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MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION
UTILITY SERVICES - AUDITING

REBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

KANSAS CITY POWER & LIGHT COMPANY
GREAT PLAINS ENERGY, INC.

CASE NO. ER-2012-0174

Jefferson City, Missouri
September 2012

** Denotes Highly Confidential Information **

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KANSAS CITY POWER & LIGHT COMPANY
GREAT PLAINS ENERGY, INC.

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Q. Please state your name and business address.

A. Charles R. Hyneman, Fletcher Daniels State Office Building, 615 East 13th Street, Kansas City, Missouri.

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

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

Q. Are you the same Charles R. Hyneman who filed direct testimony in this rate case?

A. Yes, I am. I contributed to Staff's Cost of Service Report filed in the Kansas City Power & Light Company (KCPL) rate case designated as Case No. ER-2012-0174 on August 2, 2012.

Q. Please describe the purpose of your rebuttal testimony.

A. The purpose of this testimony is to address the issue of regulatory lag and provide the Commission with a more comprehensive perspective of regulatory lag, which is quite different from the one-sided and narrow view put forth by Kansas City Power & Light Company (KCPL) in this case and by regulated utilities in Missouri in general. I will also provide an explanation of the reasons the Staff recommends that the Commission not accept KCPL's proposal to defer and amortize in cost of service the amount it paid in severance costs under its 2011 Organizational Realignment and Voluntary Separation (ORVS) Program. Finally, I will address KCPL's proposal to seek Commission pre-approval of the creation of a new distribution maintenance department and its inclusion of its associated unknown future costs in rates in this case. KCPL refers to this proposed new distribution maintenance department as its Distribution Field Intelligence and Tech Support (DFITS) proposal.

Regulatory Lag

Q. Please describe regulatory lag.

A. "Regulatory lag" has been defined much too simply in the past as "the time between the incurrence of a cost or revenue by a utility and the reflection of that expense or revenue in rates". A more descriptive definition is provided by Alfred E. Kahn in his book *The Economics of Regulation: Principles and Institutions.*

Mr. Kahn, one of the most widely recognized and often-cited experts on the economics of regulation, provides this definition of regulatory lag:

> The regulatory lag - the inevitable delay that regulation imposes in the downward adjustment of rate levels that produce excessive rates of return and in the upward adjustments ordinarily called for if profits are too low - is thus to be regarded not as a deplorable imperfection of regulation but as a positive advantage. Kahn, A.E., The Economics of Regulation: Principles and Institutions (New York: John Wiley & Sons, 1970, Chapter 2, p.48).

Q. What did Mr. Kahn believe about the role of regulatory lag?

A. Mr. Kahn believes that regulatory lag is a method by which by a regulatory body incents positive utility management behavior. In *The Economics of Regulation: Principles and Institutions (chapter 2, page 48)* he states that "freezing rates for the period of the lag imposes penalties for inefficiency, excessive conservatism, and wrong guesses, and offers rewards for their opposites: companies can for a time keep the higher profits they reap from a superior· performance and have to suffer the losses from a poor one."

Roger Sherman wrote an article in 2003 entitled *Restructuring Industries: The Carrot and the Stick* in which he cited William Baumol as the originator of the benefits of regulatory lag. William Baumol was a professor at New York University and an emeritus professor at Princeton University:

> The idea of using "regulatory lag", the delay between rate cases, for incentive benefits came from Baumol (1968). He argued that the regulated firm would have incentive to control its costs while it was stuck with unchanging prices between rate cases, the fixed prices essentially serving as a stick. So he proposed a specific time period between rate cases, such as three years or five years, when prices would remain fixed. [Review of Network Economics Vol.2, Issue 4 – December 2003]

Q. Have any of KCPL's witnesses addressed regulatory lag in their direct testimony in this case?

A. Yes. KCPL witness Terry Bassham addresses this topic at page 8 of his direct testimony, where he states that KCPL is proposing several expense trackers as a part of this filing in order to better manage regulatory lag for certain expenses. He believes these trackers will provide the Company with a better opportunity to obtain full and timely recovery of the costs it incurs to serve its customers. Mr. Bassham also states that KCPL is proposing an interim energy charge ("IEC") to better manage its regulatory lag.

KCPL witness Darrin Ives at page 2 of his direct testimony states that the purpose of his testimony is, in part, to address the Company's requests in this case for certain expense trackers, a regulatory mechanism that KCPL believes can provide relief from extensive regulatory lag that prevents the Company from realizing an earned return on equity that is reasonable in relation to the return on equity allowed by this Commission. Mr. Ives continues with his discussion of regulatory lag at page 4 where he states "while KCP&L has actively managed its cost structure, the regulatory lag inherent in the current Missouri regulatory framework has made it difficult, if not impossible, to manage cost increases imposed on us by others, which are also driving the need for this requested increase. To better manage regulatory lag for certain cost increases, in addition to amounts requested in this case, we are proposing certain expense trackers as more fully outlined in later sections of this testimony and described by other Company witnesses."

At page 20 of his direct testimony Mr. Ives explains why he believes a tracker is appropriate for KCPL's property tax expenses. He describes how property taxes have been increasing over the past five years. He states that:

> Cost of service components, such as property taxes, that are out of Company management's control to contain or manage are significant contributors to regulatory lag and impact the Company's ability to earn returns reasonably close to returns allowed by this Commission. Property taxes, and similar costs such as RES costs and transmission costs discussed above, are costs ideally addressed through regulatory mechanisms such as expense riders and trackers.

Q. Please describe how regulatory lag is supposed to work in rate of return regulation.

A. In the actual operating environment, a utility's revenues, expenses and rate base are constantly changing. In a rate case, a specific test year is selected to develop a utility's revenue requirement based on the most current investment in plant and other assets and normalized level of revenues and expenses. Through matching the rate base with normalized revenues and expenses, a revenue requirement is developed that should produce a revenue level that will allow for the recovery of all of the utility's prudently incurred expenses and also provide it an opportunity to earn a reasonable rate of return on its investment in its regulated rate base. Once the revenue requirement is ordered by the

Commission and rates are set, a long list of variables come into play that will affect a utility's ability to earn at the authorized level established by the Commission.

Q. What are examples of some of these variables?

A. One example is when a utility is not engaged in a large amount of construction and adding a large amount of new plant additions to its rate base. During this period, due to the rate recovery of its plant investment through depreciation expense and the resulting increases in depreciation reserve, shareholder investment in regulated rate base is constantly declining. However, its overall rate of return is based on the higher dollar amount rate base that was set in the previous rate case. This regulatory lag results in the utility's investors recovering more of a financial return on the rate base in rates than was determined reasonable and set in rates in the previous rate case. This factor, which from a utility standpoint is considered positive regulatory lag, is sometimes referred to as the "declining rate base factor." While this is considered positive regulatory lag by the utility, ratepayers, who are being required to pay a financial return on a rate base that is higher than the actual amount supplied by the investors, would consider a declining rate base a negative regulatory lag.

Another factor that comes into play with regulatory lag is an increase in cost of an operating expense such as fuel and purchased power expense from the normalized level determined in a rate case and included in rates. While the cost of natural gas has decreased dramatically over the past few years, resulting in lower fuel and purchased power costs to the utility, other fuel costs, such as coal and nuclear fuel, have been increasing. But the normal operation of regulatory lag can provide a counterbalance to the impact of rising fuel costs through offsetting changes in other revenue requirement factors. For example, revenue levels are set at a fixed level in a rate case, but increasing revenues due to an increase in the number of customers or increases in usage per customer can compensate, and sometimes more than compensate, for any increase in fuel costs.

Moreover, increases in efficiency and advances in technology also can result in significant cost reductions that can offset any increases in fuel or other expenses that are increasing. A perfect example of how this occurs can be seen in KCPL's last rate case, No. ER-2010-0355. In December 2010, near the end of its 2010 rate case, KCPL began the internal discussions that led to its conclusion that it could operate the combined KCPL-GMO utility with 140 fewer management employees. This fact suggests that either KCPL-GMO were previously significantly inefficient and imprudent in maintaining an overstaffed work force of 140 management employees, or increases in efficiency and/or advances in technology allowed KCPL to provide the same level of utility service with a significantly decreased management staff. Because KCPL made the decision to reduce its management work force by 140 employees at the end of the rate case process, the costs of the 140 employees are included in current KCPL and GMO electric rates and KCPL is enjoying the regulatory lag effect of increases in efficiency and advances in technology and will directly benefit from this regulatory lag until current rates are changed in the beginning of 2013.

As can be seen by these examples, under rate of return regulation, regulatory lag is a naturally occurring phenomenon that can either operate to a utility's financial benefit or detriment. It is, in essence, a necessary ingredient to rate of return regulation that, if eliminated or manipulated, could result in a distorted revenue requirement calculation and reduction in incentives for the utility to be highly efficient and productive. However, some adjustments to the naturally occurring impact of regulatory lag can be made without causing a serious distortion of utility rates if proper safeguards are in place for both the utility and the ratepayers.

Q. How could the manipulation or elimination of regulatory lag result in a distorted regulatory process?

A. In several ways. The first and probably the most significant is when regulatory lag is manipulated to a great extent or eliminated altogether through a combination of ratemaking mechanisms such as expense trackers, automatic adjustment clauses, IEC's and accounting authority orders (AAOs).

The key factor in rate of return regulation – the competitive pressure on utility management to control costs, and take actions to keep costs as low as possible – is absent or seriously weakened when regulatory lag mitigation measures are adopted without proper safeguards. In my opinion, when regulatory lag is not allowed to function as designed, such as with an improperly designed fuel adjustment clause that provides little or no incentives for a utility to control fuel and purchased power costs, utilities will have no incentive to keep fuel costs low as possible. In this situation, there is guarantee of rate recovery of all prudently incurred costs and the burden of proof that utility management is not acting in the most efficient and effective manner possible to control costs is very difficult for even the most experienced regulators to meet. Utility management is keenly aware of this fact.

Q. Is it the role of the Commission to serve as a substitute for a competitive marketplace?

A. Yes, I believe it is. However, in this context this means that it is incumbent on the Commission, through the use and application of ratemaking policies and procedures, to allow regulatory lag to operate as naturally as possible to ensure that competitive pressures are present in the operation of regulated utilities in Missouri.

There is an expectation that a regulatory agency such as the Commission is expected to serve as a substitute for a competitive marketplace. The ratemaking decisions made by the Commission are expected to be based on the same factors that exist in the open market. The essential purpose of rate regulation is to achieve the results that are achieved by competitive firms in a competitive business environment, which are prices determined by competition, reasonable profits, and adequate service quality.

Q. Do you have an example of how the elimination of regulatory lag by the use of pension trackers may have led to excessive pension costs being charged to KCPL's customers?

A. Yes. On or about May 4, 2011 Great Plains Energy (GPE), KCPL and GMO's parent company hired Deloitte Consulting LLP ("Deloitte Consulting") to provide strategic consulting services regarding KCPL's pension program design. GPE identified four areas for consideration related to its traditional pension plans: benchmarking, current plan analysis, alternative plan design options, and implementation options for pension plan re-design. One of the tasks to be performed by Deloitte Consulting was to discuss with GPE the overall competitiveness of retirement benefits as compared to other utilities and recent competitive trends in retirement plan design.

The Staff obtained a copy of the Deloitte Consulting Report ("Deloitte Report") in response to Staff Data Request No. 246S. A copy of this Report is attached as Schedule CRH-1HC to this testimony. ** ______________________________________

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Q. How do you relate the excessiveness of KCPL's pension costs to your discussion of regulatory lag?

A. The Regulatory Plan Stipulation and Agreement approved in Case No. EO-2005-0329 included specific ratemaking treatment for pension cost to be used in rate cases filed between 2005 and 2010, the period covered by the Regulatory Plan. However, both the number of these pension trackers and the scope of compensation-related trackers

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have grown considerably. I believe that both the high number of trackers and the specific design of the pension trackers that are currently in place, and have been in place for several years, has likely contributed to these excessive pension costs for KCPL.

Q. Are you asserting that there is a direct causal link between KCPL's ability to use pension trackers and its excessive pension costs?

A. No. However, the existence of excessive KCPL pension costs and the fact that these costs are not subject to the inherent regulatory lag competitive pressures causes Staff to be concerned about the potential impact of escalating regulatory lag mitigation measures. It is this concern that is the basis of my testimony on regulatory lag.

Q. How may pension and OPEB trackers are currently in effect for KCPL and GMO?

A. There are approximately 16 pension and OPEB expense trackers being included in the current rate cases for KCPL and GMO-MPS and GMO-L&P. These trackers were designed to ensure KCPL and GMO receive a full and complete recovery of each and every dollar of pension expense and OPEB expense, including a financial return on the trackers included in rate base which have during some periods included a profit return of 11.25 percent. With this type of ratemaking treatment, and with the absence of regulatory lag and its associated cost control incentives, there is actually a perverse incentive for KCPL to increase its pension costs and pension regulatory assets for various reasons, one of which is that this type of behavior increases rate base and profit.

Q. Are GPE's excessive benefits costs restricted to only its pension plan?

A. No. As noted at page 21 of the Deloitte Report, **__________________

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Q. Are there actions that KCPL could have taken over the past few years that would have reduced the cost of its pension plans?

A. Yes. A large number of companies in the U.S. have made changes to their pension plans to reduce their ongoing cost, including switching from a "defined benefit" pension plan to a "defined contribution" benefit plan due to the high costs of maintaining a defined benefit pension plan. In its Report, Deloitte Consulting made several suggestions to GPE that would decrease the cost and volatility of its pension plans.

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** Deloitte Consulting defines the differences between the types of pension plans at page 33 of its Report.

All of these are actions that KCPL could have taken in the past if it had appropriate incentives to control its pension costs. For some reason, KCPL has not made significant changes in its pension plans that would result in significant cost reductions to date, and what is a concern to the Staff is that the reason for this inaction may be the lack of the competitive incentive to keeps pension costs as low as possible through the forces of regulatory lag.

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Q. Has the Staff been supportive of utility requests to lessen the impact of regulatory lag that was negative to the utility and its shareholders?

A. Yes. In the past the Staff has been supportive of targeted and limited utility proposals to lessen the immediate impact of regulatory lag. Staff has also been supportive of regulatory lag mitigation measures during major utility construction periods such as KCPL's Regulatory Plan. The Staff's acceptance of utility proposals to mitigate or eliminate regulatory lag in some respects shows that the Staff has been attentive to utility concerns about regulatory lag.

Q. Does the Staff believe that given the recent onslaught of utility proposals to eliminate or mitigate regulatory lag, it is now time to re-evaluate its position and approach to utility-requested regulatory lag mitigation mechanisms?

A. Yes. The Staff has been supportive in the past and expects to continue to be supportive of some level of regulatory lag mitigation measures, including limited use of cost trackers and AAOs. However, because of the potential for significant ratepayer harm, especially in the long run, from the increasing acceptance of regulatory lag mitigation mechanisms, the Staff has recently developed a heightened level of concern about the proliferation of regulatory lag mitigation measures.

The Staff recognizes that there were a number of regulatory lag mitigation measures passed by the Missouri legislature in recent years that are likely permanent in nature. The Staff has no concern with these measures. The Staff also recognizes that the Commission has approved and allowed the implementation of a number of regulatory lag mitigation measures over the past several years, many of which have had the support of the Staff. The Staff's current heightened concern about the elimination of the beneficial impact of regulatory lag is caused by the continuously increasing number of measures to eliminate what utilities believe to be the detrimental impact of regulatory lag, but effectively leave in place regulatory lag that is detrimental to customer interests.

The Staff's concern is that with the ever increasing number of regulatory lag mitigation measures being requested by utility companies, there is a very real and significant potential for the distortion of basic ratemaking principles that have guided utility regulation in Missouri for decades. These basic ratemaking principles have contributed, in my opinion, to Missouri having reasonable electric utility rates when compared to other parts of the country.

Q. What is Staff recommending to the Commission concerning regulatory lag mitigation measures being requested by KCPL in this case?

A. The Commission has great control over both the number of, and design of, utility-proposed regulatory lag mitigation measures requested in rate cases, such as this KCPL rate case. In its evaluation of these utility requests, the Staff recommends the Commission consider giving a higher level of scrutiny to the utility-proposed measures and implementing some safeguards to protect the interests of customers.

Q. Is the Staff proposing specific safeguards for the Commission to apply in this case?

A. No. However, while no safeguards can replace the benefits of regulatory lag, the Staff believes the Commission could consider ordering some safeguards as it deems appropriate in this case and in future rate cases.

Q. Please describe some measures the Commission could consider in cases where it approves utility-requested regulatory lag mitigation measures.

A. Some of these measures may include verifying the absolute need for the measure, the likely success of the measure if implemented, the likely impact of the measure on utility management's incentives to control the related costs given the absence of the competitive forces of regulatory lag, and requiring modifications to the measure to address the potential elimination of the cost control incentives. Finally, a cap on the length of time that the regulatory lag mitigation measure should be in effect, such as five years, should also be seriously considered.

Q. Please provide an example of how the Commission could address a utility-requested regulatory lag mitigation measure using these recommendations.

A. As an example, if a utility proposed a mechanism to reduce or eliminate the impact of regulatory lag for a specific expense, the Commission should require the utility to provide strong evidence that the utility does not have the significant ability to control the cost, that the cost is increasing steadily and that the cost is material to the utility's overall operations. A good rule of thumb for this materiality test would be the FERC USOA net income test for accounting authority orders, *i.e.*, that the expense be at least five percent of net income.

If the proposed measure meets the above tests and the Commission determines that the measure is reasonable and likely to solve the short-term utility financial concerns, the Commission could require specific ongoing evidence that elimination of the competitive incentives inherent in regulatory lag has not caused utility management to not focus on the cost and has taken all actions possible to keep the cost as low as possible. The Commission could require some type of benchmarking studies be performed by utility management to provide some assurances that, since the costs will no longer be subject to the competitive pressure of regulatory lag, they are still receiving the appropriate level of scrutiny by utility management.

In addition to benchmarking the same costs at other utilities, another measure the Commission could take in an effort to keep some cost control incentives in place is to require that the expense that is being excluded from the competitive pressures of regulatory lag be included as a component of the utility's management compensation program. Putting some compensation at risk for control of a cost that is not subjected to normal regulatory lag competitive pressures will provide some assurance that management is not totally ignoring this cost.

Q. Are you suggesting that if a utility proposal meets these tests and the Commission implements appropriate safeguards that the Staff will automatically recommend approval of utility requests to mitigate regulatory lag?

A. No. The Staff is merely providing to the Commission some options for it to consider when it evaluates the merits and the potential impact of utility-requested regulatory lag mitigation measures.

Q. Do you agree that it is important for the Commission to seek a level of balance and fairness both to utility ratepayers and shareholders when it addresses the issues of regulatory lag in a utility rate case?

A. Yes. To achieve this level of balance and fairness, I believe it is important to approach the regulatory lag issues being raised by utilities today from a historical perspective.

One of the characteristics of regulatory lag is that it tends to be sensitive to various economic factors facing utilities, including the overall health of the economy. During previous time periods when certain economic factors were in place, regulatory lag resulted in financial benefits to shareholders. In other periods, such as the current period with the current economy, regulatory lag has not worked to the benefit of utility shareholders. As an illustration, after its Wolf Creek rate cases in the mid 1980s, KCPL's earnings were so good that, for a period of approximately 20 years, it did not file a rate increase case with the Commission. In fact, during this period KCPL's earnings were so strong that it even agreed periodically to reduce its rates, although by a relatively small amount.

It is quite safe to say that due to the positive regulatory lag (positive to KCPL shareholders) from a declining rate base, customer growth, strong off-system sales and possibly other factors, KCPL was earning at or above its authorized return on equity for this 20-year period. KCPL did not have an "opportunity" to earn its authorized ROE during this period, the evidence indicates that it was almost a "guarantee" that it would earn at or above its authorized ROE for this 20-year period.

Given this historical perspective, a very important question that should be addressed is what regulatory lag mitigation measures were put into place to protect KCPL's ratepayers from paying excessive and unreasonable rates from 1985 to 2005? The answer is none, with the possible exception that Staff would occasionally perform an earnings review and file an earnings complaint case against KCPL. However, these earnings reviews were infrequent and performed at a very high level. Also, from Staff's perspective, the agreed-upon amount of rate reduction that took place was not designed to eliminate all of KCPL's excess earnings at the time of the earnings review.

KCPL witness Ives recognized regulatory lag has always existed in the Missouri regulatory framework. The difference now is that when the business environment in which

KCPL operates no longer produces positive regulatory lag (from the shareholder perspective) and excess earnings, KCPL calls for strong and drastic regulatory lag mitigation measures which, if not carefully controlled and if allowed to remain in place for the long term, have a very high probability of significantly skewing the Missouri regulatory framework, which, as noted above, has worked very well in the past. As reflected in response to Staff Data Request No. 485 Mr. Ives states:

> There has always been regulatory lag inherent in the Missouri regulatory framework. In the past, however, the impact of regulatory lag for the recovery of eligible costs was offset by the increase of revenues resulting from customer growth. For the past several years, there has been minimal customer growth in the company's Missouri service territory. Additionally, certain costs have been increasing more dramatically than in prior periods, reflecting the changing regulations under which the Company must operate.

This is why I believe it is important to view all current utility regulatory lag mitigation measures with a keen awareness and understanding of the past. With this perspective of the past one will note that regulatory lag is a naturally occurring phenomenon, it is affected by changes in economic conditions and it benefits, at differing times, both shareholders and ratepayers. Any attempt to adjust the symmetrical nature of regulatory lag should be done carefully so as not to significantly alter the inherent fairness and balance in naturally occurring regulatory lag.

Q. Please summarize your testimony on regulatory lag.

A. In a 2009 rate case hearing in Case No. ER-2010-0036, Chief Staff Counsel Kevin Thompson made the following statement to the Commission: "regulatory lag is a normal and inevitable part of utility regulation. You know that regulatory lag cuts both ways, sometimes to the benefit of the customer and sometimes to the benefit of the utility." (Tr. 214-215) While I agree with Mr. Thompson, I would go one step further and state that regulatory lag is not only inevitable, but necessary. It plays a vital role in making rate of return regulation work fairly and equitably and with inherent incentives for the utility to operate at reasonable levels of productivity and cost effectiveness.

The Staff has in the past and will likely continue to support some specific, targeted and short-term measures to mitigate the impact of regulatory lag, such as supporting the use of AAOs when necessary and the use of expense trackers in certain limited and special circumstances. But the Staff believes these measures require greater scrutiny today and in the future by both the Staff and the Commission. The Staff believes that due to the increasing number of regulatory lag mitigation measures currently in place and continuously being proposed by utilities, the potential for distortion of the very important role of regulatory lag is very real.

Distortion of the nature and beneficial role of regulatory lag through modification and elimination of the essential ratemaking policies and principles that have served the Missouri regulatory framework over many years is a very real possibility if the constant barrage of regulatory lag mitigation measures is not given greater scrutiny and important countervailing safeguards put in place. This greater scrutiny should be given with solid understanding of the role of regulatory lag and how regulatory lag has been allowed to operate in the past, when utilities were operating in a more favorable economic environment.

The Commission, the Staff and Missouri utilities, including KCPL, allowed regulatory lag to operate basically unfettered for 20 years from 1985 to 2005, and I would say, appropriately so. KCPL was allowed to retain earnings significantly above its allowed rate of return for approximately 20 years, solely because of regulatory lag. Assuming that regulatory lag has not operated in favor of KCPL's shareholders since 2005, to date this is a much smaller period of time than the previous period of positive regulatory lag. Based on this long-term perspective, Staff believes that the Commission's polices regarding regulatory lag should not be fundamentally different in periods of unfavorable regulatory lag to utilities compared to periods of favorable regulatory lag. This is the appropriate perspective from which to view KCPL's current concerns of regulatory lag and its effect on current earnings.

Organizational Realignment and Voluntary Separation ("ORVS") Program

Q. Please describe the ORVS Program.

A. ORVS is a voluntary separation program instituted by GPE in March 2011 for KCPL management employees. Under the ORVS Program, any non-union employee could voluntarily elect to separate from KCPL and receive a severance payment equal to two weeks of salary for every year of employment, with a minimum severance payment equal to fourteen weeks of salary.

Q. Did KCPL realize savings as a result of the timing of its ORVS Program?

A. Yes. Because KCPL announced the ORVS program at the conclusion of its 2010 rate case, it was too late to include the significant reduction in KCPL's employee payroll and employee benefits costs (pensions, OPEBs, medical insurance, etc.) in the rates that are in existence today. According to KCPL, through regulatory lag its savings from ORVS (dollars collected from ratepayers in current rates with no associated expense) is approximately $15 million annually.

Q. How many employees accepted KCPL's severance offer and when did these employees separate from KCPL?

A. Approximately 140 employees were separated under ORVS and the majority separated on April 30, 2011.

Q. What ratemaking treatment is KCPL seeking in this case?

A. KCPL is seeking to recover in rates from its customers ORVS costs in the amount of $20.5 million (which have already been recovered by KCPL, as discussed below), mostly through a 5-year amortization to expense. As shown in the chart below, the total ORVS costs that are being sought by KCPL and by KCPL-Greater Missouri Operations (GMO) in its companion rate case, Case No. ER-2012-0175, are approximately $30 million:

ORVS Costs	KCPL	GMO-MPS	GMO-L&P	Total GPE	Percent
Severance	$8,749,617	$2,457,069	$819,957	$12,026,643	40%
Payroll Taxes	$454,912	$148,277	$49,482	$652,671	2%
Transition Svcs	$132,594	$44,902	$14,008	$191,504	1%
Subtotal	$9,337,123	$2,650,248	$883,447	$12,870,818	43%
FAS 88	$11,195,684	$4,114,085	$1,564,462	$16,874,231	57%
Total	$20,532,807	$6,764,333	$2,447,909	$29,745,049	100%

Q. How does the amount KCPL is seeking to recover in rates compare to the dollar amounts that KCPL and GMO have already recovered in rates through regulatory lag?

A. Solely because KCPL implemented the ORVS Program when it did, KCPL and GMO will enjoy regulatory lag savings in the amount of $34 million for salary and benefits recovered in rates that are not being paid to employees. The total salaries for the ORVS employees were $12.5 million. Using KCPL's estimate for benefits, the cost of these employees' benefits was $7.6 million, for a total annual savings of approximately $20 million.

Rates from the last rate case in which the salary and benefits costs of ORVS employees are included will be in effect for approximately 1.68 years (from May 4, 2011 for KCPL and June 25, 2011 for GMO through January 27, 2013, the operation-of-law date for this case). Total salary and benefits savings is calculated by multiplying the annual savings of $20 million times the period of time rates will be in effect of 1.68 years for a total savings of $34 million.

Q. You have shown that KCPL and GMO will enjoy $34 million of savings from the ORVS program. After subtracting the relevant costs of ORVS to KCPL and GMO, what is the amount of ORVS costs that have been over-recovered due to the existence of regulatory lag?

A. As can be seen in the ORVS Cost chart above, total costs of the ORVS program without consideration of FAS 88 pension expense is approximately $13 million, consisting primarily of employee severance costs. Since the Staff has included all of KCPL's requested FAS 88 costs in this case, FAS 88 is not considered a cost of the program. So, due to the timing of when KCPL initiated the ORVS program, KCPL and GMO will have over-recovered ORVS costs in the amount of $21 million ($34 savings less $13 costs) when rates from the 2010 rate cases which went into effect on May 4, 2011 (June 25, 2011 for GMO) are changed from this case on January 27, 2013.

Q. Did the Staff include the FAS 88 pension settlement charges in its revenue requirement proposal for KCPL in this case?

A. Yes.

Q. Does the Staff believe the Commission should allow KCPL to defer ORVS severance costs as an asset on its balance sheet and amortize this deferred expense over future periods, as requested by KCPL?

A. No. It would not be reasonable to defer and amortize this one-time non-recurring expense from a ratemaking accounting standpoint and it would unquestionably be unfair to KCPL's customers to allow KCPL to defer this one-time expense and charge customers over future periods.

Q. Please briefly state the reason why the Staff believes it would be unreasonable and unfair to allow the treatment sought by KCPL for this one-time expense.

A. The main reason is stated quite succinctly by KCPL witness Kelly Murphy in her direct testimony, where she states at page 4 that "[t]his reduction in the number of employees also resulted in associated reductions in the cost of employee-related benefits that would otherwise have occurred, bringing the total annual savings to approximately $20 million annually, including amounts capitalized."

Due to the fact that KCPL shareholders will benefit in the amount of the $21 million net savings from the ORVS event, there is no reason why KCPL should recover from its customer costs that have more than already been paid for by its customers directly in utility rates.

Q. At page 5 of her direct testimony, Ms Murphy describes a $16.6 million ($11.4 million allocated to KCPL) pension settlement charge that was primarily related to the ORVS Program as follows:

> Under the ratemaking method used for pensions, there was a $16.6 million pension settlement charge, excluding joint partner shares, that resulted from non-union pension distributions in 2011, primarily due to the voluntary separation program. KCP&L deferred its share of the charge as a regulatory asset. It expects to recover its deferred asset over future periods pursuant to the Non-Unanimous Stipulation and Agreement Regarding Pensions and other Post Employment Benefits approved in Case No. ER-2010-0355.

Did you include the pension settlement charge that KCPL asserts was primarily related to the ORVS Program as a cost in your net KCPL savings analysis shown above?

A. No. The pension settlement charges related to ORVS are referred to as FAS 88 costs. Based on the language of the Non-Unanimous Stipulation and Agreement Regarding Pensions and other Post Employment Benefits approved in Case No. ER-2010-0355, Staff is including the FAS 88 costs of the ORVS Program in rates in this case. Because of this, it should not be considered as a cost of the ORVS Program in the net savings analysis.

Q. If you did include KCPL's $11.4 million ORVS FAS 88 charge in your analysis would KCPL still have over-recovered all of its ORVS costs and its ORVS FAS 88 cost?

A. Yes, by $4 million total company. However, as noted above, the FAS 88 pension costs are separately calculated and are not a part of the costs of the ORVS program. Staff has included the FAS 88 pension costs as a five-year amortization addition to pension expense in this case.

Distribution Field Intelligence and Tech Support ("DFITS")

Q. What is the Staff's position on KCPL's proposal to include costs of potential future distribution plant maintenance department, employees and equipment into KCPL's cost of service in this rate case?

A. Staff recommends the Commission reject KCPL's request to include the costs of the proposed DFITS work group, because the costs do not exist and are not known and measurable at this time.

Q. Please describe KCPL's DFITS proposal.

A. In his direct testimony, KCPL witness William Herdegen described why KCPL believes it is necessary to establish a new technical field group it calls Distribution

Field Intelligence and Tech Support. According to Mr. Herdegen, KCPL needs this additional work group because "the number, variety, complexity, and interoperability of distribution devices has increased, and will continue to increase." To support this new work group KCPL requested that the Commission include in rates what KCPL estimates to be the future cost of establishing, training, and sustaining the proposed DFITS group. Mr. Herdegen described the estimated startup costs of employee salaries, vehicles, field tools, and field test equipment.

Q. What are the estimated future payroll costs to KCPL if it actually does create a new distribution maintenance department?

A. Mr. Herdegen explains that in addition to the capital plant costs of a Simulation and Training Laboratory, as well as vehicles and testing equipment, KCPL proposes to include in cost of service in this rate case the estimated payroll and benefit costs of ten employees (field technicians and analysts) that it believes it will hire at some unspecified date. The estimated labor and benefit costs were calculated based on an individual salary of $93,600, plus benefits at 61% of payroll, ($57,110) for a total cost of $150,710 per employee, multiplied by ten employees for a total employee cost of $1,507,000 annually.

Q. Are the costs of KCPL's proposed new distribution maintenance department known and measureable at this time?

A. No.

Q. Has the Commission historically required that costs be known and measurable as a condition of inclusion into a utility's cost of service?

A. Yes. The estimated future costs proposed by KCPL are neither known nor measurable, nor matched to any specific date. The Staff's recommendation to the Commission that it not accept this KCPL proposal is based, in part, on the clear policy guidance given by the Commission to KCPL in its Report and Order in Case No. ER-2006-0314, KCPL's 2006 rate case.

In that Report and Order, the Commission noted the importance of the matching principle applied to a utility's revenues and expenses in a rate case. In its 2006 rate case KCPL sought to include employee costs that were not yet incurred and were not yet known or measurable at the true-up cutoff date. In rejecting KCPL's proposal to include the cost of employees hired after the true-up date in the 2006 KCPL rate case, the Commission stated:

> If the Commission does not take a snapshot of a company's revenues and expenses as of the known and measurable date, the true-up date, or any date, for that matter, then what? KCPL's employee count, as well as a host of other revenues and expenses, has no doubt changed since the true-up hearing; the Commission will get yet another snapshot of those changes when KCPL files its next rate case. To set just and reasonable rates, the Commission simply must match revenues and expenses as of a certain date.

Q. Did KCPL witness Herdegen address this clear statement of Commission policy expressed to KCPL in its 2006 rate case?

A. No. KCPL did not acknowledge this longstanding policy of the Commission. However, KCPL did address the known and measurable principle and the necessity of matching revenues and expenses in KCPL's DFITS proposal in its Kansas jurisdiction. In its recent rate case filing with the Kansas Corporation Commission, Docket No. 12-KCPE-764-RTS, KCPL witness John Weisensee described how KCPL does not propose to set rates on budgeted or projected data, with the single exception of its DFITS proposal.

Mr. Weisensee was quite emphatic when he stated in his KCC testimony that "in no case is budgeted or projected data beyond June 30, 2012 being used (excluding DFITS)."

> Q. Does KCP&L propose that cost of service in this case be based on budgeted or projected data?
>
> A: No, we do not propose that rates be set based on budgeted or projected data, with one exception. Company witness William P. Herdegen, III, in his Direct Testimony proposes a Distribution Field Intelligence and Technical Support ("DFITS") work group. Costs for this proposed work group are based on budgeted data since KCP&L is seeking Commission approval to implement this new work group in this case. (Weisensee Direct Docket No. 12-KCPL-764 RTS, page 6)

Unlike its Kansas testimony, KCPL's testimony in Missouri fails to recognize KCPL's departure from the ratemaking matching principle with regard to DFITS. In his direct testimony in this current Missouri rate case, Mr. Weisensee describes how all of the costs KCPL is requesting in its cost of service are known and measurable. He also testifies that all KCPL's requested adjustments have either occurred or are expected to occur prior to the true up cutoff date of August 31, 2012. Mr. Weisensee in his Missouri testimony in this case does not mention any exception for the DFITS group:

> Q: What historical test year did KCP&L use in determining rate base and operating income?
>
> A: The revenue requirement schedules are based on a historical test year of the twelve months ending September 30, 2011, with known and measurable changes projected through August 31, 2012. We will update the schedules as of March 31, 2012 and then true up to actuals as part of the true-up process. (Weisensee Direct ER-2012-0174, page 6)
>
> Q. Please explain the adjustments to reflect known and measurable changes that have been identified since the end of the historical test year.
>
> A: These adjustments are made to reflect changes in the level of revenue, expense, rate base and cost of capital that either have occurred or are expected to occur prior to the true-up date in this case, August 31, 2012. For example, payroll expense and fuel costs have

> been adjusted for known and measurable increases. (Weisensee Direct ER-2012-0174, page 7)

While the Staff rejects any proposal to increase utility rates based on estimated future costs that do not currently exist, and therefore are not known and measurable, it will consider actual incurred costs if they occur in the current test year or true-up period. If KCPL chooses to incur costs related to this proposed department that are reasonable, prudent, known, and measurable prior to the August 31, 2012 cutoff period, the Staff will consider whether or not it would be appropriate to include such costs in this rate case. To be considered in the Staff's true-up payroll and benefits recommendation, employees will have to meet all KCPL criteria for employment, including passing all required medical evaluations by the end of the true-up period in this case.

Q. By its proposal in this case is KCPL seeking pre-approval of its DFITS program and its associated costs?

A. Yes, it is.

Q. Has the Commission ever pre-approved programs and program costs in a utility rate proceeding?

A. No, I do not believe it has ever taken such action.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	))))	Case No. ER-2012-0174

AFFIDAVIT OF CHARLES R. HYNEMAN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Charles R. Hyneman, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 27 pages to be presented in the above case; that the answers in the foregoing Rebuttal 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.

Ch R. Hy

Charles R. Hyneman

Subscribed and sworn to before me this 5th day of September, 2012.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

D Suzie Mankin

Notary Public

SCHEDULE CRH-1

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY