BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

POSTHEARING BRIEF OF UNITED STATES DEPARTMENT OF ENERGY/NATIONAL NUCLEAR SECURITY ADMINISTRATION (DOE/NNSA)

NP VERSION

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****[redacted]** Designates "Proprietary" and "Highly Confidential" (HC) Information.
Such Information Should be Treated Confidentially
Pursuant to the Standard Protective Order.**

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DOE/NNSA'S POSTHEARING BRIEF

INTRODUCTION

DOE/NNSA intervened in this proceeding on behalf of the DOE/NNSA plant in Kansas City, a large customer of Kansas City Power and Light Company (KCPL), as well as other affected Federal Executive Agencies.[1] Testimony of the following witnesses on behalf of Intervenor was filed and is summarized as follows:

1) Direct Testimony of James R. Dittmer was filed on August 8, 2006 in both HC and NP versions (marked and received as Exhibit 803 and 803HC). In that testimony Witness Dittmer addressed the following issues: Response and critique of the testimony of KCPL witnesses Chris Giles and Michael Schnitzer's proposal to reflect unreasonably low estimate of non-firm off-system sales margins as a revenue credit within KCPL's adjusted retail cost and recommending an adjustment to eliminate test year amortization expense related to repairs stemming from a 2002 ice storm.

2) Rebuttal Testimony of James R. Dittmer was filed on September 15, 2006, in both HC and NP versions (marked and received as Exhibit 804 and 804HC). In that testimony Witness Dittmer addressed the following issues: KCPL through Witness Don

[1] Although trial counsel for KCPL appeared to imply in his cross-examination of DOE/NNSA Rate of Return Witness, Dr. J. Randall Woolridge, that the intervention was on behalf of the Department of Energy as a whole, this intervention is identical to previous interventions before this Commission going back to 1969, Case No. 16803, i.e representing the customer interests of the DOE/NNSA Facility and other affected Executive Agencies, pursuant to a Delegation from the General Services Administration. See Application to Intervene filed herein by US DOE on behalf of its DOE/NNSA Kansas City Facility wherein it is clearly stated: DOE-NNSA is authorized by a grant of Delegation of Authority from the General Services Administration pursuant to Section 201 (a)(4) of the Federal Property and Administrative Services

Frerking, proposed to allocate off-system sales margins between the Missouri retail, Kansas retail and Federal Energy Regulatory Commission (FERC) wholesale jurisdictions employing a new allocation methodology that KCPL refers to as the "unused energy allocator." Witness Dittmer rebutted Company's use of the "unused energy allocator" to allocate non-firm off-system sales margins, rather than employ the "energy with losses allocator" that has been traditionally used for allocating this cost of service revenue credit between jurisdictions.

3) Surrebuttal Testimony of James R. Dittmer was filed on October 6, 2006 in both HC and NP versions (marked and received as Exhibit 805 and 805HC). In that Surrebuttal Testimony Mr. Dittmer addressed the following issues: First, within its initial direct filing, through Witness Don Frerking, KCPL proposed to allocate off-system sales margins between the Missouri retail, Kansas retail and FERC wholesale jurisdictions employing a new allocation methodology that KCPL refers to as the "unused energy allocator." Within rebuttal testimony filed on September 8, 2006 Mr. Frerking continued to embrace the concept of employing the "unused energy allocator" to assign off-system sales margins to the various jurisdictions. However, while continuing to embrace the concept of employing the "unused energy allocator," Mr. Frerking nonetheless revised and purportedly corrected the calculation underlying the noted allocator. One purpose of the surrebuttal testimony was to establish that, notwithstanding the Company's revision to its allocator development, all arguments that Witness Dittmer made in rebuttal testimony in opposition to the use of the "unused energy allocator" remained valid. In fact, the revision actually further highlighted one of the significant problems of its use that Mr. Dittmer discussed within rebuttal testimony. Secondly, KCPL Witness Michael Cline filed rebuttal testimony addressing the topic of the Additional Amortization required to achieve financial metrics

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Act of 1948, as amended (49 U. S. C. 481 (a) (4)) to represent the ***customer interests*** of affected executive agencies agreed to by a number of parties signing the Stipulation and Agreement in Case No. EO-2005-0329. Witness Cline provided a rebuttal schedule that attempted to show that the revenue requirement is lower in the short run if capital requirements are funded through "traditional ratemaking" rather than through "Additional Amortization." There are elements to Mr. Cline's analysis that are, in the words of Witness Dittmer, "very misleading". Accordingly, a second purpose of Witness Dittmer's Surrebuttal testimony was to respond to some of Mr. Cline's assertions or conclusions.

4) Errata to Mr. Dittmer's Direct Testimony was filed on October 27, 2006 in an HC Version (marked and received as Exhibit 809 and Ex. 809HC) corrected some numbers in the HC portion of his Testimony.

5) Direct Testimony of Dr. J. Randall Woolridge in NP version was filed on August 8, 2006 (marked and received as Exhibit 801). In that testimony, Dr. Woolridge addressed the following issues: Appropriate cost of capital and return on equity for KCPL and a critical analysis of the direct testimony of KCPL Witness Dr. Samuel C. Hadaway. He recommended a Return on Equity (ROE) of 9.00% for KCPL based on a Discounted Cash Flow (DCF) methodology and which was supported by the Capital Asset Pricing Model (CAPM).

6) Surrebuttal Testimony of Dr. J. Randall Woolridge in NP version was filed on October 6, 2006 (marked and received as Exhibit 802). In that testimony, Dr. Woolridge addressed the following issues: a response to KCPL Witness Hadaway and a further critique of KCPL witness Hadaway's cost of capital recommendations.

7) Direct Testimony of Gary C. Price in NP version was filed on August 6, 2006 (marked and received as Exhibit 806). In that testimony, Mr. Price addressed the following issues: appropriate rate design and revenue allocation method to be adopted by the

of the Federal government in this proceeding, (Emphasis Supplied).

Commission in this case.

8) Rebuttal Testimony of Gary C. Price in NP and HC versions was filed on September 15, 2006 (marked and received as Exhibit 807 and 807HC). In that testimony, Mr. Price addressed the following issues: response to various parties proposals relating to rate design and revenue allocation.

9) Surrebuttal and Cross-Surrebuttal Testimony of Gary C. Price was filed in both HC and NP versions on October 6, 2006 (marked and received as Exhibit 808 and Ex. 808HC). In that testimony Mr. Price addressed the following issues: additional comments on other parties testimony and an update of his recommendations.

Parties filed Prehearing Briefs in this case on October 12, 2006. Intervenor DOE/NNSA filed its Brief in both an HC and a NP version. In this Posthearing Brief we will generally follow the format of that Brief and address most of the same issues as in that Brief for the benefit of the Commission.

OFF-SYSTEM SALES

The filed issues list sets out the Off-system Sales Issues to be determined as follows;

1. **What level of off-system sales margin should be included in determining KCPL's cost of service?**
2. **How should the off-system sales margin be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?**
3. **What parameters do the Commission-approved Stipulation & Agreement (Experimental Regulatory Plan) in Case No. EO-2005-0329 impose on the treatment of off-system sales revenue in this case?**
4. **Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders?**
5. **Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?**

The following are DOE/NNSA's recommendations to the Commission for its findings and conclusions relating to these issues from the facts and testimony which DOE/NNSA submits were elicited at the hearings held from October 16 through October 27, 2006.

1. What Level Of Off-System Sales Margin Should Be Included In Determining KCPL's Cost Of Service?

DOE/NNSA recommends a level of off-system sales margin be included in KCPL's cost of service in the "all company" amount of ** [redacted] "** **(HC)**[2] allocated among jurisdictions using the energy allocator recommended in this brief.

KCPL Witness Michael M. Schnitzer presented a modeling technique designed to estimate the range of possible margins from off-system sales to be achieved during the period that rates being established within this proceeding will be in effect (i.e., most of 2007), and further, created a probabilistic distribution for such range of possible outcomes. Mr. Schnitzer testified that there was a 50:50 probability that 2007 off-system sales margins would be ** [redacted] ** **(HC)** (Schnitzer Direct, Exhibit No. 30 and 30 HC, page 3, line 17).

As discussed in greater detail later in this brief, DOE/NNSA has proposed off-system sales margins should be credited to the Missouri jurisdictional cost of service at the 50th percentile of probability of occurrence as the "most likely" or "normalized" level of off-system sales margins. DOE/NNSA submits that the testimony in this case supports ** [redacted] ****(HC)** as the level of off-system sales margin KCPL actually experienced during the historical twelve months ending June 30, 2006—the end of the update period ordered by the Commission in this case (Dittmer Direct, Exhibit No. 803 NP and 803HC, page 8, line 6, et seq.).

Office of Public Counsel (OPC) Witness Ralph Smith testified to the best estimate that should be used for establishing KCPL's revenue requirement:

> The most accurate estimate of off-system sales margin should be reflected in operating revenues for purposes of establishing the revenue requirement for KCPL

[2] All references to HC numbers in this brief are set between asterisks thus **[redacted]** followed by an **(HC)** notation.

> in this proceeding. Based on the review of information conducted to date, the median value shown on Company Exhibit MMS-6 of ** [redacted]_** **(HC)** appears to represent that best estimate (Smith Direct, Exhibit No. 210 and 210 HC, p. 7, line 15).

Burton L. Crawford, KCPL Witness, testified that "[t]he 2006 and 2007 budgets proposed in the late summer and early fall of 2005 project ** [redacted] ** **(HC)** and ** [redacted]_** **(HC)**, respectively, for wholesale margins" (Burton Crawford, Direct, Exhibit 15 and 15 HC, page 20, line 1).

2. How Should The Off-System Sales Margin Be Allocated To The Missouri Retail, Kansas Retail And FERC Wholesale Jurisdictions?

DOE/NNSA requests that the Commission reject KCPL's never-before-utilized "unused energy allocator" to assign non-firm energy sales margins to the Missouri jurisdiction. In support of its opposition to KCPL's proposed "unused energy allocator" DOE/NNSA notes that such an allocator rewards low load factor customers/jurisdictions and punishes high load factor customers/jurisdictions – which is contrary to cost causation principles (Dittmer, Rebuttal Exhibit 804 and 804 HC, p. 2 et seq., Dittmer Surrebuttal, Exhibit 805 and 805 HC, p. 3 et seq.).

DOE/NNSA proposes that the "total company" level of off-system sales margins be allocated to the Missouri retail jurisdiction on the basis of the "energy with losses allocator" that was employed to allocate the cost of facilitating off-system sales in this case, and which has been employed in every KCPL case as well as, to DOE/NNSA's knowledge, every Missouri electric utility rate proceeding in all recent years.

Staff witness Erin L. Maloney, with the assistance of other members of the Commission Staff, developed the "jurisdictional energy allocators" supported by DOE/NNSA. Ms. Maloney stated that "the energy allocation factors were calculated after applying adjustments for large customer annualization, weather adjustment and customer growth." The jurisdictional energy allocators developed by Staff are as follows:

Missouri Retail	0.5668
Kansas Retail	0.4243
Wholesale	0.0089

(Maloney Direct, Exhibit 122, page 2, line 16 and page 10, line 11). Ms. Maloney testified that the "jurisdictional energy allocators" are used by Staff to allocate Off-system Sales Margins (Maloney Surrebuttal, Exhibit 124, page 6, line 14).

In order to allocate off-system sales margins among Missouri, Kansas and the FERC wholesale customers KCPL designed a never before employed "unused energy allocator". DOE/NNSA Witness James R. Dittmer explained the method that KCPL Witness, Don Frerking used to create the "unused energy allocator" (Dittmer Rebuttal, Exhibit 804 and 804 HC, page 2, line 10 and Dittmer Surrebuttal, Exhibit 805 and 805 HC, page 3. line 5) and why its use leads to inefficiency.

> Average of 12 Coincident Demands for the Jurisdiction (whether it is Missouri, Kansas or FERC) [line 1 of Surrebuttal JRD Schedule] expressed as a percentage of system peak demand. [line 2 of Surrebuttal Schedule JRD 1]
>
> Times KCPL's peak capacity allocated to each jurisdiction based on the 12 CP Coincident Demand percentages [line 2 times line 3 of Surrebuttal Schedule JRD 1]
>
> Times Total Hours in a Year (8,760)
>
> Equals - Subtotal" Available Energy" for each Jurisdiction
>
> Less: Actual Energy Served to Each Jurisdiction for the Year (Sales plus Line Losses For Each Jurisdiction)
>
> Equals - "Unused Energy" for Each Jurisdiction [Line 13 of Surrebuttal Schedule JRD 1].[3]
>
> This calculation is made for each jurisdiction- Kansas, Missouri and FERC. Using this algorithm, each jurisdiction's "unused energy allocator" is then

[3] Note that in Mr. Dittmer's Surrebuttal Schedule JRD 1 line 7 is computed by multiplying line 3 (not line 1) times line 5

developed by dividing its calculated "unused energy" by the total company amount of "unused energy."

KCPL's development of its "unused energy allocator" is shown on the top half of Mr. Dittmer's Surrebuttal Schedule JRD-l. The rationale given for use of this factor to allocate off-system sales margins stated within Company workpapers is as follows:

> The allocation of the margins is dependent on and must be consistent with how the total generation costs are being allocated to the jurisdictions (Demand and Energy Allocator).Through the Demand allocator the jurisdictions have essentially paid for the "rights" to a certain level of MWH output. This "Available Energy" is calculated by multiplying the average CP load by 8760[4] (the hours in a year).The "Unused Energy" is calculated by subtracting a jurisdiction's actual "Energy Used" from its "Available Energy". The Unused Energy" is essentially a measure of the portion of the fixed costs that the jurisdictions have paid for but not used, and is also a measure of the energy available to make off-system energy sales (Company workpaper "Unused Energy Allocator.xls") (Dittmer Rebuttal, Exhibit No. 805 and 805 HC, Page 2, line 10).

Mr. Dittmer testified that despite the change in Mr. Frerking's methodology from his Direct to his Rebuttal Testimony that Mr. Dittmer's criticism of Mr. Frerking's "unused energy allocator" remains valid (Dittmer Surrebuttal, Exhibit 805 and 805 HC, page 5, line 4).

Mr. Dittmer explained defects with the "unused energy allocator" in his rebuttal testimony:

> There are several reasons for rejection of the "unused energy allocator", including:
>
> - KCPL's methodology attempts an assessment of production facility usage by jurisdiction in order to purportedly credit each jurisdiction for their "underutilization" of such assets. Unfortunately, there is no corresponding refinement in the allocation of system energy generation expenses, which would be required using KCPL's methodology. Under KCPL's approach, the lower load factor jurisdictions will be allocated proportionately more off-system sales margins in consideration of the proportionally higher number of hours out of the year they are not fully utilizing the production facilities that they are paying for through allocation of fixed production costs on a 12 CP basis. However, the KCPL methodology completely and

[4] As noted this methodology was changed in Mr. Smith's Rebuttal Testimony from a percentage of average load to a percentage of peak capacity. The change in calculating the Unused Energy can readily be seen by comparing Mr. Dittmer's Rebuttal and Surrebuttal Schedules JRD 1.

unfairly ignores the higher energy costs that the lower load factor jurisdictions impose on the system when their "peak loads" cause more generation from higher cost natural gas units.

- KCPL's methodology is overly simplistic and is built upon a key implicit assumption that does not square with reality.
- KCPL's methodology "rewards" low load factor jurisdictions with larger off system sales credit allocations and "punishes" the higher load factor jurisdictions.
- KCPL's methodology is inconsistent with previous allocation treatment approved by the Missouri Public Service Commission, and to my knowledge, every other jurisdiction (Dittmer Rebuttal, Exhibit 804 and 804 HC, page 3, line 24).

In addition Lena M. Mantel, staff witness, commented on the faulty reasoning in the application of the "unused energy allocator" and also makes a critical point on the reason various types of generation plants are built and why it makes no sense to allocate the benefits of a base load plant to a jurisdiction that had less to do with its being constructed.

> The result of the application of this allocation factor is that KCPL is allocating more off-system sales revenue to the low load factor jurisdiction (Kansas) than to the high load factor jurisdiction (Missouri). My rebuttal testimony provides general resource planning information regarding what type of generation units are built for low load factor utilities and what generation is built for high load factor utilities. Typically, high load factor utilities are most cost effectively served with a higher proportion of base load generation (i.e., high capital and low variable costs generation). Low load factor utilities are typically served most cost effectively with more intermediate and peaking generation (i.e., low capital and high variable cost generation.) To use an allocation factor that allocates more margin to the lower load factor jurisdiction, as KCPL is doing, is **<u>giving Kansas more benefits from the base load generation that would not have been constructed if it was not for the higher load factor jurisdiction</u>**, which is Missouri [Emphasis Added] (Mantle Rebuttal, Exhibit No. 125, page 2, line 15).

Ms. Mantel makes the additional point that a base load plant is the most efficient and lowest cost plant to use for generation when the usage is for longer time periods (higher load factor) and that higher cost peaking and intermediate plant is the most efficient for usage during shorter time periods (lower load factor) (Mantel Rebuttal, Exhibit 125, page 3, line 6 and Cost Curve page 4). Thus, the higher the load factor of a jurisdiction the more efficient its use of low variable cost plant. The “unused energy allocator” by rewarding the jurisdiction with the lower load factor (Kansas) also gives Kansas the economic motivation to continue to be an inefficient, low load factor jurisdiction.

Ms. Mantel shows graphically at page 4 of her Rebuttal Testimony (Exhibit 125) the cost curves of plant built for high load factor and low load factor utilities and at page 6 the load curves of high and low load factor utilities. These two sets of curves graphically demonstrate why high load factor utilities have a greater percentage of base load generation and resultant lower unit energy costs. The curves also demonstrate why low load factor utilities have a greater percentage of peaking generation and resultant higher unit energy costs. This supports the conclusion that when a utility has high and low load factor jurisdictions that it is the available capacity of the base load plant that was built to serve high load factor jurisdiction that results in the highest margins from off-system sales. The high load factor jurisdiction has lower variable cost plant to sell into the competitive off-system energy market. On the other hand the low load factor jurisdiction may have a higher percentage of unused peaking plant available for sale into the off-system market but the higher operating cost of the peaking plant causes such plant to either not be able to sell into the off-system market or causes the off-system sales margins to be thin.

Finally, the cross-examination of Mr. Frerking which appears in the transcript Vol. 8 and quoted below in the Jurisdictional Allocation section demonstrates that he has absolutely no experience or training in jurisdictional allocation causing his testimony to be thoroughly lacking in credibility.

3. What Parameters Do The Commission-Approved Stipulation & Agreement (Experimental Regulatory Plan) In Case No. Eo-2005-0329 Impose On The Treatment Of Off-System Sales Revenue In This Case?

DOE/NNSA submits that KCPL has contractually bound itself by its execution of the Stipulation and Agreement (hereinafter the “Experimental Regulatory Plan” or “Plan”) approved by the Commission in Case No. ER-2005-0329 (Exhibit 143), by an amendment to the Experimental Regulatory Plan and by statements of its officers, to allocate all margins from off-system sales to its ratepayers.

Staff Witness Steve Traxler testified that the Plan (Exhibit 143) requires that off-system energy and capacity sales be treated “above the line” for ratemaking purposes (Traxler Direct, Exhibit No. 134 and 134 HC, page 5, line 5, page 26, lines 13 and 27, page 27, line 7). DOE/NNSA Witness Dittmer agreed with Mr. Traxler commenting that this was an issue addressed in great detail in the Experimental Regulatory Plan and by the Commission Order on the Plan (Dittmer Rebuttal, Exhibit No. 804 and 804 HC, p. 14). Staff Witness Traxler demonstrated that such an interpretation was reasonable and that the Commission could independently find it to be reasonable, irrespective of application of the Plan testifying that “[t]he net margin from off-system sales have consistently been used by the Staff and accepted by the Commission to determine the overall revenue requirement of electrical corporations within the Commission jurisdiction” (Traxler Direct, Exhibit No. 134 and 134 HC, page 30, line 16).

The record is replete with agreements by KCPL that it will not attempt to take for itself any of the margins from off-system sales. The Plan so states at Paragraph III B. 1. j p.57. Subsequently, on July 25, 2005, also in Case No. ER-2005-0329 the Commission ordered the parties to the Plan to “submit language reflecting the off-system sales agreements” by July 26, 2005. On July 26 the parties to the Plan filed a response to the Commission’s July 25 order which contained an agreement, on page 2, amending the Plan as follows:

Section III.B.1.j is amended to read as follows:

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

> these revenues and associated expenses should be excluded from the ratemaking process. KCPL agrees that all of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates.

On page 28, beginning at line 21 of his Direct Testimony (Exhibit No. 3 and 3 HC), KCPL Witness Giles confirmed that "KCPL will not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process" and confirmed this agreement again in response to Staff Counsel Dottheim's cross-examination at the hearing of this case (Transcript Vol. 9, page 742, line 9). Following this exchange with Mr. Dottheim, KCPL Witness Giles testified that KCPL has "no inherent right to earnings from the off-system sales market as long as the costs of the assets generating those wholesale earnings are in retail prices" (Transcript Vol 9, page 751, beginning with question on line 3).

4. Should KCPL's Customers Receive The Benefit Of All Margins Of Off-System Sales Or Should It Be Shared Between Customers And Shareholders?

KCPL Witness Schnitzer calculated that there was a 50:50 probability that KCPL's off systems sales would be ** [redacted] ****(HC)** in 2007, the first year that KCPL's rates from this case would be in effect. (Schnitzer Direct, Exhibit No. 30, p 20, line 19; Giles Direct, Exhibit 3 and 3 HC, page 24, line 1) and a 25% probability that the off-system sales would be below ** [redacted] ** **(HC)** or a 75% probability that KCPL's off-system sales revenue would exceed ** [redacted] ** **(HC)** (Schnitzer Direct, Exhibit No. 30, p. 20, line 10; Giles Direct, Exhibit No. 3 and 3 HC, page 25 line 14).

As stated above, the Plan and subsequent amendment approved by the Commission in Case No. EO-2005-0329 (Exhibit 143) is a contract binding KCPL and the other parties to the Plan, and requires that all of KCPL's off-system sales margins be allocated to rate payers. Thus, DOE/NNSA's response to this issue is that <u>all of the benefit</u> of off-system sales margins should go to KCPL customers.

Instead, contrary to the plain and unambiguous terms of its agreement, KCPL proposes to allocate the greater portion of the off-system sales margins to itself. KCPL's rationale is that it is too risky for KCPL to give up these margins (See Giles Direct. Exhibit No. 3 and 3 HC, page 23, lines 7 and 20 and page 25, line 19). Mr. Giles explains that the risk inherent in KCPL's receipt of approximately ****** [redacted] ** **(HC)** of KCPL's "total earnings" (Id. page 24, line 19) or ** [redacted] ** **(HC)** of its "earnings" (Giles Rebuttal, Exhibit No. 4 and 4 HC, page 3, lines 2 and 22; page 4, line 7 and page 7, line 6) from off-system sales requires KCPL's disproportionate allocation. Mr. Giles proposed a balancing of off-system margins between the company and ratepayers stating:

> . . . the only reasonable and responsible method to determine the appropriate amount of off-system sales margin to include in test year revenue is to project the amount of off-system sales margin expected during the first year that the increased rates would be in effect, calculate the risk of those off-system sales and share that risk between retail customers and the Company. This method provides the best balance of interests among customers, investors, and creditors, particularly in view of the scale of KCPL's construction program through the 2010 timeframe (Giles Direct, Exhibit 3 and 3HC, page 25, line 3).

Staff Witness Traxler, responded to KCPL's "risk sharing" plan in his Rebuttal Testimony:

> Q. Is Mr. Giles recommended treatment for off-system sales margin in this case consistent with language in the Regulatory Plan Stipulation and Agreement requiring full recognition of the margin from off-system sales?
>
> A. **No it is not**. Mr. Giles recommended level of ** [redacted] ** **(HC)** [million] off-system sales margin required an adjustment reducing the 2005 test year level by $19 million for the stated purpose on page 7, lines 7-11, of his rebuttal testimony "to adjust the return on equity to reflect this additional risk" related to the margin from off-system sales. Mr. Giles' proposal to adjust the return on equity by assigning off-system sales margin to shareholders violates the intent of language in the Regulatory Plan Stipulation and Agreement which specifically precludes KCPL from recommending such an adjustment. If KCPL believed that assigning a portion of the margin on off-system sales to shareholders was

> necessary in order to earn a reasonable return on equity ROE for shareholders, then KCPL should not have agreed to language in the Regulatory Plan Stipulation and Agreement which precludes KCPL from doing so (Traxler Surrebuttal, Exhibit 136 and 136 HC, p. 26, line 8 et seq., Emphasis Supplied).

5. Should A Mechanism Be Adopted To Ensure That The Benefit Is Received By The Appropriate Party Or Parties? If So, What Mechanism?

There are obviously many different mechanisms available to the Commission for effectuating KCPL's commitment that all revenues from off-system sales would be treated "above the line" for ratemaking purposes. At present KCPL has not offered any (Dittmer Rebuttal, Exhibit 804 and 804 HC, p. 15; Giles cross-examination, Transcript Vol 9, page 752, line 19). Regardless, as argued above, KCPL has agreed that it has no right to off-system sales margins.

DOE/NNSA recommends that the Commission give serious consideration to the suggestion of OPC Witness Ralph C. Smith:

> Is OPC willing to consider an alternative treatment of off-system sales margins that would provide specific consideration for the potential for a large variation in the level of off-system sales margin that KCPL could realize during the rate effective period? (Smith Direct, Exhibit No. 210 and 210 HC, Page 10, line 7)

Mr. Smith responded beginning at page 11, line 11,

> OPC is willing to consider an alternative mechanism by which KCPL would establish a regulatory liability (or asset) account, and would record its actual achieved off-system sales margin during the rate effective period in excess of (or below) the * * [redacted]_* ***(HC)** in such account. For example, if in 2007, KCPL realized off-system sales margin of * * [redacted]_** **(HC)**, the Missouri jurisdictional portion of the difference between the realized amount and the [redacted]_** **(HC)** that was recognized above the line for ratemaking purposes in this proceeding would be recorded by KCPL in Account 254, Regulatory Liability.
>
> Q: What are the benefits of such an accounting treatment?
>
> The benefits are that this would assure that KCPL's ratepayers can be provided with 100% of the off-system sales margin realized by KCPL. The ** [redacted] ** **(HC**) that I recommend be reflected in the determination of KCPL's revenue requirement in this case is a median amount. That means that there is a significant likelihood that KCPL will achieve a much higher level of off-system sales margin during 2007. KCPL's median projected amount of ** [redacted] ** **(HC)** this also corresponds with KCPL's 2007 projected budgeted amount.
>
> The range of potential off-system sales margins for calendar year 2007

> that KCPL considered in its analysis ran from * * [redacted] * * to * * [redacted]. * * **(HC)** Additionally, as described at page 16 of KCPL witness Schnitzer, "there is a 90% likelihood that the Off-System Contribution Margin will be between ** [redacted] ** **(HC)** ... and a 5% chance that the margin will be greater than ** [redacted] **.**(HC)** Thus, by instituting this type of regulatory accounting in recognition of the special circumstances of KCPL's unique situation, ratepayers could benefit significantly if KCPL realizes higher than its median projected amount of off-system sales At the same time, if KCPL does not actually realize off-system sales margins in 2007 equal to or greater than its projected median amount of ** [redacted], ** **(HC)** KCPL's concerns are addressed by recording the difference in a regulatory asset account. This accounting for variances in the achieved level of off-system sales margins would thus provide KCPL with a realistic opportunity to earn the return on equity authorized in this case during the rate effective period.
>
> Q. Is KCPL already using similar accounting for some of its other fuel-related costs or revenues?
>
> A. Yes. As noted on page 33, lines 2 1-23, of KCPL witness Blunk's direct testimony, the Regulatory Plan Stipulation and Agreement requires KCPL to record all SO2 emission allowance sales proceeds as a regulatory liability in Account 254. It further provides that KCPL may recommend an appropriate amortization period for SO2 emission allowances that have been recorded in Account 254 to be included in the Company's 2009 rate case revenue requirement.

DOE/NNSA submits that OPC Witness Smith's methodology could solve the problem that Staff and Intervenors have expressed: that they will not receive all of the bargained for off-system sales margins that they should. The problem KCPL Witness Giles raised that KCPL runs too great a risk if the cost of service approved by the Commission were to reflect a reduction for off-system sales that it does not attain has no merit and is overcome by OPC Witness Smith's methodology.

ICE STORM COSTS

No amount of the amortization of the costs associated with the 2002 ice storm should be included in rates, as KCPL has already recouped such costs.

DOE/NNSA opposes KCPL's proposal to include within the Missouri jurisdictional cost of service amortization of ice storm costs incurred in 2002. In support of such position, DOE/NNSA argues that such costs have already been recovered with existing Missouri jurisdictional rates. Further, the scheduled expiration of the existing amortization coincides very closely with the expected implementation date for new rates being established within this proceeding (Dittmer Direct Testimony, Ex. No. 803 and 803HC, pp. 19-27). Staff of the Commission took no position regarding this issue. See Supplemental Prehearing Brief of Staff at p. 18. Staff's position in its Direct case is that the unamortized ice storm deferral balance at September 30 should be included as the "adjusted" or "normalized" level of ice storm amortization expense to be included within the adjusted test year cost of service. Because there are only four months of amortization left as of September 30, Staff's proposed level is one third of the full amortization amount that was included in the historic test year that KCPL proposes to leave unadjusted. See Direct Testimony of Staff Witness Phillip Williams, Exhibit No.139 and 139HC, at p.51, Staff Adjustment S-86.2. DOE/NNSA submits that at most, only the December 31, 2006 balance (i.e., one month's worth of amortization) should be included within the test year cost of service in this case.

ADDITIONAL AMORTIZATION

No Regulatory Plan additional amortizations have been showed by the evidence in this case to be allowed, as there is no competent and substantial evidence in this record which shows that KCPL's credit rating is or will be downgraded.

In order for this Commission to find that "additional amortizations" should be allowed in this case, competent and substantial evidence is required to support such a finding, not merely the "knee-jerk" application of the Regulatory Plan and its Stipulation.[5] State ex rel. Dyer v. Public Service Commission 341 S. W. 2nd 795, (Sup. 1961), certiorari denied 81 S. Ct. 1351, 366 U.S. 924, 6 L. Ed. 2d 384. DOE/NNSA submits that at most, amounts

[5] In addition to Intervenor DOE/NNSA, Jackson County, AARP, Trigen and Wal-Mart are not signatories to the Regulatory

calculated on test year values to achieve the minimum financial metrics agreed to by the parties in the 2005 Stipulation and Agreement can be granted only if the Commission finds that evidence offered herein supports a finding that Standard and Poor's (S&P) will or is about to downgrade KCPL's credit rating and that a downgrading of KCPL's debt will be more unreasonable and costly to KCPL ratepayers than requiring ratepayers to fund the additional amortization expense.[6] KCPL offered no such evidence. Opinion testimony by employees of KCPL or non-S&P consultants is, we submit wholly deficient.[7] No testimony has been offered to demonstrate whether ratepayers would be better off if KCPL debt was downgraded compared to the high cost of additional amortization. Staff of the Commission did offer an Exhibit which was prepared by S&P, Exhibit No. 150, which carried the following caveat:

"Table 1 contains the revised (credit) guidelines. It is important to emphasize that ***these metrics are only guidelines*** associated with expectations for various rating levels. Although credit ratio analysis is an important part of the ratings process, ***these three statistics are by no means the only critical financial measures that Standard & Poor's uses in its analytical process. We also analyze a wide array of financial ratios that do not have published guidelines for each rating category***" (Emphasis Supplied).

And further at p. 4: "Again, ratings analysis is **not driven solely by these financial ratios, nor has it ever been**. In fact the hew financial guidelines that Standard & Poor's is incorporating for the specified rating categories reinforce the analytical framework whereby other factors can outweigh the achievement of otherwise acceptable financial ratios (Emphasis Supplied).

As a matter of fact one of the major financial weaknesses impacting KCPL's credit according to S&P has nothing to do with the building of IATAN 2 or costs associated with that plant but instead according to S&P relates to the risk profile of Strategic Energy, a separate **unregulated** subsidiary of Great Plains Energy. See Staff Exhibit No. 145.

Stipulation.

[6] The Commission should be cognizant that requiring present ratepayers to assist in financing KCPL's construction program through added amortization expense which will be paid back to future ratepayers results in an intergenerational subsidy. What the parties to this case would have accomplished in the Rate Design Stipulation filed in this case, i.e. beginning to eliminate interclass subsidies will thus be negated if the Commission in allowing added amortization expense at the recommendation of the Signatory Parties to the Experimental Regulatory Plan will simply create a new intergenerational subsidy. This is not we submit, prudent nor sound ratemaking.

[7] KCPL offered various witnesses to support its proposition. None of these employees or consultants are employees of S&P nor demonstrated that they were privy to S&P's calculations and determination of credit risk.

If a "gross up" for taxes is to be added to any additional amortizations, it should be allowed only if it is included as a future off-set to rate base.

If the Commission allows any additional amortization, then DOE/NNSA supports Staff's calculations in this case. See Draft Nonunanimous Stipulation dated October 31, 2006[8].

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

The Commission, not being a party to the Stipulation & Agreement reached among some of the parties in Case EO-2005-0329, is free to determine the risk factors it believes are relevant based on competent and substantial evidence in this record or apply no risk factors at all or determine that no additional amortization in any amount should be allowed. NNSA/DOE not being a party to the Stipulation & Agreement reserved the right to argue that no additional amortization should be allowed and that rates should be set according to the cost of KCPL to serve its customers including a reasonable return on its equity. If the Commission sets KCPL's rates according to criteria that S&P uses to determine its rating of KCPL's debt is to defer to the judgment of S&P thereby avoiding the Commission's statutory obligation to use its best judgment in setting rates for KCPL's ratepayers that are just and reasonable. If the Commission does decide to apply a risk factor in this case, it must do so based on the competent and substantial evidence in this record.[9]

If Regulatory Plan additional amortizations are granted in this case then they should be treated as an offset to rate base in the next case.

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[8] At the time of the preparation of this Brief a Draft Stipulation was circulating among the parties.

[9] It would appear that Public Counsel is arguing for 10% risk factor and Staff at 30%. See True-Up List filed by Staff on November 8th, 2006 and True-Up Direct Testimony of Russell Trippensee, Exhibit No.___..

If the Commission allows any Plan additional amortizations then such balance should be used as a rate base offset so long as any net unamortized balance exists. Once the entire balance has been amortized, only then should there no longer be a rate base offset. Staff Witness Traxler testified as follows:

> For clarification then, assuming no change in the Staff's $80 million revenue excess/earnings excess determination, the additional $75 million amortization, to meet benchmark financial ratios, would offset all but $5 million of the Staff's recommended rate reduction of $80 million.
>
> Thus, in lieu of a rate reduction under traditional ratemaking treatment, ratepayers would receive a $75 million rate base offset in KCPL's next rate case. This provision for a rate base offset appears throughout the KCPL experimental regulatory plan Stipulation and Agreement in Case No. EO-2005-0329 (see pages 18, 27, 32, 37 and 40 of the Stipulation and Agreement) (Traxler Direct, Exhibit No. 134, 134 HC, page 20, line 3).

JURISDICTIONAL ALLOCATION

What Is The Appropriate Method (4 CP Vs. 12 CP) To Use For Allocating Generation And Transmission Costs Among Jurisdictions?

Jurisdictional demand allocation refers to the process by which demand-related costs are allocated to the applicable jurisdictions, in this case Missouri, Kansas and Federal. DOE/NNSA recommends that the appropriate jurisdictional allocator for allocation of generation and transmission costs to the Missouri jurisdiction is the 4 CP allocator. There are two principal reasons for using the 4 CP allocator rather than the 12 CP allocator used by KCPL. First, KCPL presented no competent evidence that the 12 CP allocator is appropriate while Staff and Praxair both presented compelling evidence in favor of the 4 CP allocation methodology. Second, the 4 CP allocator is the most appropriate allocator for a utility with KCPL's load profile.

Regarding the first reason, KCPL Witness Don Frerking prepared and testified on behalf of the 12 CP Jurisdictional Allocator (Frerking Direct, Exhibit No. 9 and 9 HC, page 6, line 4). Mr. Frerking admitted that in KCPL's last litigated rate case and in its surveillance reporting through 2004 the company had used a 4 CP jurisdictional allocator. (Transcript Vol. V. 8, page 593 lines 4 and 11 and page 594, line 4) Cross examination of Mr. Frerking demonstrated that he had absolutely no experience or training in the development of jurisdictional allocators rendering his testimony on the subject completely incompetent and unreliable. Since KCPL depended entirely on Mr. Frerking's testimony for use of the 12 CP allocator, there is no competent or substantial evidence upon which the Commission could base a decision to use this allocator.[10] On cross examination Mr. Frerking admitted that he had never conducted an independent jurisdictional allocation analysis before (Transcript Vol 8, page 573, line 5 and page 576, line 22); that in preparing for his assignment of filing testimony on jurisdictional allocations, he had not taken any special classes or attended any conferences related to jurisdictional allocations, (id. page 573, line 10); that his college education did not provide him with any special training related to conducting a jurisdictional allocation analysis (id. page 573, line 14); that in preparing for his assignment in this case he did not consult any textbooks or other treatises related to jurisdictional allocations (id. page 573, line 18); that prior to filing his testimony, he had consulted a couple papers on the calculation of jurisdictional allocations, but nothing which would provide a criteria on when to apply one method versus another (id. page 575, line 3); that he did not consult any testimony filed in any other jurisdiction (id. page 575, line 6); that prior to filing his testimony he had never seen ***A Guide to FERC Regulation and Ratemaking of Electric Utilities and Other Power***

[10] "This court reviews the decision of the Commission, not the judgment of the circuit court. *State ex rel. City of St. Joseph v.Public Serv. Comm'n,* 713 S.W. 2d 593, 595 (Mo.App, 1986). Judicial review of the Commission's order is limited to a determination of whether the order is lawful and reasonable. *State ex rel. City of West Plains v. Public Serv. Comm'n,* 310 S.W. 2d 925, 933 (Mo. Banc. 1958). "[Q]uestions of lawfulness turn on whether the Commission's orders or decisions are statutorily authorized and questions of reasonableness turn on whether there is competent and substantial evidence upon the whole record to support them. . . Where a decision of the Commission turns on purely factual issues, this court may not substitute its judgment for that of the Commission if the order is supported by competent and substantial evidence on the record as a whole. *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Serv. Comm'n,*585 S.W. 2d 41, 47 (Mo. Banc. 1979). This court is allowed to determine whether, upon consideration of the evidence, the Commission could reasonably have reached the result that it did. *Capital City Water Co.* 850 S.W. 2d [903] at 912" *State ex rel. Office of the Public Counsel v. Public Service Commission of Missouri,* 938 S.W.2d 339, 342 (Mo.App.1997).

that Staff Witness Maloney relied on for her determination of whether to use a 4 CP or a12 CP method for allocating between jurisdictions (id. page 575, line 22); that he does not know the rationale FERC uses in determining the proper jurisdictional allocation methodology to use (id. page 576, line 13 and 17); that he did not do any independent analysis to determine whether 12 or 4 CP was more appropriate (id. page 577, line 8); that the reason for using a 12 CP methodology was to maintain consistency among jurisdictions (i.e. Kansas and Missouri) (id. page 577, line 18); that the use of the 12 CP methodology in Kansas was the result of an agreement among the parties in the Kansas regulatory plan Stipulation & Agreement that preceded this current case (Id. page 578, line 15); and that at the time he filed his testimony in the Kansas case, he had not conducted an independent analysis to determine whether the 4 CP methodology was the most appropriate methodology to use for allocating demand facilities in Kansas because it was stipulated in the Kansas case that they would use the 12 CP methodology (id. page 579, line 12).

The second reason referred to above is that the 4 CP allocator is the most appropriate for a utility with KCPL's load profile. Staff Witness Erin Maloney provided compelling and competent evidence that the appropriate jurisdictional demand allocator for KCPL is the 4 CP methodology. Maurice Brubaker, on behalf of Praxair, supported Ms. Maloney's four summer coincident peak jurisdictional demand allocation methodology as being consistent with cost of service principles. (Brubaker Rebuttal, Exhibit 605, page 4, line 11)

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 methodology refers to utilizing the recorded peaks in each of the four (4) peak summer months of the selected test year. (Maloney Direct, Exhibit 122, page 7, line 1). Generation units and transmission lines are planned, designed, and constructed to meet a utility's anticipated system peak demands plus required reserves, the contribution of each individual jurisdiction to these peak demands is the appropriate basis on which to allocate the costs of these facilities. (id. line 6).

Staff Witness Maloney calculated the jurisdictional allocation by summing the peak hourly loads for the summer months (June, July, August and September) for each jurisdiction. Then the contribution to total system peak is calculated by dividing the sum of each jurisdiction's summer peaks by the total of the total system peak. This provides the percentage contribution by each jurisdiction to the system peak. (Id. page 7, line 13). Ms. Maloney then used three tests used by the FERC to test whether the company's load profile makes it appropriate for the company to use a 12 CP or a 4 CP allocation methodology. (Id. page 8, line 20 et seq.) Each of the three FERC tests indicated that the 4 CP methodology was appropriate. (Id. page 7 and 8)

As explained by Praxair Witness Maurice Brubaker, "[b]ecause of the inability to store electricity, production and transmission plant must be sized to meet the maximum demand imposed on these facilities. Given this basic concept it is clear that KCPL's production and transmission facilities have been constructed to meet its predominantly summer peak." (Brubaker Rebuttal, Exhibit No. 604, page 3, line 15)

Ms. Maloney testified that "…the 4 CP methodology is appropriate for a utility, such as KCP&L, where the monthly peak demands during summer months are significantly higher than the non-summer monthly peak demands." (Maloney Rebuttal, Exhibit No. 123, page 2, line 12)

As shown in both Staff Witness Maloney's and Praxair Witness Brubaker's testimony the 4 CP methodology allocates more plant to the low load factor, i.e. summer peaking jurisdiction (Kansas) that has caused the summer peak and thus required the utility to construct additional plant especially for the purpose of serving this summer peak. Thus, the allocation follows cost causation principles and allocates plant to the jurisdiction that caused the cost. (Brubaker Direct, Exhibit No. 601 and 601 HC, Page 22, line 5; Maloney Direct Exhibit No. 122, page 5, line 13)

COST OF CAPITAL

Appropriate Capital Structure

The appropriate capital structure for KCPL is set out in Exhibit JRW 1 reproduced below by DOE/NNSA Witness Dr. J. Randall Woolridge, and contained in his Direct Testimony, Exhibit 801[11]:

Exhibit_(JRW-1)

Kansas City Power & Light Company
Cost of Capital

As of September 30, 2006

Capital Source	Capitalization Ratio	Cost Rate	Weighted Cost Rate
Long-Term Debt	44.67%	6.16%	2.75%
Preferred Stock	1.52%	4.29%	0.07%
Common Equity	53.81%	9.00%	4.84%
Total	100.00%		7.66%

Appropriate Return on Common Equity (ROE)

As can be seen from Dr. Woolridge's Exhibit the appropriate ROE for the Commission to find in this case is 9.00%. Dr. Woolridge explains how he made this determination in his Testimony (Exhibit 801 pp.15-49). He based his recommended return on the application of the DCF methodology and used as a check the CAPM. He applied a

[11] As pointed out subsequently (Footnote 13 below) Staff Witness Barnes on November 7, 2006 filed True-Up Testimony which slightly revised the capital structure of KCPL. If the Commission were to accept that capital structure the impact on Dr. Woolridge's recommendation would be to slightly reduce the over-all return for KCPL since the cost of long-term debt is

traditional DCF methodology and utilized a growth rate based on analysts ranges (Exhibit 801, pp. 21-25)[12]. His full analysis can be found in his Direct Testimony, Exhibit No. 801 appearing at pp. 9-48, which clearly establishes the validity of his recommendations.

There were three other witnesses who filed rate of return testimony in this case:

1) Matthew Barnes on behalf of Staff; recommended a median return on equity of 9.37 %, See Barnes, Direct Testimony Exhibit No.101, p3, in both HC and NP versions. He also filed Rebuttal Testimony, Exhibit No. 102 in both HC and NP versions and Surrebuttal Testimony Exhibit No. 103[13].

2) In addition Office of Public Counsel filed the testimony of Richard A. Baudino, Direct Testimony, Ex. No.202, and Surrebuttal Testimony of Richard A. Baudino, Ex. 203. Mr. Baudino, Director of Consulting for J. Kennedy and Associates, recommended Rate of Equity was 9.90%, See Direct Testimony, Exhibit 202, at p. 2.

3) KCPL filed the testimony of Dr. Samuel Hadaway who recommended an 11% ROE and also added an additional adder of .50%. See Direct Testimony, Ex. No. 34, Rebuttal Testimony, Ex. No. 35, and Surrebuttal, Ex. No. 53.

As can clearly be seen the independent witnesses in this case, Staff, OPC and DOE/NNSA are all recommending a Return on Equity in the 9% range utilizing a

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less than that of equity.

[12] Counsel for KCPL introduced a Study of the Impact of the 2003 Dividend Tax Cut by Gene Amromin, Paul Harrison, Nellie Liang and Steve Sharpe written for the Federal Reserve Board in 2005 (Exhibit No. 33) for the proposition that the tax cut had no impact on equity holders contrary to Dr. Woolridge's position outlined in his Direct Testimony (Exhibit No. 801) at pp.6-7. For a more recent and somewhat contrary finding as it relates to executives see "Executive Financial Incentives and Payout Policy: Firm Responses to the 2003 Dividend Tax Cut" by Jeffrey R. Brown, Nellie Liang and Scott Weisbenner made to the Federal Reserve Board, January 2006. The Report can be found at: http://www.federalreserve.gov/pubs/feds/2006/200614/index.html .

[13] Staff filed True-Up Testimony by Witness Barnes and by Witness Traxler which recommends an increase in the Rate of Return to 7.88 % due to long term debt increase and a change in the capital structure. See Traxler True-Up Direct at p. 4 and Barnes True-Up Direct testimony at p. 2, Exhibit No.____. The Return on Equity recommendation remains the same with a midpoint of 9.37%. Staff Witness Traxler also stressed in his True-Up Direct that KCPL has been over-earning for

traditional DCF methodology. Only one witness, KCPL's Hadaway, proposed an equity return which was far above the range of the other three. We submit that the 11% return and such adder is not supported by any empirical study nor by competent and substantial evidence. A critique of KCPL Witness Hadaway's overall recommendations follows below.

KCPL's Witness Hadaway recommended a proposed a capital structure consisting of 44.67% long-term debt, 1.52% preferred stock, and 53.81% common equity. He proposed a long-term debt cost rate of 6.16%, a preferred stock cost rate of 4.29%. His common equity cost rate rate was 11.00% with an adder of .50%.[14] KCPL Witness Hadaway's overall recommendation can be summarized below:

Capital Source	Ratio	Cost Rate	Weighted Cost Rate
Long-Term Debt	44.67%	6.16%	2.75%
Preferred Stock	1.52%	4.29%	0.07%
Common Equity	53.81%	11.50%	6.19%
Total	100.00%		9.01%

KCPL Witness Hadaway's proposed rate of return is excessive due to among other things an overstated equity cost rate according to DOE/NNSA Witness Woolridge, Direct Testimony, Ex. 801, pp.52-56. KCPL Witness Hadaway estimates an equity cost rate for KCPL by applying DCF and risk premium models to the proxy group of electric utility companies. His equity cost rate approaches include three nontraditional DCF models (he threw out his first model which generated an ROE almost identical to Staff Witness Barnes mid-range)[15] and three risk premium models. His equity cost rate estimates and recommendation are summarized below:

some time. See Traxler, True-Up Direct testimony at p. 6, Exhibit No.____..

[14] Although Dr. Hadaway maintained that his recommendation is 11.0% with an adder of .50%, KCPL Witness Giles testified that if the Commission grants a return of 11.50% and if KCPL were able to achieve off-system margins of $54.6 million on a Missouri jurisdictional basis **KCPL would realize an actual return on equity of 12.8%**. See Tr. Vol. 10, In Camera, HC at p. 777.

[15] See Staff Witness Matthew J. Barnes, Direct Testimony, Exhibit 101, at p.17.

Summary of Hadaway Approaches and Results

	Twenty-Four *Value Line* Electric Companies
DCF Analysis	
Constant Growth DCF (GDP Growth)	11.2%-11.3%
Multistage DCF (GDP Growth)	10.6%-10.8%
DCF Range	**10.6%-11.3%**
Risk Premium Analysis	
Utility Debt + Risk Premium	10.94%
Ibbotson Risk Premium	11.15%
Harris-Marston Risk Premium	11.78%
Reference Group Cost of Equity	**11.00%**
KCPL Cost of Equity	**11.50%**

KCPL Witness Hadaway's equity cost rate in the opinion of Dr. Woolridge is too high, primarily because of (1) his use of an inappropriate, unjustified, and inflated DCF growth rate of 6.6%, Woolridge Direct Testimony, Exhibit No. 801, pp. 54-55. (No other witness in this proceeding relied on or adopted a growth rate based on the Gross Domestic Product, ((GDP)), the only rationale for such a rate is that it produces a rate higher than analysts forecasted growth rates; (2) his use of outdated and biased equity risk premium estimates, See Woolridge Surrebuttal, Exhibit 802, p.7; and (3) an unwarranted and non-empirical risk adjustment of 50 basis points. See Woolridge Direct Testimony, Exhibit No. 801, pp.49-58) and Surrebuttal, Exhibit 802 at p.3. On cross examination by Commissioner Clayton, KCPL Witness Hadaway estimated that in the last 5-10 years his recommended range of equity returns for all utilities that he has testified for varied only from a low of 11.0% to a high of 11.5% (and 11.8% in one case). See Tr. Vol. 12, p. 72. We submit that this stark admission alone renders his specific recommendation herein as meaningless and without merit as it applies to KCPL. Further on cross-examination, Dr. Hadaway admitted in the current Commonwealth Edison case before the Illinois Commerce Commission[16], a non-comparable company to KCPL, that he recommended a ROE of 11.0%, the identical ROE that he has recently recommended before the New Mexico Commission on behalf of Public Service Company of New Mexico, another non-comparable company to KCPL, this time in a gas rate proceeding. Tr. Vol.12, p.1244). On cross-examination by Staff Counsel Thompson, Dr. Hadaway admitted that for the years 2004-2005 his recommended rate of equity returns were **higher** than what any of the State Utility Commissions awarded. See Tr. Vol.12, pp.1319-1320.

Return On Equity Should Not Be Adjusted Either Upwards Or Downwards To Reflect Increased Or Decreased Risk Or Company Performance.

As we said earlier no evidence was offered in testimony by any party or witness which would indicate any need for an upward adjustment in ROE[17]. Although KCPL Witness Hadaway recommended an upward adjustment in the ROE of .50% he offered no **empirical** study which supported his recommendation and it was nothing more than mere "opinion" at most. See Tr. Vol.12, pp.1304-1305. As pointed out by Dr. Woolridge in his Surrebuttal Testimony Ex. 802,

" Mr. Hadaway added 50 basis points to his equity cost rate estimate for the proxy group to reflect the additional business risk of KCPL to account for the Company's higher capital expenditure budget relative to the proxy group. He has based this adjustment on one factor – KCP&L's high level capital expenditures in the coming years. As indicated in his response to Data Request DOE_20060612-4-2, Mr. Hadaway performed no studies to assess the business and/or financial risk of KCPL relative to the proxy group. Business and financial risk for an electric depends on many factors, but Mr. Hadaway has not accounted for any factors other than capital expenditures. Furthermore, the 50 basis point adjustment is totally arbitrary and without merit. Mr. Hadaway has performed no studies to justify the magnitude of the 50 basis point adjustment.

In addition, in making this risk adjustment, Mr. Hadaway provides no assessment of

[16] See Docket No. 05-0597 before the Illinois Commerce Commission.

[17] DOE/NNSA Witness did not make an adjustment to his equity return specifically for the impact of the Regulatory Plan but did observe in his Rebuttal Testimony that the impact of the Regulatory Plan certainly had an impact of lowering the risk by at least 30 basis points due to the agreement by the Signatory Parties to maintain the current credit rating of KCPL. See Woolridge Surrebuttal at p.5, Exhibit No. 808.

the financial risk of KCP&L relative to the proxy group. As shown in Exhibit_(JRW-4), the Company's proposed capital structure includes a common equity ratio which is 622 basis points higher than the average of the proxy group. This indicates a lower level of financial risk. However, Mr. Hadaway has failed to even recognize the lower financial risk of KCP&L let alone to make a downward adjustment to reflect KCP&L's lower level of financial risk." Woolridge, Surrebuttal, Exhibit No. 802.

DOE/NNSA Witness Woolridge agreed that the Stipulation and Regulatory Plan has "not eliminated" the Company's financing, construction, and regulatory risks. But, as he indicated in his direct testimony, there are elements of the Agreement which significantly reduce the riskiness of KCPL, including the impact of the risk associated with KCPL's ongoing investment plan. These elements in the Regulatory Plan include agreements that: (1) the Resource Plan is reasonable; (2) that there will be no objections to pension expense, (3) that KCPL can increase amortization to maintain S&P financial ratio benchmarks, and (4) there will not be challenges to specified infrastructure projects, including those for generation, transmission, and distribution, into KCPL's rate base on the ground that the projects were not necessary or timely, or that alternative technologies or fuels should have been used by KCPL. See Woolridge Surrebuttal, Exhibit No. 808, at p4.[18]

We submit that after the Commission reviews all of the proposed recommendations for rate of return and ROE in this case it will find that an ROE of 9% and an overall rate of return of 7.66%[19] is just and reasonable for KCPL based on the evidentiary record in this case.

CLASS COST-OF-SERVICE AND RATE DESIGN:

[18] Staff Witness Barnes in his Rebuttal Testimony observed that the rating agencies have recognized the benefits of the regulatory Plan. See Barnes, Rebuttal testimony, Exhibit No. ___at p.___.

[19] As we observed if the Commission accepts Staff Witness Barnes adjusted capital structure then the overall ROR would be 7.68%. See Footnotes 11 and 13.

Most of the parties in this case including, KCPL, Staff, Office of Public Counsel, Praxair, DOE-NNSA and other industrial intervenors have reached a consensus for a Stipulation which would settle all rate design issues in this case including Cost of Service. Such Stipulation was filed with the Commission on November 9, 2006.

CONCLUSION

Intervenor, DOE/NNSA submits that after careful consideration of the competent and substantial evidence in this record that such evidence supports a reduction in current rates for KCPL[20] as also recommended by the Commission Staff and by the Public Counsel.[21] If the Commission decides that an additional amortization is necessary in this case based on competent and substantial evidence in this record then the rate payers are entitled to a reasonable return on those amortizations (certainly not less than KCPL's allowed return on equity in this case) and an offset to rate base needs to be made in the next KCPL rate case.[22] Intervenor also recommends and supports the Rate Design Stipulation filed herein.

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[20] We do not mean to imply that we do not support the building of IATAN 2. We do believe that current rates and the recommended ROE and overall Rate of Return of DOE/NNSA Witness Dr. J. Randall Woolridge support such construction and will balance the interests of shareholders and ratepayers as required by Missouri law.

[21] Staff has made a True-Up recommendation regarding its rate reduction to $29,209,848. A hearing on the True-Up is scheduled to conclude November 17, 2006.

[22] At the time of this submission Staff was projecting a rate reduction for KCPL of approximately $29 million, Public Counsel at approximately $30 million and DOE/NNSA at approximately $41 million. See KCPL Exhibit No. 46 as adjusted for the estimate of the impact of the True-Up Testimony filed by Staff Witness Traxler. Exhibit____ on November 7, 2006. The primary differences between Staff and DOE/NNSA is due to the difference in Cost of Equity, Ice Storm Damages recovery and Off-System Sales recommendations.