as rewards for meeting corporate goals. In accordance with the Commission's traditional treatment of incentive compensation, Staff proposes to exclude $3,028,308 in short-term awards and $899,007 in long-term awards paid in bonuses tied to goals that do not benefit ratepayers.

The Commission must understand that Staff seeks to exclude from cost of service only a fraction of the total amount paid by KCPL in incentive compensation during the test year. KCPL and its parent, Great Plains Energy (GPE) provide various incentive plans, including the Executive Plan, ValueLink and the Rewards Plan; GPE incentive compensation is charged to KCPL on an allocated basis. Short-term incentives are available to all employees; long-term incentives are available only to management. Short-term incentives operate under a two-step process. Funding is determined by GPE Earnings Per Share (EPS). Funds are distributed based on financial, operational and personal goals, but EPS is the primary goal. The GPE EPS goal is set by the Board of Directors. Although not all employees met their goals and received incentive compensation, the entire amount designated to fund incentive compensation was paid out.

Staff proposes to disallow short-term incentive compensation tied to financial goals. Staff proposes to exclude 32% of both the GPE and KCPL Executive Plan awards, 16% of the ValueLink awards and 20% of the Rewards Plan awards because shareholders rather than ratepayers are benefited by meeting the company's financial goals. Staff also proposes to exclude discretionary awards because the lack of clearly defined goals for such awards provides no basis for finding that they confer any benefit on the ratepayers.

The Commission has disallowed incentive compensation in the past where the goals were either ill-defined or tied primarily to shareholder wealth maximization. *In the Matter of Union Electric Company,* 29 Mo.P.S.C. (N.S.) 313,325 (*Report & Order,* 1987) ("an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the incentive plan."); *In the Matter of Southern Union Company, doing business as Missouri Gas Energy,* 5 Mo.P.S.C.3d 437, 458 (*Report & Order,* 1997) ("The Commission finds that the costs of MGE's incentive compensation program should not be included in MGE's revenue requirement because the incentive compensation program is driven at least primarily, if not solely, by the goal of shareholder wealth maximization, and it is not significantly driven by the interests of ratepayers."); *In the Matter of Southern Union Company, doing business as Missouri Gas Energy,* 12 Mo.P.S.C.3d 581, 606-7 (*Report & Order,* 2004):

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

> compensation plan relating to the company's financial goals will be excluded from the company's cost of service revenue requirement.

KCPL offers long term equity compensation (i.e., GPE stock) as incentive compensation for executives. Staff proposes to exclude these awards because (1) they were primarily tied to achieving of financial goals, including the performance of GPE's unregulated subsidiary; (2) they were funded with equity rather than cash; and (3) there is a double award for 2005 and 2006. Additionally, the equity incentives are tied to a "change in control" provision intended to assist in resisting hostile takeovers and to provide a "golden parachute" to management. There is no benefit to ratepayers. The Commission has previously disallowed awards based on achieving the goals of an unregulated parent and unregulated affiliates. For example, in *In the Matter of Southwestern Bell Telephone Company,* 29 Mo.P.S.C. (N.S.) 607, 627 (*Report & Order,* 1989), the Commission stated:

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

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

> The structure of the plan provides an implicit incentive for participants to try to increase SBC's stock price. This in turn could encourage senior managers to spend a greater percentage of time on non-regulated companies and discourage time and effort spent on Missouri operations . . . . The likelihood of SBC managers emphasizing whatever they perceive will cause the market to react

> favorably to SBC stock, including giving priority to unregulated subsidiaries, further convinces the Commission that Missouri ratepayers should not fund the long-term incentives.

KCPL's witness, David Cross, points out that incentive compensation awards are common in industry, including the utility industry, and that improvements in the Company's performance necessarily benefit ratepayers as well as shareholders. "In my professional opinion, the use of incentives for both executives and broad base employee populations is a tremendously powerful tool to ensure operational efficiency, which clearly serves the interests of utility customers." Cross points out that ratepayers benefit when KCPL can obtain financing at favorable rates, a direct result of its meeting its financial goals. Cross also points out that the incentive compensation program allows KCPL to attract and keep good managers, as well as to undertake and fund the Comprehensive Energy Plan.

Cross' comments are true, at least to some degree. Consequently, as stated above, Staff has allowed the majority of KCPL's incentive compensation cost in cost of service. Staff has only disallowed incentive awards that represent things that primarily benefit the shareholders. Those are things that should be paid for by the shareholders, regardless of any indirect benefit to the ratepayers. In the case of financial performance, Staff witness Harris points out that a strong financial performance is sometimes obtained by neglecting the things that the ratepayers depend on, like regular maintenance and tree-trimming. For these reasons, Staff urges the Commission to disallow that portion of KCPL's incentive compensation costs related to maximizing shareholder wealth and that portion unsupported by clearly defined goals.

2. Pensions:

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

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

a. Joint Partners and SERP:

On pages 10-11 of Kansas City Power & Light Company's Regulatory Plan—the Stipulation and Agreement the Commission approved in its July 28, 2005 Report and Order, as amended by Order dated August 23, 2005, in Case No. EO2005-0329—the parties agreed to methodology designed to implement the following:

> e. PENSION EXPENSE
>
> The intent of this pension expense agreement is to:
>
> A. Ensure that KCPL recovers the amount of the net prepaid pension asset representing the recognition of a negative Statement of Financial Accounting Standards No. 87 (FAS 87) result used in setting rates in prior years;
>
> B. Ensure that the amount collected in rates is based on the FAS 87 cost using the methodology described below in item 2;
>
> C. Ensure that once the amount in item A above has been collected in rates by KCPL, all pension cost collected in rates is contributed to the pension trust;
>
> D. Ensure that all amounts contributed by KCPL to the pension trust per items 3 and 5 below are recoverable in rates; and

> E. Ensure that KCPL will receive no more or less than the amount in item 3 below before KCPL is required to fund the plan.

They also agreed, "Any FAS 87 amount (as calculated in item 2 above), which exceeds the minimum Employee Retirement Income Security Act of 1974 ("ERISA") contribution, will reduce the prior net prepaid asset currently recognized in rate base of $63,658,444 ($34,694,918 Missouri jurisdictional)." (KCPL Regulatory Plan page 12).

Where the Staff and KCPL disagree in this case is whether the $34,694,918 Missouri jurisdictional amount is to be allocated among KCPL and its partners in generating plant it owns with them. The generating plants KCPL with partners are the Iatan and LaCygne stations. (Traxler Surrebuttal, pp. 4-5.) KCPL takes the position there should be no allocation among the partners. (Wright Rebuttal, p. 5-7.) Staff's position that the Missouri jurisdictional $34,694,918 must be apportioned among KCPL and its partners in the Iatan station (Aquila, Inc., and The Empire District Electric Company) and the LaCygne station (Westar Energy, Inc.) in the same proportion that payroll costs for those stations are allocated to those partners. (Traxler Surrebuttal, p. 5).

If the Missouri jurisdictional amount is not apportioned among the partners, the pension asset included in rate base for Kansas City Power & Light Company will be overstated and allow Kansas City Power & Light Company to recover from Kansas City Power & Light Company ratepayers amounts in excess of Kansas City Power & Light Company's costs and that, instead, its partners should recover. Further, if Kansas City Power & Light Company's position is accepted here and the allocation is properly made as Staff advocates here in rate cases brought by Aquila, Inc. or The Empire District Electric Company, then two Missouri utilities will recover the same amounts from their ratepayers for the same costs that are incurred only once, i.e., there will be a double recovery.

Because this rate case is one of a series of rate cases contemplated by the KCPL regulatory plan the Commission approved in Case No. EO2005-0329, the Staff anticipates that how this issue is resolved in this case likely will not only affect the rates the Commission orders here, but also how the Commission will address this issue in the future KCPL rate cases during the period of the KCPL regulatory plan. (Staff witness Traxler surrebuttal, pp. 4-5).

The Staff's dispute with Kansas City Power & Light Company regarding Supplemental Executive Retirement Plan costs is over Kansas City Power & Light Company's refusing to fund the SERP costs collected in rates. (Staff witness Traxler Surrebuttal, p. 9) Kansas City Power & Light Company is required by ERISA to fund its normal defined benefit pension plan which is a FAS 87 cost; however, ERISA does not require Kansas City Power & Light Company to fund its SERP. (Traxler Surrebuttal, p. 9).

As stated above, KCPL's Regulatory Plan has as one of its express intents that pension costs collected from ratepayers and accounted for under FAS 87 are contributed to the pension trust. (Subsection C of that portion of the plan quoted above). Therefore, because KCPL's SERP is accounted for under the FAS 87 accrual accounting method, unless KCPL actually funds its SERP, the Staff opposes the collection of accrued SERP costs in rates and, instead, proposes including an average annual amount of actual KCPL SERP benefit payments to retirees. (Traxler Surrebuttal, p. 9).

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?

This issue concerns the accounting treatment of monies recovered from insurance and lawsuits with respect to the destruction of KCPL's Hawthorn Station Unit 5, and the rebuild of that unit.

KCPL's Hawthorn 5 generating unit was originally commissioned into service in 1969. On February 17, 1999 an explosion at Hawthorn 5 totally destroyed the steam generator. KCPL decided to rebuild Hawthorn 5 after examining alternatives. KCPL needed the unit back in service as soon as possible so demolition of the plant took place in the spring and early summer of 1999 and construction began on the "new" unit in mid-summer 1999. Hawthorn 5 was substantially rebuilt to a new, state of the art, coal-fired base load generating unit with a completely new steam generator (boiler), feed water system and pumps, air quality control system including the installation of a Selective Catalytic Reduction (SCR) system, scrubber and bag-house, control room, transformer, fuel-handling equipment, and water intakes. The steam turbine generator was substantially rehabilitated and updated. (Williams Direct, pp. 31-32).

KCPL received insurance recoveries and lawsuit settlements amounting to $247.9 million. (Of this total, insurance recoveries amounted to $209.75 million and lawsuit settlements amounted to $38.178 million.). (Williams Direct, pp. 33, 36; Williams Surrebuttal, p. 3). There are two Staff Hawthorn 5 adjustments:

Accounting Treatment:

> One, KCPL booked the insurance recoveries and lawsuit settlements as an increase to depreciation reserve as salvage instead of a reduction of plant in service, results in the plant in service balance being overstated. As a consequence of KCPL's methodology, manual adjustment is required for both financial and regulatory purposes to remove the amount of depreciation relating to the amounts of plant construction received from insurance and lawsuit settlement. (Williams Direct, pp. 34, 36).

Allowance For Funds Used During Construction (AFDC):

> Two, KCPL has overstated the plant in service as a result of calculating AFDC on the entire cost of the reconstruction of Hawthorn 5 instead of treating the funds received from insurance recoveries before and during the reconstruction as an offset to the cost of reconstruction. (Williams Direct, p. 35). The total insurance proceeds were reduced by $5.0 million associated with replacement power and an additional $2.219 million relating to administrative and general cost offsets. These two amounts were not considered by the Staff as capital expenditures like the reconstruction of Hawthorn 5 costs. The net amount of insurance recoveries after the aforementioned deductions was the amount used as an offset to the cost of reconstruction which is used to calculate the AFDC. (Williams Surrebuttal, p. 16).

a. Accounting Treatment:

The Staff believes that KCPL should have booked the insurance recoveries and lawsuit settlements received before and during the reconstruction to plant in service as a direct offset to the cost of reconstruction. (Williams

Direct, p. 35). KCPL indicated to the Staff that insurance proceeds and lawsuit settlement amounts were booked to salvage in the depreciation reserve in accordance with the instructions for Account 108 of the USOA. (Williams Direct, p. 39). KCPL witness Lori Wright states in her rebuttal testimony that KCPL was required by Paragraph 108, Section B (18 CFR Ch. 1, p. 351) to treat the insurance proceeds related to Hawthorn 5 property damage as salvage and record the proceeds to FERC Account 108, Accumulated Provision For Depreciation. (Wright Rebuttal, p. 2).

A review of the instructions for Account 108 of the USOA shows that it was not designed to address KCPL's Hawthorn 5 situation:

> At the time of the retirement of depreciable electric utility plant, this account shall be charged with the book cost of the property retired and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance.

(Williams Direct, p. 39). In unusual, unique, extraordinary situations such as the rebuild of Hawthorn 5 due to a catastrophic explosion, a utility may seek a waiver or letter ruling from the FERC to deviate from the USOA. (Williams Surrebuttal, p. 10). The unusual nature of the events surrounding the Hawthorn 5 explosion is that the unit was not retired as the above FERC instruction suggests as Paragraph 108 states "at the time of the retirement…" While some equipment was retired and removed, the unit was rebuilt to like-new status. Thus, the unit was not retired. The above instructions for Paragraph 108 do not contemplate the circumstances surrounding the Hawthorn 5 rebuild.

The Staff accountants sought to review the issue with FERC auditors in the Regulatory Accounting Branch, Office of Enforcement, Division of Finance

Regulation. Staff accountants were not told anything to indicate that the Staff's approach was inappropriate. (Williams Surrebuttal, p. 9).

Even though KCPL did not seek a waiver or a letter ruling from the FERC, this Commission is not bound by the USOA to establish rates. The Commission's rule 4 CSR 240-20.030(4) states as follows:

> In prescribing this system of accounts, the commission does not commit itself to the approval or acceptance of any item set out in any account for the purpose of fixing rates or in determining other matters before the commission. This rule shall not be construed as waiving any recordkeeping requirement in effect prior to 1994.

(Williams Surrebuttal, p. 11).

The Staff would note two applicable Western District Court of Appeals decisions: *State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 645 S.W.2d 44, 53-54 (Mo.App. 1982) (hereinafter referred to as *SWBT*) and *Union Electric Co. v. Public Serv. Comm'n*, 136 S.W.3d 146 (Mo.App. W.D. 2004) (hereinafter referred to as *UE*).

In *SWBT* the Western District Court of Appeals addressed the Federal Communications Commission (FCC) counterpart to the FERC USOA. The FCC USOA permitted rate base inclusion of the cost of projects to be completed within one year or less, which projects are referred to as short-term construction work in progress (CWIP). The Western District Court of Appeals held that SWBT was not entitled to include short-term construction in rate base by reason of the FCC-ordered accounting rules, and also cited Missouri statute and Commission rule respecting the adoption of a system of accounts by the Commission. At the time of the *SWBT* case, Section 392.210.2 stated that "[t]he system of accounts required [to be established and used by telephone corporations] shall follow, as nearly as may be, the system prescribed by the interstate commerce commission." 645 S.W.2d at 54. By amendment in 1984, "Federal Communications Commission" was substituted for "interstate commerce commission" in Section 392.210.2. The Commission's rule 4 C.S.R. 240-30.040(3) stated as follows at the time of the *SWBT* decision:

> The adoption by telephone companies in Missouri of the uniform system of accounts issued by the Federal Communications Commission . . . shall in nowise bind the commission to the approval or acceptance of any item or account for the purpose of fixing rates or in determining any other matter that may come before the commission.

Id. By amendment, "telecommunications" was substituted for "telephone" in 4 C.S.R. 240-30.040(3), subsequent to 1982. As previously noted, the Western District Court of Appeals held that the Commission was not bound to include short-term CWIP in rate base. *Id.*

The Chapter 393 counterpart to Section 392.210.2 is Section 393.140(4) which states, in relevant part, that the Commission shall "[h]ave power, in its discretion, to prescribe uniform methods of keeping accounts, records and books, to be observed by . . . electrical corporations . . . engaged in the manufacture, sale or distribution of . . . electricity for light, heat or power . . ." The 4 CSR 240-20 counterpart to 4 CSR 240-30.040(3) is 4 CSR 240-20.030(4), which, as previously noted, states that in prescribing a system of accounts, the Commission does not commit itself to the approval or acceptance of any item set out in any account for the purpose of fixing rates or in determining other matters before the Commission.

In *UE*, UE took expenses for software work performed to modify its computers for the Y2K problem as an immediate expense because the software was not improved beyond its original state and but was merely restored to its normal working state. Since UE contended that the costs were merely part of the ongoing cost of preventing the failure of the systems and were in no way extraordinary, it should be allowed to expense the Y2K costs in the year incurred rather than capitalize them over time. Based upon the Staff's recommendation, the Commission determined that UE's Y2K costs should not be expensed because of the unusual and nonrecurring nature of these costs. The Commission ordered the costs deferred until the project was completed and all facts regarding the reasonableness and prudence of the expenses were available and an appropriate method of recovery could be determined. UE contended that the adjustment was proper only if the evidence demonstrated that the costs were unusual, non-recurring and extraordinary. *Id.* at 150, 155, 156. The Court affirmed the Commission as follows:

> There is sufficient evidence in the record to justify the Commission's finding that the Y2K problem and UE's resulting expenses were unusual, would not be recurring, and should be deferred until the project is complete, when the prudence of the expenditures and the appropriate method of recovery can be determined. We find the Commission's Order reasonable and supported by competent and substantial evidence upon the whole record.

Id. at 156.

b. AFDC:

The Staff reduced the amount of AFDC for Hawthorn 5 to $7.63 million from the $20.64 million calculated by KCPL to eliminate a return on proceeds that was calculated by KCPL on the insurance received. The $7.63 amount is a recalculation of AFDC considering the insurance recoveries that relate to the capital costs, excluding from the insurance recoveries amounts for insurance received of $5 million for replacement power and $2.19 million of cost described by KCPL as administrative and general cost offsets. (Williams Surrebuttal, pp. 5, 16). The books and records of KCPL should be corrected to reflect no allowance of AFDC on the insurance proceeds received by KCPL. The insurance proceeds were received by KCPL specifically for rebuilding the power plant, including the capital costs of the rebuild. The monies were not to cover other costs incurred by KCPL during the period of construction. KCPL's customers should not be required to pay the carrying cost for the funds used during construction that were covered by insurance proceeds. (Williams Surrebuttal, pp. 16-17).

Ms. Wright asserts that KCPL did not have excess cash from insurance proceeds to fund the Hawthorn 5 rebuild and therefore did not need to use as much debt or equity to pay for the project. She states that the Staff's analysis omits KCPL spent approximately $162 million in unreimbursed purchased power from the time of the explosion until the rebuild in service date of June 2001 and approximately $10.0 million on cost of removal, and KCPL incurred approximately $296 million in cash expenditures related to Hawthorn 5 in excess of insurance proceeds. (Wright Rebuttal, pp. 3-4).

It is not appropriate to use in the AFDC analysis the cash flow impacts of the amounts expended by KCPL for (i) replacement power not covered by insurance and (ii) cost of removal of the destroyed facilities collected in depreciation rates for 30 years at the time of the explosion which destroyed the facilities. It was a management decision prior to the explosion as to what was deemed to be a proper level of insurance to carry concerning replacement power. KCPL could have filed with the Commission for an AAO to defer the uncovered costs of replacement power for consideration for recovery at a future time. KCPL did not do so. Also replacement power is an operating expense, not a capital expenditure. The money from the insurance proceeds (other than the $5 million for replacement power and the $2.219 million for administrative and general cost offsets) were for reconstructing Hawthorn 5 including financing the construction, both being a capital expenditure. To now seek recognition of the replacement power costs in essence as an offset to the insurance proceeds prior to and during the rebuild of Hawthorn 5 and the removal costs which have been recovered in rates from ratepayers over 30 years is inappropriate and inconsistent. Through its calculation of AFDC, KCPL seeks to charge the ratepayers a financing charge for the financing of the construction while it had monies received from insurance on hand for the reconstruction of Hawthorn 5. (Williams Surrebuttal, pp. 17-19).

Finally, regarding KCPL's assertion of unreimbursed replacement power costs respecting the Hawthorn 5 explosion, Staff noted that although it is unlikely that KCPL overearned during the time of the reconstruction of Hawthorn 5, there has been a very significant increase in off-system sales since the rebuilt Hawthorn 5 commenced service in 2001, and KCPL has had an opportunity to recoup much of the profits lost during the time of the Hawthorn 5 reconstruction. (Williams Surrebuttal, pp. 20-21.)

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 relates to costs incurred due to an unusually severe ice storm in January of 2002. KCPL obtained an AAO from the Commission in Case No. EU-2002-1048, permitting it to defer the Missouri jurisdictional portion of these costs and to amortize them between September 2002 and January 2007. In its Order, The Commission expressly reserved the right to consider the ratemaking treatment of these deferred costs in a later case. According to the Reconciliation, this issue is worth $2,661,169.

This issue was raised by the United States Department of Energy, National Nuclear Security Agency (USDOE) and Staff has no position on the issue. USDOE's position is that none of these ice storm costs should be included in rates because these costs have actually already been fully recovered from Missouri ratepayers. USDOE points out that KCPL's Missouri earnings from 2002 through 2005 have been at least robust, and probably excessive excessive. According to its annual surveillance reports, KCPL's earned ROE for each year from 2002 through 2004 was significantly in excess of those granted by the Commission to other utilities during the same period. Thus, USDOE contends, the inclusion of any of the 2002 ice storm costs in rates in this case would result in an unwarranted over-recovery.

In summary, USDOE argues, the entire amount of Missouri jurisdictional ice storm costs included within KCPL's Missouri jurisdictional cost of service should be removed. USDOE contends that, given the level of return that KCPL's Missouri jurisdictional operations achieved during the years 2002 through 2005, it is clear that these so-called "extraordinary" costs have already been fully recovered within rates.

5. EEI Dues:

What amount of EEI dues should be included in rates?

This issue concerns dues paid by KCPL to the Edison Electric Institute (EEI), a national association of investor-owned electric utilities. This issue is worth $345,335.

Staff's position is that dues paid to EEI, should be removed because EEI is primarily engaged in lobbying. EEI's efforts are aimed at benefiting the electric industry by lobbying for changed legislation, particularly environmental policy. Staff's position is that while this activity may benefit shareholders, it does not provide a direct benefit to ratepayers. The Commission has accepted Staff's position in the past. For example, in *Staff v. Union Electric Co.,* 29 P.S.C. [N.S.] 313, 332, the Commission said that "dues paid to the Edison Electric Institute do not produce any direct benefit to the ratepayers because lobbying activities do not directly benefit ratepayers."

Staff historically disallows all of the dues paid to EEI. In this case, Staff has disallowed only 65% of the payments to EEI. Staff's position is that, unless the Company can submit additional documentation demonstrating that the EEI dues confer a direct benefit to ratepayers, its adjustment for EEI dues is conservative.

6. Severance Costs:

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

This issue concerns payments made to terminated employees. What amount of such payments, if any, should be included in cost of service and collected from ratepayers?

Staff recommends that the Commission include no severance costs in KCPL's cost of service. Although KCPL has now removed the severance payments made to two GPE executive officers who left the Company in 2005 from its proposed case, the Company still seeks recovery of some "normalized" amount of severance as cost of service in this case. Yet, KCPL excluded severance costs from the calculation of earning per share in calculating its incentive compensation, which indicates that even KCPL does not consider severance a normal recurring cost of doing business.

Severance costs are not a recurring cost of providing electric service. Normally severance costs are incurred on an irregular basis. Companies incur severance costs to ultimately reduce the cost of labor, which in turn may benefit both the utility and its regulated customers. However, in this case KCPL has failed to provide evidence that the Company’s severance costs will benefit any party other than KCPL's shareholders. Moreover, KCPL may have already recovered all of its past severance costs through regulatory lag.

Staff has recommended recovery of certain types of severance payments in past cases, when a utility company demonstrates that a corporate reorganization actually did result in net payroll savings that would be passed through to customers. In contrast, among other questionable severance payments, KCPL seeks to recover the severance costs associated with a high-level corporate officer who was employed by KCPL for less than 36 months. Either this was a bad hiring decision and this employee could not handle the job responsibilities or the individual just decided to leave the Company. Either way, there is no reason why KCPL should charge its regulated customers for this severance payment. Likewise, KCPL seeks to charge Missouri ratepayers for GPE's former CEO's $1.2 million severance payment. Staff is unable to understand why KCPL believes it would be reasonable to charge Missouri ratepayers for this severance payment.

By proposing an adjustment to recover a "normalized" level of severance costs, KCPL ignores the positive financial benefits that continue to accrue to the Company as a result of terminating an employee and paying severance benefits. If a base amount is built into rates for severance costs, a company can quickly accrue a substantial regulatory benefit because it ceases paying high executive salaries but only pays the severance package once. Such is the problem with incorporating a one-time expense into ongoing, forward-looking rates.

The act of incurring severance costs to create a customer benefit, such as lower payroll costs, occurs infrequently. This occurrence is primarily through major employee downsizings or corporate reorganizations resulting from a merger that created merger synergies or savings. KCPL has *not* undertaken such a process in the recent past and this is not the premise of the Company's case here. Accordingly, the Commission should exclude such expenses that "were a one-time occurrence and not an ongoing expense."[1]

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?

This issue concerns the extent to which an agreed settlement of the bad debt issue should be applied. This issue is worth $146,023.

The Company and Staff have agreed to calculate the net write-off percentage that will be applied to Missouri-jurisdictional revenue by using Missouri-only information for bad debt expense. The net write-off percentage is calculated by dividing the actual write-offs by Missouri-jurisdictional revenues excluding gross receipts taxes. The net write-off percentage is 0.61%.

Staff witness Bolin testified that her initial approach was to remove test year Kansas bad debt costs from Account 904, Uncollectible Expenses, and then apply a four-year-average-total-Company-net write-off ratio to Staff's annualized Missouri revenues in this case. During the settlement conference, the Company expressed a concern that this approach was not capturing all of the bad debt expense created by Missouri customers. Bolin agreed to revise the bad debt

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[1] *In the Matter of Missouri Public Service, a Division of UtiliCorp United Inc.,* 7 Mo.P.S.C.3d 178, 207 (*Report & Order,* March 6, 1998). *See also In the Matter of St. Louis County Water Company*, 10 Mo. P.S.C. 3d 255, 258 (May 3, 2001) ("As a result of the merger, the Company had the opportunity to reduce its workforce, but in doing so incurred separation and severance costs. These costs are unusual and will not be incurred again. The Commission finds that, for ratemaking purposes, these costs are non-recurring.")

write-off ratio so that it would be based upon Missouri-only information.

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?

It is the Staff's understanding that KCPL and the Staff do not have an issue regarding the amount of fuel and purchased power to be included in the Company's revenue requirement. While not agreeing on methodology, KCPL has accepted the Staff's dollar value, which will be subject to true-up. In testimony, Public Counsel witness Ralph Smith recommended that the Company update the NYMEX price it used for the September 2006 Henry Hub natural gas futures contract. (Smith Direct, pp. 16-18.) At this time, it is not clear to the Staff that there is an issue with respect to fuel and purchased power. If it turns out that there is, it would be between KCPL and Public Counsel, and it is likely to be resolved by the true-up phase of this proceeding. In any event, the Staff has no position on this issue.

9. Surface Transportation Board Litigation:

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

KCPL expects to incur significant litigation costs before the Surface Transportation Board (STB) in a complaint it has filed against Union Pacific (UP), charging that UP's rates for transporting coal from Wyoming to KCPL's Montrose

Station are unreasonably high. Due to the infrequency of complaint cases, the associated costs are not considered normal and recurring. Non-recurring costs are either removed from cost of service, or deferred and amortized to expense over a period of years.

It is Staff's position, as stated in Staff witness Hyneman's Direct Testimony, that Staff adjustment S-9.2 to **____________________**, is appropriate. The Staff is treating all incremental costs related to the STB case incurred in 2005 and in 2006 through June as a regulatory asset. **__________

____

____

__________________________.**

Staff also believes it is appropriate for all incremental non-employee labor costs directly related to this complaint case be treated 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 **___** years. Staff states that if the STB case results in a refund, any refund received by KCPL would first offset any existing balance of the regulatory asset, with the remainder used to offset fuel costs in future rate cases.

Staff believes that KCPL's efforts to pursue this complaint case and keep fuel costs as low as possible are in the best interests of KCPL's customers.

10. SO2 Premiums:

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

NP

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

On July 28, 2005, in Case No. EO-2005-0329, the Commission issued a Report and Order that approved KCPL's experimental regulatory plan. That Order also approved a Stipulation and Agreement including the following language:

> KCPL currently purchases coal from vendors under contracts that indicate nominal sulfur content. To the extent that coal supplied has a lower sulfur content than specified in the contract, KCPL may pay a premium over the contract price. The opportunity to burn coal with lower sulfur content is both advantageous to the environment and reduces the number of SO2 emission allowances that must be used. To the extent that KCPL pays premiums for lower sulfur coal up until January 1, 2007, it will determine the portion of such premiums that apply to retail sales and will record the proportionate cost of such premiums in Account 254. But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually.

Staff recommends that the Commission charge all SO2 premiums paid by KCPL to its coal suppliers against the Account 254 Regulatory Liability in rate base instead of charging these payments to fuel expense. Staff also recommends reducing KCPL's June 30, 2006, balance in Account 254 by the annual amount of SO2 premiums KCPL is actually paying to its coal suppliers. Reducing the Account 254 Regulatory Liability has the effect of increasing KCPL's rate base.

However, OPC reads the Stipulation and Agreement to bar Staff from proposing future ratemaking treatment of KCPL's SO2 liability in a different manner from how KCPL is required to account for this liability on its books and records through the period ending December 31, 2006. Staff disagrees and does not believe the Stipulation and Agreement bars the Commission from ordering any type of ratemaking treatment of this liability as a result of this rate case.

The Stipulation and Agreement states, "But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually." The Staff views this requirement as simply preventing KCPL from charging more than $400,000 to this account on an annual basis, up to and including calendar year 2006. The rates from this case do not go into effect until January 2007, which is after the ending date of the period specified in the Stipulation and Agreement for this issue, which is December 31, 2006. Notably, KCPL, who also participated in the negotiation of the Stipulation and Agreement, appears to share Staff's perspective.

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.

Charges to FERC USOA Account 925, Injuries and Damages, consist of: (1) insurance premium expense (KCPL pays premiums on a general liability insurance plan in order to cover costs incurred above its $1,000,000 self-insured level); (2) numerous minor to moderate cash payments made for damages to third parties and for medical services for injured employees; and (3) non-cash accruals for estimated contingencies. Those claims that KCPL does not charge directly to Account 925 are charged to Account 228. In order to convert from KCPL's accrual-based accounting to a cash basis, Staff witness Vesely testified that he deleted all of the accrued amounts for estimated claims from Account 925 and replaced that amount with a three-year average of the actual cash payments recorded in Account 228. The amounts booked to Account 925 for insurance premiums and cash payments were not adjusted.

KCPL's witness Lori Wright testified that Staff's conversion to a cash-basis account using a three-year average of actual cash payments in place of accrued estimated fails to consider that the results of the cash lead/lag study accounts for the effects of the timing of cash payments versus accrual accounting. In other words, KCPL charges that Staff has ignored the time value of money. According to Wright, Vesely should have compared the three-year average of actual cash payments to a comparable three-year average of the estimated accrued claims allowances.

Staff witnesses Vesely and Phil Williams testified that Wright's reference to the lead/lag study was inapposite. The lead/lag study included in Staff witness Williams' testimony only reflects the cash flow effects of the time lag between receipt of funds from ratepayers and payment by KCPL of injuries and damages expenses. It identifies the time lag or lead between the date KCPL collects funds from customers and the date KCPL pays out monies for settling injuries and damages claims. However, the lead/lag study has nothing to do with the annualized amount of injuries and damages expenses.

KCPL's suggestion that a three year average of accruals be used is also not well-taken. Cash payments are a better reflection of KCPL's actual known and measurable injuries and damages expense. The accruals that KCPL proposes to use for setting rates are simply estimates of the costs KCPL might eventually incur to settle claims arising from accidents. Unlike cash payments actually made, these accrual amounts do not represent real costs to KCPL, but rather are simply guesses made when the time the casualty events occurred. Vesely testified that accruals have exceeded actual cash payments in four of the five years ending with the test year; thus, a three-year average of the accruals would inevitably overstate KCPL's actual injuries and damages expenses. Over the five-year period 2001-2005, accruals exceeded actual cash payments by over $3 million.

The annual amount of actual cash payments fluctuates. In 2004, total cash paid out on claims actually exceeded accrual amounts ($1,780,895 to $1,162,510). In 2003, a relatively large amount was paid out on claims ($2,483,366; but less than the accrual figure for that year of $2,527,128). Staff's proposed three-year average of actual cash payments, which exceeds the amount of test year actual cash payments, is nonetheless below the level of test year accruals. To use either the test year accrual amount or an average of accrual amounts would overstate this expense item in KCPL's cost of service.

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

Staff originally made an adjustment of ($373,468) (Missouri jurisdictional) to amortize Rate Case Expense over three years. In his Surrebuttal Testimony, Staff witness Harris states: "KCPL has provided Staff with data that has resulted in Staff's changing the adjustment from ($373,468) to $156,252. Staff will continue to review ongoing rate case expense incurred through the period ending September 30, 2006, and make the appropriate recommendations in its true-up testimony filing."

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 and GPE have certain projects and strategic initiatives that involved large payments to outside contractors. Staff and the Company are in substantial agreement as to the treatment of the costs associated with these projects. For three of the four projects, Staff recommended that the test year expenses be deferred and expensed over five years. This treatment was proposed because the results of the projects will benefit ratepayers over a period of years and it is therefore equitable to pay for the projects over a period of years. KCPL agrees, but proposes that the deferred amounts be included in rate base. In that case, KCPL would earn a return on the deferred portion of the expenses.

Deferred and unamortized expenses are not normally included in rate base. To be included in rate base, the deferred and unamortized expense must be a used-and-useful asset. Assets are defined by the Financial Accounting Standards Board as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." Even if an item qualifies as an asset, it must also be used and useful in order to be included in rate base. An item is “used and useful” when it is actually being used, and is actually necessary, to provide utility service.

The deferred and unamortized expenses that KCPL proposes to include in rate base here are not assets and are not used and useful. Therefore, they cannot be included in rate base. While Staff believes that there is a sufficient possibility of ratepayer benefit from these projects to allow them to be expensed to cost of service over a period of years, that benefit is neither so certain nor so great that the ratepayers should also be required to pay interest on the unamortized portion of the expenses. Staff’s position is a compromise between the extremes of no recovery and full recovery including interest.

One of the fundamental principles of regulatory accounting is the matching principle. This principle requires that costs incurred for current service be expensed in the current year. It also requires that costs that are necessary to provide service over future years be capitalized or deferred and recovered by a charge to expense over the useful life of the underlying asset or the period in which the asset will provide benefits. KCPL's proposed amortization period of five years is quite accelerated – it suggests that KCPL believes that its programs will only be beneficial over a five-year period. If the Commission does allow the inclusion of these deferred and unamortized expenses in rate base, then Staff believes that the amortization period should be extended to 15 years to reflect the likely useful life of the regulatory asset.

The Commission recognized the importance of matching the costs of a service to those that enjoy the benefit of the service in *In the Matter of Missouri-American Water Co.,* Case No. WO-2002-273 (*Report and Order on Remand*), pp. 41-42:

> The AAO is one of the Commission's chief regulatory tools for implementing another aspect of the Matching Principle. As discussed above, one aspect of the Matching Principle is to match revenues and expenses with the period in which they were incurred. However, under another aspect of the Matching Principle, "ratepayers are charged with the costs of producing the service they receive." The purpose is to match costs with benefits so that the ratepayers that enjoy the benefits of utility property also bear the costs thereof.

The Commission has also recognized the importance of amortizing a deferred expense over the period during which the benefits of the regulatory asset will be enjoyed:

> The Commission finds that competent and substantial evidence has been presented and adduced to support the Commission's approval of the recovery of the SLRP carrying cost over a ten-year period.
>
> Ten years relates better to the period in which it is anticipated the benefits will be realized and ten years relates closer to the deferral period itself, and is, therefore, just and reasonable.

> The Commission does note that Staff has provided ample evidence to show that its proposal of the 20-year amortization period was not extreme as noted in the Commission's Report and Order in the prior MGE rate case, Case No. GR-96-285.
>
> While Staff has produced sufficient evidence to support its position, the Commission finds that it is not necessary to relate the amortization period for the deferral or carrying costs to the life of the property constructed but rather to the deferral period or the period during which it is anticipated the benefits will be realized.

In the Matter of Missouri Gas Energy, Case No. GR-98-140 (*Report & Order,* issued August 21, 1998).

14. Payroll, Including A&G Salaries:

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

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

This issue concerns the amount of payroll expense to include in KCPL's cost of service. There are two sub-issues. The first concerns the allocation of some of the payroll costs of KCPL's affiliate, GPES, to KCPL. How should that be done? The second concerns executive salaries ("A&G Salaries"): What proportion of executive salaries should be included in KCPL's cost of service as an expense and what proportion, reflecting time devoted to managing construction projects, should instead be capitalized?

a. Allocation of GPES Payroll Expense:

The first issue is settled. KCPL witness Lori Wright testified that she does not agree with the allocation percentage used by the Staff to allocate annualized payroll costs of GPES employees to KCPL. Staff witness Bolin derived her allocation percentage from the average of payroll billings from GPES to KCPL of

66.57% for the period from August 2005 to December 2005. However, the Company completed a reorganization of employees effective August 1, 2005, resulting in approximately 80% of GPES's employees being transferred to KCPL. For this reason, Staff correctly excluded billings prior to August 2005 because those billings would not accurately the post-reorganization situation. However, that adjustment results in Staff having only five months of billings on which to base the normalized billing percentage of 66.57% used in their case. KCPL witness Wright therefore suggested, and Staff agreed, that the percentage of payroll billings should be trued up to September 30, 2006, consistent with the update of employees on the Company's payroll. Payroll billings from GPES to KCPL will therefore be normalized using the billings during the period August 2005 through September 2006.

b. Capitalization of A&G Salaries:

Staff contends that KCPL does not capitalize an appropriate level of A&G salaries to construction. In the test year, KCPL only capitalized 4.42% of total A&G salaries and 95.58% of A&G salaries were expensed. KCPL did not capitalize any incentive compensation, although such awards should be expensed or capitalized using the same percentage as regular salary. From a ratemaking perspective, KCPL's failure to appropriately capitalize executive time devoted to construction activities overstates payroll expense included in cost of service. If the Commission adopts KCPL's allocation method in this case, payroll expense in the cost of service would be overstated by approximately $5.7 million on a total company basis.

KCPL is in a major construction phase. Construction activities necessarily require management, executive and supervisory functions. Yet, most of KCPL's executive management assigns little or none of their time to construction activity. KCPL currently has several large construction projects planned between now and 2010, including the Iatan 2 coal-fired, base load unit, wind generation facilities in Kansas and major investment in environmental equipment for existing coal units. Many of KCPL and GPE's executive employees are actually committing a fairly significant amount of their time to the planning and ongoing oversight of these construction projects. The time that they spend on these functions should be capitalized, not expensed; but KCPL's records do not reflect this mandatory capitalization.

Staff determined the appropriate capitalization ratio by examining the allocation of payroll, between expense and construction, for all employees except executives. This analysis indicated that non-executive KCPL employees were devoting 23.59% of their time to construction activity. However, KCPL claims that its executives devote only 4.42% of their time to construction-related activities. Staff assumes that executive management, having oversight responsibility for all employees involved in construction activity, should allocate at least the same 23.59% of its time to construction activity.[2]

KCPL's witness Wright testified that "It is simply impossible to assess time directly charged to construction related to the A&G salaries that otherwise would have been included in FERC Account 920 that the Staff is attempting in its case

[2] Staff's direct case used the figure 21.41%; however, this figure was based on an error in KCPL's FERC Form 1.

to analyze separately." Wright claims that FERC Account 920 is utilized by virtually all employees in the Company at some level. KCPL has proposed use of a blended expense versus capital percentage derived from its FERC Form No. 1 to determine the appropriate annualized payroll to be allowed in cost of service rather than analyzing A&G salaries separately as Staff has done. KCPL claims that it did a study and determined thereby that 15.32% of A&G salaries were directly charged to construction. The two components mentioned above total 19.74% (4.42% + 15.32%), leaving 80.26% to be expensed. This amount must then be reduced, Wright testifies, by the amount of A&G salaries allocated to capital, using the 4.42% originally suggested by KCPL, resulting in 78.35% of annualized payroll costs being included in cost of service.

Staff responds that the USOA, Electric Plant Instructions 3 and 4, require that payroll be accurately allocated between cost of service and capital. Electric Plant Instruction 4, Overhead Construction Costs, states:

> All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead . . . .

Electric Plant Instruction 3, Components of Construction Costs, item (12), states:

> General administration capitalized includes the portion of the pay and expenses of the general officers and administrative and general expenses applicable to construction work.

Staff concludes that KCPL is not complying with the USOA and requests that the

Commission so find and authorize the General Counsel to seek penalties.

In response to Staff Data Request No. 252.1, attached as Schedule 2 to Staff Witness Bolin's Surrebuttal Testimony, the Company provided a list of 19 executive employees who have oversight responsibility for construction activity. By using data provided in response to another Staff data request (No. 263), Staff was able to determine that only 4.09% of the payroll for these 19 executives was directly assigned to construction activity. Attached as Schedule 3 to Bolin's Surrebuttal is Staff's analysis showing the name and job description for the GPE and KCPL employees identified by KCPL as having oversight responsibility for construction activity. The combined annual salaries of these 19 executives amounts to $5,622,925. Combined, these 19 executives directly assigned only $230,170 -- 4.09% of their total salaries -- to construction activity in 2005. Yet some of these employees clearly hold positions tied directly to construction activity. Bolin's Schedule 3, lines 18-21, reflects four employees whose job descriptions are clearly tied to construction activity. These employees necessarily charge a significant amount of their time to construction activity. However, the remaining 15 executives charged less than 1% of their time to construction activity in 2005. (DR 252.1.) Bolin testified that this is of "considerable concern" given the fact that KCPL identified these 15 employees as having "oversight responsibility" for construction activity.

Staff witness Bolin details, in her Surrebuttal Testimony, the serious flaws that she has found in the "studies" relied upon by KCPL. In particular, the results announced by Ms. Wright do not accord with responses provided by KCPL to

Staff discovery requests. KCPL witness Wright states on page 23, of her Rebuttal Testimony, that "[t]he 78.35% proposed by KPCL is more reflective of the construction activity ongoing for the annualization of payroll costs considered for the test year." But this 78.35% payroll expense ratio recommendation is a significant change from the payroll expense ratio reflected in KCPL's June 30 updated payroll adjustment of 80.67%. These sorts of unexplained inconsistencies, reviewed by Bolin in detail in her testimony, should raise serious doubts for this Commission with respect to KCPL's assertions. There is only one right answer for the Commission will choose as to what percentage of KCPL's annualized payroll should be charged to expense and thus paid by the ratepayers. Based upon KCPL witness Wright's rebuttal testimony, the Commission must decide whether the payroll expense ratio should be 78.35%, as recommended by KCPL witness Lori Wright, or the 76.47% recommended by Staff witness Bolin in her Surrebuttal Testimony.

15. Other Benefits:

What amount of other benefits should be included in rates?

This issue concerns the calculation of the amount of expenses incurred by KCPL in providing various employee benefits to be included in cost of service and recovered from the ratepayers.

The amount for other benefits to be included in the cost of service used for setting rates should be based on actual test year amounts as updated and, ultimately, trued-up. Where appropriate, construction costs and billings for facilities owned jointly with others should be reduced to properly reflect allocation of parts of those cost to the joint owners. Consistent with KCPL's Regulatory Plan, the amounts for other benefits should not be based on speculative projections of costs beyond the updated test year and, instead, should be based on known and measurable costs. (Bolin Surrebuttal, pp. 5-7).

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.

Staff has made adjustments to normalize KCPL's test year non-payroll maintenance expense. Normalization adjustments reflect the removal of events or items within the test year that are either non-recurring or which exhibit significant annual volatility or which occur on an infrequent basis. Normalization adjustments are necessary in order to ensure that an appropriate amount of costs is included in the rate structure so that the Company does not either over-collect or under-collect expenses.

In his Surrebuttal, Staff witness Harris testified that he revised the methodology used in normalizing maintenance expenses, resulting in removing the proposed transmission maintenance adjustment of $168,515. In its direct case, KCPL normalized non-labor production maintenance expense using historical 6-year average costs multiplied by inflation factors. KCPL originally did not normalize transmission and distribution (T&D) maintenance expense in its direct filing. KCPL witness Marshall testified at page 2 and Schedule JRM-4 of his Rebuttal Testimony, that KCPL has now included adjustments to normalize non-labor T&D maintenance expense.

Staff initially adopted KCPL's 6-year approach but without the inflation factors. After additional consideration, Staff witness Harris concluded that the Company's straight-across-the-board approach failed to recognize significant differences between various types of plant. Harris therefore analyzed each functional plant group separately and selected a methodology to use for normalizing maintenance expense for each. Harris presented his revised maintenance normalization analysis as Schedule 1 attached to his Rebuttal Testimony.

Staff rejects KCPL's contention that maintenance expenses should reflect "escalated dollars." This would constitute single-issue ratemaking. KCPL drew its escalation factors from the Handy-Whitman Index, which is primarily based on labor costs. However, KCPL's maintenance expenses do not include any labor costs. Additionally, the Index addresses capitalized construction costs, not maintenance costs. Harris testified that comparing the capitalized construction cost of plant to the expensed maintenance cost of the same plant is like comparing the cost of an automobile to the cost of an oil change or tune-up needed to maintain the continued operation of the automobile.

KCPL is proposing the use of inflationary factors, not generally accepted in traditional ratemaking, that are based on labor-related capitalized construction costs to normalize its non-labor-related expensed maintenance costs. Additionally, the Handy-Whitman Index used by KCPL is for a large region and is not specific to the Company's Missouri operations; therefore, it does not apply to any real inflation that KCPL may or may not be experiencing for operation and maintenance costs for its production, transmission and distribution facilities.

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. 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. Staff, on the other hand, contends that only known and measurable amounts can be included in cost of service and that the values proposed by KCPL are inappropriate because they are not yet known and measurable.

Staff witness Williams testified that he made adjustments to annualize property tax expense. Staff computed property tax expense by examining the actual amounts of property tax payments made by KCPL during the five years 2001 through 2005. Staff witness Williams developed a ratio of the actual property tax payments to the level of property at January 1 for each of those years. The ratio was applied to the plant-in-service balance at the end of the test year, December 31, 2005, to calculate an annualized property tax amount in this case.

The state and local taxing authorities determine the annual property tax payment through an assessment of the value of the utility's real property. This assessment is made based upon the property balances on January 1 of each year. The taxing authorities also determine a property tax rate that is applied to the assessed values to compute the property tax liability. The property taxes are paid to the state of Missouri and the local taxing authorities at the end of each year, generally by December 31st. The Kansas property taxes are paid in two increments, one by December 31st and the other by the following May 15th. KCPL calculates property tax expense on a total company basis and allocates a portion to Missouri.

Not all property tax payments are properly expensed. That portion that relates to construction activity as of the assessment date of January 1 of each year must instead be capitalized. Consequently, property tax expense in the cost of service must not include any amounts paid with respect to construction activity.

KCPL's witness Green complains that Staff's adjustment does not reasonably reflect the increased property tax expense that KCPL will incur in 2006 and following years, "let alone the increased property tax expense due to applicable plant additions during 2006." The calculation of property taxes for utility property located in Missouri and Kansas is determined by applying the tax levy rates as imposed by the applicable local taxing jurisdictions to the assessed value of the taxable property of KCPL as of the beginning of the calendar year, which was $701,885,630. Green testified that, subsequent to the filing of this rate case, KCPL received its final 2006 property tax assessments from all state and local assessing authorities in Missouri and Kansas. Therefore, KCPL proposes adjustments totaling $5,143, 767 on a total company basis.

KCPL witness Burright testified that this proposed adjustment would annualize the real estate taxes, personal property taxes and payments-in-lieu-of-taxes (PILOTs) for *pro forma* end-of-period plant-in-service. The amount of the adjustment relating to real estate and personal property taxes is $4,843,767 before jurisdictional allocations and the PILOT portion is $300,000, for a total adjustment of $5,143,767. Starting from taxes on plant-in-service as of December 31, 2004, adjustments are made for estimated 2006 assessments on plant-in-service as of December 31, 2005, anticipated 2006 tax levies and expected plant additions through September 30, 2006. Although the new wind generating facility in Kansas is exempt from real and personal property taxes, it will be subject to PILOTs amounting to $300,000.

Staff witness Williams testified that Staff has properly adjusted the property taxes in this case. Staff adjusted its calculation of annualized property taxes to include the portion of the Kansas 2005 property taxes that were actually paid in 2006. Staff's calculation of property taxes was based upon the ratio of property taxes paid in 2005 to the January 1, 2005, plant balances. This ratio was then applied to the December 31, 2005 (January 1, 2006) plant balances. Williams testified that this is the proper relationship and reflects how tax payments are actually determined by the taxing authorities.

KCPL contends that Staff's methodology does not reflect (1) the known increases in the assessed valuation of plant for 2006 and the corresponding increases in property tax liability and (2) property taxes on plant that will be added to plant in service during 2006. Staff's recalculation of the annualized property taxes to reflect the changes in the assessed valuation does not increase Staff's annualized property taxes as Mr. Green suggests but actually decreases the property taxes by $203,516. KCPL's receipt of the assessment values for 2006 does not mean that KCPL knows what the levy will be. Williams testified that when the assessed values are increased, the corresponding tax levy rates are often adjusted downward to keep the property tax levels revenue neutral. Property taxes that will not be known and measurable until after the operation of law date in this case in 2007 are not appropriately included in the cost of service in this case. Likewise, Staff has not taken anticipated tax levy rate changes into account at this time as they are not yet known and measurable.

KCPL witness Green is correct that Staff has not included 2006 plant additions in its property tax calculations, because those additions will not be assessed until the January 1 following the in-service date and the corresponding tax liability will not be due until the following December 31.

In conclusion, Staff urges the Commission to reject KCPL's proposed adjustments to the property tax expense item because KCPL's adjustments are not based on known and measurable changes, but are instead mere estimations.

18. Decommissioning Expense:

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

This issue concerns the amount of money necessary to fund KCPL's share of the decommissioning trust fund for the Wolf Creek nuclear generation station. It appears that Wolf Creek will remain in service for 60 years rather than 40, consequently, the annual funding amount will necessarily change.

The Staff asserts that reductions for decommissioning expenses will not occur until 2007, beyond the operation of law date for this case. This adjustment is therefore out-of-period and beyond the scope of this case. The Staff agrees that the cost reductions should be reflected in the next rate case to be filed by KCPL on or about February 1, 2007.

19. True-up:

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

Staff will address this issue is a Supplement to its Prehearing Brief to be filed on October 13, 2006.

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?

Staff will address this issue is a Supplement to its Prehearing Brief to be filed on October 13, 2006.

21. Weather Normalization/Customer Growth:

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

This issue concerns whether the Large Power [LP] customer class is significantly weather sensitive such that weather normalization is appropriate. There is an observable increase in class usage during the summer months. However, the question is whether or not this increase is simply attributable to seasonal changes, as opposed to daily fluctuations in weather, such that weather normalization is inappropriate. There is also a question as to the appropriateness of the application of a growth factor, given the low level of homogeneity of energy use patterns within the LP class.

It is Staff's position, as stated in Staff witness Lange's Surrebuttal Testimony, that the LP customer class is not appropriate for weather normalization as the loads of this class in the winter are relatively flat and the small increase in usage observable in the summer is influenced by the season, not day-to-day weather fluctuations. Staff believes it is inappropriate to adjust LP class usage in order to reflect this seasonal fluctuation as it is inherently "normal." Staff does not consider it appropriate to apply a growth factor to the LP class, as this class contains the largest energy users and the lowest number of customers, and is not homogenous in how and when it demands electricity. Staff recommends the adoption of the actual LP usage with an annualization adjustment based on a review of monthly consumption for each customer during the test year.

Staff's recommendation, to neither weather-normalize the LP class nor to apply a growth factor to the class, is appropriate because this class includes the large customers that the Staff individually annualizes in its case instead of treating collectively by applying a growth factor. Also, Staff attributes the increase in the LP class load in the summer months to the influence of the season, as opposed to the day-to-day fluctuations associated with other customer classes. Additionally, while the Staff believes that some customers in the LP class are weather sensitive, that portion is a small percentage of the whole and the adjustment to the class load that may be measured is within the error margin of the weather sensitivity modeling. Further, if LP class usage is weather normalized, the revenues for the class must also be weather normalized. Because the LP rate is complex, the weather normalization of theses revenues is extremely difficult, if not impossible, to do correctly. Finally, Staff does not weather normalize the LP class for any other electric utility. For the foregoing reasons, neither weather normalization nor the application of a growth factor are appropriate for the LP 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 proper allocation of plant-related costs to the three jurisdictions -- Missouri, Kansas and FERC Wholesale. Staff takes the position that these demand-related costs should be allocated based on the four coincident peak ("4 CP") methodology. (Maloney Direct, pp. 7-8.). KCPL is proposing a 12 CP methodology. (Frerking Direct, p. 6.) KCPL is also proposing 12 CP in its rate case in Kansas, with the concurrence of the staff of the Kansas Corporation Commission. The 12 CP allocation method would allocate more plant investment and costs to the Missouri jurisdiction and less to Kansas. (Featherstone Rebuttal, p. 15).

Demand, which is expressed in kilowatts (kW) or megawatts (MW), refers to the rate at which energy in kilowatt hours (kWh) or megawatt hours (MWh) is delivered to or by a system. Peak demand is the largest electric load requirement on a utility's system within a specified time period, such as a month. Generation units and transmission lines are constructed to meet peak demands; therefore, it makes sense to allocate the associated costs to the various jurisdictions served by the utility on the basis of their relative peak demands. The term "coincident peak" refers to the load of each jurisdiction that coincides with the hour of the Company's overall system peak. A "4 CP utility" is one that has a high demand during the four summer months and relatively low demand during the other (off-peak) months. For such a utility, the capacity planning process will be driven by the load requirements in those four months. (Maloney Direct, pp. 6-8). On the other hand, a "12 CP utility" utility has a relatively flat load curve without a lot of month-to-month statistical variation. (Maloney Rebuttal, p. 2).

The Staff's position in support of use of as 4 CP methodology for KCPL in this proceeding is based on the following:

a) KCPL's load curve fits the profile of a 4 CP utility. Its monthly peak demands in the summer months are considerably higher than those in the other months. (Maloney Direct, pp. 7-8).

b) The results of four quantitative monthly peak tests are all consistent with the range of values that prompted the Federal Energy Regulatory Commission ("FERC") to determine in various cases that a 4 CP methodology was appropriate. Staff witness Erin Maloney ran those tests using the test year (2005) data, as well as data for the years 1999-2004. Without exception, the test results pointed to a 4 CP utility. (Maloney Rebuttal, p. 3; Schedule 2;).

c.) KCPL used a 4 CP allocator in its last rate case and has used the 4 CP allocator in its earnings surveillance reporting for years up through 2004. In 2005, the Company switched to the 12 CP. There was no significant change in KCPL's monthly peak demand between 2004 and 2005 that would warrant such a change. (Maloney Surrebuttal, pp. 5-6).

d.) KCPL offers no quantitative rationale for its sudden change to a 12 CP allocation method and no otherwise convincing rationale. Contrary to KCPL's suggestion, KCPL's "operational realities," supplementary to the quantitative tests, including such considerations as load shape, configuration of generating fleet and extent of scheduled maintenance opportunities, are not at all like those of The Empire District Electric Company's, for which the Staff recommended a 12 CP methodology. Nor does it make sense to include spot market off-system sales as part of the analysis. (Maloney Surrebuttal, pp. 4-5).

The Commission should reject the Company's attempt to switch to a 12 CP demand allocation method for KCPL and instead authorize the continued use of the 4 CP method.

23. Off-system Sales:

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

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

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 will address this issue is a Supplement to its Prehearing Brief to be filed on October 13, 2006.

24. Depreciation:

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

This issue concerns the amount of depreciation expense that KCPL will collect from ratepayers on an annual basis. As the assets devoted to the public service are consumed in the provision of that service, the ratepayers must make the investors whole by returning to them in cash the value lost by the assets. Put another way, the ratepayers buy the assets from the investors at cost, over time. Depreciation expense represents that cash payment to the investors. Staff proposes depreciation rates that will decrease the annual depreciation expense realized by KCPL from $65 million to $55 million. This $10 million annual decrease in depreciation accrual is based upon Staff's current depreciation study using current methodologies.

Staff last performed a depreciation study for KCPL in the mid-1980's. Depreciation rates were subsequently revised in 1994 and 2005, but a full depreciation study was not performed either time. In the current depreciation study, Staff performed a broad-group, average-life depreciation study utilizing the straight-line method, broad-group procedure and whole life technique. (Schad Direct, p. 3.) Staff's current deprecation rates are based on Staff's estimate of average service life and net salvage value for each capital account. Based upon its depreciation study, Staff recommends that the Commission adopt the depreciation rates for the various accounts as set out in Schedule 2 to the Direct Testimony of Staff witness Rosella L. Schad.

Staff assigned depreciation rates to the wind generation and nuclear generation assets on a basis other than a broad-group, average-service-life depreciation study. Staff assigned a 20-year life for the wind assets based upon KCPL's Regulatory Plan. Staff assigned depreciation rates to the Wolf Creek generation plant assets based upon the expected extension of the nuclear plant's operating license from 40 years to 60 years.

Staff's analysis also indicates that KCPL's book depreciation reserve is over-accrued by approximately $800 million. (Schad Direct, p. 11.) If this over-accrual were adjusted, it would have the effect of increasing the rate base and, consequently, the revenue requirement. Staff recommends, therefore, that the depreciation reserve not be adjusted at this time and that the reserve imbalance be monitored in future depreciation studies.

The depreciation rates determined by the Staff's study will decrease the currently-ordered depreciation accrual by approximately $10 million annually, based on June 30, 2006, Missouri jurisdictional allocated plant-in-service balances. (Schad Direct, p. 9.)

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?

Staff will address this issue is a Supplement to its Prehearing Brief to be filed on October 13, 2006.

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

26. Class Cost-of-Service:

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

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

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

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

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

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

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

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

Should revenue adjustments be phased-in over multiple years?

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

How should any increase in the revenue requirement be implemented?

a. Distribution Costs:

Distribution costs should be allocated to classes based on factors that take into account the extent to which the different classes of customers use the same distribution facilities, such as distribution substations, primary lines and secondary lines. (Pyatte Rebuttal, pp. 6-7).

The allocation of primary distribution costs should include a customer-related component since there is a component of these costs that must be incurred to serve customers, regardless of their demand for electricity, *i.e.*, how much electricity they use. (Pyatte Rebuttal, p. 6).

The cost of distribution substations should be allocated based on class contribution to class peak demand because doing so reflects the sharing by the classes of the use of the distribution substations, whereas allocating these costs based on class contribution to customer maximum demand recognizes no class sharing of the distribution substations. (Pyatte Rebuttal, pp. 5-6).

The demand-related costs of primary and secondary distribution lines should be allocated based on a weighted average of each class's customer maximum demand and annual class peak demand, where the weighting factors were based on the average number of customers in each class that share a transformer, because such an allocation factor best reflects the sharing by the classes of the use of the primary and secondary distribution lines. (Pyatte Rebuttal, pp. 6-7).

In summary, distribution costs should be allocated to classes as follows:

FUNCTIONAL CATEGORY	ALLOCATION METHOD
Distribution Substations	Class Peak @ Substation
OH/UG Lines	
Primary-Customer Related	Weighted Customers @ Primary
Secondary-Customer Related	Weighted Customers @ Secondary
Primary-Demand Related	Diversified Demand @ Primary
Secondary-Demand Related	Diversified Demand @ Secondary
Line Transformers	
Secondary-Customer Related	Weighted Customers @ Secondary
Secondary-Demand Related	Customer Maximum Demand @ Secondary

(Pyatte Direct, p. 16-21, and Rebuttal, pp. 5-7.)

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

Ideally, production capacity and transmission costs should be allocated to classes based on the time-of-use method that Staff developed and which the Commission has characterized stated as the most theoretically appropriate approach for allocating generation costs. *In the Matter of Kansas City Power and Light Company*, 25 Mo. P.S.C. (N.S.) 605 (*Report & Order,* March 30, 1983), Otherwise, the Average and Peak (A&P) method using twelve non-coincident peaks (12 NCP) that the Staff used in this case is a good proxy for the time-of-use method. Further, by relying on non-coincident class peaks, the Staff's A&P 12 NCP method is better than a method that relies on a coincident peak or on non-coincident peaks during only part of a year, since utilities design their generating systems to meet demand at all times and not just to meet maximum system demand or to meet demand during part of a year. (Busch Surrebuttal, pp. 2-5 and Rebuttal, pp. 3-10; Pyatte Direct pp. 14-16 and Rebuttal, p. 3).

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

To maintain consistency between jurisdictional allocations and class allocations, margins from off-system sales should be allocated on the basis of class contribution to energy. (Pyatte Surrebuttal, p. 3).

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

Staff's position is that it does. (Pyatte Surrebuttal, p. 2).

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

According to the Staff's class cost of service study, updated through September 30, 2005, the following classes have the following revenue deficiencies relative to the cost of serving them:

	Retail	Resi-dential	SGS	MGS	LGS	LPS	Light
Deficiency (thousands)	$0	$14,305	($1,306)	($5,526)	($2,651)	($4,822)	$0
Deficiency (percentage)	0%	8.24%	-3.53%	-8.75%	-2.41%	-4.84%	0%

(Pyatte Surrebuttal, Sch. JP-6 (Revised).)

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

It is Staff's position that they should be allocated based on salaries and wages and not by class contribution to energy since these costs have little or nothing to do with energy. (Pyatte Surrebuttal, pp. 2-3 and Rebuttal, p. 8; Brubaker Direct, p. 28.)

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

It is the Staff's position that revenue shifts should be made between classes to better align the revenues from each class with the cost to serve each class because the Staff's analysis indicates that changes are warranted and the opportunity exists to do so; movement towards class cost of service is well-defined, even if the magnitude is not — all the filed studies show that the general service ("GS") classes (Small GS, Medium GS, and Large GS) revenues exceed KCPL's cost of serving them; all but Public Counsel's study show that the Large Power Service ("LPS") class is paying more than its costs, and no study showed that shifts should not be made. KCPL's future capacity additions will compound, rather than ameliorate, any current misalignments between class costs and class revenues. (Pyatte Rebuttal, pp. 9-12 and Direct, p. 22; Busch Direct, pp. 2-4).

The Staff's recommendation is that, on a revenue-neutral basis, the revenue responsibility of each class that shows revenue responsibility greater than its cost of service should have its revenue responsibility adjusted downward, and that downward adjustment should be measured by the smallest downward adjustment in revenue responsibility necessary to match revenue responsibility with cost of service for the class with the smallest revenue deficiency. The class having revenue responsibility less than cost of service would then be increased to make up the difference. In other words, the adjustment to match revenue responsibility with cost of service for each of those classes whose cost of service exceeds their revenue responsibility should be limited to the smallest percentage adjustment required to exactly match revenue responsibility with cost of service for the one class with the smallest revenue deficiency, and the total change in revenue responsibilities for those classes would then be shifted to the class having revenue responsibility below cost of service. (Busch Direct, pp. 2-3).

Therefore, based on the Staff's updated class cost-of-service study (Pyatte Surrebuttal, Sch. JP-6 (Revised)) and Staff's foregoing recommendation, the following percentage changes to rates should be made on a revenue-neutral basis to better align class costs of service with class revenues:

	Retail	Resi-dential	SGS	MGS	LGS	LPS	Light
Change	0.00%	4.30%	-2.41%	-2.41%	-2.41%	-2.41%	0.00%

(Busch Supplemental Surrebuttal, Sch. JAB-2 (Revised).)

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

Yes, see the Staff's briefing immediately above.

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

Staff supports moving class revenue responsibilities closer to class costs of service in this case. Staff does not support multiple year phase-in of overall revenue neutral shifts in class revenue responsibilities. (Pyatte Rebuttal, pp. 13-14).

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

Staff has proposed no change to the lighting class, but has proposed uniform changes to all the general service classes in order to move class revenue responsibilities closer to class cost of service while maintaining rate continuity, that is, preserving signals for customers to choose schedules based on size and load factor. (Busch Direct, p. 3 and Sch. JAB-2; Pyatte Direct, pp. 22-23 and Rebuttal pp. 12-13).

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

Any increase in total company revenue requirement the Commission may order in this case should be implemented on an equal percentage basis. (Busch Direct, p. 4; Pyatte Rebuttal, p. 14 and Sch. JP-9.)

27. Rate Design:

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

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

a. Should a comprehensive analysis of KCPL's class cost-of-service issues and rate design be conducted after the conclusion of the regulatory plan and the in-service date of Iatan 2?

Given the number of years since KCPL's rates were last reviewed by this

Commission and the magnitude of the costs of the generation and upgrades KCPL is making to its generating stations over the next several years, it would be appropriate, after KCPL's regulatory plan ends and after Iatan 2 is fully operational and used for service, for the Commission to consider in depth class costs of service and class revenue responsibilities to better align them for each class, including those served under general service all-electric rates. (Pyatte Rebuttal, pp. 14-17.)

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

No. KCPL's general service customer charges are uniquely based on customer size and are designed to ensure large, low-load factor customers who choose service on a smaller customer rate schedule (e.g., a LGS customer who switches to the MGS tariff) nonetheless continue to make a contribution to fixed costs in recognition that the customer is larger than typical for the class. KCPL's proposal undercuts this purpose and should be rejected. (Pyatte Rebuttal, p. 15.)

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; however, KCPL's proposed tariff language is vague as to who would qualify for the rate. (Pyatte Rebuttal, pp. 17-18.) Presently, all-electric customers must exclusively use electricity for "all lighting, cooking, water heating, comfort space heating (except aesthetic fireplaces), comfort cooling, general purposes, and any other purposes requiring energy . . . ." (KCPL Rate 20, Schedule MGA, PSC MO No. 7, Sheet 18.) Customers on the all-electric rate receive about a 20% discount in the non-summer billing season relative to those not on all-electric rates. (Pyatte Rebuttal, p. 16.)

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.)

C. Customer Programs:

29. Weatherization Program:

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

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

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

> **The Missouri Department of Natural Resources and the City of Kansas City object to the inclusion of this issue and asserts that its is not properly before the Commission in this case.*

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 **12th day of October, 2006**, either by hand delivery, electronic mail, facsimile transmission, or First Class United States Mail, postage prepaid.

/s/ Kevin A. Thompson