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Issues: *True-up; Regulatory Plan Amortizations, Employee Levels, Rate Case Expense, Incentive Compensation*
Witness: *Steve Traxler*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *True-up Direct Testimony*
Case No.: *ER-2006-0314*
Date Testimony Prepared: *November 7, 2006*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

FILED[2]

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Missouri Public Service Commission

TRUE-UP DIRECT TESTIMONY

OF

STEVE M. TRAXLER

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2006-0314

Jefferson City, Missouri
November 2006

Staff Exhibit No. 163
Case No(s). ER-2006-0314
Date 11/16/06 Rptr MK

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF STEVE M. TRAXLER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Steve M. Traxler, of lawful age, on his oath states: that he has participated in the preparation of the foregoing SurTrue-Up Testimony in question and answer form, consisting of 19 pages to be presented in the above case; that the answers in the foregoing SurTrue-Up Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Steve M. Traxler

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

TONI M. CHARLTON
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

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

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TRUE-UP DIRECT TESTIMONY

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STEVE M. TRAXLER

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2006-0314

Q. Please state your name and business address.

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

Q. Are you the same Steve M. Traxler who has previously filed direct, rebuttal and surrebuttal testimony in this proceeding for the Staff?

A. Yes, I am.

Q. What is the purpose of your true-up direct testimony?

A. The purpose of this testimony is to report the results of the Staff's true-up audit of Kansas City Power & Light Company (KCPL) in this proceeding, address a true-up issue Staff has with KCPL related to projected employee levels, address a change in position by KCPL on the incentive compensation issue, address a change in the risk factor used in the credit metrics calculation supporting the Regulatory Plan Additional Amortization and address Staff's true-up treatment for rate case expense.

EXECUTIVE SUMMARY

Q. Please briefly summarize your true-up direct testimony.

A. The Regulatory Plan approved in Case No. EO-2005-0329 established a true-up date of September 30, 2006 for KCPL's first rate case:

> (i) Schedule. Rate schedules with an effective date of January 1, 2007 will be filed with the Commission on February 1, 2006. The test year will be based upon a historic test year ending December 31, 2005, (initially filed with nine (9) months actual and three (3) months budget data), with updates for **known and measurable** changes, as of June 30, 2006 and with a true-up through September 30, 2006. (Page 30, Emphasis added)

The Staff has completed a true-up audit of KCPL's electric operations through September 30, 2006. In this true-up direct testimony I discuss: (i) the results of the Staff's true-up audit, (ii) the calculation of the Regulatory Plan Additional Amortization based upon these results, (iii) the Staff's recommended treatment for rate case expense, (iv) a change in KCPL's position on the incentive compensation issue, and (v) the following issue that Staff has with KCPL's annualized payroll calculation included in its September 30, 2006 cost of service determination based upon actual filled positions as of that date.

KCPL's annualized payroll expense level includes annual wages for 113 employees who were not on KCPL's payroll register as of September 30, 2006. Projected employee additions as well as any other changes which occur after the September 30, 2006 true-up date should be excluded from the true-up cost of service determination. The September 30 true-up date was intended by the signatory parties to the Regulatory Plan to provide KCPL the opportunity to reflect its plant investment and cost of service as close to the January 1, 2007 operation-of-law date for this case as reasonably possible and still permit audit by the Staff and other parties and determination by the Commission. Reflecting employee additions beyond September 30 is contrary to the ratemaking principle of matching all of KCPL's cost of service components: rate base, cost of capital, revenues and expenses, at the same time – September 30, 2006, which still permits audit and determination of actual results prior to the operation-of-law date.

RESULTS OF THE TRUE-UP AUDIT

Q. Please describe the true-up audit of KCPL's electric operations performed by the Staff in this proceeding.

A. Per the Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329 establishing a true-up in this proceeding, the Staff has updated its case to reflect known and measurable events affecting significant elements of KCPL's electric cost of service for the period June 30, 2006 through September 30, 2006. The revenue requirement areas updated by the Staff are the following:

Rate Base: Plant in Service including the new wind generating capacity completed as of September 30, 2006, Depreciation Reserve, Deferred Taxes, Fuel Inventories, Cash Working Capital, Materials and Supplies, Prepayments, Regulatory Assets and Liabilities, Customer Contributions in Aid of Construction, Customer Deposits, Cash Working Capital Income Tax and Interest Offsets and Allocation Factors.

Income Statement: Revenues from Customer Growth, Bad Debts, Payroll (Employee Levels and Wage Rates), Employee Benefits, Pension Cost, Payroll Taxes, Fuel and Purchased Power Expense (Fuel and Purchased Power Prices, System Loads), Rate Case Expense, Depreciation Expense, Maintenance Expense – Wind, Income Tax (Effect of Trued-Up Items), Allocation Factors and the Regulatory Plan Additional Amortization.

Rate of Return: Rate of Return Calculation (excluding Return on Equity), Capital Structure and Weighted Cost of Debt.

Q. How did the Staff conduct its true-up audit?

A. The Staff updated its analysis in the areas listed above using the same methods and approaches it used in its cost of service calculation reflected in the Reconcilement filed with the Commission in this case. Any method and/or assumption changes from Staff's direct filing are addressed in Staff's rebuttal and/or surrebuttal testimony. To the extent a method was changed from Staff's direct case in rebuttal and/or surrebuttal, then those methods were consistently used in the true-up process.

Q. What capital structure is the Staff using as of September 30, 2006?

A. The Staff is using Great Plains Energy, Inc.'s (GPE) actual capital structure as of September 30, 2006, which consists of 53.69% common equity, 1.53% preferred stock and 44.79% long-term debt.

Q. What is the Staff's true-up rate of return recommendation in this case?

A. After updating the long-term debt rate and capital structure percentages, the Staff's rate of return recommendation at true-up is 7.88%, reflecting a mid-range return on equity of 9.37%.

Q. What is the overall result of the Staff's true-up audit?

A. The Staff's recommended revenue requirement for KCPL, prior to recognition of a Regulatory Plan Additional Amortization, is an excess revenue requirement of $29,209,848.

Q. What was the Staff's recommended revenue requirement for KCPL in its direct filing prior to recognition of a Regulatory Plan Additional Amortization?

A. The Staff's direct filing reflected an excess revenue requirement of approximately $80 million prior to recognition of a Regulatory Plan Additional Amortization of $76 million.

Q. Can the Staff's true-up audit revenue requirement be compared to the revenue requirement reflected in the Staff's direct filing?

A. No. The $80 million excess revenue requirement reflected in the Staff's direct filing cannot be characterized as a Staff recommendation because it was not based upon accurate data. It contained errors and omissions which were corrected prior to the Reconcilement filed with the Commission on October 10, 2006. KCPL has not filed a rate case in Missouri in more than two decades. There was a significant learning curve in terms of Staff's understanding of the data provided by KCPL and in KCPL's understanding of the data requested by the Staff. There is no question that some of the errors should have been caught and eliminated prior to Staff's direct filing. Other errors were not evident until after KCPL had reviewed the work papers supporting the Staff's direct filing. The majority of the changes from the Staff's $80 million excess revenue requirement (prior to recognition of a Regulatory Plan Additional Amortization) in its direct filing to the excess revenue requirement of $34 million, reflected in the Reconcilement filed with the Commission on October 10, 2006, was due to correction of errors and additional data supplied by KCPL. Thus, the Staff's excess revenue requirement result of $29 million from the true-up audit is not comparable to the Staff's direct filing.

Q. Is the Staff's true-up audit result comparable to the $34 million excess revenue requirement (prior to recognition of a Regulatory Plan Amortization) reflected in the Reconcilement filed with the Commission on October 10?

A Yes. The reduction in Staff's excess revenue requirement of $34 million, based upon changes through June 30, 2006, to $29 million based upon changes through September 30, 2006 is due primarily to recognition of an additional $116 million in

Missouri jurisdictional plant in service and the related rate of return and annual depreciation expense. Approximately $85 million of the additional plant represents KCPL's new wind generating facility in Spearville, Kansas. The true-up date for this case was tied primarily to the in-service date for the wind generating facility in Spearville.

Q. How can Staff's true-up audit result in an excess revenue requirement recommendation for KCPL given its significant commitment to construction activity during the period of the Regulatory Plan?

A. KCPL's electric rates in Missouri will not be impacted by construction activity, under a traditional cost of service approach, until the new plant additions are fully operational and used for service. As stated previously, the excess revenue requirement of $34 million, based upon changes through June 30, 2006, has been reduced by the additional plant placed in service between June 30, 2006 and September 30, 2006. However, Staff's true-up audit result still reflects an excess revenue requirement due primarily to:

1) KCPL's earned return on equity (ROE) in 2005 and recent years is significantly higher than the ROE recommended by the witnesses for the Staff, Department of Energy and the Office of the Public Counsel in this case. KCPL's earned ROE on its Missouri operations for 2005 was 10.33%. KCPL's earned ROE for the years 2001 through 2004 was also significantly higher than the recommended ROE by all parties in this case, except KCPL.

2) The Staff's comprehensive depreciation study performed by Staff witness Rosella Schad in this case reflects a material reduction in KCPL's annual depreciation expense due to changes in life assumptions for various plant accounts.

3) Recognition of new wind generation facilities at $0 fuel cost in the fuel model in the true-up audit has replaced a significant level of higher cost fuel from KCPL's other generating units.

4) KCPL is continuing to experience customer growth which mitigates some of the increases to its cost of service.

5) A wind production tax credit which reduces revenue requirement by $6.5 million was not reflected in the Staff's cost of service at June 30, 2006 because it results from the new wind generating facility which was not in service until the September 30 true-up date.

In summary, a finding by the Staff and other parties of an excess revenue requirement should not be viewed as illogical or extreme because of ongoing major construction activity by KCPL. An electric utility's allowed ROE in Missouri is limited to its net investment currently operational and in use for providing electric service.

In KCPL's 1985 rate increase case which reflected rate base recognition for the Wolf Creek generating unit, the Staff determined that KCPL's cost of service without recognition of the Wolf Creek generating unit was an excess revenue requirement. The non-Wolf Creek generating unit revenue requirement excess was eliminated by the rate base recognition of the Wolf Creek generating unit. KCPL's investment in the Iatan 2 generating unit will not impact KCPL's rates until after the rate case scheduled for 2010.

EMPLOYEE LEVELS AT SEPTEMBER 30, 2006

Q. Is there a disagreement between the Staff and KCPL regarding the number of employees that should be reflected in the annualization of KCPL's payroll cost as of September 30, 2006?

A. Yes. KCPL's payroll cost annualization includes $6.3 million for 113 employees who were not employed by KCPL or on the payroll register as of September 30, 2006. The Staff is opposed to cost of service recognition for employee additions expected to occur beyond the September 30, 2006 true-up date established for this case in the Regulatory Plan Stipulation and Agreement approved in Case No.- EO-2005-0329 and in this proceeding.

Q. How does KCPL characterize the additional 113 employees in their payroll cost annualization adjustment?

A. There are 49 people that have accepted an offer for employment as of September 30, 2006 that have a scheduled start date in October or November 2006. There are three people that accepted an offer for employment in October 2006 who are also scheduled to start employment in October 2006. There are 55 people who have accepted an offer of employment but have not been accepted by KCPL pending medical and background checks. None of these 55 people have a start date for beginning employment. Finally, KCPL has included an additional six positions for which KCPL has not received an acceptance of an offer made to potential candidates.

Q. Why is KCPL attempting to fill a significant number of positions at this time?

A. KCPL initiated a "Workforce Realignment" in 2005 which resulted in the termination of approximately 118 positions as of March 1, 2006. KCPL indicated that it expected to fill most if not all of these positions with qualified applicants. The Staff does not know why KCPL did not fill the 113 positions prior to the September 30, 2006 true-up date given that KCPL had six months to do so. According to KCPL's work papers, none of the offers to potential employees were made **prior to** late August 2006.

Q. Is there any benefit to KCPL from delaying the filling of the 113 vacant positions until October/November 2006?

A. Yes. By delaying employment of these additional 113 employees until October and November 2006, KCPL will increase its reported earnings for 2006. Because KCPL did not pay the salaries for these former employees from April 2006 through October/November 2006, its reported earnings for 2006 will be higher.

Q. Is a higher reported ROE justification for delaying the filling of 113 vacant positions?

A. No. KCPL has been aware of the cutoff date of September 30, 2006, for the true-up audit, since July 28, 2005, the date that the Stipulation and Agreement in Case No. ER-2005-0329 was approved by the Commission, and even as early as Spring 2005 when it entered into the Stipulation and Agreement with the signatory parties. KCPL's decision to delay the offers of employment to potential candidates until late August and September has eliminated the Staff's and other parties' ability to determine the final number of employees added and their respective salary levels by the agreed to September 30, 2006 true-up date.

Q. Did the Staff inform KCPL early in the Staff's audit of the Staff's position regarding unfilled positions as of the September 30, 2006 true-up date?

A. Yes. In discussions with Tim Rush, KCPL Director of Regulatory Affairs, Cary Featherstone, Staff audit supervisor, made it clear that only actual people employed and on the payroll as of September 30, 2006 would be considered for cost of service recognition in this case. The Staff was hoping to avoid a true-up issue regarding unfilled positions by making sure KCPL understood that the September 30 true-up date is a cutoff date for matching all of KCPL's cost of service components which include rate base, cost of capital, revenues and expenses. The Staff's position on calculating payroll based upon actual employee levels is long-standing, having been consistently applied by the Staff for decades.

Q. How long has KCPL been aware of the agreed to September 30, 2006 true-up date for this case?

A. As previously discussed, the September 30, 2006 true-up date was addressed on page 30 of the Regulatory Plan Stipulation and Agreement in Case No. EO 2005-0329. The Stipulation and Agreement was approved by the Commission on July 28, 2005 and was filed with the Commission on March 28, 2005.

Q. What was the intended purpose of the September 30, 2006 true-up date?

A. A "known and measurable" date is established in any major rate case for the purpose of reflecting changes in cost of service as close to the Staff's direct filing date as possible. The known and measurable date agreed to for this case was June 30, 2006. The Staff filed its direct case on August 8, 2006. A "true-up date" is only recommended in special circumstances when a company has a significant cost of service increase which will not occur in time for the Staff's direct filing, but will occur on a date prior to the operation-of-law date which provides the Staff sufficient time to update its cost of service calculation to reflect the significant cost of service change, as well as all other material changes, which represent a matching of rate base, cost of capital, revenues and expenses, as of the true-up date. The true-up date for this case was tied primarily to the in-service date for KCPL's new wind generation facility in Spearville, Kansas. The intent of the September 30, 2006 true-up date was to allow KCPL, and other parties, the opportunity to determine KCPL's cost of service as close to the operation-of-law date as possible. A true-up date is a considerable benefit to the utility because of the opportunity for the new rates established to be based upon the most current "matching" possible of the utility's cost of service components – rate base, cost of capital, revenues and expenses.

Q. Has a "known and measurable" and "true-up" date been used historically in Commission cases to match all cost of service components at the same point in time?

A. Yes. A known and measurable date and true-up date have been consistently used to establish a final cutoff date for measuring all of the components of cost of service – rate base, cost of capital, revenues and expenses at the same point in time. If all the cost of service components are not measured at the same point in time, a distortion is reflected in the final revenue requirement result.

Q. Are "known and measurable date" and "true-up date" issues between the Staff and a utility company generally related to a utility company's desire to reflect additional costs beyond the known and measurable and true-up dates?

A. Yes. In my experience, known and measurable date and true-up date issues have comprised attempts by the utilities to reflect additional cost increases without consideration for any cost reductions that may be occurring beyond the known and measurable date or true-up date. Proposals to go beyond the known and measurable date or true-up date distort the revenue requirement result because potential and/or known cost reductions beyond the known and measurable date or true-up date have not been proposed to be reflected in the cost of service determination. KCPL's proposal to recognize in cost of service 113 employees not employed by KCPL or on the payroll register as of September 30, 2006 is a proposal by KCPL to go beyond the September 30, 2006 true-up date. Additionally procedural schedules and the staffing requirements of other major cases pending before the Commission do not provide additional audit time for the purpose of determining KCPL's completed employee level changes and related salary levels at a later date.

Matching all cost of service components as of the same point in time is the best approach for setting just and reasonable rates in the ratemaking process.

Q. Does KCPL's September 30, 2006 cost of service calculation attempt to reflect any cost reductions beyond the September 30, true-up date?

A. No. This true-up issue with KCPL is consistent with similar issues involving other utilities in prior cases. The Staff is not aware of any attempt by KCPL to identify any offsetting cost reductions which occur after the agreed upon true-up date.

Q. Has KCPL lost employees since the end of September 30, 2006?

A. Yes. An organization the size of KCPL has a constant turn-over of employees. Employees retire or leave for other reasons all the time. Some employees retired or left the employment of KCPL since the end of September 30, 2006 that Staff has included in its payroll annualization. When Staff attended a meeting at KCPL offices on October 31, 2006, Staff learned of a retirement celebration for one of KCPL's long time employees. This individual is in Staff's payroll calculation. Even though KCPL will likely replace this individual, there generally remains a period when the Company will not be paying a salary for the retired employee, resulting in savings until a replacement is hired.

Q. Has KCPL made any attempt to identify any costs reductions in its request to increase payroll for individuals not on the payroll as of September 30, 2006?

A. No. KCPL has made no reduction in any of its projected payroll costs increases for employees who have left the Company. KCPL's proposed adjustment to increase payroll costs is a one-sided adjustment considering only projected increased costs and no off-setting decreases in payroll or off-setting decreases anywhere else in its operations.

Q. Please summarize your testimony on this issue.

A. KCPL proposes to include 113 employee additions for individuals who were not employed by KCPL as of the September 30, 2006 true-up date. Six of these positions are not even supported by an acceptance of an offer from a qualified candidate. Fifty-five of the prospective employees do not have scheduled employment start dates because the prospective employees have not yet passed a medical examination or background check. The signatory parties to the Stipulation and Agreement in Case No. EO-2005-0329 agreed to a true--up date of September 30, 2006. KCPL's request for including the salaries for an additional 113 employees projected to start employment in October and November 2006 is contrary to the September 30, 2006 cutoff date for calculating KCPL's cost of service. These open positions have been vacant since April 2006. KCPL has had six months to fill these positions prior to the September 30, 2006 true-up date agreed to for this case. KCPL should be held to the agreement to measure its cost of service based upon actual changes through September 30, 2006. There is no additional time for the Staff to audit KCPL's payroll records to determine how many of the prospective 113 employees are actually hired and what their annual salaries will be. There is also no additional time for Staff to audit KCPL's operations for possible cost reductions which may have occurred after the September 30, 2006 true-up date. Every case requires a cut-off period and in this case, KCPL agreed that the cut-off period for the true-up would be September 30, 2006.

KCPL's annualized payroll level should be limited to actual employees on the payroll as of September 30, 2006. Once a true-up date has been agreed to, all of the parties should be expected to comply with it.

REGULATORY PLAN AMORTIZATION

Q. Is the Staff proposing a change in the calculation of the off-balance sheet obligation portion of the Regulatory Plan Additional Amortization?

A. Yes. At the hearings last month, I indicated that the Staff would be making this change in its true-up filing. The Staff has changed the risk factor assumption for KCPL's purchased power capacity contracts from 30% to 50% based upon corrected data supplied by Standard & Poor's.

Q. How do KCPL's purchased power capacity contracts impact the calculation of the Regulatory Plan Additional Amortization?

A. A Regulatory Plan Additional Amortization must be reflected in KCPL's cost of service when revenue levels calculated, under a traditional cost of service approach, fail to provide sufficient cash flow to meet two credit metrics necessary for the opportunity for maintaining an investment grade credit rating for KCPL. KCPL's purchased power capacity contracts are treated as a debt equivalent for purposes of calculating the Funds From Operations (FFO) Interest Coverage and FFO at 25% of Average Total Debt. Treating purchased power capacity contracts as a debt equivalent increases the FFO required to meet both credit metrics.

Q. How does the risk factor impact the calculation of the debt equivalent value for KCPL's purchased power capacity contracts?

A. Standard & Poor's assigns a risk factor for purposes of determining the net present value of the contractual capacity payments to be treated as a debt equivalent in calculating the two credit metrics identified in my last answer. A higher risk factor increases the FFO required to meet the two credit metrics.

Q. Why is Staff changing the risk factor for KCPL's purchased power capacity contracts from 30% to 50%?

A. In its direct filing, Staff used a 30% risk factor assumption based upon an August 1, 2006 research report from Standard & Poor's for KCPL. This report referenced a 30% risk factor assumption for KCPL's purchased power capacity contracts. I contacted Standard & Poor's by email on October 18, 2006 to verify that the 30% risk factor had not changed since the August 1, 2006 research report. I received a response from the Standard & Poor's analyst for KCPL indicating that the 30% risk factor referenced in the August 1 research report that I was using was in error. The analyst indicated that a 50% risk factor was assigned to KCPL's purchased power capacity contracts and a corrected version of the August 1, 2006 research report was provided to me for both KCPL and GPE. I was also sent a May 8, 2003 Standard & Poor's research report entitled "Buy Versus Build" Debt Aspects of Purchased-Power Agreements. That research report indicates that a 50% risk factor is used by Standard & Poor's when the purchased power capacity contracts are for three years or longer. Staff used the 50% risk factor in calculating the true-up audit Regulatory Plan Additional Amortization based upon this corrected information from Standard & Poor's.

Q. Are the other parties to this case in agreement with assigning a 50% risk factor to KCPL's purchased power capacity contracts?

A. No. The Office of the Public Counsel (OPC) is recommending a 10% risk factor for KCPL's purchase power capacity contracts. KCPL is in agreement with the Staff.

Q. Are the other parties to this case in agreement with the Staff's calculation method for the Regulatory Plan Additional Amortization with the exception of the disagreement on the risk factor addressed in your last answer?

A. The Staff believes there is a "settlement in principle" on the method of calculation of the Regulatory Plan Additional Amortization among the parties to this proceeding consistent with the calculation changes addressed on pages 12 – 14 of my surrebuttal testimony. At this time, the principal parties interested in this issue are circulating a written stipulation and agreement on this matter for submission to the Commission.

Q. What does the Staff's true-up Regulatory Plan Additional Amortization calculations show?

A The Regulatory Plan Additional Amortization is $64 million based upon the results of the Staff's true-up audit.

Q. Please explain the change in the Regulatory Plan Additional Amortization, resulting from the true-up audit, from the level reflected in the Staff's updated cost of service calculation through June 30, 2006.

A. First, I would note that absent the Regulatory Plan Additional Amortization, the Staff would be recommending a rate reduction for KCPL for both cost of service results through June 30, 2006 and September 30, 2006. The primary reasons for KCPL's excess revenue requirement situation are addressed on pages 6 and 7 of this true-up direct testimony. Therefore, the entire revenue requirement increase that Staff is recommending for KCPL is due to the Regulatory Plan Additional Amortization which represents the additional cash flow necessary for KCPL's opportunity of maintaining its investment grade credit rating. The level of the Regulatory Plan Additional Amortization has changed from $86 million (based upon results at June 30, 2006) to $64 million based upon the results of the true-up audit at September 30, 2006. This reduction is due to an increase in available cash flow resulting from the following changes which were not reflected in the Staff's cost of service calculation as of June 30, 2006:

1) KCPL's net operating income is $4.6 million higher due to the rate of return (ROR) on the additional $116 million in plant additions added between June 30 and September 30, 2006. Eighty-five million dollars ($85 million) of the additional plant is KCPL's new wind generating facility in Spearville, Kansas. An increase in net operating income represents additional cash flow which reduces the level of the Regulatory Plan Additional Amortization necessary for maintaining KCPL's investment grade credit rating.

2) The additional $116 million in plant additions generates an additional $4.8 million of book depreciation expense which represents additional cash flow which reduces the level of the Regulatory Plan Additional Amortization necessary for maintaining KCPL's credit rating.

3) The most significant factor contributing to the reduction in the necessary Regulatory Plan Additional Amortization is the increase in deferred income tax expense that results from the additional $116 million in plant additions. The new plant additions generate a $12.7 million increase in deferred income tax expense

resulting from a higher accelerated tax depreciation deduction on KCPL's IRS tax return. IRS rules protect this additional cash flow (reduction in current income taxes) by not allowing state regulatory bodies from reflecting the higher accelerated tax depreciation deduction in rates. The increase to KCPL's cash flow from the $12.7 million increase in deferred income tax expense also reduces the level of a Regulatory Plan Additional Amortization necessary for maintaining KCPL's credit rating.

In summary, the reduction in the Staff's recommended revenue requirement increase for KCPL from $52 million, based upon results through June 30, 2006, to $35 million, based upon the true-up audit results, is due primarily to the additional cash flow generated from adding $116 million in plant additions between June and September 30, 2006.

RATE CASE EXPENSE

Q. How did the Staff update KCPL's rate case expense in the true-up audit?

A. The Staff has reflected for KCPL a level of rate case expense representative of an ongoing amount for rate case expense.

INCENTIVE COMPENSATION PLAN COSTS

Q. In its June 30, 2006 updated cost of service, did KCPL change its method for calculating the level of incentive compensation plan cost from the method used in its direct filing?

A. Yes. In its direct filing KCPL used a three-year average of actual costs for the years 2003, 2004 and 2005. In its updated cost of service calculation as of June 30, 2006, KCPL used a three-year average of actual costs for 2004 and 2005 and a budgeted level for 2006.

Q. Did the Staff view the use of the 2006 budgeted incentive compensation plan cost to be a true-up issue?

A. Yes. The funding and financial goals for KCPL's 2006 incentive compensation plans are based to some extent on the earnings per share (EPS) for KCPL and GPE for 2006. EPS amounts for 2006 will not be known until well after the January 1, 2007 operation-of-law date for this case, Case No. ER-2006-0314. KCPL's cost of service should be calculated based upon actual results as of the September 30, 2006 true-up date.

Q. Has KCPL recently informed the Staff that it desires to eliminate the true-up issue related to budgeted 2006 incentive compensation plan costs?

A. Yes. KCPL's Director of Regulatory Affairs, Tim Rush, informed me on Friday, November 3, 2006 that KCPL was going back to using the three-year average of its actual incentive compensation plan costs for 2003-2005 in order to eliminate a true-up issue on incentive compensation plan costs.

Q. Does this conclude your true-up direct testimony?

A. Yes, it does.