BEFORE THE CORPORATION COMMISSION

OF THE STATE OF KANSAS

In the Matter of the Application of Kansas	]	
City Power & Light Company for Approval	]	KCC Docket No. 09-KCPE-246-RTS
to Make Certain Changes in its Charges for	]	
Electric Service to Continue the	]	
Implementation of its Regulatory Plan	]	

REDACTED DIRECT TESTIMONY OF

ANDREA C. CRANE

RE: REVENUE REQUIREMENTS
AND COST OF CAPITAL

ON BEHALF OF

THE CITIZENS' UTILITY RATEPAYER BOARD

February 3, 2009

PUBLIC VERSION

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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.

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. I was named President of the firm in 2008.

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 300 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 Masters degree in Business Administration, 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 or about September 5, 2008, Kansas City Power & Light Company ("KCPL" or "Company") filed an Application with the Kansas Corporation Commission ("KCC" or "Commission") seeking a rate increase of $71.63 million. This rate increase request includes $60.43 million relating to a traditional revenue requirement deficiency and another $11.20 million in additional cash flow that the Company claims is necessary to maintain its investment grade credit rating. The Company's request would result in an increase of approximately 17.5% over retail sales revenue at present rates. The Company's filing is based on a test year ending December 31, 2007, with pro forma adjustments through March 30, 2009.

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 cost of capital and revenue requirement claims. Brian Kalcic is also filing testimony on behalf of CURB addressing rate design issues.

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

A. The most significant issues in the Company's filing are a) its projected utility plant-in-service increases, b) proposed increases in salaries and wages, c) increased incentive compensation and other employee benefit costs, d) proposed increases in generation, transmission, and distribution maintenance costs, e) the Company's request for a 10.75% return on equity, and f) the Company's request for an additional increase of $11.20 million to maintain certain credit ratios. The Company's filing represents the third case to be filed pursuant to the Regulatory Plan that was agreed upon by the Company and the KCC Staff in Docket No. 04-KCPE-1025-GIE.

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 a reasonable test year to use in this case to evaluate the reasonableness of the Company's claim.
2. The Company has a cost of equity of 9.39% and an overall cost of capital of 7.82% (see Schedule ACC-2).[1]
3. KCPL has pro forma test year rate base of $1,230,624,887 (see Schedule ACC-9).
4. The Company has pro forma operating income at present rates of $82,444,677 (see Schedule ACC-15).
5. KCPL has a pro forma revenue deficiency of $22,852,203 (see Schedule ACC-1). This is in contrast to the Company's claimed revenue requirement deficiency of $60,430,000.
6. If the KCC decides to permit the Company to increase rates in order to meet the bond coverage ratios outlined in the Stipulation in Docket No. 04-KCPE-1025-GIE, then an additional increase of $23,925,672 would be necessary (see Schedule ACC-41), resulting in an overall revenue increase of $46,777,875. (see Schedule ACC-1)
7. Any increase granted by the KCC relating to cash flow requirements should be applied as a rate base deduction beginning in the rate case filed in 2009, as

[1] Schedules ACC-1, ACC-39, ACC-40, and ACC-41 are summary schedules, ACC-2 to ACC-8 are cost of capital schedules, ACC-9 to ACC-14 are rate base schedules, and ACC-15 to ACC-38 are operating income schedules.

required in the Stipulation in Docket No. 04-KCPE-1025-GIE. The rate base deduction should equal the full, pre-tax amount of any such increase approved in this case, as well as all amounts collected as a result of the Stipulations in the last two base rate case proceedings.

IV. BACKGROUND OF THE REGULATORY PLAN

Q. Can you briefly describe the Regulatory Plan[2] that was approved by the KCC for KCPL?

A. Approximately five years ago, the KCC opened a docket to address the Company's future electric supply requirements and related pricing issues. The KCC, at the request of the Company, established a workshop forum to address various issues, including Integrated Resource Planning and related financial issues.

As a result of that process, the Company entered into a Regulatory Plan that addressed certain financial and policy issues over the next five years, during the period of construction of new generating capacity at Iatan. The Regulatory Plan was agreed to by the Company, Staff, Sprint, and the Kansas Hospital Association. CURB was not a signatory to the Settlement Agreement for the Regulatory Plan.

[2] Throughout this testimony, I will use the term "Regulatory Plan" to refer to the provisions of the Stipulation and Agreement in Docket No. 04-KCPE-1025-GIE, as well as the provisions outlined in the associated appendices.

Q. Please briefly outline the provisions of the Regulatory Plan.

A. Pursuant to the Regulatory Plan, KCPL agreed to undertake a series of capital investments, including the addition of 800-900 MWs of new coal-fired generation and 100 MWs of new wind generation. The Company also agreed to make certain investments with regard to transmission and distribution facilities and environmental upgrades, and to introduce several programs to address Demand Response, Efficiency, and Affordability issues.

The Regulatory Plan provided for KCPL to file a base rate case on or before May 1, 2006. That case was resolved by a Stipulation approved by the KCC on December 4, 2006. The Regulatory Plan permitted, but did not require, KCPL to file base rate cases in 2007 and 2008. This case is the second optional base rate case to be filed pursuant to the Regulatory Plan. The Regulatory Plan also requires the Company to file a base rate case on or before August 15, 2009, with new rates to be effective June 1, 2010.

The Regulatory Plan recognized that it was important for KCPL to maintain an investment grade rating during the construction process. In order to assist KCPL to maintain this rating, the Regulatory Plan contained a provision for "an amortization accounting [adjustment] to be referred to as a Contribution in Aid of Construction ("CIAC")."[3] Pursuant to the Regulatory Plan, the CIAC was an amount that would be treated as an additional amortization expense and added to KCPL's cost of service for ratemaking purposes if required in order to meet the cash flow requirements of the rating agencies. The Regulatory Plan provides that the accumulated CIAC will be treated as an increase to the depreciation

[3] Stipulation and Agreement, KCC Docket No. 04-KCPE-1025-GIE, p. 6.

reserve and deducted from rate base in future KCPL proceedings beginning in 2009. In essence, the CIAC provision equates to a prepayment of the new generating facilities by ratepayers if required to meet cash flow objectives.

Q. Please summarize the Stipulation that was agreed to in the Company's last base rate case.

A. In its last case, the Company requested a rate increase of $47.06 million, including $12.84 million in CIAC. In addition, the Company proposed to implement an Energy Cost Adjustment ("ECA") mechanism.

The Stipulation in that case provided for a total revenue increase of $28.0 million. The Stipulation provided that $11.0 million of this increase "will be treated for accounting purposes as a pre-tax payment on plant on behalf of customers. The $11 million pre-tax payment shall be treated as an increase to KCPL's depreciation reserve and will be assigned to primary plant accounts in a future rate case." In addition, the Stipulation included the establishment of an ECA mechanism and provided for off-system sales margins to flow back to customers through the ECA. The Stipulation also provided for the establishment of an Energy Efficiency Rider ("EER") to recover affordability, energy efficiency, and demand side management program costs. Finally, the Stipulation specified the accounting treatment for several types of costs, such as rate case costs, talent assessment costs, employee augmentation costs, enhanced security costs, pension costs, certain litigation costs, and a Department of Energy ("DOE") refund relating to Wolf Creek. Other issues addressed in the

Stipulation included depreciation rates, asset retirement obligations and cost of removal, decommissioning, SO_2 emission allowances, and Allowance for Funds Used During Construction ("AFUDC") on Iatan 2.

Q. What are the credit ratios that are addressed in the Regulatory Plan?

A. The Regulatory Plan addresses three credit ratios that should be considered by the signatory parties: total debt to total capitalization, funds from operations interest coverage, and funds from operation as a percentage of average total debt. The Regulatory Plan states that KCPL will address the first ratio through its issuance of securities. Thus, the Regulatory Plan states that the CIAC mechanism will be used, if necessary, to achieve the objectives for the other two ratios, funds from operations interest coverage and funds from operations as a percentage of average total debt.

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. The Company utilized the following capital structure and cost of capital in its filing:

	Percent	Cost Rate	Weighted Cost
Common Equity	55.39%	10.75%	5.95%
Preferred Stock	1.15%	4.29%	0.05%
Long Term Debt	43.47%	6.32%	2.75%
Total	100.00%		8.75%

A. Capital Structure

Q. Are you recommending any adjustments to this capital structure or cost of capital?

A. Yes, I am recommending adjustments to the Company's capital structure, its cost of debt, and its cost of equity claims.

Q. How did the Company determine its capital structure claim in this case?

A. KCPL's claim is based on the projected capital structure of its parent company, Great Plains Energy ("GPE") at March 31, 2009.

Q. Has the Company provided further information about its capital structure?

A. Yes, it has. In response to KCC-170, the Company provided its updated capital structure at November 30, 2008. This is the most recent actual capital structure provided by KCPL. I believe that it is more appropriate to utilize this actual capital structure than the projected capital structure proposed by the Company. Accordingly, on Schedule ACC-2, I have reflected this updated capital structure at November 30, 2008 and I have used this actual capital structure to determine my revenue requirement recommendation.

B. Cost of Debt

Q. What cost of debt have you included in your overall cost of capital recommendation?

A. I have used the Company's actual cost for long-term debt at November 30, 2008 as updated in the response to KCC-170.

C. Cost of Equity

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 KCPL, I have relied primarily upon the DCF. 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 a comparable group of companies, I utilized the same comparable group as that selected by the Company.

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 under two scenarios. First, I calculated the dividend yield using the average of the stock prices for each company over the past three months. The use of a dividend yield using a three-month average price mitigates the effect of stock price volatility for any given day. The three-month average is also consistent with the methodology used by KCPL witness Dr. Samuel Hadaway. Based on the average stock prices over the past three months, and the current dividend for each company, I determined an average dividend yield of 5.32% for the comparable group, as shown in Schedule ACC-5.

I also calculated a current dividend yield at January 12, 2009, which showed an average dividend yield of 5.16% for the comparable group. This calculation is also shown in Schedule ACC-5. Based on these determinations, I recommend that a dividend yield of 5.32% be used in the DCF calculation. This recommended dividend yield is higher than the average historic dividend yield of 4.52% shown in Schedule 5 to Dr. Hadaway's testimony due to the use of more recent data. My recommended dividend yield will be increased by ½ 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 ½ 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 Schedule ACC-6 and group averages are summarized below:

Past 5 Years - Earnings	1.5%
Past 5 Years - Dividends	0.0%
Past 5 Years - Book Value	3.4%
Past 10 Years - Earnings	1.4%
Past 10 Years - Dividends	(0.7%)
Past 10 Years - Book Value	2.6%
Estimated Next 5 Years - Earnings	6.0%
Estimated Next 5 Years - Dividends	4.5%
Estimated Next 5 Years - Book Value	4.6%

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 historic growth rates should be considered because security analysts have been 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 sold securities were the same firms that provided investors with research on these securities, including forecasts of earnings growth. This resulted in a direct conflict of interest since it has traditionally been in the best interest of securities firms to provide optimistic earnings forecasts in the hope of selling more stock. Therefore, earnings growth forecasts should be analyzed cautiously by state regulatory commissions.

The continued unreliability of analysts' future forecasts has been confirmed with the recent economic problems faced by the financial community in late 2008 and 2009. Many firms, including Value Line, incorrectly forecasted steady growth for companies whose stock prices have now fallen dramatically, and in some cases for firms that have now required bailouts from other firms or the federal government. Although Value Line does not sell stock, its forecasts appear to be just as optimistic as many of the securities firms. The KCC needs only to examine actual results in 2008 to realize that earnings forecasts should be viewed with a healthy dose of skepticism.

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

A. Based on my review of this data, I believe that a growth rate of no greater than 4.5% should be utilized. This recommended growth rate is equal to the projected five-year growth rate in dividends per Value Line. Moreover, my recommended growth rate is higher than the actual average growth rates over the past five or ten years in earnings, dividends or book value. Value Line is projecting an average earnings growth rate of 6.0% for the companies in the comparable group, but this growth is unrealistic given the current economic environment, especially over the next 12-18 months. KCPL will be filing another base rate case in 2009 and the KCC will have the opportunity to reevaluate its cost of capital at that time.

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

A. My analysis indicates a cost of equity using the DCF methodology of 9.94%, as shown below:

Dividend Yield	5.32%
Growth in Dividend Yield (1/2 X 4.50% X 5.32%)	0.11%
Expected Growth	4.50%
Total	9.94%

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. Utility stocks have traditionally 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 have generally been less than 1.0.

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

A. My CAPM analysis is shown in Schedule ACC-7. First, I used a risk-free rate of 4.00% for the yield on long-term U.S. Government bonds. In addition, I used the average Beta for the proxy group. This resulted in an average Beta of 0.76, as shown in Schedule ACC-8. Finally, since I am using a long-term U.S. Government bond rate as the risk-free rate, the risk premium that should be used is the historic risk premium of stocks over the rates for long-term government bonds. According to the 2008 Ibbotson Valuation Yearbook, *Market*

Results for Stocks, Bonds, Bills, and Inflation, 1926-2007 the risk premium of using geometric mean returns is 4.9%.

Q. How did you determine your recommended risk-free rate of 4.0%?

A. In the past, I have generally recommended using a risk-free rate based on the most recent rate for thirty-year U.S. Government bonds. However, the thirty-year rate is currently at an historic low of under 3.0% and there has been substantial volatility in the rate over the past few weeks. Given this volatility and the fact that the rate is currently at historic low levels, I believe that the current rate may not be reasonable to use in setting utility rates.

In order to determine a reasonable risk-free rate to use in the CAPM, I reviewed the thirty-year U.S. Government bond rates since January 2008. The thirty-year rate was generally above 4.0% until late in 2008, dropping rapidly to 2.62% by the end of the year. Based on the level of rates experienced during 2008, and the fact that the Company will be filing another rate case in 2009, I recommend that the KCC utilize a rate of 4.0% as the risk-free rate in the CAPM. This 4.0% rate provides a balance between current rates and the rates experienced over the past twelve months.

Q. Turning to the issue of the risk premium, 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 use of the arithmetic mean would suggest 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 returns to develop an historic relationship. Therefore, the geometric mean is the appropriate measure, as illustrated in the above example.

Q. Did Dr. Hadaway also utilize a geometric mean in his risk premium analysis?

A. Yes, he did. In at least one of his risk premium analyses, Dr. Hadaway relied upon the geometric mean returns as reported by Value Line.

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

A. Given a long-term risk-free rate of 4.00%, a Beta of 0.76, and a risk premium of 4.9%, the CAPM methodology produces a cost of equity of 7.72%, as shown on Schedule ACC-7.

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

4.00% + (0.76 X 4.9%) = 7.72%

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 7.72 % to 9.94% 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 9.39%, as shown below:

DCF Result	9.94% X 75% =	7.22%
CAPM	7.72% X 25% =	2.38%
Total		9.39%

This weighting methodology is consistent with the methodology that I have used in prior cases before the KCC, as well as in other jurisdictions that have expressed a preference for the DCF model.

Q. Why is your recommendation substantially lower than the cost of equity recommended by Dr. Hadaway?

A. My recommendation is substantially lower than Dr. Hadaway's primarily because he used unrealistic growth projections. Dr. Hadaway calculated three DCF results. His first DCF model used a constant growth based only on analysts' estimated growth rates. This resulted in an average growth rate of 6.70%, which I believe is overly optimistic, especially when one considers the time period over which these rates will be in effect.

Dr. Hadaway's second DCF analysis used long-term projected GDP growth as his growth rate. This methodology resulted in an average growth rate of 6.50%. Dr. Hadaway claims that the long-term GDP "is the most general measure of economic growth in the U.S. economy."[4] While it may be true that GDP is the most general measure of economic growth in the U.S. economy, it does not follow that GDP is an appropriate rate to utilize for utility dividends in a DCF model. Moreover, Dr. Hadaway developed his GDP growth rate of 6.50% by averaging historic GDP growth over 10, 20, 30, 40, 50, and 60 years. However, as shown on Schedule SCH-4 to Dr. Hadaway's testimony, the ten-year average of 5.2% and the twenty-year average of 5.5% are both well below the growth rates of 6.6% to 7.3% that occurred in the remaining periods reviewed. Given that the Company will be filing its next rate case next year, the use of a GDP growth rate that is heavily dependent upon high growth rates, especially the 11.0% plus growth rates that occurred during the 1973 to 1984 period, is particularly inappropriate. There is no evidence that GDP growth is the appropriate growth

[4] Testimony of Dr. Hadaway, page 32.

rate to use for utility dividends and this is especially true of GDP growth from thirty years ago.

Dr. Hadaway's third DCF analysis employed a two-stage DCF, using the Value Line projected dividend for the first stage and the long-term projected GDP for the second stage. Dr. Hadaway's analysis used Value Line projections from June-August 2008, while my analysis uses the most recent Value Line projections. Moreover, Dr. Hadaway's two-stage model is again flawed due to the use of the GDP.

D. <u>Overall Cost of Capital</u>

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

A. As shown on Schedule ACC-2, I am recommending an overall cost of capital for KCPL of 7.82 %, as shown below:

	Percent	Cost Rate	Weighted Cost
Common Equity	50.76%	9.39%	4.76%
Preferred Stock	1.27%	4.29%	0.05%
Long Term Debt	47.98%	6.25%	3.00%
Total	100.00%		7.82%[5]

[5] Does not add due to rounding.

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 made various post-test year adjustments through March 31, 2009.

A. Utility Plant In Service

Q. Please describe the Company's claim for utility plant in service.

A. The Company has included utility plant-in-service additions and retirements through March 30, 2009 in its claim. The most significant addition relates to the environmental upgrades at Iatan 1. According to the Company's workpapers, the Company has included post-test year net plant additions of $325.4 million related to Iatan 1 upgrades in its filing. These upgrades are expected to go into service in mid-February, 2009.

Pursuant to the Regulatory Plan, if the Company elected to file a base rate case in 2008, it was to have been filed by March 1, 2008, reflecting plant-in-service additions through December 31, 2008. KCPL requested that the KCC postpone this filing deadline for sixty days. In approving the Company's request, the KCC stated that "other deadlines in the procedural schedule triggered by the filing of KCPL's rate case will be extended, such as inclusion of new plant investments to February 28, 2009, filing of the Commission's Order to February 10, 2009, and effective date for rates to March 1, 2009."

The Company subsequently filed a Petition for Reconsideration seeking clarification of the KCC's Order. Specifically, KCPL requested that the KCC approve an unspecified delay in the filing of the 2008 base rate case, rather than approving a specific sixty-day delay. In this Petition for Reconsideration, the Company indicated that the sixty-day delay referenced in the original petition was illustrative and requested flexibility in the actual filing date, based on progress made at Iatan 1 on the environmental upgrades. The Commission approved the Company's Petition for Reconsideration on April 30, 2008.

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

A. Yes, I am recommending two adjustments to the Company's claim. First, the Company's claim is based on projected costs through March 31, 2009. That claim includes costs for the Iatan 1 upgrades as well as costs for various other projects. As of the filing date of this testimony, we do not know if the Company will meet its projection of utility plant-in-service. However, at this time, we do have actual plant-in-service balances through December 31, 2008. Therefore, my first adjustment trues-up plant that was actually in-service at December 31, 2008 with the Company's projected December 31, 2008 balance per its filing. Since the majority of the Iatan 1 upgrades were projected by the Company to go into service in February 2009, the majority of the projected 2008 additions related to other types of investment. We now have actual results at December 31, 2008 that indicate that KCPL's actual plant was below the December 31, 2008 projection included in its filing. Therefore, the KCC should take this actual plant balance into account while evaluating the Company's revenue requirement claim.

Q. Please describe your second adjustment.

A. In response to KCC-241, the Company indicated that it had inadvertently included certain costs related to merger and integration systems for the Aquila acquisition in its rate base claim. Cost recovery for these systems was addressed in the Stipulation in Docket No. 07-KCPL-1064-ACQ. Pursuant to that stipulation, KCPL was permitted to defer $10 million of transition costs, defined as "the costs incurred to integrate and centralize Aquila's and GPE's and/or KCPL's operational functions, such as but not limited to information technologies and customer service functions." These costs were to be deferred and recovered over 5 years, beginning with rates resulting from the Company's 2009 base rate case. The Company was not permitted to include any of these deferred costs in rate base.

According to the response to KCC-241, the Company's claim includes $14.3 million in post-test year utility plant in service additions that were related to merger and integration activities. Therefore, at Schedule ACC-10, I have also made an adjustment to eliminate these costs from the Company's rate base. That Company acknowledges that these costs should not be included in rate base.

Q. Have you made any adjustment to the Company's claim for 2009 plant additions?

A. No, I have not. As stated, the majority of these additions relate to the Iatan 1 upgrades and I have not made any adjustment to the Company's projected costs. However, there are several factors that the KCC should keep in mind as it evaluates the Iatan 1 project.

These project costs have increased significantly since the Regulatory Plan was approved. The Regulatory Plan included $271.8 million for the Iatan 1 environmental upgrades. According to the testimony of Mr. Davis, the original "control budget estimate", developed when the projects were approximately 20-25% engineered, was $376.8 million. The current estimate is a total of $484.2 million, an increase of 28.5% over the control budget estimate and an increase of 78.1% over the amount approved in the Regulatory Plan. The Company has also suggested in response to KCC-94S that the Company's claim for Iatan 1 was understated since it only included a portion of common plant that will be used for both Iatan units. According to this response, FERC requires all common plant to be recognized at the time that the first unit to utilize this common plant is placed into service. Thus, KCPL argues that under that approach, 100% of the common plant should have been recognized in its rate base claim in this case, along with the Iatan 1 environmental upgrades.

The KCC approved a Regulatory Plan based on representations made by the Company regarding the magnitude of costs for certain projects. KCPL presented the Regulatory Plan as a framework that was necessary in order for the Company to build new generation, and to meet other commitments necessary to serve Kansas customers. The generation resources envisioned under the plan were justified by the Company based on assumptions with regard to cost, customer growth, environmental concerns, and other factors that may no longer apply. The KCC should consider holding the Company, and its shareholders, responsible for the assumptions on which the Regulatory Plan was based, especially when one considers the fact that the Company was able to fund its acquisition of Aquila during the period of the Regulatory Plan. While I am not making any adjustment to the Company's proposed 2009 additions, the KCC may want to limit the costs included in rates resulting from this case to the costs projected by KCPL in the Regulatory Plan. The KCC may also want to investigate further the significant cost overruns that have occurred in the Iatan 1 environmental upgrades.

It is interesting to note that in this case, the Company has sponsored the testimony of two witnesses, Carl Churchman and Kenneth M. Roberts, testify on the reasonableness of the Company's costs for the Iatan 1 environmental upgrades. Mr. Roberts' consulting contract with KCPL includes a rate for his services of *****CONFIDENTIAL** [redacted] **CONFIDENTIAL*****, according to the response to CURB-87, and to date his firm has been paid over $8.0 million, most of which has been capitalized.[6]

Q. Is it your understanding that the amounts currently projected for Iatan 2 are also in excess of those included in the Regulatory Plan?

A. Yes, while the specific estimates are proprietary, it is my understanding that the costs for Iatan 2 are expected to exceed those approved in the Regulatory Plan. The Company should have some obligation to ensure that the assumptions presented to the KCC were accurate, since it was these assumptions that the KCC relied upon in deciding whether or not to

[6] KCPL Response to CURB-88.

approve the plan. To the extent that certain assumptions on which the Regulatory Plan was based were not accurate, KCPL's shareholders should bear at least a portion of that risk.

Capital projects included in the Regulatory Plan totaled $1.23 billion. It should be noted that the Regulatory Plan was meant to be incremental to the capital expenditures that would normally be made by KCPL. Thus, as pointed out during the cross-examination of Mr. Giles in Docket No. 04-KCPE-1025-GIE, total capital expenditures were projected to be approximately $2 billion over the life of the Regulatory Plan:[7]

Q. Just for clarity too, what we talk about in this plan is the resource plan, this is about $1.2 billion of expenditures over a 5-, 6-year period roughly, correct?

A. Correct.

Q. But just to be clear, $1.2 billion is not all of KCPL's capital expenditures over this period, correct?

A. That's true.

Q. These are just -- these are the incremental, over and above what KCPL would normally spend?

A. That's right.

Q. So just what is over this 5-year period, if it's not the $1.2 billion that is going to get spent, what is the right number?

A. We -- our capital budget runs excluding nuclear fuel about 140 to 150 million per year.

Q. That would be another 7 to 800 million in capital expenditures over the period?

[7] Transcript of June 17, 2005 Hearing, pp. 42-43, KCC Docket No. 04-KCPE-1025-GIE.

A. That's correct.

Q. So you're actually talking about $2 billion worth of capital expenditures over the term of this regulator (sic) plan is probably a more accurate description?

A. That's true.

According to the testimony of Mr. Cline in the 2007 base rate case, total capital expenditures, including expenditures associated with the Regulatory Plan and normal, on-going capital expenditures, were expected "to exceed $2.5 billion" during the 2007-2011 timeframe. That estimate has now been revised again. According to the response to CURB-115, actual and projected capital expenditures over the 2007-2011 timeframe are now projected to be *****CONFIDENTIAL** [redacted] **CONFIDENTIAL *****. This represents a substantial increase over the amounts included in the five-year Regulatory Plan and an increase over amounts projected in the last case. KCPL, and its shareholders, should bear at least some responsibility for these escalating costs, since the assumptions used to justify the Regulatory Plan have not been supported with actual results.

B. <u>Accumulated Depreciation</u>

Q. How did the Company develop its claim for accumulated depreciation?

A. The Company's claim for accumulated depreciation is based on its balance for accumulated depreciation at December 31, 2007, adjusted to reflect additions to the depreciation reserve through March 30, 2009. The Company developed its post-test year adjustment by including fifteen months of additional depreciation on plant that was in service at December 2007. In addition, the Company included fifteen months of additional depreciation on utility plant-in-service additions, excluding the Iatan 1 upgrades, based on an assumption that additions were added consistently during this period. Finally, with regard to Iatan 1, the Company included approximately six weeks of depreciation expense additions to the reserve, based on a projected in-service date of approximately February 15, 2009.

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

A. Yes, since I am recommending an adjustment to the Company's utility plant-in-service claim, as discussed above, it is necessary to make a corresponding reserve addition. Therefore, I have made an adjustment to eliminate from the reserve depreciation expense on plant that I have also eliminated from the Company's revenue requirement.

Q. How did you quantify your adjustment?

A. I began with the recommended plant adjustment of $18,005,144. I assumed that, on average, one-half of this plant was included in the Company's depreciation reserve adjustment. I then applied the composite monthly depreciation rate to this average plant to determine a monthly depreciation reserve adjustment. Finally, I multiplied this monthly amount by fifteen months to reflect the period of time used by KCPL in its pro forma depreciation reserve claim. My adjustment is shown in Schedule ACC-11.

C. Cash Working Capital

Q. What is the Company's cash working capital claim in this case?

A. KCPL has included a cash working capital claim of ($25,991,183), which includes the impact of post-test year adjustments. Excluding the cash working capital associated with post-test year adjustments, the Company's cash working capital claim is ($24,225,697). Thus, the Company has a negative cash working capital requirement. This negative cash working capital requirement is primarily the result of the fact that the Company sells its accounts receivables, minimizing the revenue lag for a large percentage of the Company's sales.

Q. Are you recommending any adjustments to the Company's claim for cash working capital?

A. Yes, I am recommending two adjustments. In the response to KCC-248, the Company indicated that it had used an incorrect revenue lag for bulk power sales and other revenue. KCPL mistakenly used a revenue lag of 25.08 days in its filing, rather than the 27.29 days used for its other cash working capital elements. In KCC-248, the Company filed a revised cash working capital claim, incorporating the 27.29 revenue lag for bulk power sales and other revenue. Accordingly, at Schedule ACC-12, I have made an adjustment to the Company's cash working capital claim to reflect this correction.

Q. Are you recommending any other adjustments to the Company's cash working capital claim?

A. Yes, I am. In its filing, the Company included a cash working capital requirement associated with fuel and purchased power costs. As a result of the Stipulation in Docket No. 07- KCPE-905-RTS, the Company is permitted to recover these costs through an ECA clause. In fact, these costs are recovered on a dollar-for-dollar basis from ratepayers. Since the Company's request for an ECA was accepted by the KCC, I am recommending that the KCC eliminate fuel and purchased power costs from the cash working capital calculation.

The ECA is typically based on two factors: estimated fuel and purchased power costs for the current period and an actual cost adjustment true-up factor. Therefore, in any given month, there is likely to be either an under-recovery or over-recovery of fuel and purchased power costs. Consequently, in any particular month, the revenue received by KCPL may be reimbursing the Company for fuel and power purchased in the past, or it may be providing funds for fuel and power that is still to be purchased in the future.

Because of the special nature of purchased fuel and purchased power adjustment clauses, these costs are frequently excluded from the cash working capital calculation. This is because it is very difficult at any point in time to determine if the Company is being compensated for prior costs, current costs, or future costs. Therefore, I am recommending that the cash working capital associated with fuel and purchased power costs be removed from the cash working capital calculation. This adjustment is also shown in Schedule ACC-12.

Q. Have you updated the Company's cash working capital claim for the impact of the operating expense adjustments that you are recommending?

A. No, I have not. However, I do recommend that the KCC update the Company's cash working capital claim to reflect the level of expenses ultimately found to be appropriate and authorized by the KCC.

D. <u>Fossil Fuel Inventory</u>

Q. How did the Company develop its claim for fossil fuel inventory?

A. As described on page 11 of Mr. Blunk's testimony, inventory values for oil, lime and limestone were calculated using the average inventory quantities for the 13-month period ending June 2008, multiplied by the June 2008 per-unit value. Coal inventory was determined based on a Utility Fuel Inventory Model ("UFIM") that attempts to identify the level of inventory resulting in the lowest expected overall cost.

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

A. Yes, I am recommending two adjustments. First, I am recommending an adjustment to the quantity of coal inventory. The Company's quantity of coal in inventory is based on a theoretical model, not on actual results during the test year. However, as discussed in the Company's testimony, coal supplies have been impacted by rail disruptions, speculative traders, and clean air regulations. Therefore, it is entirely possible that in any given year the Company may not meet its targeted coal inventory projections. The targeted coal inventory levels being claimed in this case are significantly above the actual inventory levels during the test year. Accordingly, the Company's inventory claim for coal inventory, which is based on modeling rather than on actual results, appears to be overstated.

Q. What do you recommend?

A. I recommend basing the coal inventory level on the average balance for the thirteen months ending June 2008. This methodology is consistent with the methodology used by KCPL for other types of fuel inventory. This methodology is especially reasonable in this case, since the Company will be filing another base rate case next year and coal inventory levels can be updated at that time, if necessary. My adjustment is shown in Schedule ACC-13.

Q. Are you recommending any adjustment to the unit price for coal included in the Company's inventory claim?

A. No, I am not. It is my understanding that the Company has contractual commitments for its expected coal requirements. Therefore, I have not made any adjustment to the per unit cost included in the Company's claim.

Q. What is your second adjustment?

A. In developing its inventory claim for oil, KPCL used a projected March 2009 price. This resulted in a significant increase to the per barrel cost of oil relative to the actual test year inventory cost. However, since the Company's case was filed, the price of oil has fallen considerably. In fact, according to inflationdata.com, prices have fallen consistently since June 2008. In fact, prices are now below levels at January 2008, as shown below:

Monthly Average Domestic Crude Oil Prices 2008		
	U.S. Average (in $/bbl.)	
Month	**Nominal**	**Inflation Adjusted**
Jan-08	$84.70	$85.24
Feb-08	$86.64	$86.94
Mar-08	$96.87	$96.37
Apr-08	$104.31	$103.15
May-08	$117.40	$115.12
Jun-08	$126.33	$122.64
Jul-08	$126.16	$121.84
Aug-08	$108.46	$105.16
Sep-08	$96.13	$93.34
Oct-08	$68.50	$67.19
Nov-08	$49.29	$49.29
Dec-08	$32.94	$32.94

Therefore, in my opinion, the Company has not justified any increase over the actual test year costs. Accordingly, at Schedule ACC-14, I have made an adjustment to eliminate the Company's post-test year increase to its oil inventory costs.

E. Summary of Rate Base Issues

Q. What is the impact of all of your rate base adjustments?

A. My recommended adjustments reduce the Company's rate base claim from $1,254,148,612, as reflected in its filing, to $1,230,624,887, as summarized on Schedule ACC-9.

VII. OPERATING INCOME ISSUES

A. Salary and Wage Expense

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

A. KCPL's claim is based on the number of budgeted employees for KCPL and GPE[8] at March 2009. In developing its claim, the Company annualized payroll increases that occurred in 2008. 2008 management increases averaged 3.75% while union increases ranged from 3.0% to 3.75%. In addition, the Company annualized additional payroll increases that are not expected to occur until 2009. In addition to payroll costs, the Company also made adjustments to include overtime costs, severance costs, and incentive payments in its claim.

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

A. Yes, I am recommending several adjustments. First, I am recommending that the KCC eliminate 2009 payroll increases from the Company's revenue requirement claim. The Company has included non-union increases of 3.75% estimated to occur on March 1, 2009, fifteen months beyond the test year in this case. Such increases are speculative and do not meet the known and measurable criteria for post-test year adjustments. The Company is under no contractual obligation to award these increases.

In addition, KCPL has included union increases of 3.25% to 3.75% that are projected to occur from February 1 through April 1, 2009. Including adjustments that extend this far out past the end of the test year violates the matching principle, which requires the

[8] Approximately 68% of GPE's costs are allocated to KCPL.

components of the regulatory triad to be matched at a point in time. Therefore, the 2009 increases included by the Company should be rejected by the KCC. My adjustment to eliminate these increases is shown in Schedule ACC-16.

Q. What is your second payroll expense adjustment?

A. My second adjustment relates to employee vacancies. The Company's claim assumes a full complement of budgeted employees. However, as shown in the Company's Manpower Reports, KCPL/GPE have consistently had a large number of vacant positions. According to the reports provided in response to CURB-26, the Company has consistently had vacancies at any given time over the past three years, as one would expect in a company of this size.

It is normal and customary for companies to have unfilled positions at any given time as a result of terminations, transfers, and retirements. If utility rates are set based on a full complement of employees, and if these employee positions remain vacant, then ratepayers will have paid rates that are higher than necessary, to the benefit of shareholders. Therefore, when setting rates, I recommend that the KCC consider the fact that, at any given time, positions are likely to be vacant.

Q. How did you quantify your adjustment?

A. My adjustment is based on the average percentage of vacant positions for each month during 2007, the test year in this case. Based on the reports provided in response to CURB-26, I calculated that, on average, 1.94% of the Company's positions were vacant during 2007.

Therefore, I reduced the Company's pro forma payroll expense by 1.94% to eliminate payroll costs associated with vacant positions. The actual level of vacancies in the test year, 1.94%, is generally consistent with the three-year average of 2.08% vacancies experienced by KCPL in the three years prior to the test year. My adjustment to reduce the Company's pro forma payroll expense claim to recognize employee vacancies is shown in Schedule ACC-16.

Q. Other than the adjustment related to vacant positions, did you make any other adjustment to the number of employees as projected by KCPL in its claim?

A. No, I did not. Therefore, my recommendation reflects the projected number of employees, adjusted only to recognize the fact that employee vacancies occur continuously in a company the size of KCPL.

Q. What is your final payroll expense adjustment?

A. As shown on the workpapers supporting its payroll expense adjustment, Adjustment No. 20, KCPL reduced its payroll cost claim to eliminate a pro forma share of costs that are billed to Joint Partners. In determining the amount to reflect for billings to Joint Partners, the Company used a three-year average of actual billings to the Joint Partners.

I believe that the Company's methodology understates costs to the Joint Partners. These costs have increased in each of the past three years, which is not surprising when one considers the salary and wage increases that have been granted to employees during this time. Thus, assuming that the quantity of work for the Joint Partners has remained relatively constant from year-to-year, one would still expect billings to Joint Partners to increase each year, due to annual salary and wage increases.

Q. What do you recommend?

A. I recommend that the actual test year billings to the Joint Partners, adjusted to reflect the 2008 salary and wage increases, be incorporated into the Company's revenue requirement. In order to quantify my adjustment, I have increased the actual test year billings to the Joint Partners by 3.5%, which represents the average salary and wage increase granted in the test year. My adjustment is shown in Schedule ACC-16.

Q. Are you also recommending a payroll expense adjustment relating to Wolf Creek payroll?

A. Yes, I am. In its filing, the Company included 2009 executive and management increases of 4.0% and 3.75% respectively. For the reasons discussed above with regard to 2009 KCPL payroll increases, I am recommending that these increases be eliminated from the Company's revenue requirement claim. These 2009 increases are speculative, do not meet the known and measurable standard, and are well outside of the test year in this case. Accordingly, I recommend that the Company's request to recover these increases in this case be denied. My adjustment is shown in Schedule ACC-17.

My recommendation is especially reasonable when one considers the magnitude of the increases that took place at Wolf Creek in 2008. According to the Company's workpapers, the increase for executives was 10.6% in 2008, and the increase for other management employees was 3.75%. These increases, especially the executive increase of 10.6%, suggests that the non-union increases awarded at Wolf Creek are especially generous.

B. Incentive Compensation Expense

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

A. The Company included costs for several incentive compensation plans in its filing, including $4,306,008 for an equity compensation plan available to officers and $4,754,644 for the management ValueLink plan. These plans provide for incentive payments based on three criteria: financial, operational, and individual goals.

While the weighting of these goals differs somewhat based on the plan, no awards are made unless certain financial objectives are met. Thus, financial parameters form the basis that determines whether or not <u>any</u> awards will be made.

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 benefits 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 just and reasonable rates. 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. Are KCPL employees being well compensated, separate and apart from these employee incentive plans?

A. Yes, they are. Over the past several years, the Company's non-union employees have consistently received 3.8% annual salary increases. Management at Wolf Creek has fared even better, with some executives receiving increases of 10.6%. Moreover, there is no indication that KCPL is having difficulty attracting quality non-union employees to its workforce. The Company's salary and wage levels appear reasonable, even if the incentive compensation plans are not taken into account.

Moreover, the description of the ValueLink Plan provided to employees, which was provided to the parties in response to KCC-58, repeatedly refers to ValueLink as a "bonus." In addition, the description of the executive incentive plan is explicit in stating that the "Plan provides competitive incentives for the achievement of increased shareholder value over a multi-year period."

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

A. Yes, I am recommending that the KCC deny the Company's request to recover these costs from ratepayers. These plans are bonus plans driven by financial benchmarks. Moreover, the prospective incentive plan payments are not known or measurable, since they are based on future levels of operating income and other variables that cannot be quantified with certainty until the end of each year. My recommendation will require the Company to establish incentive compensation plans that shareholders are willing to finance. As long as ratepayers are required to pay the costs of these incentive plans, then there is no incentive for the Company 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 reject the Company's claim to recover these incentive compensation costs from ratepayers. My adjustment is shown in Schedule ACC-18.

Q. Are these awards in some cases based on industry peer group statistics?

A. Yes. However, the problem with tying these awards to industry peer groups is that no company wants to be below the average of the group. Studies of peer groups performed by Mercer and other human resource consulting firms put compensation on a continuing upward spiral as each company that falls below the mean or median attempts to increase their position among their peers. For that reason, awards that rely upon industry peer groups can result in inflated salaries that continue to escalate as the companies below the average attempt to raise their standing in the group.

Q. Have other states rejected claims for incentive compensation costs?

A. Yes. In a 2000 base rate case involving Middlesex Water Company, Board Staff argued in its Initial Brief that,

> Staff is persuaded by the arguments of the RPA that, at this time, the incentive compensation expenses should not be recovered from ratepayers. According to the record, incentive compensation expenses have tripled since 1995. In addition, the record also indicated that the bonuses are significantly impacted by the Company achieving financial performance goals. These facts lend strength to the RPA's position that it is inappropriate for the Company to request recovery of bonuses in rates at this time.[9]

[9] I/M/O the Petition of Middlesex Water Company for Approval of an Increase in Its Rates for Water Service and

While the Administrative Law Judge ("ALJ") in that case recommended that Middlesex be permitted to recover 50% of its incentive compensation costs in rates, the BPU rejected the ALJ's recommendation and instead ordered that 100% of these costs be disallowed.[10]

In an earlier decision, the BPU found that including employee incentives in utility rates is especially troublesome during difficult economic times, finding that,

> We are persuaded by the arguments of Staff and Rate Counsel that, at this time, the incentive compensation or "bonus" expenses should not be recovered from ratepayers. The current economic condition has impacted ratepayers' financial situation in numerous ways, and it is evident that many ratepayers, homeowners and businesses alike, are having difficulty paying their utility bills and otherwise remaining profitable. These circumstances, as well as the fact that the bonuses are significantly impacted by the Company achieving financial performance goals, render it inappropriate for the Company to request recovery of such bonuses in rates at this time. Especially in the current economic climate, ratepayers should not be paying additional costs to reward a select group of Company employees for performing the job they were arguably hired to perform in the first place.[11]

It is indisputable that ratepayers are once again facing very difficult economic conditions. Consumers and regulators are examining management bonus plans with renewed interest. Now, more than ever, ratepayers deserve relief from costs that are designed to benefit the Company and its shareholders, but which may not provide a direct benefit to ratepayers.

Other Tariff Charges, BPU Docket No. WR00060362, Staff Initial Brief, p. 37.

[10] I/M/O the Petition of Middlesex Water Company for Approval of an Increase in Its Rates for Water Service and Other Tariff Charges, BPU Docket No. WR00060362, Order Adopting in Part/Modifying in Part/Rejecting in Part Initial Decision at 25-26 (June 6, 2001).

[11] I/M/O the Petition of Jersey Central Power & Light Company for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions, BRC Docket No. ER91121820J, Final Decision and Order Accepting in Part and Modifying in Part the Initial Decision at 4 (June 15, 1993).

Q. If the KCC rejects your proposal to disallow 100% of the incentive compensation costs, should it consider making a partial disallowance of these costs?

A. Yes. As stated above, the awards are dependent upon KCPL achieving certain financial thresholds. However, once that threshold is met, then the actual amount of individual incentive awards is dependent upon several factors, such as corporate financial performance, operational performance, and individual performance. Various weightings are given to these criteria. However, in general, 40% of the resulting individual awards are directly tied to corporate financial parameters. Thus, if the KCC rejects my recommendation to eliminate 100% of the incentive compensation costs, it should at least disallow that portion of the individual incentive awards that is directly tied to financial performance. In that case, I would recommend that the KCC disallow an average of 40% of the claimed incentive compensation costs.

C. Severance Expense

Q. How did the Company determine its claim for severance costs in this case?

A. KCPL's claim is based on a three-year average of costs, covering 2005-2007.

Q. Do you believe that this is a reasonable methodology to utilize in establishing prospective rates?

A. No, I do not. I believe that the Company's methodology ignores the fact that the Company undertook a major severance program in 2005 and 2006, i.e., the talent assessment program.

While the Company eliminated the specific talent assessment costs incurred in 2006 when it developed its three-year average, the implementation of this program was intended to restructure and realign the Company's personnel needs. Therefore, the talent assessment program is likely to have reduced the need for severance costs in the future. Accordingly, in my opinion, the use of costs that relate to years prior to the talent assessment program are not necessarily representative of prospective operations.

Q. What do you recommend?

A. Given the significant personnel changes that occurred in 2005 and 2006, I recommend that the actual test year severance costs be used to determine the Company's revenue requirement in this case. These costs are more representative of prospective costs than the costs incurred prior to the talent assessment program. My adjustment is shown in Schedule ACC-19.

D. <u>Payroll Tax Expense</u>

Q. Have you also 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 payroll adjustments relating to salaries and wages for both the Company and for Wolf Creek, as well as my adjustments for incentive compensation costs and severance costs. To quantify this adjustment, I utilized the statutory Social Security and Medicare tax rate of 7.65%. This payroll tax adjustment is shown in Schedule ACC-20.

E. Employee Benefits Expense - 401K Contributions

Q. Are you recommending any adjustment to the Company's claim for costs associated with its 401K contributions?

A. Yes, I am. In its filing, KCPL included 401K costs, based on annualized payroll costs at KCPL and GPE. The Company used a contribution rate of 2.721% for KCPL payroll and of 4.119% for GPE payroll.

Since I am recommending adjustments to the Company's payroll cost claim, it is necessary to make corresponding adjustments to its claim for related 401K costs. Therefore, I have reduced the Company's 401K cost claim to eliminate contributions related to the payroll costs that I have disallowed. To quantify my adjustment, I applied the 2.721% 401K contribution rate to my recommended disallowance of KCPL payroll costs, and the 4.119% contribution rate to my recommended adjustment related to GPE payroll costs. My adjustment is shown in Schedule ACC-21.

F. Bad Debt Expense

Q. How did the Company quantify its bad debt expense claim in this case?

A. As discussed in the testimony of Mr. Weisensee, the Company calculated its bad debt expense by applying a state-specific net bad debt write-off factor to test period jurisdictional revenues. In quantifying its claim, the Company used the net bad debt write-offs (accounts written off less recoveries of accounts previously written off) for the test year and the retail revenues for the period July 2006 to June 2007. The Company also included a pro forma adjustment at proposed rates to reflect incremental bad debts associated with the incremental revenues associated with this base rate case.

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

A. Yes, I am recommending that the bad debt factor be based on actual revenues received during the test year, instead of on revenues received for the twelve-month period ending June 2007. In determining an appropriate bad debt factor, regulatory commissions generally match the time period over which revenues are received with the time period over which bad debts are written off. While there is invariably a lag between when a specific revenue is booked and when that revenue is written-off, attempting to match the specific timing of revenues and write-offs adds unnecessary complexity to the analysis. Moreover, in this case new rates went into effect in January 2006. Therefore, using the twelve-month period ending June 2007 for the revenue component can distort the results by spanning two periods during which different rates were in effect.

The Company's methodology is also internally inconsistent because it applies its proposed bad debt factor to pro forma revenue, rather than to revenue that has already been recognized on its books and records of account. Thus, the Company's pro forma adjustment at present rates is not based on revenue actually received during the latter half of 2008, but on prospective, normalized revenue. Moreover, the additional adjustment at proposed rates similarly was developed by applying the bad debt factor to prospective revenue that reflects the full rate increase being requested in this case. Therefore, while the Company reflected a revenue lag in developing its bad debt factor, it did not take this revenue lag into effect when applying that factor to pro forma revenues.

For all these reasons, I recommend that the Company's bad debt expense claim be based on a factor that is developed based on actual net write-offs during the test year and actual test year revenues. This methodology results in a bad debt expense factor of 0.3469% instead of the 0.3675% utilized by KCPL. I have applied my bad debt expense factor to the Company's claimed pro forma revenue at present rates in order to quantify the revenue requirement impact of my recommendation. My adjustment is shown in Schedule ACC-22.

Q. How did you account for bad debt expense associated with your proposed rate increase?

A. In order to account for bad debt expense associated with my proposed rate increase, I have included a bad debt expense factor in my revenue multiplier. Thus, the bad debt expense included in my recommendation is matched to the overall level of the rate increase that I am recommending in this case.

G. Maintenance Expense

Q. Please describe the Company's expense adjustments relating to maintenance costs.

A. KCPL has included several maintenance adjustments in its filing. These include adjustments relating to generation in the amount of $5,062,895, transmission in the amount of $643,092, distribution in the amount of $5,722,680, and information technology in the amount of $1,439,921. I am recommending adjustments in each of these four areas.

Q. How did the Company quantify its production maintenance expense adjustment?

A. KCPL utilized a seven-year average of maintenance costs, adjusted to reflect cost increases to 2009 based on Handy Whitman Index factors. In addition, the Company made several other adjustments to eliminate maintenance costs for facilities that are no longer in use or to normalize costs for facilities that went into service during the seven-year period.

Q. Please describe your adjustment relating to the Company's production maintenance expense claim.

A. I am recommending that the actual test year level of production maintenance costs be used to determine the Company's revenue requirement in this case. My recommendation is based on two factors. First, while the Company's historic maintenance costs have fluctuated from year-to-year, the actual test year costs appear reasonable in light of these fluctuations. Historic costs increased each year from 2001 to 2003. However, in 2003, production maintenance costs began a decline that continued until 2006. Costs increased sharply in 2007, which was the highest year for production maintenance costs in any of the past seven years.

Second, the Company has not provided any support for its claim that historic costs should be increased by the Handy Whitman Index factors. While these factors may provide some general guidance regarding typical cost movement, there is no indication that such factors are appropriate for determining base rates. The Company has not provided any studies or other supporting documentation to demonstrate that the use of the Handy Whitman Index factors provides an appropriate methodology for use in setting utility rates. Given the fact that these costs have fluctuated over the past seven years, that the test year costs were high relative to historic levels, and that the Company has not supported its proposal to adjust historic costs by the Handy Whitman Index factors, I recommend that the actual test year costs be used as the basis for the Company's revenue requirement.

Q. Are you proposing to adjust the test year costs for any of the facility-specific adjustments included by KCPL in its filing?

A Yes. KCPL included one adjustment to remove a credit relating to a payment received by the Company during the test year relating to its Spearville wind generation facility. I have increased the Company's test year costs to reflect the impact of removing this credit. The other adjustments proposed by KCPL are not necessary since they relate to events that are already captured in the actual test year results. My adjustment is shown in Schedule ACC-23.

Q. Please describe your adjustment to the Company's transmission maintenance expense claim.

A. KCPL included incremental transmission maintenance costs of $643,092 in its filing. The

Company's claim was based on a five-year average of transmission costs, indexed to 2009 using the Handy Whitman Index factors. In addition, the Company included an adjustment to reflect its actual test year level of transmission software costs. These costs were not incurred prior to the test year and therefore they are not included in the Company's five-year average.

Similar to my discussion of production maintenance costs, these costs have also fluctuated on a nominal basis over the past several years. The actual test year costs were high relative to costs incurred during the prior four-year period. Moreover, once again the Company failed to demonstrate that the Handy Whitman Index factors were appropriate for use in establishing pro forma transmission maintenance costs in a base rate case proceeding. For these reasons, I have utilized the Company's actual test year level of transmission maintenance costs, including maintenance software costs, in my revenue requirement. My adjustment is shown in Schedule ACC-24.

Q. Please describe the Company's claim for distribution maintenance costs.

A. KCPL has included an increase of $5,722,680 in distribution maintenance costs. Once again, the Company utilized a five-year average, adjusted to 2009 by use of the Handy Whitman Index factors.

Q. Please describe your recommended adjustment to the Company's claim.

A. Once again I am recommending that the KCC reject the Company's proposal to utilize the

Handy Whitman Index factors to determine pro forma costs. However, with regard to distribution maintenance costs, I am not recommending that the actual test year costs be utilized. Rather, I am recommending a three-year average of historic costs.

Q. Why did you utilize a three-year average for distribution maintenance costs as opposed to your recommendation to use test year costs for production and transmission maintenance expenses?

A. While actual distribution maintenance costs in 2007 were well above costs incurred in 2006, the test year costs were significantly lower than the actual costs incurred in 2005. Therefore, while production and transmission costs were high in the test year relative to historic levels, this was not the case with regard to distribution costs. Accordingly, the use of the actual test year distribution costs may understate the Company's pro forma distribution maintenance costs. Accordingly, in this case, I believe that the use of a three-year historic average is a more appropriate methodology than the use of the actual test year costs. My adjustment is shown in Schedule ACC-25.

Q. Please describe the Company's adjustment relating to Information Technology maintenance costs.

A. The Company's adjustment to Information Technology maintenance costs includes two components. First, the Company annualized the impact of software agreements that were entered into, or terminated, during the test year. This adjustment increased the Company's expense claim by $750,937. Second, the Company included an adjustment of $688,984 relating to expensed items costing less than $100,000. This adjustment was based on KCPL's 2008 budget.

Q. What adjustment are you recommending to the Company's claim for Information Technology maintenance costs?

A. I am recommending that the Company's adjustment to expensed items be disallowed. A budgeted expenditure does not meet the regulatory standard for a known and measurable change to the test year. In general, budgeted expenses should not be used for setting regulated utility rates, as budgets are generally too speculative to be used for ratesetting. Accordingly, at Schedule ACC-26, I have made an adjustment to eliminate these costs from my recommended revenue requirement. If adequate supporting documentation is provided during the rebuttal stage of this case to justify a post-test year adjustment, I will revise my recommendation, if appropriate.

H. Credit Card Expense

Q. Please describe the Company's claim for credit card processing costs.

A. In its filing, the Company included adjustments to its credit card processing costs to reflect a) an increase in the number of customers using credit cards to pay their bills and b) a reduction in the per transaction fee incurred by KCPL. As discussed in the testimony of Mr. Dennis, the Company began offering credit card payments in 2007. Therefore, the test year may not represent a prospective level of credit card payments. The Company used a projected acceptance rate of 7.5% in developing its claim for credit card processing costs. The specific details of the Company's per transaction cost for credit cards is confidential.

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

A. Yes, it appears that the acceptance rate estimated by KCPL may be overly optimistic. In response to CURB-92, the Company indicated that the actual acceptance rate through September 2008 was only 4.6%. Moreover, it appears from the response to KCC-238 (Confidential) that the number of credit card transactions has actually declined since September. Therefore, I am recommending a reduction to the Company's claim to reflect a lower acceptance rate than the rate used by the Company in its filing. It should be noted that in the last case, the Company estimated an acceptance rate of 10.0%, more than double the actual acceptance rate realized in 2008.

Q. How did you quantify your adjustment?

A. I have used the September 2008 acceptance rate of 4.6%, and the per transaction cost included in the Company's filing to quantify my adjustment. My adjustment may be conservative since, as indicated above, it appears that the number of monthly credit card transactions has actually declined since September 2008. My adjustment is shown in Schedule ACC-27.

I. Corporate Image Advertising Expense

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

A. Yes, I am recommending that institutional and image advertising costs of $406,758 be disallowed. This corporate image advertising should not be included in a regulated utility's revenue requirement. The purpose of such advertising is to promote the institution, in this case KCPL and GPE, and its shareholders. Such advertising is designed to favorably influence customer opinion. These ads constitute "soft-lobbying" of ratepayers, and others, on behalf of the Company. This advertising may also be used to enhance the attractiveness of unregulated offerings. Such advertising is not necessary for the provision of regulated utility service and should not be paid for by ratepayers. At Schedule ACC-28, I have made an adjustment to eliminate institutional and image advertising costs from rates.

Q. How did you identify the amount of corporate image advertising included in the Company's claim?

A. To quantify the amount of corporate image advertising costs included in the Company's claim, I relied upon KCPL's response to KCC-47. This response quantified the Company's advertising categories based on the advertising undertaken by KCPL during the year. I have disallowed all advertising classified by the Company as "image" advertising.

J. Lobbying Expense

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

A. Yes, I am recommending that lobbying costs be disallowed. Based on several data request responses, I have identified $98,278 in lobbying costs. I am recommending that these costs be eliminated from the Company's claim. My adjustment is shown in Schedule ACC-29.

Q. What types of costs are included in your adjustment?

A. My adjustment includes test year payroll costs that have been identified by the Company as pertaining to lobbying activities, legislative services fees, a portion of costs paid to the Missouri Energy Development Association, and costs incurred for meeting with legislators.

Q. Are lobbying costs an appropriate expense to include in a regulated utility's cost of service?

A. No, they are not. Lobbying costs are not necessary for the provision of safe and adequate utility service. Moreover, the lobbying activities of a regulated utility may be focused on policies and positions that enhance shareholders but may not benefit, and may even harm, ratepayers. Regulatory agencies generally disallow costs involved with lobbying, since most of these efforts are directed toward promoting the interests of the utilities' shareholders rather than its ratepayers. Ratepayers have the ability to lobby on their own through the legislative process. Moreover, lobbying activities have no functional relationship to the provision of safe and adequate electric service. If the Company were to immediately cease contributing to these types of efforts, utility service would in no way be disrupted. Clearly, these costs should not be borne by ratepayers. For all these reasons, I recommend that lobbying activities be disallowed as shown in Schedule ACC-29.

K. Company Donations Expense

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

A. Yes, I am. I am recommending that $168,823 in donations be eliminated from the Company's claim. Approximately $107,000 of this adjustment relates to the Dollar Aide Match program, a program designed to assist customers who cannot otherwise pay their bills. While this is a very worthwhile program, the costs should be funded by shareholders, not ratepayers. This is a program that provides a $0.50 company match for every $1.00 contributed by ratepayers. Thus, ratepayers have already made their decision whether or not to contribute to this program through their share of the donations. The concept of a Company "match" is misleading if this match is required to be funded by ratepayers, who have already funded the first half of these contributions. Thus, shareholders, not ratepayers, should be responsible for any additional funding.

The remaining donations that I have disallowed include payments to such organizations as the Kansas Convention and Visitors Center, the Nature Conservancy, and the Kansas City Art Institute. In addition, the Company has included costs for various festival and dinner sponsorships. These sponsorships are more appropriately categorized as image and institutional advertising, which should be disallowed for the reasons outlined earlier in my testimony. My adjustment to disallow the Company's claim for donations, as well as for the image and institutional advertising included in this category, is shown in Schedule ACC-30.

L. Sporting Event Expense

Q. Did the Company incur any costs for sporting events that were booked above-the-line and included in cost of service in this case?

A. Yes, it did. According to the responses to KCC-68, KCC-78, and KCC-79, the Company has included $188,266 of sports-related costs in its revenue requirement claim. This includes various costs for golf tournaments, costs for Kansas City Chiefs season tickets, season tickets to the Kansas City Royals, and other related costs, including $5,895 for luncheons at the Kansas City Chiefs games.

Costs relating to sporting events do not directly relate to the provision of safe and adequate regulated utility service and they should not be borne by regulated ratepayers. Moreover, ratepayers do not receive any benefit from these expenditures, except for the lucky few that get the opportunity to attend sporting events along with Company personnel. It is unreasonable to expect all utility customers to subsidize tickets for sporting events. The Company's claim is especially troublesome given the current economic hardship in which many of Kansas' ratepayers find themselves. Accordingly, at Schedule ACC-31, I have made an adjustment to eliminate these costs from my recommended revenue requirement.

M. Miscellaneous Operating Expense

Q. Are there other costs included in the Company's revenue requirement claim that should not be borne by ratepayers?

A. Yes, there are. The Company's claim includes $571,511 in additional costs that I recommend be disallowed, as shown in Schedule ACC-32. These costs include movie tickets, gift cards, floral arrangements for dinners, banquet costs for the Elms Resort and Spa, and various other items. This adjustment also includes approximately $100,000 for costs associated with transitioning the corporate image as a result of the Aquila merger.

The most significant adjustment, however, relates to employee appreciation activity costs incurred at Worlds of Fun. The Company's claim includes almost $200,000 of such costs. While I have no objection to the Company showing its appreciation to employees, ratepayers should not be required to fund these types of expenditures. In fact, KCPL has not demonstrated that any of the costs included in this adjustment were necessary to the provision of safe and adequate service. Given the significant financial burdens that ratepayers are being asked to bear during the period of the Regulatory Plan, as well as the particular hardships currently being faced by ratepayers due to the country's recession, the KCC should be vigilant in eliminating unnecessary costs from the Company's revenue requirement claim. My adjustment to eliminate these costs is shown in Schedule ACC-32.

N. Interest on Customer Deposits

Q. How did the Company determine its claim for interest on customer deposits?

A. The Company's filing includes the actual test year interest costs incurred by KCPL. Since interest costs are booked below-the-line, these costs were not included in the Company's actual test year operating costs. Therefore, KCPL made an adjustment to move these costs above-the-line. Such an adjustment is appropriate, since customer deposits are subtracted from rate base as non-investor supplied capital. Since ratepayers receive a rate base deduction for customer deposits, the Company should be given the opportunity to recover the associated interest costs.

Q. Are you recommending any adjustment to the Company's claim for interest on customer deposits?

A. Yes, I am. Interest on customer deposits should be synchronized to the level of customer deposits included in rate base. The Company's rate base reflects customer deposits at December 31, 2007, the end of the test year. However, its interest expense claim is based on a fluctuating level of customer deposits during the test year. Therefore, I am recommending an adjustment to synchronize interest expense with the test year ending balance of customer deposits that is deducted from rate base.

Q. What interest rate did you use in quantifying your adjustment?

A. To quantify my adjustment, I used an interest rate of 1.0%. This is the current rate approved by the KCC. My adjustment is shown in Schedule ACC-33.

O. Property Tax Expense

Q. How did the Company develop its property tax expense claim in this case?

A. The Company's claim was based on its 2008 budgeted property tax costs. To develop its claim, KCPL used its actual 2008 assessed property values, based on plant balances at January 1, 2008, and projected 2008 tax levy rates. The Company then made an additional adjustment to reflect estimated payments in lieu of taxes ("PILOT") of $338,792 relating to the wind generation facility.

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

A. Yes, I am. In its filing, the Company indicated that it would know the amount of its actual 2008 property tax expense by the end of 2008. In response to KCC-163, the Company updated its claim to reflect actual 2008 property taxes. Therefore, at Schedule ACC-34, I have made an adjustment to incorporate this update in my revenue requirement recommendation. Since actual taxes were higher than the projection included in the Company's filing, this adjustment increases the KCPL's revenue requirement.

P. Depreciation Expense

Q. Are you recommending an adjustment to the Company's depreciation expense claim?

A. Yes, I am recommending one adjustment. As discussed previously, I am recommending certain adjustments relating to utility plant in service additions that the Company included in its rate base claim. Therefore, at Schedule ACC-35, I have made an adjustment to exclude annual depreciation expense associated with my recommended plant disallowance. To quantify my adjustment, I used the composite depreciation rate for the Company's projected plant additions through December 2008. This is the same rate that I used in quantifying the related adjustment to accumulated depreciation that was discussed earlier in my testimony.

Q. Interest Synchronization and Taxes

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

A. Yes, I have made this adjustment at Schedule ACC-36. It is consistent (synchronized) with my recommended rate base, capital structure, and cost of capital recommendations. I am recommending a lower rate base, a higher debt ratio, and a lower cost of debt than the rate base, debt ratio, and cost of debt included in the Company's original filing. The net result of these adjustments is a higher pro forma interest expense for the Company. This higher 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 my recommendations. Therefore, my recommendations result in an interest synchronization adjustment that reflects a lower income tax burden for the Company, and an increase to pro forma income at present rates.

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

A. As shown on Schedule ACC-37, I have used a composite income tax factor of 39.58%, which includes a state income tax rate of 7.05% and a federal income tax rate of 35%. These are the state and federal income tax rates contained in the Company's filing. My revenue multiplier, which is shown in Schedule ACC-38, reflects these same income tax rates. In addition, the revenue multiplier includes uncollectible costs at a rate of 0.3469%, which is the actual test year rate as discussed earlier in my testimony.

VIII. REVENUE REQUIREMENT SUMMARY

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

A. My adjustments show that KCPL has a revenue deficiency at present rates of $22,852,203, as summarized on Schedule ACC-1. My recommendations result in revenue requirement adjustments of $37,577,797 to the Company's requested revenue requirement increase of $60,430,000.

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

A. Yes, at Schedule ACC-39, I have quantified the revenue requirement impact of the rate of return, rate base, and expense recommendations contained in this testimony.

Q. Have you developed a pro forma income statement?

A. Yes, Schedule ACC-40 contains a pro forma income statement, 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 increase. My recommendations will result in an overall return on rate base of 7.82%.

IX. CASH FLOW CONSIDERATIONS AND REGULATORY PLAN COMMENTS

Q. Will your recommended rate increase require additional cash flow in order for the Company to meet the coverage ratios outlined in the Regulatory Plan?

A. If the KCC adheres to the provisions of the Regulatory Plan, then an additional increase relating to cash flow may be required if my recommendations are accepted by the KCC. There were two coverage ratios included in the Regulatory Plan that can be addressed through the CIAC mechanism, funds from operations as a percentage of interest coverage and funds from operations as a percentage of total debt. (The third ratio, total debt to total capital, is being addressed by KCPL through its issuance of securities.)

I have attempted to examine the resulting coverage ratios based on the information available to me from the Company's filing. This calculation is shown in Schedule ACC-41. The calculation of funds from operations utilizes the operating income and depreciation and amortization reflected in my revenue requirement calculation. Deferred income taxes are based on the amount included in the Company's filing. I have calculated long-term debt based on the Kansas-jurisdictional share of total debt reflected in my capital structure. I have calculated pro forma interest expense on this debt, based on the composite debt cost used in my cost of capital calculation.

For the remaining variables, capitalized lease obligations, off-balance sheet adjustments, interest on short-term debt, and off-balance sheet interest expense, I have reflected the amounts provided in Schedule MWC-3. However, I have not made an independent review of these amounts, to determine if they should be included in the coverage ratio calculation. I simply present them on Schedule ACC-41, to provide the KCC with a preliminary indication of whether a CIAC adjustment is necessary.

Q. What are the coverage ratios resulting from your calculation?

A. As shown on Schedule ACC-41, I calculated a funds from operations / interest coverage ratio of 4.69. This is well above the target ratio of 3.8 referenced in the Regulatory Plan. Clearly, no CIAC is required in order for the Company to meet this ratio.

With regard to funds from operations / total debt, my preliminary calculation shows a ratio of 22.80%, slightly below the 25% target specified in the Regulatory Plan. However, the 23.29% is still in the range for BBB debt, as shown in Appendix E to the Regulatory Plan. Moreover, the denominator of this ratio contains approximately $66.5 million in off-balance sheet adjustments and capitalized lease obligations, which may not be appropriate to include in the calculation or may have been overstated by KCPL. In fact, the Regulatory Plan acknowledged that it may be improper to include these obligations, stating that, "[t]he prudence of the 'Capitalized Lease Obligations' and 'Off-Balance Sheet Obligations' will be determined in the first general rate case that affords the Commission the opportunity to review the matter." This issue was not addressed in the Stipulation in last year's case.

Therefore, at this time, I do not have sufficient information to definitively conclude whether or not a CIAC adjustment is needed to meet this second ratio and maintain an investment grade rating for KCPL.

Q. If the KCC decides to require a funds from operation / total debt ratio of 25.0%, how much additional revenue would be required?

A. As shown on Schedule ACC-41, increasing the ratio from 22.80% to 25.00% would increase the Company's revenue requirement by $23,925,672, assuming that the KCC accepts the Company's claims for Capitalized Lease Obligations and Off-Balance Sheet Adjustments. If the KCC approves recovery of this additional amount, then the $23,925,672 should be deducted from rate base beginning with the rate case filed in 2009, as required under the Regulatory Plan. In addition, additional revenues collected pursuant to the Stipulations in the last two base rate cases should also be reflected as a rate base deduction. Any amounts raised from ratepayers due to cash flow requirements should be deducted from rate base on a pre-tax basis so that ratepayers receive full value for the funds that they have contributed.

Q. If the KCC does not accept all of your recommended revenue requirement adjustments, what impact would there be on the cash flow calculation?

A. If the KCC finds that under a traditional revenue requirement analysis, the Company has the need for a rate increase that differs from the amount of $22,852,203 that I recommend, or if the KCC finds that the Company has a need for a rate decrease, then the cash flow adjustment discussed above should be adjusted accordingly. For example, if the KCC awarded a return on equity that is higher than the return I recommend, the Company would have more operating income than the operating income reflected in my testimony. In that case, a smaller cash flow adjustment would be required. Therefore, in the event that some of my revenue requirement adjustments are rejected, then any additional cash flow allowance would need to be recalculated based on the revised financial parameters established by the KCC.

Q. Do you question the need for ratepayers to provide any additional revenues for cash flow purposes at this time?

A. Yes, I do. The Regulatory Plan was designed to assist KCPL in a long-term construction program that was supposed to be necessary in order to continue to provide safe and reliable electric service to Kansas ratepayers. It was envisioned at that time that all parties would focus on the specific cash flow needs of programs outlined in the Regulatory Plan. Since the Regulatory Plan was approved, the Company has acquired Aquila's electric operations in Kansas and Missouri, as well as certain merchant services operations. That transaction had a total indicated value of $1.7 billion. Moreover, KCPL assumed approximately $1 billion of net debt and other liabilities. In addition, KCPL's actual capital expenditures have vastly exceeded the estimates envisioned in the Regulatory Plan.

CURB always had reservations about the CIAC component of the Regulatory Plan, particularly since this component weakened the authority of the KCC and effectively transferred an important portion of the ratesetting process to credit rating agencies, whose primary focus is investors, not ratepayers. Given the fact that KCPL was able to meet its cash flow requirements in order to acquire Aquila, and given the fact that the Iatan projects are significantly over the amounts projected in the Regulatory Plan, the KCC may want to reconsider the CIAC mechanism. In addition, the amount of CIAC required to meet cash flow requirements pales in comparison to the magnitude of the construction program being undertaken by KCPL. Therefore, the KCC should consider whether it makes sense to abandon well-established ratemaking principles and award any CIAC, given the fact that the eventual rate base deduction will be a very small percentage of the overall capital additions included in rates. In addition, as stated previously, providing this cash flow allowance permits credit rating agencies, rather than the KCC, to effectively set rates for KCPL.

It should be noted that in addition to these financial concerns, I have been informed by counsel that CURB has reservations about the legality of the CIAC mechanism outlined in the Regulatory Plan. Thus, there may be legal, as well as financial reasons, for determining that no CIAC adjustment is necessary in this case.

X. ECONOMIC RELIEF PILOT PROGRAM

Q. Please discuss the Company's request for an Economic Relief Pilot Program.

A. As described in the testimony of Mr. Dennis at pages 13-14, the Company is proposing to implement an Economic Relief Pilot Program ("ERPP"). This program would provide a fixed $50 monthly credit to low-income residential customers. Based on a maximum of

1,000 participants, the proposed annual budget is $630,000. KCPL is proposing to defer 50% of the costs of this program for recovery in its next base rate case. The remaining 50% would be funded by shareholders.

Q. Do you have any comments regarding KCPL's proposal?

A. Yes, I do. Low-income programs are commendable and I am generally supportive of such programs. The Consumer Counsel for CURB has advised me that the CURB Board supports such programs and urged the Commission in KCC Docket No. 04-GIMX-531-GIV ("531 Docket") to determine that such programs are not impermissibly discriminatory or unduly preferential because they have a rational basis for them.[12] However, the Commission determined in the 531 Docket that low-income assistance rates similar to the program proposed by KCPL are impermissibly discriminatory and unduly preferential.[13] As a result, unless KCPL would agree to fund 100% of the proposed ERPP from shareholders or the Commission reverses its decision in the 531 Docket, it would appear KCPL's proposed ERPP would be considered impermissibly discriminatory and unduly preferential under the Commission's order in the 531 Docket.

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[12] *Comments of CURB,* February 6, 2004, KCC Docket No. 04-GIMX-531-GIV.

[13] "The Commission has previously determined that low-income assistance rates in the form of pure discounts are impermissibly discriminatory and unduly preferential, and that there is no basis to depart from the prior determination of the Commission in this regard." *Order Accepting Staff's Report and Recommendation and Closing Docket,* ¶ 13, August 31, 2005, KCC Docket No. 04-GIMT-531-GIV.

Q. Does this conclude your testimony?

A. Yes, it does.

<u>VERIFICATION</u>

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 30 th day of January, 2009.

Notary Public Marjorie M. Deren

My Commission Expires: December 31, 2013