Exhibit No.:
Issues: Interchange Sales
Jurisdictional
Allocations
Amortization
Expense
Witness: James R. Dittmer
Type of Exhibit: Surrebuttal Testimony
Sponsoring party: DOE-NSSA
Case No.: ER-2006-314
Surrebuttal Testimony Date: October 6, 2006

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. ER-2006-0314**

# Public Version

## SURREBUTTAL TESTIMONY

**OF**

**JAMES R. DITTMER**

**ON BEHALF OF**

**THE DEPARTMENT OF ENERGY – NATIONAL NUCLEAR SECURITY ADMINISTRATION**

**Kansas City, Missouri**
**October 2006**

**"**[redacted]**" Designates that "Highly Confidential" or "Proprietary" information has been removed pursuant to the Standard Protective Order**

# SURREBUTTAL TESTIMONY
# OF
# JAMES R. DITTMER
# KANSAS CITY POWER AND LIGHT COMPANY
# CASE NO. ER-2006-0314

**Q. PLEASE STATE YOUR NAME AND ADDRESS.**

A. My name is James R. Dittmer. My business address is 740 Northwest Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

**Q. BY WHOM ARE YOU EMPLOYED?**

A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a consulting firm engaged primarily in utility rate work.

**Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS CASE?**

A. Yes. On August 8, 2006 I filed direct testimony on behalf of the United States Department of Energy that is representing the interest of the National Nuclear Security Administration ("DOE-NNSA") and other affected Federal Executive Agencies. On September 8, 2006 I filed rebuttal testimony – also on behalf of DOE-NSSA.

**Q. ON WHOSE BEHALF ARE YOU FILING SURREBUTTAL TESTIMONY IN THIS CASE?**

A. This surrebuttal testimony is also being filed on behalf of DOE-NNSA.

**Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

A. I will be addressing two topics. First, within its initial direct filing, through witness Mr. Don Frerking, KCPL proposed to allocate off-system sales margins between the Missouri retail, Kansas retail and 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 this surrebuttal testimony is to establish that, notwithstanding the Company's revision to its allocator development, all arguments that I made in rebuttal testimony in opposition to the use the "unused energy allocator" remain valid. In fact, the revision actually further highlights one of the significant problems of its use that I discussed within rebuttal testimony.

Second, KCPL witness Mr. Michael Cline has filed rebuttal testimony addressing the topic of the Additional Amortization required to achieve financial metrics agreed to by a number of parties signing the Stipulation and Agreement in Case No. EO-2005-0329. Mr. Cline provides a rebuttal schedule that attempt 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 very misleading. Accordingly, a second

purpose of this surrebuttal testimony is to respond to some of Mr. Cline's assertions or conclusions.

## UNUSED ENERGY ALLOCATOR

**Q. PLEASE BEGIN BY FIRST PROVIDING YOUR UNDERSTANDING OF THE COMPANY'S REVISED CALCULATION OF ITS PROPOSED "UNUSED ENERGY ALLOCATOR."**

A. KCPL originally developed the unused energy allocator for each jurisdiction (Missouri, Kansas, and FERC) in the following manner:

Average of 12 Coincident MW Demands
for the Jurisdiction (whether it is Missouri, Kansas or FERC)

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

This calculation was originally made for each jurisdiction – Kansas, Missouri and FERC. Using this algorithm, each jurisdiction's "unused energy allocator" was then developed by dividing its calculated "unused energy" by the calculated total company amount of "unused energy." KCPL's original development of its "unused energy allocator" is shown on the top half of Schedule JRD-1 that was attached to my rebuttal testimony filed on September 8, 2006.

Within its rebuttal filing, KCPL revised the development of the "unused energy allocator." Specifically, now KCPL proposes to calculate the "Available Energy" employed in its factor development for each jurisdiction by multiplying the total system capacity available times each jurisdictions' demand factor times the total number of hours in the year (i.e., 8,760). The actual development of KCPL's revised "unused energy allocator" can be found on the top half of attached Surrebuttal Schedule JRD-1.

**Q. WHAT IS THE IMPACT OF THIS KCPL REVISION?**

A. KCPL originally calculated the Missouri jurisdictional "unused energy allocator" to be 46.18%. KCPL's revised Missouri jurisdictional "unused energy allocator" is 51.55%. Thus, KCPL's revision causes over five percent more of non-firm off-system sales margins to be allocated to the Missouri jurisdiction. I would note that a portion of that shift is caused by updating for the twelve months ending December 2005 versus KCPL's original filing that was based on the twelve months ending September 2005. Ultimately the revenue requirement value of this allocation issue to the Missouri jurisdiction will be dependent upon the "total company" off-system sales margin determined by this Commission to be reasonable. As noted elsewhere in this record, there is also a significant difference among the parties as to quantification of the appropriate ongoing level of total company off-system sales margins to be considered within cost of service development. On the bottom half of attached Surrebuttal Schedule JRD-1 I show the value of this allocation issue at the Company-proposed as

well as DOE-NSSA-proposed total company level of non-firm off-system sales margins being proposed.

**Q. WITHIN AN EARLIER ANSWER YOU STATED THAT, NOTWITHSTANDING THE KCPL REVISIONS DESCRIBED WITHIN ITS REBUTTAL TESTIMONY, THE ARGUMENTS YOU MADE WITHIN YOUR REBUTTAL TESTIMONY REMAINED VALID. PLEASE EXPAND UPON THAT COMMENT.**

A. Within my rebuttal testimony I addressed four arguments in opposition to the adoption of KCPL's "unused energy allocator." Notwithstanding a fairly significant change in its development, adoption of the KCPL-revised "unused energy allocator" would still be inappropriate. None of the criticisms stated within my rebuttal testimony have been addressed with the KCPL revision. To the contrary, the revised calculation actually emphasizes one of the flaws of the allocator that I addressed within rebuttal testimony.

**Q. PLEASE EXPLAIN THE FLAW THAT HAS BEEN EMPHASIZED AS A RESULT OF THE KCPL REVISION.**

A. Within my rebuttal testimony I described how the purported propriety of the "unused energy allocator" is built upon an implicit assumption that virtually all "unused" MWHs that become the basis for the "unused energy allocator" would have been "used" to make additional off-system sales. I went on to explain and quantify how KCPL was

achieving off-system MWH sales volumes that were but a fraction of the calculated "unused energy."

KCPL has revised the calculation of the "unused energy" to consider the maximum capacity that each jurisdiction was "paying for" rather than only the 12 CP average of each jurisdiction's demands as had been employed within its original calculation. As a result of this revision, the calculated total company "unused energy" grew from the originally-calculated amount of 7,205,409 MWHs to a revised amount of 22,760,083 MWHs. This revision highlights and emphasizes a point made within my rebuttal testimony–namely, that because of market conditions, KCPL undertakes sales that are but a mere fraction of the theoretical amount of "unused energy" that it has to sell. Thus, to suggest–as employment of the "unused energy allocator" implicitly does–that the level of off-system sales margins being achieved is significantly influenced by "available energy" simply does not comport with the facts of the situation. Accordingly, for this, and other reasons stated within my rebuttal testimony, I strongly urge the rejection of this never-before-adopted allocation methodology.

This very key assumption that the majority of the calculated "unused energy" is being sold is simply incorrect. Specifically, in each year, there are many hours when KCPL does not make interchange sales from a number of units that are not being "used" to make retail sales. Because the market price for interchange sales is below the variable running cost for many of its units, no interchange sales are made from KCPL's relatively high cost units for many hours of the year even though such units

are clearly available to make additional interchange sales (and used within the development of the "unused energy allocator"). In fact, during calendar year 2005, KCPL had non-firm interchange sales of only ** [redacted] ** MWHs. Clearly, many of the "unused" MWHs calculated to be available for sale into the wholesale market (as discussed above–22,760,083) are not being sold on the non-firm interchange market. KCPL's "unused energy allocator" fails to recognize that, just because a jurisdiction is not "using" all the energy it is "paying for," does not mean that KCPL will have a market in which to sell such "unused energy."

It cannot be overemphasized that employment of this erroneous assumption that is implicit within the development of KCPL's "unused energy allocator" invalidates its adoption. Jurisdictions should not be given "credit" for unused energy when clearly significant amounts of so called "available" energy are not being sold because market conditions do not permit.

## "ADDITIONAL AMORTIZATION" ANALYSIS

**Q. PLEASE STATE THAT PORTION OF MR. MICHAEL CLINE'S REBUTTAL TESTIMONY THAT YOU WILL BE ADDRESSING.**

A. At page 5 of his rebuttal testimony Mr. Cline states the following:

> Ratepayers are disadvantaged in the short-run if a high level of cash flow for financing is provided through Additional Amortizations rather than the cash being sourced through traditional ratemaking. This concept is illustrated in the attached Schedule MWC-3. The Schedule

illustrates two scenarios for financing a $1 million capital expenditure. The first solves for the mix of equity and debt required to generate the necessary earnings needed to reach an FFO to Total Debt ratio of 25% without Additional Amortizations. The second scenario assumes the expenditure is financed with 100% debt. Since there are no marginal earnings under this scenario, full reliance on Additional Amortizations is required in order to maintain a 25% FFO to Total Debt ratio. The resulting Additional Amortization is $400,000, or 40% of the expenditure amount. *The revenue requirement in the second scenario is over 300% greater than that of the scenario with no Additional Amortizations.* (Michael W. Cline Rebuttal Testimony, page 5, *Emphasis included within original testimony text*)

Because I will be addressing Mr. Cline's rebuttal Schedule MWC-3, for convenience I have affixed a copy of the noted document to this testimony as Surrebuttal Schedule JRD-2.

**Q. WHAT WAS THE PURPOSE OF MR. CLINE'S TESTIMONY YOU HAVE QUOTED.**

A. In an earlier discussion leading up to the quote above Mr. Cline asserts a conclusion that an over-reliance on Additional Amortization would be inferior to achieving a similar financial metric through means such as granting a higher return on equity or other means of traditional rate relief. However, that discussion segued into a question of "what would be the impact on ratepayers" of granting more Additional Amortization in lieu of more "traditional" rate relief. The quote above was provided in answer to this latter question. Thus, it would appear that the purpose of Mr. Cline's testimony is to

draw the reader to a conclusion that even in the short run it is cheaper for ratepayer if more rate relief is granted in the form of "traditional" cost of service rate relief *rather than* through reflection of "Additional Amortization."

**Q. WHAT EXCEPTION DO YOU TAKE TO MR. CLINE'S REBUTTAL TESTIMONY?**

A. First, I want to disperse any mistaken notion that might be drawn from Mr. Cline's rebuttal testimony and Mr. Cline's rebuttal Schedule MWC-3 (again, that has been affixed to this surrebuttal testimony as Surrebuttal Schedule JRD-2) that the granting of a higher return on equity or the granting of some other form of "traditional" rate relief might some how be less expensive for ratepayers *even in the short run.* Second, while I disagree with assumptions employed in Mr. Cline's schedules, I would agree that his math works in *his* example–*for a one year period.* However, even by Mr. Cline's admission, this is a "short run" calculation. By limiting his analysis to one year Mr. Cline conceals the much higher cost to ratepayers *over the long run* if this Commission were to substitute the granting of rate relief to achieve agreed-upon targeted financial metrics through authorizing a higher return on equity rather than granting "Additional Amortization" expense.

**Q. DOES MR. CLINE'S REBUTTAL SCHEDULE MWC-3 DEMONSTRATE THAT THE GRANTING OF RATE RELIEF IN THE FORM OF TRADITIONAL RATE RELIEF IS LESS EXPENSIVE TO RATEPAYERS IN**

**THE SHORT RUN THAN GRANTING RATE RELIEF IN THE FORM OF "ADDITIONAL AMORTIZATION?"**

A. Absolutely not. Schedule MWC-3 is a mathematical exercise that calculates the incremental revenue requirement cost, for one year only, of financing $1.0 million of incremental capital investment in two different ways. Under one scenario it is assumed that the $1.0 million of capital investment will be financed with 68% equity and 32% debt, with equity and debt costs of 11.5% and 6.0%, respectively. Under the second scenario, it is assumed that 100% of the incremental capital investment will be financed with debt with an interest rate of 6.0%. Both scenarios target a Funds-From-Operations to Debt ratio of 25%, which is consistent with one of the financial metric targets included within the Case No. EO-2005-0329 Stipulation and Agreement.

With the 68% equity/32% debt scenario, a relatively small amount of Funds-From-Operation ('FFO') is required to meet the incremental financing that is only 32% debt financed. In fact, not-too-coincidentally under this first scenario, all of the targeted FFO percentage can be met with an 11.5% return on the assumed (68%) equity financing of the investment.

Under the 100%-debt-financing scenario described, with absolutely no Funds-From-Operations ('FFO') generated from any assumed equity return requirement, and with a much higher "debt' base upon which the 25% FFO/Debt ratio is calculated, this hypothetical scenario calculates a needed after-tax "Additional Amortization' amount of $250,000 ($1,000,000 debt base times the targeted FFO/Debt ratio of 25%).

Further, under the 100% debt-financing scenario, the after-tax amortization amount is grossed up for assumed federal and state income taxes to arrive at the revenue requirement impact of the "Additional Amortization" calculated. From Schedule MWC-3 Mr. Cline appears to lead the reader to a conclusion that it is cheaper, at least in the short run, if more "traditional" rate relief – such as in the form of authorizing a higher equity return and/or assuming a higher equity ratio – is recognized when developing retail rates in lieu of allowing more "Additional Amortization" expense.

**Q. DO YOU AGREE WITH SUCH A CONCLUSION?**

A. No. I believe Mr. Cline's example was created utilizing unrealistic assumptions with a specific intention to incorrectly draw a conclusion that "Additional "Amortization" is more expensive for ratepayers – at least in the short run – than the granting of additional "traditional" rate relief. In actuality, I believe the only thing that Mr. Cline's example points out is that it is a mathematical certainty that if a company were to undertake a required financing with 100% debt, and if one were to assume that there were no Funds-From-Operations being generated from existing operations in excess of the targeted minimums, that the utility would be looking for some form of rate relief that would provide incremental FFO to meet the targeted FFO/Debt ratio on any incremental debt financing.

**Q. PLEASE DISCUSS THE ELEMENTS AND ASSUMPTIONS SURROUNDING MR. CLINE'S EXAMPLE WITH WHICH YOU TAKE EXCEPTION.**

A. First, his analysis was limited to considering only the cost of capital and FFO/Debt ratio required for the assumed *incremental* capital investment. It does not consider the fact that the FFO resulting from depreciation expense, deferred tax expense and equity return on *existing* plant investment already included in rate base could be available to meet all or a portion of the 25% FFO/Debt ratio on the *incremental* debt financing assumed within his two scenarios. In fact, it would only be logical to assume that the *existing* capital structure–prior to the incremental financing required–was already relatively equity-thick and thus generating substantial FFO before a company would consider financing a significant capital investment with 100% debt financing. To the extent that FFO from existing operations was more than adequate to meet the minimum targeted FFO/Debt ratio for existing debt it could be possible that no "Additional Amortization" would be required to meet the incremental FFO/Debt ratio associated with the *incremental* debt financing assumed in Mr. Cline's example.

Second, Mr. Cline's simple illustration completely fails to recognize the fact that the *incremental* capital investment will result in *incremental* non-cash depreciation and deferred income tax expense that will yield more FFO than he has reflected within his example. If Mr. Cline had reflected the FFO resulting from non-cash depreciation and deferred income taxes associated with the assumed incremental investment, a lower amount of Additional Amortization expense would have been required under both scenarios analyzed.

Third, I am not a cost of capital expert, but I believe that most cost of capital experts would agree that a capital structure financed with 68% equity–which Mr. Cline uses in the scenario designed to generate the purported lower short run revenue requirement – would be costly and inefficient. If a Company were to finance incremental capital investment with such a high percentage of equity, I submit it would probably do so only because its capital structure had become, or was becoming, too debt leveraged. In sum on this point, I believe this proportionately high equity financing assumption is unrealistic and has been specifically employed to create an example that will support a pre-conceived conclusion. Conversely, as already noted, I believe it is reasonable to assume that a utility would only undertake the financing of a significant capital investment with 100% debt financing if its capital structure already had a proportionately high equity ratio that was generating a FFO/Debt ratio in excess of the targeted minimum that would be available to provide coverage on all or a significant portion of incremental debt financing. In short, I believe Mr. Cline's financing assumption have been specifically established to be able to undertake the mathematical calculations that would purportedly support his desired conclusion–namely, that in the short run Additional Amortization is more expensive to ratepayers than granting other forms of traditional rate relief or recognizing other mixes for financing incremental capital investment required

Fourth, Mr. Cline's limited example fails to reveal that rate relief in the form Additional Amortization can be substituted for a higher equity return to achieve the same targeted minimum FFO/Debt ratio. Specifcally, I would emphasize that

Additional Amortization can be substituted for a higher return on equity yielding exactly the same targeted FFO/Debt ratio as well as the same level of required rate relief. While rates for the immediate future will be no higher when Additional Amortization is substituted for a higher equity return, future rates will be reduced from that otherwise calculated as the "Additional Amortization" is eventually returned as a "credit" amortization to ratepayers within ensuing test year cost of service studies.

**Q. REFERRING TO THE LAST POINT MADE, PLEASE FURTHER EXPAND UPON HOW ADDITIONAL AMORTIZATION CAN BE SUBSTITUTED FOR A HIGHER EQUITY RETURN TO ACHIEVE THE SAME TARGETED MINIMUM FFO/DEBT RATIO.**

A. This result is simply a mathematical outcome of the way the FFO/Debt ratio is calculated and can be observed by example. Specifically, on attached Surrebuttal Exhibit JRD-3 I first show within columns (c) and (d) the two scenarios designed by Mr. Cline within his Schedule MCW-3. I note that column (b) of attached Surrebuttal Schedule JRD-3 also shows the source of, or describes the calculation underlying, amounts shown on a given line.

As shown within column (e), I have revised the "return on equity" assumed from the Company-proposed 11.5% to the DOE-NSSA-proposed 9.0%. When the lower DOE-NSSA-proposed return is reflected, the targeted FFO/Debt ratio is no longer met, and accordingly, a level of Additional Amortization is calculated to achieve the additional FFO to meet the targeted FFO/Debt ratio. As one can observe from a

review of calculations shown in column (e), the targeted FFO/Debt ratio can be met through the granting of rate relief in the form of Additional Amortization versus a higher return on equity with no difference in required rate relief. Thus, *in the short run*, rate relief granted will be the same whether authorized in the form of Additional Amortization or a higher equity return. However, all other things equal, rates will be lowered *in the long run* if the rate relief in the short term is granted in the form Additional Amortization *rather than* in the form of a higher equity return. Again, this occurs inasmuch as costs deferred through the Additional Amortization would, in subsequent years, be reflected as a "credit" or reduction to the otherwise-calculated test year cost of service.

In the example shown in column (e) of Surrebuttal Schedule JRD-3, one can observe that the revenue requirement remains the same with Additional Amortization and a 9.0% return on equity as it had been with the Company-proposed 11.5%. However, the before-tax Additional Amortization in the amount of $27,441 that is being deferred in year one in this example would eventually be returned to ratepayers "with interest" over ensuing years following the heavy construction period. The "interest" to be returned to ratepayers would be in the form of a rate base offset as the deferred credit balance generated with the Additional Amortization expense is reflected as a reduction to rate base in future rate proceedings.

**Q. WHAT IS THE PURPOSE THE CALCULATIONS SHOWN ON COLUMNS (F) AND (G) OF SURREBUTTAL SCHEDULE JRD-3?**

A. The primary purpose of calculations reflected within column (f) is to simply show how, with continuing employment of the Company's assumption that there is no available "excess" FFO from existing operations to meet the FFO requirement for incremental debt financing, that the revenue requirement will automatically change by merely moving from the Company's original 68% equity/32% debt financing split to a 50% equity/50% debt financing plan. The point being, under the rigid assumptions that KCPL employed in establishing its original two scenarios, the mere shifting of financing assumptions drives the revenue requirement outcome of the calculation. Mr. Cline attempts to draw a conclusion from calculations under his two original scenarios that the revenue requirement will be lower through the granting a higher equity return or other traditional cost of service increases than it would be through the granting of rate relief based upon Additional Amortization. In reality, what Mr. Cline's calculations demonstrate is simply that in the short run financing with debt will be more expensive than financing with equity *if one assumes that the targeted FFO/Debt ratio cannot be maintained with FFO from existing operations.*

Column (g) simply shows, once again, how the revenue requirement in this initial year under analysis will not change if the rate relief granted is based on Additional Amortization rather than a higher return on equity even under the 50%-equity/50%-debt financing assumption that is reflected within Column (f).

**Q. YOUR DISCUSSION THUS FAR HAS ADDRESSED THE SHORT RUN, OR FIRST YEAR IMPACT, OF VARIOUS FINANCING PROPOSALS AND/OR**

**BASES FOR GRANTING RATE RELIEF. SHOULD THE LONG TERM IMPACT OF VARIOUS FINANCING ALTERNATIVES ALSO BE CONSIDERED IN ANY ANALYSIS OF ALTERNATIVES BEING CONSIDERED?**

A. Yes. As I have noted, Mr. Cline's analysis and discussion was limited to a one year period. For reasons previously stated, I believe his analysis is flawed – at least from the perspective of attempting to defend the conclusion he wishes to draw from such calculations. However, forgetting those disagreements for the moment, I would simply emphasize that any analysis that addresses the revenue requirement impact of granting rate relief on the basis of a traditional cost of service versus Additional Amortization, or financing with debt versus equity, should always consider the expected impact over a period of more than one year.

As already noted, rate relief in the form of Additional Amortization expense will result in future savings to ratepayers as the deferred credit is eventually considered within future test year cost of service calculations. Second, undue reliance on equity financing is expensive to ratepayers. Specifically, not only is the return on common equity typically the highest cost of alternative sources of capital, common equity returns are required to be "grossed up" for additional federal and state income. For example, after converting for required income tax payments, the before-tax cost – or revenue requirement impact – of a 9.0% return on equity is 14.4% (9.0% times the gross tax conversion factor of 1.602564 equals 14.4%). The true cost – or before-tax cost of equity – is more than double the interest cost of 6.0% reflected within Mr.

Cline's Schedule MWC-3. Thus, the high cost of equity-rich financing *over the life of the capital investment* should be carefully evaluated when financing alternatives are explored.

**Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the Application of Kansas City Power & Light Company to Modify Its Tariff to Begin the Implementation of Its Regulatory Plan | ) ) ) | Case No. ER-2006-0314 |

**AFFIDAVIT**

**STATE OF MISSOURI** )
) **SS.**
**COUNTY OF JACKSON** )

BEFORE ME, the undersigned notary public, this day personally appeared JAMES R. DITTMER, to me known, who being duly sworn according to law, deposes and says:

"My name is JAMES R. DITTMER. I am of legal age and a resident of the State of Missouri. I certify that the foregoing testimony and exhibits, offered by me on behalf of the Department of Energy–National Nuclear Security Administration, are true and correct to the best of my knowledge and belief."

James R. Dittmer

SUBSCRIBED AND SWORN to before me, a notary public, on this 5th day of October, 2006.

KARA DANIELLE INCE
Notary Public - Notary Seal
State of Missouri, Cass County
Commission # 06905947
My Commission Expires Jun 26, 2010

Notary Public in and for the State of Missouri

My Commission Expires: 6-26-2010

**Reconcilation of KCPL and DOE's Recommendations**
**Regarding Interchange Sales Margins**
**Reflects Impact of Allocation Issue at KCPL's and DOE's**
**Recommended Total Company Margin Level**
**Case No. ER-2006-0314**

| Line No. | Description | Reference | Total Company | Missouri | Kansas | Wholesale |
|---|---|---|---|---|---|---|
| | (a) | (b) | (c) | (d) | (e) | (f) |
| | Development of Allocators: | | | | | |
| 1 | Production - kW | | 2,652.1 | 1,427.4 | 1,201.5 | 23.2 |
| 2 | Production - % | | 100.00% | 53.82% | 45.30% | 0.88% |
| 3 | | | | | | |
| | Peak Capacity Allocated on Demand Basis | | 4,389.0 | 2,362.2 | 1,988.3 | 38.5 |
| 4 | | | | | | |
| 5 | Annual Hours | | 8,760 | 8,760 | 8,760 | 8,760 |
| 6 | | | | | | |
| 7 | Total Energy - mWh | Ln 1 x Ln 5 | 38,447,640 | 20,692,771 | 17,417,938 | 336,930 |
| 8 | | | | | | |
| 9 | Energy With Losses - mWh | | 15,687,557 | 8,960,193 | 6,583,077 | 144,287 |
| 10 | Energy With Losses - % | | 100.00% | 57.12% | 41.96% | 0.92% |
| 11 | | | | | | |
| 12 | Unused Energy - mWh | Ln 7 - Ln 9 | 22,760,083 | 11,732,578 | 10,834,861 | 192,643 |
| 13 | Unused Energy - $ | | 100.00% | 51.55% | 47.60% | 0.85% |
| 14 | | | | | | |
| 15 | | | | | | |
| 16 | | | | | | |
| 17 | Value of Allocation Issue Utilizing KCPL's Proposed | | | | | |
| 18 | Level of Total Company Off-System Sales Margins | | | | | |
| 19 | | Line 13 X Line | | | | |
| 20 | Energy - Profit on Sales (KCPL's Unused Energy) | 20, Col. C ** | [redacted] ** | | | |
| 21 | | | | | | |
| 22 | | Line 10 X Line | | | | |
| 23 | Energy - Profit on Sales (Energy With Losses) | 23, Col. C ** | [redacted] ** | | | |
| 24 | | | | | | |
| 25 | Difference - Value of Allocation Issue Utilizing | | | | | |
| 26 | KCPL's Proposed Total Company Off-System | | | | | |
| 27 | Sales Normalized Margin Level | Ln 23 - Ln 20 ** | [redacted] ** | | | |
| 28 | | | | | | |
| 29 | Value of Allocation Issue Utilizing DOE's Proposed | | | | | |
| 30 | Level of Total Company Off-System Sales Margins | | | | | |
| 31 | | Line 13 X Line | | | | |
| 32 | Energy - Profit on Sales (KCPL's Unused Energy) | 32, Col. C ** | [redacted] ** | | | |
| 33 | | | | | | |
| 34 | | Line 10 X Line | | | | |
| 35 | Energy - Profit on Sales (Energy With Losses) | 35, Col. C ** | [redacted] ** | | | |
| 36 | | | | | | |
| 37 | Difference - Value of Allocation Issue Utilizing | | | | | |
| 38 | DOE's Proposed Total Company Off-System | | | | | |
| 39 | Sales Normalized Margin Level | Ln 35 - Ln 32 ** | [redacted] ** | | | |
| 40 | | | | | | |
| 41 | Total Impact on Missouri Rev Requirement | | | | | |
| 42 | of DOE-NSSA Margin Adjustment | Ln 20- Ln 35 | | $ (21,125,097) | | |

Surrebuttal Schedule JRD-1

## Schedule MWC-3
## Impact of Financing on Revenue Requirements

| | Equity Financing | Debt Financing |
|---|---|---|
| Capital Investment | 1,000,000 | 1,000,000 |
| Equity Financing | 684,932 | |
| Debt Financing | 315,068 | 1,000,000 |
| Total Financing | 1,000,000 | 1,000,000 |
| Return on Equity | 11.50% | 11.50% |
| Earnings | 78,767 | - |
| Amortization | | 400,641 |
| Deferred Taxes | - | (150,641) |
| Funds from Operations | 78,767 | 250,000 |
| FFO / Debt Ratio | 25% | 25% |
| Interest Rate | 6% | 6% |
| Interest Expense | 18,904 | 60,000 |
| Tax Rate | 37.60% | 37.60% |
| Total Income Taxes | 47,462 | - |
| Deferred Taxes | - | (150,641) |
| Current Taxes | 47,462 | 150,641 |
| **Revenue Requirement** | **145,133** | **460,641** |
| Proof | | |
| Revenue | 145,133 | 460,641 |
| Amortization | - | 400,641 |
| Interest Expense | 18,904 | 60,000 |
| Pre-tax Income | 126,229 | - |
| Income Taxes | 47,462 | - |
| Earnings | 78,767 | - |

This schedule was originally affixed to Mr. Michael Cline's rebuttal testimony filed on September 8, 2006 and has been reproduced here only for convenience when reviewing the Surrebuttal Testimony of James Dittmer

## Analysis of Alternatives Regarding Authorized Returns, Capital Mix for Incremental Financings, & "Equity Returns" Versus Recognition of Additional "Amortization Expense"

| Line No. | Description | Reference | Duplication of Company's Example | | Company Suggested Financing Split but Assuming a 9.00% ROE | 50/50 Debt/Equity Financing | Assumed 9.00% ROE & 50/50 Debt/Equity Financing |
|---|---|---|---|---|---|---|---|
| | | | Equity Financing | Debt Financing | | | |
| | (a) | (b) | (c) | (d) | (e) | (f) | (g) |
| 1 | Capital Investment Required | Assumed | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 |
| 2 | Equity Financing | Assumed | 684,932 | | 684,932 | 500,000 | 500,000 |
| 3 | Debt Financing | L. 1 - L. 2 | 315,068 | 1,000,000 | 315,068 | 500,000 | 500,000 |
| 4 | Total Financing | Line 1 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 | 1,000,000 |
| 5 | FFO/ Debt Ratio Required | Per S&A | 25% | 25% | 25% | 25% | 25% |
| 6 | Required Funds From Operation | Line 3 * Line 5 | 78,767 | 250,000 | 78,767 | 125,000 | 125,000 |
| 7 | Authorized Return on Equity | Assumed | 11.50% | 11.50% | 9.00% | 11.50% | 9.00% |
| 8 | Equity Earnings on Assumed Equity Financing | Line 2 * Line 7 | 78,767 | - | 61,644 | 57,500 | 45,000 |
| 9 | Additional FFO Required After | | | | | | |
| 10 | Considering After Tax Equity Returns | | | | | | |
| 11 | - In the Form of After-tax Amortization | Line 6 - Line 8 | (0) | 250,000 | 17,123 | 67,500 | 80,000 |
| 12 | Tax Gross Up Factor | 1/(1-Tax Rate) | 1.602564 | 1.602564 | 1.602564 | 1.602564 | 1.602564 |
| 13 | Before-Tax Amortization | Line 11 * Line 12 | (0) | 400,641 | 27,441 | 108,173 | 128,205 |
| 14 | Assumed Interest Rate | Assumed | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| 15 | Interest Expense | Line 3 * Line 14 | 18,904 | 60,000 | 18,904 | 30,000 | 30,000 |
| 16 | Tax Rate | Given | 37.60% | 37.60% | 37.60% | 37.60% | 37.60% |
| 17 | Income Taxes on Equity Return | (L. 12 -1)*L. 8 | 47,462 | - | 37,144 | 34,647 | 27,115 |
| 18 | Deferred Taxes | L. 11 - L. 13 | 0 | (150,641) | (10,318) | (40,673) | (48,205) |
| 19 | Total Current Taxes | Line 17 - Line 18 | 47,462 | 150,641 | 47,462 | 75,321 | 75,321 |
| 20 | **Revenue Requirement** | Lines 8+13+15+17 | **145,133** | **460,641** | **145,133** | **230,321** | **230,321** |
| 21 | Proof: | | | | | | |
| 22 | Revenue Requirement: | Line 20 | 145,133 | 460,641 | 145,133 | 230,321 | 230,321 |
| 23 | Amortization | Line 13 | (0) | 400,641 | 27,441 | 108,173 | 128,205 |
| 24 | Interest Expense | Line 14 | 18,904 | 60,000 | 18,904 | 30,000 | 30,000 |
| 25 | Pre-tax Income | Sum Lines 22 - 24 | 126,229 | - | 98,788 | 92,147 | 72,115 |
| 26 | Income Taxes | Line 24 * Line 16 | 47,462 | - | 37,144 | 34,647 | 27,115 |
| 27 | Earnings | Line 25 - Line 26 | 78,767 | - | 61,644 | 57,500 | 45,000 |

**Surrebuttal Schedule JRD-3**