

Exhibit No.:
Issue: Incentive Compensation
Witness: Michael Halloran
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Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2007-0291
Date Testimony Prepared: August 30, 2007

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2007-0291

REBUTTAL TESTIMONY

OF

MICHAEL HALLORAN

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

**Kansas City, Missouri
August 2007**

Exhibit No. 14
Case No(s) ER-2007-0291
Date 10/1/07 Rptr MW

REBUTTAL TESTIMONY

OF

MICHAEL HALLORAN

Case No. ER-2007-0291

1 **Q. Please state your name and business address.**

2 A. My name is Michael Halloran. My business address is 1717 Main Street, Suite 4400,
3 Dallas, Texas, 75201.

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

5 A. I am employed by Mercer Human Resource Consulting ("Mercer") in the Human Capital
6 Advisory Services business. Within Mercer I am a Worldwide Partner, one of 250 in a
7 Firm of over 17,000 people.

8 **Q. What are your responsibilities?**

9 A. I am a senior consultant working with Mercer clients in the area of compensation.
10 Specifically, I provide consulting services to senior management teams and Boards of
11 Directors regarding issues related to the design, structure and level and character of
12 executive compensation programs. In my career, I have served a large number of
13 companies in the *Fortune* 1000 across a wide range of industries, including over 20
14 companies in the utilities industry. This includes utilities in electric and gas operations in
15 both the regulated and non-regulated environments.

16 **Q. Please describe your education, experience and employment history.**

17 A. I received a B.A. in Mathematics from Northwestern University. I also received an
18 M.B.A. in Finance and Accounting from Northwestern's Kellogg School of Management.

1 I began my consulting career with Towers Perrin in 1976 in Chicago in the area of
2 executive compensation. I was later promoted to Principal and then Vice President with
3 responsibility for Towers Perrin's executive compensation consulting practice
4 worldwide, ultimately moving to New York in 1989. I joined Watson Wyatt in 1991 to
5 lead their worldwide executive compensation practice. At both organizations, I was
6 responsible for serving many large, complex organizations. In 1993, I joined Strategic
7 Compensation Associates (later renamed SCA Consulting), a boutique firm specializing
8 in executive compensation, with a focus on performance measurement and executive
9 incentive plan design. I was the Managing Partner of the New York and Chicago offices.
10 I relocated to Dallas in 1997 and opened the firm's Dallas office, while continuing to
11 serve clients as well as manage the New York Office. In the fall of 2001, SCA was
12 acquired by Mercer. I became a Worldwide Partner of Mercer at the time of the
13 acquisition. I am one of Mercer's leading consultants in the area of executive
14 compensation.

15 **Q. Have you previously testified in a proceeding at the Missouri Public Service**
16 **Commission ("Commission") or before any other utility regulatory agency?**

17 **A. I have never testified before the Commission or any other utility regulatory agency.**

18 **Q. What is the purpose of your Rebuttal Testimony?**

19 **A. I am providing Rebuttal Testimony to Chuck Hyneman of the Commission Staff and**
20 **James R. Dittner of the U.S. Department of Energy /National Nuclear Security**
21 **Administration ("DOE") regarding their proposed disallowance of short-term and long-**
22 **term incentive compensation from the rates of Kansas City Power & Light Company**
23 **("KCPL" or the "Company"). In my professional opinion, the use of incentives for**

1 executives is a tremendously powerful tool to benefit both customers and shareholders.

2 In particular, a program that focuses on the achievement of earnings per share ("EPS") is
3 beneficial for customers and shareholders.

4 **Q. Why does the incentive plan use EPS as a measure in the incentive plan?**

5 A. EPS is a measure related to funds from operations ("FFO") and operating income. Hence
6 like any investor-owned entity, its principal index of performance is capital return to the
7 investor; the basic index of this performance is framed in EPS. Because KCPL is a
8 regulated public utility, the organization is committed to its responsibility to achieve its
9 EPS through the provision of efficient, clean, safe, and affordable electricity to its
10 customer base. The incentive plans for all employees are therefore driven by a stepwise
11 combination of overall organizational financial performance measured in EPS, indices of
12 business performance that are directly tied to performance and productivity in areas
13 related to product and service delivery, and by individual performance factors relating to
14 the specific employee's responsibilities and contributions to achieving divisional and
15 overall organizational performance objectives. This stepwise integration ensures that the
16 incentives are utilized to encourage and reward performance that contributes to the
17 organization's growth and productivity specifically through the enhancement of service
18 and performance of direct benefit to its customers.

19 In addition, stronger financial performance through EPS provides additional cash,
20 allowing the utility to invest in ongoing maintenance and upgrading of facilities, which
21 ensures a steady, reliable, low cost supply of electricity to the customer. The use of
22 incentive compensation to focus the management team on the achievement of EPS goals
23 is a wise and appropriate investment in the business.

1 Q. **Why is FFO an important measure for a utility?**

2 A. FFO is important because it is a key component to the two core credit metrics used to
3 evaluate utilities. Credit rating agencies use FFO divided by debt, and FFO divided by
4 interest as two primary credit metrics.

5 Q. **Why are these credit metrics important?**

6 A. These credit metrics are important because they are used to determine credit rating. The
7 credit rating is directly tied to the interest rate that the Company must pay for debt needed
8 to finance the Company's Comprehensive Energy Plan as well as ongoing operations.

9 Q. **What happens if the utility does not maintain a sufficient credit rating?**

10 A. If credit ratings are not maintained, the Company's cost of borrowing increases, thus
11 raising the overall cost of operations. Over time, this can lead to higher rates.

12 Q. **So you are suggesting that there is a strong connection between EPS in the utility
13 and the benefits for customers?**

14 A. Yes, increasing EPS is the result of increased FFO and operating income. These results
15 serve to minimize the Company's borrowing costs via interest on debt. This, in turn,
16 ensures that a longer term strategic approach can be effected in building initiatives, such
17 as the Comprehensive Energy Plan, which would be both more costly and less feasible in
18 the absence of the stability afforded by long-term consistency in the financial
19 performance of the organization. The result of this strategy has achieved for KCPL its
20 Tier I standing and its status as an Edison award winning utility, clear evidence of the
21 benefit KCPL delivers to its customers through its approach to performance incentives.

22 Q. **Thus, an incentive program tied to a key financial metric like EPS is in the best
23 interest of KCPL's customers?**

1 A. Yes, the return on the investment in incentive compensation dollars provides a significant
2 short-term and long-term benefit for customers as well as shareholders.

3 **Q. KCPL's plan has a discretionary component. Why is a discretionary component**
4 **included in the plan?**

5 A. The plan is designed to recognize superior results, which include both financial results
6 such as EPS, as well as certain non-financial results.

7 **Q. How do these discretionary incentives best serve customers?**

8 A. By having a portion of the program tied to discretion, executives are held accountable for
9 seeing that the overall operation of the generation and delivery of electric services occur
10 in the most effective manner possible. Situations occur where quick, efficient actions can
11 create positive outcomes for customers. The discretionary component of KCPL's
12 incentive program ensures that the management team understands that strong
13 performance for the customer unrelated to financial results will be recognized and
14 rewarded.

15 **Q. Why would it be inappropriate to have 100% of the incentive tied to specific**
16 **measures?**

17 A. The utility business can be unpredictable due to the impact of weather and other factors.
18 An incentive program tied exclusively to measurable, pre-defined standards severely
19 limits the ability of the Company to motivate the management team to provide excellent
20 service to customers in areas that are unplanned and/or not covered by specific measures.

21 **Q. Does that conclude your testimony?**

22 A. Yes, it does.

In the Matter of the Application of Kansas City)
Power & Light Company to Modify Its Tariff to) Case No. ER-2007-0291
Continue the Implementation of Its Regulatory Plan)

STATE OF TEXAS)
COUNTY OF DALLAS) SS

1. My name is Michael Halloran. I am employed by Mercer Human Resource Consulting in Dallas, Texas. I am a Worldwide Partner with the firm. I have been retained as an expert witness by Kansas City Power & Light Company:

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

Michael J. Halloran
Michael Halloran

Subscribed and sworn before me this 30th day of August 2007.

Vicki L. Patrick
Notary Public

My commission expires: May 20, 2009

