BEFORE THE CORPORATION COMMISSION

OF THE STATE OF KANSAS

IN THE MATTER OF THE APPLICATION OF WESTAR ENERGY, INC. (NORTH AND SOUTH), A CORPORATION ORGANIZED AND EXISTING UNDER THE LAWS OF THE STATE OF KANSAS, FOR AUTHORITY TO FILE AND MAKE EFFECTIVE NEW SCHEDULES OF ELECTRIC RATES IN REPLACEMENT OF EXISTING FILED SCHEDULES FOR ELECTRIC SERVICE WITHIN THE STATE OF KANSAS	]	KCC Docket No. 08-WSEE-1041-RTS

DIRECT TESTIMONY OF

ANDREA C. CRANE

RE: REVENUE REQUIREMENTS AND COST OF CAPITAL

ON BEHALF OF

THE CITIZENS' UTILITY RATEPAYER BOARD

September 29, 2008

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is 199 Ethan Allen Highway, Ridgefield, Connecticut 06877. (Mailing Address: PO Box 810, Georgetown, Connecticut 06829)

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

A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various studies relating to utility rates and regulatory policy. I have held several positions of increasing responsibility since I joined The Columbia Group, Inc. in January 1989.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in approximately 275 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, West Virginia and the District of Columbia. These proceedings involved electric, gas, water, wastewater, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony is included in Appendix A.

Q. What is your educational background?

A. I received a Master of Business Administration degree, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. On May 28, 2008, Westar Energy, Inc. ("Westar" or "Company") filed an Application with the Kansas Corporation Commission ("KCC" or "Commission") seeking a rate increase of $90.04 million for its Westar Energy North ("WEN") operations, and a rate increase of $87.58 million for its Westar Energy South ("WES") operations.[1] The requested increases

1 "Westar"will be used to denote Westar Energy, Inc. or to denote the combined electric operations of WES and

would result in an overall increase of approximately 15.0% in each system. WEN encompasses the operations of the former Kansas Power and Light Company ("KPL"), while WES encompasses the operations of the former Kansas Gas and Electric Company ("KGE").

The Columbia Group, Inc. was engaged by the State of Kansas, Citizens' Utility Ratepayer Board ("CURB") to review the Company's Application and to provide recommendations to the KCC regarding the Company's revenue requirement and cost of capital claims. In addition, CURB is also sponsoring the testimony of Stacey Harden on energy efficiency projects; of Michael J. Majoros on depreciation issues; and of Brian Kalcic on certain rate design issues. In developing my recommendations, I relied upon the depreciation expense recommendations of Mr. Majoros.

Q. What are the most significant issues in this rate proceeding?

A. The most significant issues driving Westar's rate increase request are: 1) generation additions including the Spring Creek generation facility, the Emporia Energy Center, and investment in wind generation; 2) the inclusion of construction work in progress in rate base; 3) the Company's claim for a return on equity of 10.95% and its claim for a premium return of 100 basis points on its wind investment; 4) requested increases in depreciation rates; 5) requested recovery of certain past costs resulting from ice storms; 6) increases in various reserve accruals; 7) increases in vegetative management costs; and 8) increases in payroll costs and related benefits.

WEN.

III. SUMMARY OF CONCLUSIONS

Q. What are your conclusions concerning the Company's revenue requirement and its need for rate relief?

A. Based on my analysis of the Company's filing and other documentation in this case, my conclusions are as follows:

1. The twelve months ending December 31, 2007, is an acceptable test year to use in this case to evaluate the reasonableness of the Company's claims.
2. Westar has a pro forma capital structure that includes 50.13% common equity, 47.99% long-term debt, 0.50% preferred stock, and 1.38% post-1970 investment tax credits ("ITCs"), as shown in Schedules ACC-2N and ACC-2S. [2]
3. The Company has a pro forma cost of equity of 9.59%, as shown in Schedules ACC-2N and ACC-2S and an overall cost of capital of 8.08%.
4. WEN has a test year pro forma rate base of $1,729,009,393, as shown in Schedule ACC-9N.
5. WEN has pro forma operating income at present rates of $105,601,762 as shown in Schedule ACC-13N.

2 In WEN, Schedules ACC-1N, ACC-39N, and ACC-40N are summary schedules, ACC-2N to ACC-8N are cost of capital schedules, ACC-9N to ACC-12N are rate base schedules, and ACC-13N to ACC-38N are operating income schedules. In WES, Schedules ACC-1S, ACC-39S, and ACC-40S are summary schedules, ACC2S to ACC-8S are cost of capital schedules, ACC-9S to ACC-14S are rate base schedules, and ACC-15S to ACC-38S are operating income schedules.

6. WEN has a test year, pro forma, revenue deficiency of $56,712,954 as shown on Schedule ACC-1N. This is in contrast to WEN's claimed deficiency of $90,040,860. CURB's recommendation reflects the inclusion of $16,849,048 in base rate revenue that was previously approved for recovery through the Energy Efficiency Cost Recovery Rider ("ECRR").

7. WES has a test year pro forma rate base of $1,455,538,331 as shown in Schedule ACC-9S.

8. WES has pro forma operating income at present rates of $90,767,960 as shown in Schedule ACC-15S.

9. WES has a test year, pro forma, revenue deficiency of $44,636,023 as shown on Schedule ACC-1S. This is in contrast to WES's claimed deficiency of $87,582,521. CURB's recommendation reflects the inclusion of $10,288,215 in base rate revenue that was previously approved for recovery through the ECRR.

IV. INTRODUCTION

Q. Before discussing your specific recommendations, do you have any general comments about the Company's filings?

A. Yes, I do. It should be noted that much of the requested increases in WEN and WES are the result of recent regulatory decisions of the KCC and/or statutory requirements. For example, the KCC has already pre-approved the ratemaking treatment for certain wind investments as well as for investments in the Emporia Energy Center ("EEC"). In addition, the Kansas legislature has enacted legislation that requires the KCC to include in rate base certain construction work in progress ("CWIP"). These factors are responsible for a significant portion of the Company's claim in this case.

For example, for WEN, the Company is requesting a rate increase of $90.04 million. $15.7 million of this amount relates to the return on wind projects that the KCC has already approved. Another $1.8 million relates to the Company's request for a 100 basis point premium on the return associated with this wind investment. In the proceeding requesting pre-approval of Westar's wind investment, the KCC denied a similar request by the Company to charge ratepayers a premium return on wind investment. However, in this case, the Company has renewed its request for such a premium.

In addition, $35.0 million of the requested WEN increase relates to return on investment, depreciation, and operating expenses associated with the EEC, another generation addition that the KCC has pre-approved. Another $37.0 million of the Company's request relates to return on investment on CWIP (excluding CWIP on the wind projects and the EEC). Thus, it is clear that capital projects, many of which have been pre-approved by the KCC and/or addressed by legislation, are responsible for much of WEN's claim.

Similarly, since the Company has allocated its wind investment equally between WEN and WES, $15.7 million of the requested WES increase of $87.6 million relates to wind investment. Again, an additional $1.8 million results from the Company's request for a premium return on this investment. The inclusion of CWIP in rate base adds another $21.5 million to the Company's claim in WES. The Company's request also includes the revenue requirement associated with the Spring Creek generation facility, which was acquired by the Company since its last base rate case. This generation facility adds another $7.3 million to the Company's claim.

Q. Can you quantify some of the other major elements driving the Company's claim in this case?

A. Yes. In WEN, weather normalization and rate annualization adjustments made to the Company's pro forma revenue increase rates by $15.0 million. The Company's proposed depreciation expense study adds another $9.7 million to rates and its request for increased payroll and benefit costs adds still another $11.0 million. Finally, reserve normalizations and increased tree trimming costs add another $9.2 million to the Company's claim.

In WES, weather normalization and rate annualization adjustments made to the Company's pro forma revenue increase rates by $14.6 million. The Company's proposed depreciation expense study adds another $10.2 million to rates, and its request for increased payroll and benefit costs adds still another $10.0 million. Finally, reserve normalizations and increased tree trimming costs add another $9.4 million to the Company's claims in WES.

Q. Aren't there offsetting adjustments that decrease the revenue requirement request in both WEN and WES?

A. Yes, there are. In some cases, the Company is proposing accounting adjustments that will actually reduce its costs of service. Shown below is a summary of the major increases outlined above, as well as the remaining increases/decreases to the Company's revenue requirement.

	WEN (Millions)	WES (Millions)
Wind Investment (Including Premium Return)	$17.5	$17.5
Emporia Energy Center	$35.0	NA
CWIP	$37.0	$21.5
Spring Creek	NA	$7.3
Revenue Normalization/ Annualization	$15.0	$14.6
Depreciation Study	$9.7	$10.2
Payroll/Benefits	$11.0	$10.0
Revenue Normalization/ Tree Trimming	$9.2	$9.4
Other Factors	($44.4)	($2.9)
Total	$90.0	$87.6

As indicated above, in WEN, the incremental cost of the factors contributing to this rate request is offset by other factors that are helping to mitigate this rate increase, including a significant surplus in per-book revenues during the test year. As demonstrated by the Company's filing, WEN's per-book overall return was 11.4% for the test year, or approximately 16.8% on common equity. Thus, WEN has the ability to absorb more cost of service increases than does WES before a rate increase is required.

Q. In addition to the rate increases granted by the KCC in this case, are ratepayers likely to experience additional increases for utility service provided by Westar?

A. Yes. The rates that are the subject of this proceeding are only the Company's base rates. In addition to these base rate increases, customers will experience further increases relating to purchase power costs (including new purchase power agreements for wind generation), fuel cost increases for fuel used in Company-owned generation facilities, incremental costs for additional environmental projects, surcharges for future property tax increases, and increases in transmission costs that will be directly passed through to ratepayers. Thus, in evaluating the Company's request in this case, the KCC should be mindful of the fact that base rate increases are only one component of the rate increases that will be passed along to Kansas ratepayers in the near future.

V. COST OF CAPITAL AND CAPITAL STRUCTURE

Q. What is the cost of capital and capital structure that the Company is requesting in this case?

A. For the majority of its rate base claim, the Company utilized the following capital structure and cost of capital in its filing:

	Percent	Cost	Weighted Cost
Common Equity	48.46%	10.95%	5.31%
Long Term Debt	49.59%	6.38%	3.16%
Preferred Stock	0.52%	4.55%	0.02%
Post 1970 ITCs	1.43%	8.62%	0.12%
Total			8.62%[3]

In addition, Westar requested an additional return of 100 basis points, or 9.62%, on its wind investment. Therefore, the overall average cost of capital claimed by Westar was 8.68% for WEN and 8.69% for WES. Given the Company's proposed capital structure, the 9.62% premium return would result in a return on equity associated with wind investment of 13.04%.

The Company subsequently updated its cost of capital and capital structure in the response to KCC-155. In that response, Westar updated its cost of capital and capital structure for actual results as of June 30, 2008. The revised capital structure and cost components are as follows:

	Percent	Cost	Weighted Cost
Common Equity	50.13%	10.95%	5.49%
Long Term Debt	47.99%	6.55%	3.14%
Preferred Stock	0.50%	4.55%	0.02%
Post 1970 ITCs	1.38%	8.77%	0.12%
Total			8.77%

Q. What capital structure and cost of capital have you used in the development of your recommended revenue requirement?

3 Numbers do not add due to rounding.

A. I have utilized the updated capital structure at June 30, 2008, provided by the Company in its response to KCC-155. In addition, I have accepted the Company's updated capital cost components, with one exception. I have not accepted the Company's claim for a return on equity of 10.95%. Rather, I recommend a return on equity of 9.59% for Westar.

Q. As a general matter, has there been a reduction of risk to the Company since its last base rate case filing?

A. Yes, there has. Since the last base rate case, Westar's risk has been reduced significantly by the implementation of a fuel and purchase power cost adjustment mechanism, or Retail Energy Cost Adjustment ("RECA"). Since fuel and purchase power costs account for approximately 40% of the Company's operating expenses, the RECA effectively eliminates 40% of the Company's operating expense risk, a significant benefit to shareholders. In the last case, the KCC also authorized Westar to implement the Environmental Cost Recovery Rider ("ECRR"), which provides for cost recovery of certain environmental capital projects between base rate case filings. This mechanism also significantly reduces Westar's risk and ensures Westar dollar-for-dollar recovery of the annual revenue requirement associated with these capital costs in a timely manner between base rate case filings. In addition, it ensures recovery of all of these costs through an annual true-up mechanism.

Westar is also requesting that the KCC authorize it to establish a Transmission Delivery Charge ("TDC") that would permit the Company to pass through to ratepayers the annual transmission costs approved by FERC. This mechanism further reduces Westar's risk of regulatory lag and under-recovery.

Westar has also taken advantage of legislation that permits it to seek pre-approval of the ratemaking principles that will be used for certain investments. Westar has availed itself of this legislation by obtaining pre-approval from the KCC for the EEC and for its wind investment. The KCC has also approved Westar's request to defer certain extraordinary costs relating to storm damage for future recovery. While such deferrals do not guarantee that recovery will be authorized in a subsequent rate case, in the past, the KCC has permitted Westar to recover such costs, even if the Company was over-earning during the deferral period. Finally, Westar has a property tax surcharge that allows it to recover incremental property taxes between base rate case filings. While this surcharge is not new, it is another example of the risk mitigation opportunities available to Westar. Given all of these risk mitigation tools, it is reasonable to ask how much of a risk premium shareholders truly deserve, since the Company has successfully shifted most of Westar's risk to ratepayers. The KCC should be mindful of this reduced shareholder risk when it evaluates the Company's cost of equity claim in this case.

Q. How did you develop your recommended cost of equity?

A. The KCC has traditionally relied upon the Discounted Cash Flow Model ("DCF") as the primary mechanism to determine cost of equity for a regulated utility. Therefore, in determining an appropriate return on equity for Westar, I have relied primarily upon the DCF model. The DCF method is based on the following formula:

$$\text{Return on Equity} = \frac{D_1}{P_0} + g$$

where "D_1" is the expected dividend, "P_0" is the current stock price, and "g" is the expected growth in dividends.

The DCF methodology is generally applied to a comparable group of investments, usually to a group of companies that provide the same utility service as the utility service for which rates are being set. In order to determine the cost of equity for Westar, I used the same comparable group as that selected by the Company for its analysis.

To determine an appropriate dividend yield for comparable companies -- i.e., the expected dividend divided by the current price -- I calculated the dividend yield of each of the comparable companies based on the average stock price of each company over a recent fifteen-day period. This is the same methodology used by Westar's witness, Mark Ruelle. The use of a dividend yield using a multi-day average price mitigates the effect of stock price volatility for any given day. Based on the average stock prices over a recent fifteen-day period, I determined an average dividend yield for the comparable group of 4.35%, as shown in Schedules ACC-5N and ACC-5S. I increased my recommended dividend yield by one-half of my recommended growth rate, as determined below, to reflect the fact that the DCF model is prospective and dividend yields may grow over the next year. Increasing the dividend yield by one-half of the prospective growth rate is commonly referred to as the "half year convention."

Q. How did you determine an appropriate growth rate?

A. The actual growth rate used in the DCF analysis is the dividend growth rate. In spite of the fact that the model is based on dividend growth, it is not uncommon for analysts to examine several growth factors, including growth in earnings, dividends, and book value.

Various growth rates for the companies within my comparable group are shown in Schedules ACC-6N and ACC-6S and group averages are summarized below:

Past 5 Years - Earnings	1.13%
Past 5 Years - Dividends	(1.63%)
Past 5 Years - Book Value	3.19%
Past 10 Years - Earnings	2.13%
Past 10 Years - Dividends	(1.94%)
Past 10 Years - Book Value	1.94%
Estimated Next 5 Years - Earnings	6.06%
Estimated Next 5 Years - Dividends	4.50%
Estimated Next 5 Years - Book Value	4.56%

Q. Why do you believe that it is reasonable to examine historic growth rates, as well as projected growth rates, when evaluating a utility's cost of equity?

A. I believe that the KCC should consider historic growth rates because security analysts are notoriously optimistic in forecasting future growth in earnings. At least part of this problem in the past has been the fact that firms that traditionally sell securities are the same firms that provide investors with research on these securities, including forecasts of earnings growth. This results in a conflict of interest, since it has been in the best interest of securities firms to provide optimistic earnings forecasts in the hope of selling more stock. Therefore, state regulatory commissions should cautiously analyze projected earnings growth forecasts proposed by utilities.

Q. Based upon your review, what growth rate do you recommend the KCC utilize in the DCF calculation?

A. Based on my review of this data, I believe that the KCC should utilize a growth rate of no greater than 5.5%. This recommended growth rate is above the projected five-year growth rates in dividends and book value, per Value Line. Moreover, my recommended growth rate is higher than the actual historic average growth rates over the past five or ten years in earnings, dividends or book value. While my recommended growth rate is slightly below the five-year projected earnings growth rate, regulators should view projected growth rates cautiously because of the tendency of rating firms to be overly optimistic.

Q. What cost of equity is produced by the DCF methodology?

A. My analysis indicates a cost of equity using the DCF methodology of 9.97%, as shown below and as also shown on Schedules ACC-4N and ACC-4S:

Dividend Yield	4.35%
Growth in Dividend Yield (1/2 X 5.50% X 4.35%)	0.12%
Expected Growth	5.50%
Total	9.97%

Q. Did you also calculate a cost of equity based on the CAPM methodology?

A. Yes, I did.

Q. Please provide a brief description of the CAPM methodology.

A. The CAPM methodology is based on the following formula:

Cost of Equity = Risk Free Rate + Beta (Risk Premium)

or

$$\text{Cost of Equity} = R_f + B(R_m - R_f)$$

The CAPM methodology assumes that the cost of equity is equal to a risk-free rate, plus some market-adjusted risk premium. The risk premium is adjusted by Beta, which is a measure of the extent to which an investor can diversify his market risk. The ability to diversify market risk is a measure of the extent to which a particular stock's price changes relative to changes in the overall stock market. Thus, a Beta of 1.00 means that changes in the price of a particular stock can be fully explained by changes in the overall market. A stock with a Beta of 0.60 will exhibit price changes that are only 60% as great as the price changes experienced by the overall market. Traditionally, utility stocks have been less volatile than the overall market, i.e., their stock prices do not fluctuate as significantly as the market as a whole, and therefore their Betas generally have been less than 1.0.

Q. How did you calculate the cost of equity using the CAPM?

A. My CAPM analysis is shown in Schedules ACC-7N and ACC-7S. First, I used a risk-free rate of 4.46% for the yield on long-term U.S. Government bonds, which was the rate at August 21, 2008, per the Statistical Release by the Federal Reserve Board. Over the past year, this rate has ranged from 4.26% to 4.98%. In addition, I used the average Beta for the proxy group. This resulted in an average Beta of 0.81, as shown in Schedules ACC-8N and ACC-8S. Finally, since I am using a long-term U.S. Government bond rate as the risk-free rate, the appropriate risk premium to use is the historic risk premium of stocks over the rates for long-term government bonds. According to the *Ibbotson SBBI: 2008 Valuation Yearbook, Market Results for Stocks, Bonds, Bills, and Inflation*, the risk premium using geometric mean returns is 4.9%.

Q. What is the difference between a geometric and an arithmetic mean return?

A. An arithmetic mean is a simple average of each year's percentage return. A geometric mean takes compounding into effect. As a result, the arithmetic mean overstates the historic return to investors. For example, suppose an investor starts with $100. In year 1, he makes 100% or $100. He now has $200. In year 2, he loses 50%, or $100. He is now back to $100.

The arithmetic mean of these transactions is 100% - 50% or 50%/ 2 = 25% per year. The geometric mean of these transactions is 0%. In this simple example, it is clear that the geometric mean more appropriately reflects the real return to the investor, who started with $100 and who still has $100 two years later. The arithmetic mean suggests that the investor should have $156.25 after two years ($100 X 1.25 X 1.25), when in fact the investor actually has considerably less. Therefore, a geometric mean return is a more appropriate measure of the real return to an investor, if it is used as I am using it here, i.e., to develop an historic relationship between long-term risk free rates and market risk premiums. Some utilities have criticized me in the past for using a geometric, rather than an arithmetic mean return, arguing that the arithmetic mean should be used when estimating future returns. However, in my case, I am not using the mean to develop an expected outcome, I am simply using the mean return to develop an historic relationship between long-term U.S. Government bond returns and equity returns. Therefore, the geometric mean is the appropriate measure, as illustrated in the above example.

Q. What is the Company's cost of equity using a CAPM approach?

A. Given a long-term risk-free rate of 4.46%, a Beta of 0.81, and a risk premium of 4.9%, the

CAPM methodology produces a cost of equity of 8.43%, as shown on Schedules ACC-7N and ACC-7S.

Risk Free Rate + Beta (Risk Premium) = Cost of Equity

4.46% + (0.81 X 4.9%) = 8.43%

Q. Based on your analysis of the DCF and CAPM results, what cost of equity are you recommending in this case?

A. The DCF methodology and the CAPM methodology suggest that a return on equity of 8.43% to 9.97% would be appropriate. Since I recognize that the Commission has generally relied primarily upon the DCF, I have weighted my results with a 75% weighting for the DCF methodology and a 25% weighting for the CAPM methodology. This results in a cost of equity of 9.59%, as shown below:

DCF Result	9.97% X 75% =	7.48%
CAPM	8.43% X 25% =	2.11%
Total		9.59%

Q. Why is your recommendation lower than the cost of equity recommended by Mr. Ruelle?

A. My recommendation is lower than Mr. Ruelle's primarily because he used unrealistic growth projections in his DCF analysis. Mr. Ruelle ignored historic growth rates and instead relied solely upon optimistic forecasts. Moreover, Mr. Ruelle did not examine the CAPM methodology.

Q. Do you agree with Mr. Ruelle that Westar's cost of equity is higher than it was when the KCC approved a 10.0% return on equity in Westar's last base rate case?

A. No, I do not. As previously discussed, Westar has mitigated much of its risk since it filed its last base rate case. Moreover, both short-term and long-term interest rates have fallen since the last KCC decision in a Westar case, although the decreases have been much more significant in short-term rates than in long-term rates. There also has been a slight reduction in returns on equity that regulatory commissions have awarded since December 2005. All of these factors, particularly the shifting of risk from shareholders to ratepayers, indicate that the KCC should reduce the Company's common equity return from the 10.0% approved in the last case.

Q. What is the overall cost of capital that you are recommending for Westar?

A. As shown on Schedules ACC-2N and ACC-2S, I am recommending an overall cost of capital for Westar of 8.08%.

	Percentage	Cost	Weighted Cost
Common Equity	50.13%	9.59%	4.81%
Long-Term Debt	47.99%	6.55%	3.14%
Preferred Stock	0.50%	4.55%	0.02%
Post 1970 ITCs	1.38%	8.08%	0.11%
Total	100.00%		8.08%

Q. Please address the Company's request for a 1% return on investment premium to be applied to its Company-owned wind generation.

A. This issue was the subject of extensive testimony in Docket No. 08-WSEE-309-PRE. In that docket, the KCC rejected the Company's request for a premium return and there is no new evidence that suggests that its recent decision in that case should be revisited. In rejecting the Company's request for a premium return, the KCC found that:

> The Commission concludes the circumstances in this docket justify relieving ratepayers of the cost of an additional return in light of the close analysis involved in determining prudence and weighing Westar's PPA and ownership proposal. Moreover, despite Staff's not unwarranted concerns, the Commission has declined to implement an incentive mechanism at this time. In light of the uncertainties inherent in wind generation and the narrow margins as to whether PPAs or ownership is more costly, even assuming O&M costs and capacity factors as forecasted, the Commission believes the balance between shareholder and consumer interests is adequately addressed without the inclusion of the 1% incentive.[4]

Q. Why did CURB oppose the Company's request for a premium return on wind generation in the pre-approval docket?

A. As noted in my Direct Testimony in that case, K.S.A. 66-117(e) permits the KCC to apply a return on investment premium, but it does not require that utilities be awarded a return premium. Thus, the KCC has discretion to decide whether or not a premium return is warranted.

I had several concerns about the Company's request in that docket. My principal objection to the Company's request for a premium return was that the Company's shareholders were not taking on any additional risk as a result of the wind investment. In fact, shareholder risk was reduced, since the Company was granted pre-approval to include up to $282 million in rate base. In addition, the KCC authorized Westar to include in rate base all CWIP related to the wind facilities through a date that was at least 120 days before the deadline for the KCC's Order in this case. Thus, there was no indication that shareholders would incur any additional risk as a result of its wind investment.

Moreover, the KCC declined to impose any incentive mechanism that would have penalized Westar for higher-than-projected operating costs or lower-than-projected capacity factors, in spite of the fact that Westar used those projections to argue that it should own a substantial amount of wind generation, rather than acquiring its wind generation entirely through PPAs. Thus, at the present time, Westar is not at risk for its projections that may turn out to be overly optimistic. Instead, ratepayers are at risk if the Company's operating costs are higher than expected or if its capacity factors fall below expectations. The KCC should not require ratepayers to pay a premium return to shareholders, especially since it is

4 Order in Docket No. 08-WSEE-309-PRE, paragraph 112.

ratepayers that are exposed to the risks of ownership, such as potential cost increases, performance problems, and rapidly-evolving technology.

Another concern I expressed in my earlier testimony was the fact that awarding a return on investment premium would provide a significant incentive for utilities to own wind generation rather than to enter into PPAs that may be more economical. A return premium creates a bias toward ownership by the utility, ownership that may not be in the best interests of ratepayers. Moreover, as noted by the KCC in its Order, shareholder returns will grow with ownership of wind investment, even if no return premium is awarded.

Q. Does wind generation have societal benefits that should be considered?

A. Yes, there are societal benefits that make wind generation attractive. Because of these benefits, it is reasonable to include some wind generation in the portfolio mix. However, we should not lose sight of the fact that wind generation is more expensive than other sources of electric power, and that it is ratepayers, not shareholders, who are ultimately responsible for the higher costs. Thus, ratepayers will already be paying a premium for wind generation over conventional generation alternatives. While I am not opposed to ratepayers paying somewhat higher rates in order to promote renewable energy, there is no reason to place an even greater burden on ratepayers by awarding shareholders a premium return, especially when one considers the significant rate increases that ratepayers are likely to experience over the next few years. The requested return on investment premium would add approximately $46.8 million to ratepayers' bills over the next 20 years. Moreover, shareholders would receive this premium without incurring any additional risk. Accordingly, I recommended in the pre-approval case that the KCC deny the Company's request for a return on investment premium associated with Company-owned wind generation facilities.

Q. Didn't the KCC state in its Order in Docket No. 08-WSEE-309-PRE that the Company could renew its request for a premium return on its wind investment?

A. In its Order, the Commission stated that Westar "is free to make this request again in the event Westar's performance or other circumstances support an argument that the Commission should consider changing its view on this issue."[5] However, Westar's renewed request is extremely premature. Since the wind generation is not yet in service, there is no "performance" for the parties to evaluate. Moreover, there are no changed circumstances that would justify a change in the KCC's decision to reject the Company's request for a premium return. Therefore, I am once again recommending that the KCC deny the Company's request for a premium return on its wind investment.

Q. Please comment on Westar's statement that it will not undertake additional wind generation projects if a return on investment premium is not awarded by the KCC.

A. Westar's attempt to bully the KCC should be firmly rejected. With this threat, the Company clearly demonstrates that it is not interested in the public good, but only in the public's

5 Id.

pocketbook. Ratepayers are doing their fair share for the environment by paying for higher-cost wind generation. To further enhance shareholders by granting them a premium return when they are not incurring any additional risk is unconscionable. The Company's statement that it will not obtain additional wind generation without the guarantee of a premium return is childlike and self-serving. The lack of a return on investment premium would not cause Westar to abandon proposals to construct additional wind generation unless the sole reason for those proposals is Westar's desire to earn excess returns. Additional wind investment will be no more risky than other investments that Westar has made in the past or will make in the future. In fact, such investment is likely to be less risky, because Westar has the ability to seek preapproval of wind projects, as well as the associated ratemaking treatment, from the KCC. Moreover, based on current legislation and KCC precedent, it appears that, in future rate cases, Westar will be permitted to include in rate base projects that are not completed by the end of the test year, as well as post-test year CWIP related to such projects. Therefore, Westar will likely incur significantly lower risk with these projects than with many of the projects it has undertaken in the past, lending further support for my recommendation that the KCC deny the Company's request for a return on investment premium.

Q. If the KCC were to grant Westar's request, should it then also adopt the incentive mechanism proposed by Staff in Docket No. 08-WSEE-309-PRE?

A. Yes, it should. If, in spite of my recommendation, the KCC adopts a premium return for Westar's wind investment, then it should also adopt an incentive mechanism that holds

Westar responsible for the operating expense estimates and capacity projections used by the Company to justify the prudence of its ownership of wind generation. In its Order in Docket No. 08-WSEE-309-PRE, the KCC stated that "the lower revenue requirement due to the Commission's decision not to grant a 1% ROR adder at this time results in a cushion against greater than anticipated O&M costs and lower than anticipated performance (capacity factors)."[6] Thus, if a premium return is granted, ratepayers should at least have some protection against cost overruns and poor performance by the wind generation facility. However, my primary recommendation continues to be that the KCC reject the Company's renewed claim for a return on investment premium, given that shareholders are not shouldering any additional risk.

VI. RATE BASE ISSUES

Q. What test year did the Company utilize to develop its rate base claim in this proceeding?

A. The Company selected the test year ending December 31, 2007. In addition, the Company's claim includes several post-test year adjustments through August 31, 2008.

6 Id., paragraph 87.

A. Utility Plant-in-Service

Q. How did the Company develop its utility plant-in-service claim in this case?

A. Westar began with its utility plant-in-service balance at December 31, 2007. It then made several pro forma adjustments: to include CWIP in its plant-in-service claim; to include in rate base certain post-test year additions such as the wind investment, the EEC, and the Spring Creek generation facility; and to eliminate certain investments such as costs that it proposes to recover through the ECRR and a small portion of its headquarters facility that is not providing service to regulated ratepayers.

Q. Are you recommending any adjustment to the Company's claim for utility plant-in-service?

A. Yes, I am recommending two adjustments, relating to ECRR-related investments and to CWIP.

Q. Please discuss your first adjustment.

A. As described by the Company on pages 9-12 of Mr. Rohlfs' Testimony, the KCC previously approved an ECRR for Westar. This rider was intended to permit the Company, between base rate cases, to recover a return on certain investments in environmental projects, along with the associated depreciation expense. It is my understanding that the Company files an ECRR rate schedule with the KCC on March 31st of each year, requesting an ECRR surcharge related to environmental projects. Staff files its Report and Recommendations by

May 1st, other parties file their comments by May 15th, and the KCC issues its Order by May 29th of each year. In its base rate filing in this case, Westar has eliminated all environmental projects associated with the ECRR from its rate base claim. Therefore, it has reduced its utility plant-in-service, CWIP, and accumulated depreciation to reflect the transfer of these projects from base rates to the ECRR. It also eliminated depreciation expense related to the associated projects. My understanding is that the ECRR does not include operating expenses associated with environmental projects, and therefore no operating and maintenance expense adjustments were necessary.

The amounts removed by Westar correspond to the amounts requested in its most recent ECRR filing. That filing was approved, with minor modifications, on May 29, 2008, in Docket No. 08-WSEE-849-TAR. At that time, the KCC authorized WEN to collect an annual surcharge amount of $16,866,711, and WES to collect an annual surcharge amount of $10,332,018. In that filing, Westar also requested that the KCC approve continued recovery of these costs through the ECRR, rather than requiring such costs to be included in its rate base as part of its next base rate case. Since the ECRR is intended to provide recovery of these costs between base rate cases, the current ECRR tariff requires all such costs to be included in base rates each time a new rate case is filed. In Docket No. 08-WSEE-849-TAR, Westar asked for the elimination of this requirement and for authorization to continue recovery of these environmental costs through a surcharge mechanism.

Q. Was the Company's request to continue to recover these costs through a surcharge mechanism approved?

A. No, it was not. The Company's proposal was opposed by CURB and was denied by the KCC. As noted by CURB in its comments in that docket,

> The overwhelming weight of the evidence in the 981 Docket indicates that everyone understood that all of the expenditures placed into the ECRR after the company's most recent rate case would be removed from the ECRR and placed into base rates in the next rate case. Thus, the company would have the benefit of receiving revenues through the ECRR for the cost of the projects between rate cases, but would bear the normal risk of recovery of its approved revenue requirement after each subsequent rate case. This arrangement provides at least two protections for the ratepayers: (1) rate case review is more thorough than the summary review of requests for tariff and surcharge changes, and provides other parties the opportunity for meaningful review of the expenditures, as well; and (2) it properly places the risk on the company for revenue recovery over the long term.[7]

The KCC concurred, finding that these costs should be included in base rates in the next rate case. In its Order, the KCC left open the possibility that this issue could be reexamined in the current base rate case.

Q. Are you recommending that the environmental costs previously recovered through a surcharge be included in base rates?

A. Yes, I am. Since the purpose of the ECRR is to provide for recovery of certain environmental project costs between base rate case filings, there is no need to continue the surcharge once new base rates are established by the KCC. Accordingly, I recommend that the environmental costs eliminated from the Company's claim be added back for recovery

7 CURB Comments in Docket No. 08-WSEE-849-TAR, May 9, 2008, page 4.

through base rates. At Schedules ACC-10N and 10S, I have made adjustments to increase the Company's utility plant-in-service claims to include both the environmental utility plant-in-service and the CWIP associated with the environmental projects that are currently being recovered through the ECRR. On these same schedules, I have also reflected adjustments to increase the Company's reserve for depreciation to include the accumulated depreciation associated with these projects.

Q. Why is it more appropriate to recover these costs through base rates?

A. It is appropriate to recover these costs through base rates because that is the ratemaking mechanism used for a utility's capital investments. Because of the large investment in environmental projects that is required over a relatively short period of time, the legislature gave utilities the opportunity to recover the return associated with these environmental investments, as well as the associated depreciation expense, between base rate cases. But the ECRR was intended to supplement, not replace, the traditional ratemaking process. Providing for guaranteed recovery of these capital costs over their lives would effectively remove all shareholder risk. The ECRR is intended to assist the Company in meeting certain financial requirements during a period of heavy construction, but it should not result in the total elimination of all shareholder risk, or the transfer of that risk to ratepayers. For these reasons, the KCC should reject the Company's proposal to recover these costs indefinitely through the ECRR. Instead, the KCC should roll these costs into base rates when the Company has a periodic rate case. As noted by CURB in its comments in the recent ECRR proceeding, "[r]emoving environmental costs from base rates and placing them into the ECRR is contrary to the principle that the utility should be afforded the opportunity, not a guarantee, to recover its investment."[8]

B. <u>Construction Work In Progress</u>

Q. What is CWIP?

A. CWIP is plant that is being constructed but which has not yet been completed and placed into service. Once the plant is completed and serving customers, then the plant is booked to utility plant-in-service and the utility begins to take depreciation expense on the plant.

Q. In addition to the CWIP associated with the environmental projects discussed above, does the Company's rate base claim include any other CWIP?

A. Yes, it does. The Company's rate base claim includes various components of CWIP. This includes CWIP associated with the wind generation projects and CWIP associated with the EEC, as well as CWIP associated with projects that are currently being recovered through the ECRR, as discussed above. In addition, WEN has included $272.7 million of other CWIP in its utility plant-in-service claim. In WES, the Company has included $150.5 million of other CWIP in plant-in-service.

8 Id., page 6.

Q. Is the Company's claim limited to CWIP that was booked at December 31, 2007?

A. No, it is not. Not only does the Company's claim include all CWIP booked at December 31, 2007, but it also includes post-test year CWIP for the wind generation and EEC facilities. The KCC granted this extraordinary ratemaking treatment to Westar in the pre-approval dockets filed by the Company. In those cases, the KCC gave Westar pre-approval to include in rate base CWIP "through the date that is at least 120 days before the deadline for the Commission's order". Thus, Westar has included projected CWIP associated with the wind generation projects and the EEC through August 31, 2008.

Q. Do you believe that CWIP is an appropriate rate base element?

A. I do not believe that CWIP is an appropriate rate base element. CWIP does not represent facilities that are used or useful in the provision of utility service. In addition, including this plant in rate base violates the regulatory principle of intergenerational equity by requiring current ratepayers to pay a return on plant that is not providing them with utility service and which may never provide current ratepayers with utility service. However, the inclusion of CWIP in rate base is now governed by statute.[9]

K.S.A. 66-128, provides for the KCC to determine the value of the property included in rate base. The statute generally requires that "property of any public utility which has not been completed and dedicated to commercial service shall not be deemed to be used and required to be used in the public utility's service to the public."

[9] I am not an attorney and my discussion of the CWIP statute is not intended as a legal interpretation of that statute,

However, the statute also provides that certain property "may be deemed to be completed and dedicated to commercial service" under certain circumstances. Specifically, K.S.A. 66-128 (b) (2) provides that,

> Any public utility property described in subsection (b)(1) shall be deemed to be completed and dedicated to commercial service if: (A) construction of the property will be commenced and completed in one year or less; (B) the property is an electric generation facility that converts wind, solar, biomass, landfill gas or any other renewable source of energy: (C) the property is an electric generation facility or addition to an electric generation facility, which facility or addition to a facility is placed in service on or after January 1, 2001; or (D) the property is an electric transmission line, including all towers, poles and other necessary appurtenances to such lines, which will be connected to an electric generation facility.

Q. Do the post-test year projects included by Westar in its rate base claim meet the criteria outlined in the statute?

A. While I am not an attorney, I believe that the CWIP associated with the wind generation and the EEC fall into the categories of CWIP that the statute requires the KCC include in rate base. In addition, I understand that the KCC has already approved recovery of the CWIP associated with environmental projects through its approval of the ECRR rate. Since I am recommending that these environmental projects now be recovered through base rates, it is necessary to include the associated CWIP in rate base at this time.

With regard to other CWIP projects, it is unclear from the Company's filing whether these projects meet the requirements of the statute that public utility property "will be deemed to be completed and dedicated to commercial service" if certain conditions are met, one of which is that "[c]onstruction of the property will be commenced and completed in one

but rather provides my understanding of the statute from a ratemaking perspective.

year or less."[10]

Q. Did the Company provide any information with its filing explaining why it believes that it should be permitted to include all CWIP in rate base?

A. No. While Westar stated that "[t]he projects covered by this adjustment will be placed in service to benefit customers within 12 months," the Company did not provide any supporting documentation in its workpapers to demonstrate that each of these projects meets the criteria outlined in the statute. The Company appears to believe that any CWIP project that was included in CWIP at the end of the test year should be included in its rate base. This is in direct conflict with the statute, which principally states that "property of any public utility which has not been completed and dedicated to commercial service shall not be deemed to be used and required to be used in the public utility's service to the public."

Westar did not provide an estimated in-service date for all projects included in its CWIP claim. Nor did Westar provide a starting date for each of these projects. Moreover, the inclusion of projects that are not yet complete is speculative. These projects do not represent known and measurable changes to test year results. We have no way of knowing if, in fact, these projects will go into service within the one-year time frame established in the legislation or if they will ever go into utility service. The CWIP legislation requires projects to commence and be completed within one year. Westar has clearly not demonstrated that its CWIP claim meets the one-year requirement contained in the statute.

10 K.S.A. 66-128 (b) (2) (A).

Q. Are there other provisions of the statute that permit CWIP to be included in rate base even if the one-year requirement is not met?

A. Yes, there are. The statute identifies several circumstances under which CWIP may be included in rate base. However, Westar has not referenced these provisions in support of its CWIP claim. Nor has the Company made any attempt to demonstrate that the projects included in CWIP meet the requirements of these additional provisions.

Q. Do you have any other comments regarding Westar's CWIP claim?

A. Yes, I do. Since K.S.A. 66-128 was enacted, it has been my experience that Kansas utilities have pushed the envelope of reasonableness with regard to CWIP claims. Companies seem to believe that all CWIP claims must automatically be approved by the KCC. The qualifying provisions of the CWIP statute are routinely ignored by Kansas utilities, who make no effort to demonstrate that their CWIP claims meet the provisions of the statute.

Q. What do you recommend?

A. Since the KCC has already determined that Westar should be permitted to include CWIP through August 31, 2008, related to its wind investment and the EEC in rate base, I am not recommending any adjustment to the CWIP amounts included in utility plant-in-service for these projects. However, I do recommend that Westar should be required, as part of its rebuttal case, to provide the actual CWIP at August 31, 2008, associated with these projects.

With regard to other projects, I recommend that the KCC limit the Company's CWIP claim to CWIP at December 31, 2007 that has now been completed and placed into service, unless the Company demonstrates that a specific project meets the other provisions of the statute. My adjustments are shown in Schedules ACC-11N and ACC-11S.

Q. How did you quantify your adjustments?

A. In the responses to CURB-118 for WEN and CURB-253 for WES, the Company provided the amount of its CWIP claim that had been booked to plant-in-service by June 30, 2008, which was the latest available information at the time it responded to my request. On Schedules ACC-11N and ACC-11S, I have made adjustments to eliminate from rate base those projects that were not completed and serving customers by June 30, 2008.

C. <u>Ratepayer Funded Reserves</u>

Q. What are ratepayer funded reserves?

A. Ratepayer funded reserves are reserve accounts funded by the Company's ratepayers. Such reserves include the injuries and damages reserve, environmental reserve, property insurance reserve, and uncollectible reserve.

Q. How should the KCC treat these ratepayer-funded reserves for ratemaking purposes?

A. If the KCC is going to permit the Company to include assorted regulatory assets in rate base, such as deferred storm damage costs, then it should similarly require Westar to reduce rate base by the balances in these reserve accounts. These accounts were funded by ratepayers before the costs were incurred by Westar. Accordingly, at Schedules ACC-12N and ACC-14S, I have made an adjustment to reduce the Company's rate base claim by the balance of these reserve accounts.

Q. How did you quantify your adjustment?

A. In determining my adjustment, I have included only those reserve account balances at December 31, 2007, the end of the test year in this case. Although the Company is requesting significant increases in some of these reserve accounts, I believe that the test year concept is best maintained by limiting these rate base reductions to balances at December 31, 2007. Accordingly, I have reduced rate base by the balances at the end of the test year.

D. <u>Cost-Free Capital</u>

Q. Have you made any adjustment to the Company's claim for cost-free capital?

A. Yes. In response to KCC-202, Westar indicated that it should have included a rate base reduction to reflect cost-free capital associated with funding of its Statement of Financial Accounting Standards ("SFAS") 106 and 87 costs at the Wolf Creek Nuclear Operating Company ("WCNOC"). This adjustment is similar to the adjustment discussed above with regard to ratepayer-funded reserves, in that customers are supplying funds in advance for the

SFAS 106 medical and SFAS 87 non-qualified pension liabilities. Therefore, ratepayers receive a rate base reduction in recognition of the fact that ratepayers, and not shareholders, have funded these accounts. My adjustment is shown in Schedule 12S. My adjustment includes the impacts on cost-free capital as well as on accumulated deferred income taxes.

E. Sale and Leaseback of La Cygne Generating Station

Q. Please provide a brief history of the LaCygne Generating Station sale and leaseback arrangement.

A. As noted in my testimony in the last case, in 1987, the Company obtained approval from the KCC to sell its 50% undivided interest in LaCygne Unit 2, and to lease back the facility. This was a complex transaction. In requesting KCC approval, the Company represented that there were benefits to both shareholders and to ratepayers. In its order approving the transaction, the KCC stated that,

> Of equal importance to the Commission is the benefit to the customer. KGE contends the benefits of the transaction will be reflected in its cost of service. KGE proposes to amortize the book gain on the sale of LaCygne 2 to its Kansas jurisdictional cost of service over the life of the lease transaction. KGE also proposes to reduce its rate base by the book value of LaCygne 2, reflect the unamortized gain as a reduction in rate base for future rate cases and include the benefits of the use of the proceeds from the sale in its cost of service.[11]

Q. Did the Company reflect the unamortized gain as a reduction to rate base in its last case?

A. No, it did not. In its filing in that case, Westar failed to reduce rate base by the unamortized balances relating to the LaCygne transaction. Instead, it argued that "the Commission was mistaken" in adopting such an adjustment.[12] The Company contended that the unamortized gain should not be used to reduce rate base, since the cash from the gain was used to buy back debt and equity, effectively reducing the utility's cost of service.

Q. Did you agree with the Company's position?

A. No, I did not, for several reasons. First, and most importantly, the LaCygne sale and leaseback transaction was a complicated transaction that was extensively reviewed by the KCC in the proceeding in which approval of the transaction was requested. In that proceeding, and as a condition of approval, the KCC stated that the unamortized balance should be reflected as a rate base deduction during the life of the lease. Moreover, in making this determination, the KCC recognized that benefits resulting from the use of the proceeds should be included in the Company's cost of service. Thus, Westar's argument that the KCC should not reduce rate base by the amount of the unamortized gain because the proceeds were used to benefit ratepayers is without merit. The KCC should therefore have rejected any attempt by the Company to revise the ratemaking treatment upon which approval of the transaction was based. In the last case, the Company effectively attempted to change the

11 Docket No. 156,521-U, September 17, 1987 Order, page 11.

rules of the transaction and limit its potential benefit to ratepayers. However, those rules were established based on a comprehensive review and analysis conducted by the KCC at the time of approval of the transaction. In fact, the transaction might not have been approved without the Company's representation that it would reduce rate base by the unamortized gain and that the ratepayers would also benefit from the use of the proceeds. It is unfair to ratepayers for the Company to revise its position regarding the ratemaking treatment of the transaction many years after approval for that transaction has been obtained.

Moreover, in arguing for a different ratemaking treatment in its last case, the Company did not dispute the requirements of the KCC's original Order. It simply stated that the KCC was "mistaken" in its finding, a finding that appears to have been based on the Company's own representations to the parties.

Finally, the Company's argument in the last case that the rate base reduction should not be made because the funds were used in other ways that benefited ratepayers was without merit. Utilities are not regulated on a "cash" basis. Therefore, how the Company used the cash associated with this transaction should not be an issue. The issue is how the transaction was recorded for ratemaking purposes. As noted, the KCC recognized that, in addition to the rate base reduction, ratepayers should also benefit from the use of the proceeds.

As noted in my testimony in the last case, the Company had raised this issue in several previous rate cases. In the 1997 rate proceedings involving KPL and KGE, the Company argued against the adjustment that had been mandated by the original KCC Order.

12 Docket No. 05-WSEE-981-RTS, Testimony of Mr. Haines, page 22, lines 5-6.

That case was resolved by stipulation. In Docket No. 01-WSRE-436, RTS, the Company again raised this issue, without success. In that case, the Commission found that "[t]he provisions of the 1987 Order are clear and reasonable, and will be followed by the Commission."[13]

Q. What did you recommend in Docket No. 05-WSEE-981-RTS?

A. As noted in my testimony in that case, the sale and leaseback of LaCygne was a complicated transaction that was thoroughly reviewed by Staff and the Commission when approval for the transaction was sought. Based on representations made during that review process, the Commission approved the transaction with certain conditions, one of which was that the unamortized gain should be reflected as a rate base reduction. Accordingly, I recommended that the KCC uphold the prior findings of the Commission that were based on Westar's representations regarding the treatment of the unamortized gain.

Q. Did the KCC reverse itself in Westar's last base rate case and overturn years of KCC precedent by eliminating the rate base adjustment associated with the LaCygne sale and leaseback?

A. Yes, it did. Moreover, the KCC's decision was appealed to the Kansas courts. I understand that the courts upheld the decision of the KCC to reverse the earlier decision by the Commission. However, it is my understanding that the ruling was based on the particular

13 Docket No. 01-WSRE-436-RTS, Order, July 25, 2001, paragraph 76.

arguments raised in that case and would not preclude the KCC from revisiting its decision in a future case.

Q. What is the financial impact in this case of the KCC's decision to reverse the originally-approved ratemaking treatment associated with the sale and leaseback of LaCygne?

A. Based on the test year ending December 31, 2007, the reversal of the KCC's original ratemaking treatment will increase rate base by $55.2 million and increase the Company's revenue requirement by approximately $7.4 million.

Q. What are you recommending in this case?

A. In this case, I am recommending that the KCC once again reexamine this transaction, especially in light of the past history of this adjustment. This adjustment was an integral part of the approval of the LaCygne sale and leaseback transaction, and the ratemaking treatment for that transaction was determined in the resulting order. Moreover, this Order determined how the resulting gain should be booked over the life of the lease. To now reverse that determination calls into question whether parties can reasonably rely upon a KCC Order that has long-term ratemaking implications. Accordingly, at Schedule ACC-13S, I have made an adjustment to reduce rate base by the net unamortized gain associated with the LaCygne sale/leaseback transaction.

Q. Why are you recommending that the KCC reexamine this transaction in light of the fact that the KCC's decision was upheld on appeal?

A. It is my understanding that the court found that the KCC was within its legal right to change its decision when it reversed the earlier Commission decision regarding the ratemaking treatment for this transaction. However, it is also my understanding that the facts underlying the KCC decision were not reviewed by the court. Therefore, I believe that the KCC is free to again reverse its decision and to abide by the original KCC Order determining how this transaction should be handled for ratemaking purposes over the life of the lease.

It should be noted that my recommendation does not address the legality of the KCC reversal in the last case. I accept the court's decision that the KCC reversal in the last base rate case was legal. Rather, my recommendation addresses whether that reversal was ethical and rationale from a ratemaking, rather than a legal, perspective. My adjustment does not address whether the KCC could have reversed itself, but rather whether it should have. I believe that the only reasonable answer is no.

Q. If the KCC maintains its reversal of the decision in the last case to eliminate the rate base adjustment relating to the LaCygne lease and buyback, should the KCC also reexamine other prior ratemaking decisions regarding Westar?

A Yes, if the KCC decides that it is reasonable to go back to a 1987 transaction and reverse an earlier decision about the ratemaking treatment for LaCygne, then it should also reexamine other decisions that have long-term impacts for Westar. The most obvious would be to reexamine its decision regarding merger savings in the KPL/KGE merger case.

Q. How have these alleged merger savings been handled for ratemaking purposes?

A. When KPL acquired KGE, KPL paid an acquisition premium, i.e., an amount over and above net book value for the assets acquired. KPL argued that it should be permitted to recover this acquisition premium from ratepayers, claiming that the merger would result in economies of scale that would provide merger savings for customers. In 1991, the KCC allowed the Company to begin to amortize approximately $13 million of the acquisition premium. Savings above that amount were to be determined in the next base rate case and shared 50-50 between ratepayers and shareholders.

In the next base rate case, the annual merger savings were found to be $40 million, or approximately $27 million above the $13 million amortization of the acquisition premium previously approved by the KCC. Half of this amount, or $13.5 million, was to be treated as an operating expense, for a total revenue requirement recovery related to the acquisition premium of $26.5 million.

Q. Have there been significant operational changes at Westar that would impact the merger savings anticipated by the KCC?

A. Yes. The KCC's determination of merger savings was based on the organizational structure of Westar that existed at the time the KCC approved the merger. For example, when the KCC authorized recovery of a portion of the acquisition premium, it anticipated that Westar would retain its gas operations. Since that approval was granted, Westar has sold those operations, and has also sold a portion of its electric utility service area. Additionally, Westar has terminated a shared services agreement with ONEOK, the company that purchased Westar's gas operations, further undermining synergies. Therefore, certain economies of scale that were assumed would result from the merger simply are not being realized. Accordingly, if the KCC concludes that it can reverse earlier decisions with long-term ratemaking consequences, then it should also consider eliminating recovery of any acquisition premium related to the KPL/KGE merger.

As I have argued in other cases, the attempt to tie recovery of an acquisition premium to merger savings implies that there is a degree of measurement precision in tracking savings that is impossible to achieve. Given changes that occur from year to year, it is virtually impossible to accurately measure merger savings over a long period of time, such as the 40-year time horizon used by the KCC for the KPL/KGE merger. This is especially true given organizational changes that have taken place over time with regard to Westar's operations. Therefore, if the KCC finds that it can change the ratemaking treatment that was originally approved for the LaCygne sale and leaseback transaction, it should make a similar finding that the merger premiums included in Westar's cost of service are no longer tied to projected merger savings and therefore should be disallowed.

F. <u>Summary of Rate Base Adjustments</u>

Q What is the net impact of the rate base adjustments recommended by CURB?

A. My rate base adjustments will result in a pro forma rate base of $1,729,009,393 for WEN and of $1,455,538,331 for WES, as summarized on Schedules ACC-9N and ACC-9S. These recommendations reflect an increase of $87,958,311 to the rate base claim of WEN, and a rate base reduction of $61,753,539 to the rate base claim of WES. In WEN, my recommended rate base is greater than Westar's rate base claim, due to the fact that I have included in rate base significant plant that is currently being recovered through the ECRR.

VII. OPERATING INCOME ISSUES

A. Pro Forma Revenue

Q. Are you recommending any adjustments to the Company's claim for pro forma revenue?

A. Yes, I am recommending an adjustment to the Company's weather normalization claim.

Q. How did the Company determine its weather normalization adjustment in this case?

A. As described in the testimony of Mr. Oakes, Westar generally followed the same methodology that it had used in prior years to normalize revenues. However, in this case, the Company based its weather normalization adjustment on a 10-year normal instead of the 30-year normal that traditionally has been used in Kansas.

Q. What adjustment are you recommending to the Company's weather normalization claim?

A. I am recommending that the KCC continue to use the 30-year normal as the standard for "normal" weather.

Q. Why do you believe that 30-year data is more appropriate to utilize in developing the Company's weather normalization adjustment than the ten-year period recommended by Westar?

A. The thirty-year normal has been established by the National Oceanic and Atmospheric Association ("NOAA"), the government organization charged with establishing and recording the climatic conditions of the United States. NOAA was formed as a compilation of the United States Coast and Geodetic Survey, formed in 1807; the Weather Bureau, formed in 1870; and the Bureau of Commercial Fisheries, formed in 1871. The thirty-year standard is the objective standard, established by the government body responsible for determining normal weather conditions. Moreover, the thirty-year standard is the international standard adopted by the United Nation's World Meteorological Organization ("WMO"). The thirty-year normal is used for a wide range of applications and it has served as the standard in utility regulation for some time.

Q. Do you believe that the use of a NOAA standard is preferable to having regulatory commissions set their own standards?

A. Yes, I do. It should not be the role of each regulatory commission to determine "normal" weather. Rather, that determination should be made by the governmental agency and other international bodies with expertise and responsibility for tracking, analyzing, and reporting weather statistics. In the United States, that agency is NOAA, which has determined that normal weather should be defined as the arithmetic mean computed over a long period of time. NOAA has further defined the appropriate time period over which to calculate normal weather as three consecutive decades.

Q. Why are longer time periods preferable to shorter ones for weather normalization data?

A. There are a few reasons. First, longer time periods tend to average out weather and temperature extremes much better than shorter periods. Obviously, one particularly cold or warm winter with many or few heating/cooling degree days has a much greater effect upon a ten-year average than it does upon a thirty-year average. In fact, a single data point has a 10% impact on a ten-year average, but only a 3.3% impact on a thirty-year average. Therefore, the effect of a single data point is three times greater with a ten-year average than with a thirty-year average.

Second, a shorter time period such as ten years may fail to include extreme weather in computing average degree days. It is normal and customary to have a very cold or a very warm winter every so often, and the data base should include these extremes.

Q. Why is it important to have good standard weather data?

A. Utility rates are based upon normal operating conditions. If revenues are based on an accurate, consistent and widely-accepted standard for normalizing weather, in some years the Company's revenues will be less than normal, in some years the Company's revenues will be greater than normal, but over time, the Company's revenues will reflect normal weather and the Company will receive the opportunity to earn its fair rate of return. In addition, the use of an accepted objective standard, such as the thirty-year NOAA, ensures consistency from case to case.

Q. Are there other factors that lead you to favor the thirty-year NOAA standard over the ten years of data recommended by Westar?

A. Yes. Among other things, the NOAA standard has a long history of use and acceptance. The use of the NOAA thirty years as "normal" is based upon an international agreement and is commonly used to reflect normal weather conditions in a variety of industries and applications. It is my understanding the KCC traditionally has utilized a thirty-year normal.

Q. Is there a statistical reason why a thirty-year normal should be used?

A. Yes, there is. The use of thirty data points has its basis in the central limit theorem, which states that if the sample size has at least thirty data points, then the distribution of sample means is normal, resulting in a normal distribution centered around the mean with a standard deviation that decreases as the sample size increases. Essentially, the population sample of at least thirty data points will result in a bell-shaped curve.

Q. Is NOAA examining the possibility of making any changes to the manner in which it determines normal weather?

A. Yes, it is. NOAA has initiated an investigation to address 1) assuring the availability of up-to-date climate normals, and 2) assuring the representativeness of a thirty-year average normal given a changing climate state. This process was initiated in May 2007.

The first issue involves the frequency with which NOAA thirty-year normals are updated. In the past, the official NOAA weather normal was based on data during three consecutive decades. Thus, this data was essentially updated only once every ten years. Now that technology has advanced, NOAA is exploring whether it might be reasonable to update the NOAA thirty-year normal weather data more frequently. At least part of the rationale for using three consecutive decades of data was the difficulty of updating this data more frequently. Technology has advanced considerably over the past few years, to the point where it is now relatively easy to calculate a new thirty-year normal each year. I understand that NOAA may make available more frequent updates to the thirty-year normal as a result of its current investigation. I have no objection to the use of the most recent thirty years of data to calculate normal weather.

The second issue is whether a basic change from the thirty-year normal should be adopted. NOAA has not made any move in this direction at this time. While NOAA has acknowledged that the issue of climate change has been raised by utilities in regulatory proceedings, and while NOAA is exploring the impact of such climate change on the calculation of normal weather, there is no indication that NOAA plans to terminate the use of thirty years as the time period over which to calculate normal weather.

Q. If NOAA changed the methodology used to determine normal weather, and instead adopted some other time period over which to calculate normal weather, would your recommendation change?

A. Yes, it would. As noted above, there are statistical reasons for adopting a time frame of at least thirty years to determine normal weather. However, if NOAA adopted a different standard, then I would recommend a change in the time period used by regulatory commissions, including the KCC, to determine normal weather for ratemaking purposes. The important point is that an independent government body with expertise should be selecting the time period used to define normal weather. This issue should not be determined on the basis of arguments made in rate cases by parties who have their own motives for suggesting various time periods.

Q. Would it be premature for the KCC to select a time period of other than thirty years while NOAA is still investigating this issue?

A. Yes, it would. Since NOAA is the governmental organization charged with determining the appropriate time period for determining normal weather, the KCC should not take any actions that would be contrary to the NOAA standard at this time. If the KCC is inclined to adopt a time period of less than thirty years for determining normal weather, it should wait for the results of the NOAA investigation before adopting a method that is inconsistent with the current NOAA standard. Accordingly, the KCC should at least wait for the completion of the current NOAA investigation so that the results of the investigation can be considered by the Commission.

Q. Is the purpose of a weather normalization adjustment to predict future weather, as has sometimes been suggested?

A. No, it is not. The purpose of a weather normalization adjustment is not to forecast or predict weather for a particular year. Regulatory commissions are regulators, not weather forecasters. The purpose of a weather normalization adjustment is instead to determine what customer usage is likely to be, assuming "normal" weather. Thus, finding that the use of a ten-year normal is a better predictor of the weather does not provide any meaningful information about normal weather on which utility rates should be based.

The regulator is attempting to determine, on a prospective basis, what a "normal" period of operating results will be. One of the components of this determination is normal weather. The regulator is not trying to predict weather, or to make a company indifferent to weather, but rather to set rates prospectively that are normalized for weather. In some years a utility will have colder than normal weather and in some years it will have warmer than normal weather. But over time, these variations constitute normal weather.

Q. Why is it important to have a consistent standard determined by an independent objective organization like NOAA?

A. The thirty-year period for determining what constitutes normal weather was not defined by CURB, or Westar, or Staff. Rather, it was defined by the United States Government organization that is responsible for defining normal weather, i.e., NOAA. Once the KCC deviates from this objective standard, then all parties will have an incentive to promote the time period that results in the best result for their particular constituency in each particular case. For example, while Westar generally supports a ten-year period for determining normal weather in this case, one or two particularly hot summers or cold winters could make the use of a ten-year average significantly less attractive to the Company. Deviating from the objective standard as determined by NOAA will open the door to arguments in every case about how long a period of time should determine what constitutes normal weather.

Q. Isn't it possible that weather patterns do change over time?

A. Yes, it is. However, permanent changes in weather patterns are likely to take place over a long period of time. NOAA has determined that data from a period of thirty years satisfactorily represents normal weather. To the extent weather patterns do exhibit a permanent change over time, such changes will be reflected in the thirty-year NOAA data. Moreover, the KCC should not confuse the determination of "normal" weather with the issue of how customers will react to variations from normal weather. The fact that energy prices have risen, that there is better communication with customers, and that energy efficiency incentives are offered have no impact on the weather, or on the definition of normal weather. Rather, these factors impact how customers may respond to deviations from normal weather. Weather is based on climatological patterns and customers have virtually no impact on these weather patterns, at least not over the thirty-year period that is defined as constituting normal weather.

However, the KCC should be mindful of the difference between changes in weather patterns over time and changes in usage patterns over time. The two are not the same. While NOAA uses a thirty-year period to determine normal degree days, NOAA is not involved in forecasting how energy sales are likely to be impacted due to variations in degree days. For example, assume that the thirty-year normal results in 1,500 cooling degree days for the Westar service territory. A separate but related question is how customer usage changes with changes in degree days. Due to conservation efforts, more efficient appliances, price elasticity, and other factors, it is entirely possible that the impact of variations in degree days is different in 2008 than it was in 1967. My recommendation that the KCC continue to utilize a thirty-year degree day standard does not prevent the utility or other parties from presenting arguments regarding the *impact* of weather variations on energy usage. By continuing to utilize a thirty-year weather standard, the KCC is not precluding any party from providing evidence demonstrating the impact of various weather changes on electricity or natural gas usage in a utility base rate case.

Q. What do you recommend?

A. I recommend that the KCC continue to utilize a thirty-year standard for determining normal weather in this case. In response to Data Request CURB-19, the Company quantified the impact on its claim of using a thirty-year normal versus a ten-year normal. I have quantified my adjustments based on that response. My adjustments are shown in Schedules ACC-14N and ACC-16S.

B. <u>Bad Debt Expense</u>

Q. Please describe the Company's claim for bad debt expense.

A. Westar's claim is based on a three-year average of actual net charge-offs incurred as a percentage of revenue, averaged over the past three years. This resulted in an uncollectible percentage of 0.328% in WEN and of 0.324% in WES. In addition, according to the response to KIC-2-154, the Company's bad debt expense claim includes bad debt expenses on its requested rate increase, even though that entire increase is unlikely to be granted by the KCC.

Q. Are you recommending any adjustment to the Company's claim?

A. I have accepted the use of a three-year average of net charge-offs to determine uncollectible expense in this case. However, since I am recommending a lower rate increase than the revenue increase proposed by the Company, it is necessary to make an adjustment to the

Company's claim to reflect the pro forma revenue levels contained in my testimony.

Q. How did you quantify your adjustment?

A. My adjustment is shown in two parts. In Schedules ACC-15N and 17S, I have made an adjustment to eliminate the Company's bad debt expense claim relating to its proposed revenue increase. In addition, I revised my revenue multiplier to include an uncollectible expense factor, based on the uncollectible rates requested by Westar in this case. This methodology ensures that rates will reflect the appropriate uncollectible expense associated with the level of the rate increase that I am proposing in this case. Moreover, should the KCC make other adjustments to the Company's claim, my recommended methodology will result in an appropriate level of uncollectible costs being reflected in base rates.

C. <u>Salaries and Wages</u>

Q. How did the Company determine its salary and wage claim in this case?

A. Westar first annualized its payroll costs based on actual payroll and employee levels at December 31, 2007. The Company then included adjustments to reflect 2008 rate increases for both its union and non-union employees. Westar included a payroll increase of 5.63% effective March 1, 2008, for non-union employees. When the Company filed its testimony, it was still negotiating with the unions, so its 2008 union increase, effective July 1, 2008, was based on a confidential estimate. It is my understanding that the Company is still in union negotiations.

Westar then made an adjustment to increase payroll costs to reflect salaries and wages for new employees added during the first quarter of 2008. In addition, the Company eliminated costs for employees terminated during the first quarter. Finally, Westar allocated a portion of its payroll adjustment to the transmission function.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am recommending two adjustments. First, I am recommending that the KCC limit the 2008 increases reflected in the Company's filing for both union and non-union personnel to 3.0%. Second, I am recommending that the KCC capitalize a portion of the total salary and wage expense adjustment. Both of these adjustments are shown in Schedules ACC-16N and 18S.

Q. What is your rationale for limiting the Company's salary and wage adjustment to 3.0%?

A. As shown in the response to CURB-39, over the past five years the union increases have averaged 2.85% annually. Therefore, I believe that an estimate of 3.0% is reasonable for union employees. If a contract is finalized during the litigation phase of this case that results in a different annual increase, I will update my testimony as necessary.

With regard to the non-union employees, I believe that the salary and wage increases included in the Company's filing are excessive. To put this adjustment in perspective, it should be noted that WEN and WES are requesting staggering payroll increases in this filing. WEN is requesting an increase of $8.9 million and WES is requesting an increase of $9.7 million. In the Company's last base rate case, the requested increases for WEN and WES were $3.2 million and $3.9 million. In WEN, the annualized 2007 pro forma payroll was 5.11% higher than the actual 2007 payroll, in spite of the fact that non-union employees receive their annual increases on March 1. Thus, $10/12^{th}$ of the non-union increase would ordinarily already be reflected in 2007 actual test year costs. The major factor contributing to the 5.11% annualization adjustment was the fact that non-union employees received an additional increase of 3.03% on November 1, 2007. Thus, during 2007, non-union employees received an average increase of 8.29%. The Company's claim of an additional 5.63% in 2008 would effectively result in a cumulative average increase from March 2007 to March 2008 of over 14%! In addition, according to the Company's response to CURB-39, non-union employees also received two increases in 2006, one for an average of 3.11% and one for an average of 2.68%. While I understand that the KCC does not typically make ratemaking adjustments to the percentage of salary increases awarded by utilities, I believe that such an adjustment is warranted in this case. Given the magnitude of the rate increases being requested in this proceeding, and the difficult economic times in which Kansas ratepayers find themselves, the payroll increases being requested by Westar are unreasonable.

This is especially true given that these increases are post-test year increases. As noted, the Company is requesting recovery of both increases in the number of employees and increases to salary and wage rates. The KCC could take the position that both types of increases should be denied entirely, and that payroll costs should be limited to annualized costs at the end of the test year. This approach would be entirely in keeping with the test-year concept. However, I do recognize that the KCC has, in some cases, permitted post-test year increases and therefore I have recognized such increases in my revenue requirement recommendation. However, such increases should not be excessive and instead should be evaluated in light of other utility labor increases, and in light of the increases granted to employees during the test year. Given the average 8.29% increase in the test year and the fact that Westar has not demonstrated difficulty in attracting quality personnel, I believe that the additional 5.63% increase being requested in this case is excessive. Accordingly, I recommend that the KCC limit the Company's post test year adjustment to an increase of 3.0% for both union and non-union personnel.

Q. What is your second salary and wage adjustment?

A. While the Company traditionally capitalizes a portion of its salary and wage costs, it does not appear that Westar has reduced its payroll expense adjustment to reflect that portion of salary and wage costs that will be capitalized. Therefore, at Schedules ACC-16N and 18S, I have also made adjustments to include only the expense portion of my pro forma payroll adjustment in the Company's revenue requirement

D. Incentive Compensation Costs

Q. Please describe the Company's incentive compensation program.

A. The Company has several incentive compensation plans for its non-union employees. Most employees are covered under the Short-Term Incentive Plan ("STI"). This plan covers all non-bargaining employees in pay grades A through V. The plan provides for the establishment of incentive pools. The percentage of base salary included in the incentive target increases based on the pay grade. Thus, the incentive target is 25% of the base salary for pay grade A, declining to only 5% of salary for pay grades H-V. In 2007, there were four areas of performance measurement: financial, business unit specific operational targets, customer satisfaction, and safety.

Westar also offers a Bulk Power Marketing Incentive Plan and a Generation Construction Incentive Plan.

Q. How much is included in the Company's pro forma expense claim relating to incentive compensation plans?

A. As shown in the Company's response to CURB-46, the Company incurred $7,415,692 in incentive costs in 2007, which included $4,177,051 for the STI, $3,052,654 for the Bulk Power Marketing Plan, and $185,987 for the Generation Construction plan. The Company's cost of service in this case excludes $1.1 million of the $3.05 million for the Bulk Power Marketing plan.

Q. Do you believe that it is appropriate to recover all of these incentive compensation costs from regulated ratepayers?

A. No, I do not. I have several concerns about these types of programs, most of which are based, at least in part, on a utility's ability to achieve certain earnings goals. Providing employees with a direct financial interest in the profitability of the Company is an objective that would benefit shareholders, but it does not benefit ratepayers. Incentive compensation awards that are based on earnings criteria may violate the principle that a utility should provide safe and reliable utility service at the lowest possible cost. This is because these plans require ratepayers to pay higher compensation costs as a consequence of higher corporate earnings, generating an upward spiral that does not directly benefit ratepayers, but does directly benefit shareholders, as well as the management personnel responsible for establishing such programs -- to whom much of the incentive compensation is granted.

Incentive compensation plans tied to corporate performance result in greater enrichment of company personnel as a company's earnings reach or exceed targets that are predetermined by management. It should be noted that it is the job of regulators, not the shareholders or company management, to determine what constitutes a just and reasonable rate of return award to shareholders in a regulated environment. Regulators make such a determination by establishing a reasonable rate of return award on rate base in a base rate case proceeding.

Allowing a utility to charge for additional return that is then distributed to employees as part of a plan devised to divide extraordinary profits violates all sense of fairness to the ratepayers of the regulated entity. It is certain to result in burdensome and unwarranted rates for its ratepayers, and also violates the principles of sound utility regulation, particularly with regard to the requirement for "just and reasonable" utility rates.

Q. What would be the appropriate response by the KCC if the earnings of Westar were in excess of its authorized rate of return?

A. If the KCC determined that these excess earnings were expected to continue, the appropriate response would be to initiate a rate investigation, and, if appropriate, to reduce the utility's rates.

Q. Are KCC employees being well compensated, separate and apart from these employee incentive plans?

A. Yes, they are. As stated above, the Company's non-union employees received two salary increases in 2006 and two such increases in 2007. Average 2007 increases were 8.29%, well above the level of increases that is being seen in other utilities. Moreover, there is no indication that Westar is having difficulty attracting quality non-union employees to its workforce. Westar salary and wage levels appear reasonable, even if the incentive compensation plans are not taken into account.

Q. Have incentive compensation payments increased dramatically since the last case?

A. Yes, they have. As shown in the response to CURB-46, total incentive payments increased from a total of $3,736,730 in 2005 to $8,351,925 in 2006, then fell slightly to $7,415,692 in 2007. From 2005 to 2006, the STI awards increased from $1,960,790 to $6,831,193. Clearly there has been a significant increase in these costs since the last case.

Q. What are the award criteria for the STI?

A. The award criteria for the STI includes a 50% weighting of the financial benchmark. The remaining 50% is spread among operational, customer satisfaction, and safety goals, with ratios that vary depending upon whether the employee is in corporate, customer operations, or generation and marketing.

Q. What are the award criteria for the Bulk Power Marketing Incentive Plan?

A. This plan is directed toward individuals involved in the energy marketing and trading activities of Westar Energy, Inc. The Bulk Power Marketing and Trading group engages in both asset-backed and non-asset backed transactions. During 2007, the percentage of awards was determined on a sliding scale, based on the margins from asset-backed transactions. However, the actual amount of incentive awards was based on applying that percentage to the margins from non-asset backed transactions. Thus, the greater the non-asset backed margins, the greater the incentives paid to the Bulk Power Marketing and Trading Group. The result is that the incentive margins are directly tied to the margins earned on non-asset backed transactions.

Q. Did the Company provide any support or documentation for the Generation Construction awards plan?

A. The Company stated that there was no written Generation Construction plan guidelines in 2007. The Company did provide a copy of the Generation Construction plan being used in 2008. The plan currently has four awards criteria: 15% safety, 25% quality, 30% cost, and 30% schedule.

Q. Based on your review of the plans discussed above, are you recommending any adjustments to the Company's claim for its incentive compensation plan costs?

A. Since the STI is based on financial performance triggers tied to the financial performance of Westar, I recommend that the KCC limit recovery of the cost of this incentive compensation award program to reflect a 50/50 sharing with shareholders. This recommendation is based on the fact that 50% of the incentive award is directly tied to financial parameters. This recommendation will require the Board of Directors to establish incentive compensation plans that shareholders are willing to finance, at least in part. As long as ratepayers are required to pay the costs of these incentive plans, then there is no incentive for management to control these costs. This is especially true since the management of the Company and its stockholders are primary beneficiaries of such plans. Therefore, I recommend that the KCC adjust the Company's claim for the STI incentive compensation costs to eliminate recovery of 50% of these costs. My adjustment is shown in Schedules ACC-17N and ACC-19S.

Given the impact of non-asset based transactions on the overall incentive pool, I am making a similar recommendation with regard to the costs for the Bulk Power Marketing and Trading incentive plan. That adjustment is also shown in Schedules ACC-17N and ACC-19S. At this time, I am not recommending any adjustment to the Generation Construction Incentive Plan. However, since this is a relatively new program, I recommend that the KCC review it again in the Company's next base rate case to determine if any adjustment is warranted.

E. Payroll Tax Expense

Q. Have you made an adjustment to the Company's payroll tax expense claim?

A. Yes, I have made an adjustment to eliminate the payroll taxes associated with my recommended adjustments relating to salary and wage costs and employee incentive compensation costs. To quantify my payroll tax adjustment, I utilized the statutory social security and medicare tax rate of 7.65%. I then multiplied this rate by my recommended adjustments to the Company's salary and wage expense and to the incentive compensation program. My adjustments are shown in Schedules ACC-18N and 20S.

F. Directors/Officers Agreement

Q. Has the Company included any costs relating to agreements with previous officers and/or directors?

A. Yes. According to the response to KCC-62, the Company included $345,000 in its cost of service relating to an agreement with a former officer who retired in 2007. The agreement provides for lifetime medical and dental benefits for the officer, his spouse, and dependents. According to the response to CURB-123, the amount to be paid out under this agreement will depend upon retiree contribution rates and the actual medical and dental claims paid for the retiree, his spouse, and dependents. The Company is therefore unable to estimate the amounts that will be paid out under this agreement each year. According to the response to CURB-123, these future payments will be booked to Account 2283401, Deferred Compensation - Medical Liability.

Q. Are you recommending any adjustment related to this agreement?

A. Yes, I am recommending that these costs be excluded from the Company's cost of service. Although I have not seen the details of the agreement, the benefits as described appear to be above and beyond those that are traditionally awarded to retirees. Moreover, the amount booked for these benefits in the test year do not represent a normal, annualized cost but instead appear to represent a multi-year liability. For both of these reasons, I am recommending that the KCC eliminate these costs from the Company's cost of service in this case. My adjustments are shown in Schedules ACC-19N and 21S.

G. <u>Executive Compensation Costs</u>

Q. How have executive compensation costs changed since the last case?

A. Executive compensation costs have skyrocketed. As shown below, costs for the top five executive officers have increased significantly over the past several years:

Year	Top Five Executives Total Compensation
2007	$5,353,714
2006	$3,395,923
2005	$2,486,207

A review of individual compensation as stated in Westar's proxy statements indicates that Westar's executive officers received significant salary increases in the test year. For example, Mr. Moore's salary increased from $401,042 in 2006 to $525,000 in the test year, an increase of almost 31%. Mr. Sterbenz's salary increased from $275,000 to $361,875, an increase of 31.6% and Mr. Ruelle's salary increased from $275,000 to $372,159, an increase of over 35%. Mr. Moore's total compensation more than doubled in the test year, increasing from $617,948 in 2006 to $1,595,636 in 2007. Mr. Ruelle's total compensation also more than doubled while Mr. Haines and Mr. Sterbenz had increases in total compensation of 22.3% and 31.5% respectively.

Q. How does Westar determine compensation for its executive officers?

A. Westar apparently relied upon an analysis performed by Towers Perrin that examined executive compensation for Westar's officers. In that study, Westar's compensation for its top fourteen executive officers was compared with compensation at other firms. Westar compared its executive compensation programs to the median of the compensation levels at other companies. According to Towers Perrin, market data was adjusted to reflect Westar's size as measured by revenues.

Q. Do you have concerns about this methodology?

A. Yes. The use of comparable company studies that compare a utility's executive compensation with the median compensation levels at other companies results in a self-fulfilling prophecy as the companies that fall below the median attempt to reach the 50% threshold. This puts further upward pressure on the median, resulting in higher and higher executive compensation payments and higher rates for regulated ratepayers. Moreover, basing executive compensation on amounts paid by other companies does not ensure that compensation will be tied to benchmarks that benefit ratepayers. In some states, legislators are even considering legislation to limit the executive compensation costs that utility companies can pass along to the state's ratepayers.

Q. Are you recommending any adjustment to the Company's claims for executive compensation costs?

A. Yes, I am. In order to mitigate the significant increases in executive compensation costs that have occurred since the last case, I am recommending that the KCC eliminate 50% of executive compensation costs from the Company's cost of service. Since I have already recommended adjustments to the Company's salary and wage costs and incentive compensation costs, I am limiting my executive compensation adjustment to non-salary related compensation costs. My adjustment is shown in Schedules 20N and 22S.

H. Employee Benefit Costs

Q. Are you recommending an adjustment to the Company's claim for employee benefit costs?

A. The Company's claim for employee benefits includes costs for medical insurance, dental and vision insurance, life and long-term disability insurance, pensions, and other post-employment benefits ("OPEBs"). I am not recommending any adjustment to the overall level of employee benefit costs being claimed by Westar in this case. However, in developing its employee benefit cost adjustment, the Company did not reduce the amount of the adjustment to reflect the fact that a portion of its employee benefit costs are capitalized. Accordingly, at Schedules ACC-21N and ACC-23S, I have made adjustments to eliminate the capitalized portion of Westar's employee benefit adjustments from the Company's cost of service. I understand that my adjustment is consistent with the way in which pro forma employee benefits have been reflected in past cases.

I. Workers Compensation Costs

Q. Are you recommending any adjustment to the Company's claim for workers compensation costs?

A. Yes, I am. In response to KCC-34, the Company identified an abnormal/non-recurring charge of $3,718,374 made to its workers compensation costs during the test year. I am recommending that the KCC remove these costs from the Company's cost of service in this case.

Q. What is the basis for your adjustment?

A. The Company's cost of service should reflect a normal, ongoing level of prospective costs. Therefore, these costs should be removed because they do not meet the criterion for inclusion in determining a utility's revenue requirement. Such costs are not representative of ongoing utility costs and therefore should not be included in rates.

Q. Did the Company acknowledge that an adjustment to its workers compensation claim would be reasonable?

A. Yes, it did. In response to KIC-214, Westar indicated that it would not object to a normalized amount of workers compensation costs being included in its revenue requirement. In that response, Westar proposed a workers compensation adjustment based on a five-year average of workers compensation expense. This adjustment would effectively remove the abnormal and non-recurring adjustment booked to workers compensation during the test year. At Schedules ACC-22N and ACC-24S, I have made adjustments to reflect a five-year average of workers compensation costs, consistent with the Company's response to KIC-214.

J. Employee Relocation Costs

Q. What level of employee relocation costs did the Company include in its claim?

A. The Company's claim includes relocation costs of $1,111,944, which are the actual relocation costs incurred during the test year.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am. As demonstrated in the response to KCC-108, the actual test year relocation costs were high relative to costs in prior years. Moreover, relocation costs can vary significantly from year to year, depending upon the number of relocations that occur and the complexity of each move. Following are the relocation costs incurred by Westar over each of the past five years:

Year	Relocation Costs
2007	$1,111,944
2006	$745,714
2005	$232,329
2004	$606,815
2003	$203,241

Given the variation that can occur in these costs from year-to- year, and the high level of costs included in the test year, I am recommending an adjustment to reflect a five-year average of relocation costs. This adjustment will mitigate fluctuations that occur from year to year and provide a more representative level of costs in rates than the actual test year relocation expenditures. My adjustment is shown in Schedule ACC-23N and ACC-25S.

K. <u>Storm Damage Expense</u>

Q. Please describe the Company's claim for storm damage expense.

A. Westar has included deferred costs associated with three storms in its revenue requirement. In WEN, the Company included deferred costs of $47,146,264, including carrying costs, related to the 2007 ice storm. In WES, the Company included $3,587,127, including carrying costs, related to the 2007 ice storm. The unamortized balances, along with carrying costs, were included in rate base as regulatory assets. Westar is proposing to amortize these balances over a four-year period. In addition, in WES, the Company also included an unamortized balance of $15,442,900, related to costs from the 2002 and 2005 ice storms.

Q. Did the Company receive approval to defer these costs?

A. Yes, it did. On May 8, 2002, in Docket No. 02-WSRE-723-ACT, the KCC approved deferred accounting treatment for costs relating to the 2002 storm. On March 22, 2005, in Docket No. 05-WSEE-645-ACT, the KCC approved deferred accounting treatment for costs incurred in the 2005 storm. In Docket No. 08-WSEE-862-ACT, Westar received KCC authorization to defer costs relating to the 2007 ice storm. Moreover, amortization of the 2002 and 2005 deferred ice storm costs was addressed in the Company's last base rate case.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am recommending one adjustment. Specifically, I am recommending that the deferred storm damage costs relating to the 2007 ice storm be amortized over a five-year period, instead of the four-year period recommended by Westar. The use of a five-year recovery period for both systems will permit Westar to recover these extraordinary costs over a reasonable period of time without placing an undue burden on ratepayers. Moreover, the use of a five-year amortization period is consistent with the period currently being used in WES to amortize costs from the 2002 and 2005 ice storms. In its last base rate case, Westar proposed a five-year amortization of the WES costs, given the magnitude of the deferred costs. In this case, Westar has deferred WEN costs relating to the 2007 ice storm that are even larger than those deferred by WES related to the 2002 and 2005 ice storms. Accordingly, I believe that a five-year amortization of deferred ice storm costs is appropriate in both WEN and WES. My adjustments are shown in Schedule ACC-24N and ACC-26S.

L. Storm Damage Reserves

Q. Please describe the Company's adjustments with regard to its various reserve accounts.

A. Westar has included various reserve adjustments in both WEN and WES. First, the Company is requesting funding for storm damage reserves. To quantify its adjustment, Westar determined the average cost of its last three major storms (2002, 2005, and 2007). It is proposing to build a reserve, based on this average cost per storm, over a five-year period. With regard to its injuries and damages reserve, environmental reserve, and property insurance reserve, the Company is proposing adjustments based on the average annual costs experienced over the past three years.

Q. Are you recommending any adjustments to the Company's claims relating to its various reserve accounts?

A. I am not recommending any adjustment to the Company's claims with regard to its injuries and damages reserve, its environmental reserve, or its property insurance reserve. However, I am recommending that the KCC reject Westar's proposed adjustment relating to the storm damage reserve.

Q. What is the basis for your recommendation?

A. My recommendation is based on the fact that it is unreasonable to require ratepayers to build up a further reserve for future ice storms while also requiring them to retroactively pay all costs associated with prior storms. As I have stated in previous cases, ratemaking is not (or should not be) a reimbursement system. For that reason, retroactive ratemaking is generally prohibited in regulatory proceedings. However, in Kansas, the KCC has consistently permitted Westar to defer costs associated with major ice storms. Moreover, it has permitted Westar to defer these costs along with carrying costs. The KCC has also permitted Westar to recover these deferred costs from ratepayers even in situations where Westar has exceeded its authorized rate of return during the deferral period. While I do not conceptually agree with the generous ratemaking treatment that the KCC has provided for ice storm costs, I have accepted that methodology for purposes of determining my revenue requirement in this case. Hence, I have included recovery, with carrying costs, of deferred costs relating to previous ice storms.

However, if the KCC is going to permit Westar to routinely recover deferred ice storm costs from ratepayers, along with carrying costs, there is no reason to require ratepayers to also pay for a storm damage reserve. The reserve being requested by Westar would be over and above the property insurance reserve that is also being requested in this case. While I have accepted Westar's request for annual funding of $2,007,563 relating to the property insurance reserve, there is no need to fund an additional reserve for storm damage costs -- unless the KCC stops its practice of routinely allowing these costs to be deferred for future recovery from ratepayers.

Shareholders are provided with a cost of equity return that reflects the assumption that they undertake risk by investing in the utility. As discussed previously in this testimony, the amount of risk being borne by shareholders has been dramatically reduced over the past few years. This risk would be further reduced by charging ratepayers for a storm damage reserve for future storms, while at the same time guaranteeing recovery of past ice storm costs, with carrying charge, from ratepayers. Therefore, I recommend that the KCC disallow the Company's adjustment relating to funding of a storm damage reserve. My recommendation is shown in Schedules ACC-25N and ACC-27S.

M. Tree Trimming Costs

Q. How did the Company develop its claim for tree trimming costs?

A. As discussed in the testimonies of Mr. Kongs and Ms. Williams, the Company is requesting funding to enable it to begin a transition to a four-year urban/five-year rural tree trimming cycle. The Company's claim in this case is based on seven-year urban/ eight-year rural clearance plan. Westar does not currently have a cycle-based line-clearing program. According to the response to CURB-83, Westar is currently in year 11 of what it believes will be a 13-year period to clear all distribution lines since clearance activities were centralized in 1997.

Westar is requesting a total increase of $10.1 million relating to distribution line clearing activities in this case. This claim represents an increase of almost 55% over the Company's test-year costs.

Q. Are you recommending any adjustments to the Company's claim?

A. Yes, I am. Conceptually, I am not opposed to the Company adopting a cycle program. However, I believe that Westar's specific proposal in this case is excessive. The Company's 2008 budget for distribution clearing activities actually declined to $15.1 million from the test year amount of $18.7 million. Thus, the level of annual funding being requested in this case actually represents an increase of almost 67% from current funding levels. Moreover, the Company has almost completed its initial 13-year program to clear all lines. Therefore, Westar could begin to phase-in a more aggressive clearance program while it completes the last two years of its current plan.

Moreover, according to the testimony of Ms. Williams at page 18, Westar did not propose adopting a four-year urban/five-year rural program in this case because "[t]hat approach would require Westar to double the number of line clearance contractors in a short period of time and may not be realistic or achievable." However, the program that is being proposed would still represent an increase of almost 55% over the test year costs and of almost 67% over current funding levels. There is no assurance that Westar has the personnel and other resources to manage the rapid expansion of the program being proposed by the Company, even though the proposed program represents a reduction from the optimal program that Westar plans to adopt eventually.

Another factor for the KCC to consider is the fact that Westar is requesting significant rate increases in this case, much of which are the result of new generation facilities being included in rate base. In addition, it is likely that Westar will file another base rate case within a relatively short period of time. I believe that it is reasonable for the KCC to consider the magnitude of the overall increase, and the likelihood of future increases, when determining an appropriate line clearing allowance for Westar.

Q. What do you recommend?

A. I recommend that the KCC reduce the Company's adjustment to reflect a further phase-in of its proposed cycle program. Specifically, I have included an increase of 25% over the actual test year expense in my revenue requirement recommendation. Moreover, my recommendation provides Westar with almost 31% more funding than is currently budgeted for 2008. When the Company files its next base rate case, the KCC can review the Company's progress in ramping up its line clearance program and its ability to expand its program efficiently and effectively. At that time, the KCC can determine if it should again increase the Company's funding to further accelerate Westar's line clearing activities. My adjustments are shown in Schedules ACC-26N and ACC-28S.

N. Postage Expense

Q. How did the Company calculate its postage expense claim in this case?

A. The United States Postal Service ("USPS") had a postage rate increase effective May 14, 2007 and another increase effective May 12, 2008. Therefore, the test year contains some mailings at the pre-2007 rate and some mailings at the May 14, 2007 rate. All of these mailings need to be repriced at the new 2008 rates.

The Company determined its adjustment by developing a regression analysis of its postage costs over the past three years. This methodology may be appropriate for certain types of expenses that increase with inflation, or increase based on other trends, but postage costs do not fit into that category. Ideally, the Company should have determined the types of mailings it undertakes, examined the number of each type of mailing in the test year, and then priced out the volume of mailings at the current USPS rates. The Company should also have considered the impact of the increase in the number of on-line electronic billing statements.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am. I am recommending annualizing the Company's pro forma postage costs based on the specific rate increases that occurred on May 14, 2007, during the test year in this case, and subsequent to the test year on May 12, 2008. Since the Company did not provide details regarding its postal mailings in the test year, I have based my adjustment on the change in first class mail rates. First class postage was $0.39 until May 14, 2007, when it increased to $0.41. It was subsequently increased to $0.42 on May 12, 2008. During the test year, the rate was $0.39 for 133 days and $0.41 for 232 days. These test year increases must be annualized. In addition, a further increase must be applied to reflect the current rate of $0.42. As shown below, the weighted overall increase relative to the actual test-year costs is 4.35%:

Rate	Days	% Test Year	Increase to $0.42	Weighted Increase
.39	133	36.44%	7.69%	2.80%
.41	232	63.56%	2.44%	1.55%
Total				4.35%

Therefore, I am recommending an increase to the test year postage costs of $141,327 (4.35% X $3,246,483) instead of the $179,110 increase proposed by the Company. The adjustment is then allocated 53.76% to WEN and 46.24% to WES, based on the allocation of actual test year costs. My adjustments are shown in Schedules ACC-27N and 29S.

O. Advertising Expenses

Q. Did the Company include any adjustments relating to advertising costs in its claim?

A. Yes, it did. According to the testimony of Ms. Haines at page 3, Westar excluded certain costs related to advertising that is "principally to promote Westar's image."

Q. Are you recommending any further adjustment to the Company's claim for advertising costs?

A. Yes, I am. Based upon my review of the Company's data request responses, I am recommending that the KCC disallow three additional advertising expenditures. Two of these costs relate to Westar's promotion at a Titanic Exhibition and the third relates to ECK Stadium advertising. It appears that these costs relate to efforts to promote the Westar corporate image and the KCC should disallow these costs for ratemaking purposes. These costs are not necessary to the provision of safe and adequate utility service. Instead, these costs should be borne by shareholders. My adjustments are shown in Schedules ACC-28N and ACC-30S.

Q. Does the Company's advertising cost claim also include some donations that the KCC should exclude from Westar's revenue requirement?

A. Yes, it does. According to the testimony of Ms. Haines at page 2, the Company included 50% of civic and charitable expenses incurred during the test year in its revenue requirement claim. However, according to the response to KCC-46, the Company also included costs of $16,415 in its advertising claim relating to United Way inserts. These costs appear to relate to donations, and therefore they should have been subject to the 50-50 sharing afforded to other types of donations. Thus, at Schedules ACC-28N and ACC-30S, I have also made an adjustment to eliminate 50% of these costs on the basis that they are actually contributions and should have been treated as such by Westar in its filing.

Q. Do you believe that civic and charitable contributions are an appropriate revenue requirement component?

A. No, I do not. Utility rates should include a reasonable level of costs that are necessary for the provision of safe and reliable utility service. Civic and charitable contributions, while worthwhile expenditures, should not be borne by ratepayers. Civic and charitable contributions are not necessary to the provision of safe and adequate utility service. Furthermore, by including such contributions in utility rates, utilities force ratepayers to indirectly contribute to those organizations selected by utility management, effectively forcing ratepayers to support organizations whose goals and objectives may conflict with those of any specific ratepayer. For these reasons, many regulatory commissions prohibit utilities from recovering any donations or charitable contributions in their utility rates.

However, I recognize that in the past, the KCC has permitted some civic and charitable contributions to be included in utility rates. For that reason, I am not opposing the Company's claim to include 50% of its donations in rates. However, if the KCC is going to permit 50% of donations to be recovered, then all donations, including those that were booked to advertising costs, should be subject to this ratemaking treatment.

P. Interest on Customer Deposits

Q. Please describe how interest on customer deposits is typically reflected in a Company's revenue requirement.

A. As a general rule, interest payments are not explicitly included as a component of a company's revenue requirement. Rather, interest is a component of the overall return that is granted to a utility. The overall return is supposed to compensate the utility for its cost of equity (or profit to shareholders) as well as for its cost of debt (interest expense).

However, since customer deposits are subtracted from rate base, then utilities are generally permitted to include the interest paid on these customer deposits as a component of the revenue requirement. Customer deposits are considered non-investor supplied funds and therefore are generally deducted from rate base. A utility's rate base is assumed to have been funded by investors, both debt and equity investors, and it is for that reason that investors are allowed to earn a return on rate base. However, customer deposits are provided by customers, not investors. Therefore, rate base is reduced by the amount of customer deposits in order to ensure that shareholders do not earn a return on that portion of the rate base funded by customer deposits. Since the rate base no longer includes customer deposits, then the overall return on rate base no longer includes the interest on those deposits. Therefore, to make the Company whole, it is necessary to permit it to recover a separate interest expense for the interest paid on customer deposits.

Q. What level of customer deposits did the Company reflect in its rate base reduction?

A. The amount of customer deposits subtracted from rate base was the balance at December 31, 2007. This balance was $10,217,414 in WEN, and $10,220,729 in WES. However, the Company allocated a portion of these customer deposits to the transmission function. This resulted in a net amount of customer deposits subtracted from rate base of $8,661,583 in WEN, and of $9,443,281 in WES.

Q. How did the Company calculate the interest on customer deposits included in its revenue requirement claim?

A. The interest calculation should be synchronized with the amount of customer deposits eliminated from rate base. However, in determining the adjustment to interest on customer deposits, the Company used the KCC-approved rate of 3.15% and applied that rate to the total customer deposits of $10,217,414 in WEN, and $10,220,729 in WES. Therefore, it does not appear that the Company removed the interest on those customer deposits allocated to the transmission function.

Q. What do you recommend?

A. I recommend that the Company's claim for interest on customer deposits be adjusted to eliminate the interest on those deposits allocated to transmission. My recommendation is shown in Schedules ACC-29N and ACC-31S.

Q. <u>Gain on Sale of Property</u>

Q. Are you recommending any adjustments relating to the gain on sale of property?

A. Yes. In response to KIC-179, the Company indicated that a portion of the gain on the sale of the Olathe Service Center was set up as a regulatory liability to be amortized to customers in a future rate review. However, this gain was not included in the Company's revenue requirement claim in this case. Accordingly, at Schedule ACC-30N, I have reflected an adjustment to amortize this deferred liability over a three-year period.

Q. What is the basis for the three-year amortization period that you recommend for amortizing the gain on sale of property?

A. I am recommending a three-year amortization period because that is the amortization period used by Westar for its rate case expense claim. Thus, the gain on the sale of property should be fully amortized by the time of the Company's next base rate case.

R. Employee Rebate Costs

Q. Please describe the Company's employee rebate program.

A. A description of the program was provided in response to CURB-240. According to that response, Westar is offering rebates to employees and retirees toward replacement of natural gas or propane furnaces with a heat pump. During the test year, 34 Westar employees received rebates for at a total cost of $30,075.

Q. Are you recommending any adjustment to the Company's claim for these costs?

A. Yes, I am recommending that these test year costs be disallowed. These rebates are an employee perk that are not necessary to the provision of safe and adequate utility service. Moreover, these rebates are not available to utility ratepayers and the Company does not plan to offer heat pump rebates to its customers. There is no rationale for treating employees/retirees any differently than the general customer base with regard to heat pump rebates. Accordingly, I recommend that these test year costs be disallowed. My adjustment is shown in Schedules ACC-31N and ACC-32S.

S. Depreciation Expense

Q. How did the Company calculate its depreciation expense claims in this case?

A. Westar reflected several adjustments to its actual test-year booked depreciation expense. These adjustments included an annualization adjustment to reflect annualized depreciation expenses at current depreciation rates based on the Company's plant balances at the end of the test year; an adjustment to reflect the results of a new depreciation study; an adjustment to remove depreciation expense on plant recovered through the ECRR; an adjustment to transfer depreciation expense associated with Spring Creek from WEN to WES; and an adjustment to reflect depreciation expense on the new EEC facility.

Q. Is CURB recommending any adjustments to the Company's depreciation expense claim?

A. Yes, CURB is recommending several adjustments. First, CURB witness Michael Majoros is recommending several depreciation expense adjustments. Mr. Majoros's adjustments relate to the Company's claim for new depreciation rates as well as its claim associated with differences in depreciation between rates used for financial reporting purposes and rates used for regulatory purposes. At Schedules ACC- 32N and ACC-33S, I have made operating income adjustments to reflect the impact of Mr. Majoros's recommended depreciation rates and his recommendation regarding the differences in depreciation being claimed by Westar.

Q. Please explain your recommended depreciation expense adjustment associated with the EEC.

A. In response to CURB-87, Westar stated that it had overstated the amount of depreciation expense associated with the EEC in its original filing. At Schedule ACC-33N, I have made an adjustment to reflect the Company's revised depreciation expense claim associated with the EEC.

Q. Please describe your recommended depreciation expense adjustment associated with plant recoverable through the ECRR.

A. The Company eliminated from its revenue requirement claim depreciation expense associated with plant recoverable through the ECRR. The ECRR includes a surcharge to recover both the investment associated with the environmental plant upgrades as well as the associated depreciation expense. Since it is the Company's position that these costs should continue to be recovered through the ECRR, Westar eliminated the environmental plant upgrades as well as the associated depreciation expense from its revenue requirement claim. However, CURB recommends that the costs currently being recovered through the ECRR be rolled back into base rates as a result of this proceeding. Therefore, at Schedules 34N and 34S I have made adjustments to add back to the Company's revenue requirement the depreciation expense currently being recovered through the ECRR.

T. State Income Taxes

Q. Are you recommending any adjustment to the Company's claim associated with state income taxes?

A. Yes, I am. In its filing, Westar reflected a state income tax rate of 7.35%. I understand that the Kansas legislature reduced the state income tax rate to 7.1%, effective July 1, 2008. Therefore, at Schedules ACC-35N and ACC-35S, I have made an adjustment to reduce the Company's claim for state income taxes, at present rates, to reflect the reduction in the state tax rate. I have also used the new state income tax rate of 7.1% to develop my composite income tax rate, as discussed below.

Q. How did you quantify your adjustment relating to the revised state income tax rate?

A. I quantified my adjustment by comparing the prior composite federal and state income tax rate of 39.78% to the new composite rate of 39.62%. The new state rate results in a reduction of 0.41% in the composite rate.[14] I then reduced the Company's composite state and federal tax claims by 0.41% to determine the operating income impact of the reduction in the state tax rate.

U. <u>Interest Synchronization and Taxes</u>

Q. Have you adjusted the pro forma interest expense for income tax purposes?

A. Yes, I made this adjustment at Schedules ACC-36N and ACC-36S. These adjustments are consistent (synchronized) with CURB's recommended rate base, capital structure, and cost of capital recommendations. Because CURB is recommending that the investment currently being recovered through the ECRR should be rolled into base rates, my recommended rate base in WEN is actually higher than the rate base the Company included in its filing. CURB's recommendations result in higher pro forma interest expense for WEN. This higher

14 Prior rate of 39.62% less current rate of 39.78% results in a decrease of 0.16, which when divided by 39.78 results in a reduction of 0.41%. Note that all percentages are rounded.

interest expense, which is an income tax deduction for state and federal tax purposes, will result in a decrease to the Company's income tax liability under CURB's recommendations. Therefore, CURB's recommendations result in an interest synchronization adjustment that reflects a lower income tax burden for WEN, and an increase to pro forma income at present rates.

In WES, I am recommending a rate base that is lower than the rate base claimed by Westar. Therefore, my recommendations in WES result in a lower interest expense, and a higher income tax expense, than the amounts being claimed by WES. The net effect is a reduction to the Company's pro forma operating income in WES.

Q. What income tax factor have you used to quantify your adjustments?

A. As shown on Schedules ACC-37N and ACC-37S, I have used a composite income tax factor of 39.62%, which includes a state income tax rate of 7.10% and a federal income tax rate of 35%. This composite income tax factor reflects the reduction in the state income tax rate effective July 1, 2008.

Q. What revenue multiplier are you recommending in this case?

A As shown in Schedules ACC-38N and ACC-38S, I am recommending a revenue multiplier of 1.6615 for WEN and of 1.6614 for WES. These revenue multipliers include the state income tax rate of 7.1%, the federal income tax rate of 35%, and the uncollectible rates of 0.328% and 0.324% for WEN and WES respectively. As discussed earlier in this testimony, I am recommending that the KCC adjust the revenue multiplier to reflect the uncollectible costs associated with the level of rate relief that I am recommending in this case.

VIII. REVENUE REQUIREMENT SUMMARY

Q. What is the result of the recommendations contained in your testimony?

A. For WEN, my adjustments result in a base rate revenue deficiency at present rates of $56,712,954, as summarized on Schedule ACC-1N. This recommendation reflects revenue requirement adjustments of $33,327,906 to the Company's proposed increase of $90,040,860. Coincident with this base rate increase, the ECRR surcharge should be reduced by $16,849,048 to reflect the fact that these costs are now being recovered in base rates. The only costs remaining in the ECRR should be the costs relating to the prior year true-up, which is $17,669 on an annual basis in WEN.

For WES, my adjustments result in a base rate revenue deficiency at present rates of $44,636,023, as summarized on Schedule ACC-1S. This recommendation reflects revenue requirement adjustments of $42,946,498 to the revenue increase of $87,582,521 requested by WES. Coincident with this base rate increase, the ECRR surcharge should be reduced by $10,288,215 to reflect the fact that these costs are now being recovered in base rates. The annual true-up costs remaining in the ECRR are $43,803 in WES.

Q. Have you quantified the revenue requirement impact of each of your recommendations?

A. Yes, at Schedules ACC-39N and ACC-39S, I have quantified the impact on Westar's revenue requirement of the rate of return, rate base, revenue and expense recommendations contained in this testimony.

Q. Have you developed pro forma income statements for WEN and WES?

A. Yes, Schedules ACC-40N and ACC-40S contain pro forma income statements, showing utility operating income under several scenarios, including the Company's claimed operating income at present rates, my recommended operating income at present rates, and operating income under my proposed rate increases. My recommendations will result in an overall return on rate base of 8.08% for both WEN and WES.

IX. <u>OTHER ISSUES</u>

A. <u>Retail Energy Cost Adjustment ("RECA")</u>

Q. Please describe the Company's current RECA tariff.

A. The KCC approved a RECA for Westar in the Company's last base rate case. In that case, the Commission authorized Westar to establish a monthly RECA charge, reflecting projected costs for each month and an annual true-up factor. In addition, the KCC ordered Westar to credit the RECA with average annual asset-based off-system sales revenues based on the prior three years of margins.

Q. Is the Company proposing any change to its RECA tariff in this case?

A. Yes, in this case, Westar is proposing some minor modifications to the accounts that would be recovered through the RECA. In addition, Westar is proposing that the RECA be credited with the projected level of off-system sales margins estimated at the 31st percentile, i.e., one-half standard deviation below the most likely outcome. Westar is also proposing an annual true-up adjustment for its asset-based, off-system sales margins, similar to the true-up performed for the fuel and purchased power costs included in its RECA.

Q. Are you recommending any changes to the Company's proposed RECA?

A. Yes, I am recommending two adjustments. First, I am recommending that Westar's monthly RECA factors be established, and published, on a quarterly basis. This is similar to the method currently used by Kansas City Power and Light Company ("KCPL"). While the RECA factors could still vary from month-to-month, establishing three months of factors at the beginning of each quarter would allow ratepayers to have advance notice of what to expect for the upcoming quarter, and to plan accordingly. The monthly factors would continue to be based on projected data and would still be subject to an annual true-up, as they are in KCPL.

Second, I am recommending that the projected off-system sales margins be based on forecasts at the 50th percentile, instead of at the 31st percentile proposed by Westar. The use of the 50^{Th} percentile more appropriately spreads the risk of over/under projections between ratepayers and shareholders. In addition, it is consistent with the methodology established by the KCC for KCPL.

B. <u>Combined Rate Structure</u>

Q. Has CURB accepted the Company's proposal to combine WEN and WES into a uniform rate structure, and to apply a uniform RECA in each system?

A. No. While CURB is not conceptually opposed to eventually combining rates in WEN and WES, CURB believes that it is premature to move to uniform rates at this time. There have historically been cost of service differentials between the two systems and rates have been based on stand-alone cost of service studies for each system. Much of this cost differential has been due to the high capital costs initially incurred for the Wolf Creek nuclear facility, and the objective to assign those costs to the WES customers that benefited from the facility. In past cases, the KCC and other parties have taken the position that the customers in WEN should not be required to bear the higher costs associated with Wolf Creek. Now, however, there are benefits from Wolf Creek that are helping to mitigate costs in WES, including lower fuel costs. CURB has not fully examined the issue of what the impact would be on customers of combining rates at this time, given current cost differentials between WEN and WES, but it may be unfair to ask WES customers, who have traditionally paid higher rates associated with Wolf Creek, to now share any cost benefits with customers in WEN by moving to uniform rates.

In addition, there may be a carbon tax or some other carbon mitigation program imposed that would have a more significant impact on costs in WEN than in WES. Without knowing precisely what type of carbon tax program or structure may be imposed, we cannot accurately estimate the impact on each system. However, it is possible that a carbon tax or some other carbon mitigation program could be imposed in the near future, prior to the filing of Westar's next base rate case.

Therefore, while CURB is not opposed to moving toward further rate parity in this case, we believe that the cost differentials may still be too significant to combine rates at this time. Since Westar is likely to file another base rate case in the relatively near future, this issue can be re-examined at that time. Accordingly, in this case, CURB has not proposed uniform rates for WEN and WES. CURB witness Brian Kalcic provides a further discussion of CURB's specific rate design recommendations in this case.

Q. Does this conclude your testimony?

A. Yes, it does.

VERIFICATION

STATE OF CONNECTICUT)

COUNTY OF FAIRFIELD) ss:

Andrea C. Crane, being duly sworn upon her oath, deposes and states that she is a consultant for the Citizens' Utility Ratepayer Board, that she has read and is familiar with the foregoing testimony, and that the statements made herein are true to the best of her knowledge, information and belief.

Andrea C. Crane

Andrea C. Crane

Subscribed and sworn before me this 24th day of Sept, 2008.

Notary Public Marjorie M. Lerin

My Commission Expires: December 31, 2008