

DOE/NNSA Exhibit No. 803

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Issues: Hawthorn No. 5

Litigation

Recoveries

R&D Tax Credits

Witness: James R. Dittmer

Type of Exhibit: Surrebuttal Testimony

Sponsoring party: DOE-NNSA

Case No.: ER-2007-0291

Surrebuttal Testimony Date: September 20, 2007

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0291

SURREBUTTAL TESTIMONY

OF

JAMES R. DITTMER

ON BEHALF OF

**THE DEPARTMENT OF ENERGY – NATIONAL
NUCLEAR SECURITY ADMINISTRATION**

**Kansas City, Missouri
September 2007**

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Case No(s) ER-2007-0291
Date 10/1/07 Rptr MV

1 **SURREBUTTAL TESTIMONY**
2 **OF**
3 **JAMES R. DITTMER**
4 **KANSAS CITY POWER AND LIGHT COMPANY**
5 **CASE NO. ER-2007-0291**
6

7 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

8 A. My name is James R. Dittmer. My business address is 740 Northwest Blue
9 Parkway, Suite 204, Lee's Summit, Missouri 64086.
10

11 **Q. BY WHOM ARE YOU EMPLOYED?**

12 A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a
13 consulting firm engaged primarily in utility rate work.
14

15 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS**
16 **PROCEEDING?**

17 A. Yes. I filed direct testimony in this case on July 24, 2007 on behalf of the
18 United States Department of Energy that is representing the interest of the
19 National Nuclear Security Administration ("DOE-NNSA") and other affected
20 Federal Executive Agencies. Like my direct testimony in this proceeding, my
21 surrebuttal testimony is also being filed on behalf of DOE-NNSA.
22

23 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

24 A. I will be responding specifically to the rebuttal testimony filed by KCPL
25 witness Mr. Chris Giles wherein he addresses DOE-NNSA and Staff

1 adjustments for 1) amortizing subrogation proceeds stemming from a Hawthorn
2 Unit 5 explosion, and 2) amortizing Research and Development (R&D) tax
3 credits anticipated to be received in the fairly immediate future. Further, on a
4 broader note, I will be addressing what I perceive to be a very asymmetrical
5 approach to ratemaking that KCPL is proposing in this proceeding – which may
6 be being fueled by a series of rate and accounting authority decisions recently
7 issued by this Commission.

8
9 **Q. PLEASE BEGIN BY ADDRESSING THE ASYMMETRICAL**
10 **APPROACH TO RATEMAKING THAT YOU PERCEIVE TO BE**
11 **EMBODIED WITHIN KCPL'S PROPOSED DEVELOPMENT OF ITS**
12 **RETAIL COST OF SERVICE IN THIS CASE.**

13 **A.** There were a number of “non-recurring” events that were experienced within
14 the test year ending December 31, 2006 or which are anticipated to occur
15 shortly thereafter. The “non-recurring” events, and KCPL’s proposed
16 ratemaking treatment for each event, are summarized below:

- 17 • Receipt of subrogation proceeds stemming from a Hawthorn Unit 5
18 explosion. KCPL proposes to retain 100% of such proceeds for its
19 shareholders.
- 20 • Incurrence of severance costs associated with implementation of
21 KCPL’s Talent Assessment Program. KCPL proposes to defer and
22 amortize all such cost over five-years such that ratepayers pay for 100%
23 of such costs.

- 1 • Incurrence of outside services expense to facilitate the filing of amended
2 federal income tax returns that, in turn, is expected to result in tax
3 refunds related to the claiming of Research and Development tax credits.
4 KCPL proposes no adjustment to eliminate these non-recurring
5 expenditures – such that retail ratepayers will pay such costs in base
6 rates until base rates are again revised pursuant to KCPL filing another
7 Missouri retail rate application.
- 8 • Receipt of federal income tax refunds resulting from the filing of
9 amended returns for years 2000 through 2004 – that were facilitated by
10 the work undertaken by the outside experts addressed within the
11 immediately preceding section. KCPL proposes that it retain 100% of
12 such tax refunds for its shareholder.
- 13 • Receipt of a refund from the Department of Energy resulting from the
14 settlement of litigation in which KCPL was over charged for uranium
15 enrichment services purchased from the government during years 1986 –
16 1993. KCPL proposes that shareholders retain 100% of such proceeds
17 for its shareholders.

18
19 **Q. DOES MR. GILES DISCUSS WHAT HE BELIEVES TO BE THE**
20 **PROPER DEVELOPMENT OF A NORMALIZED TEST YEAR?**

21 **A. Mr. Giles states at page 3 of his rebuttal testimony:**

22 Rates are set for a future period. In this case, rates will become
23 effective in 2008 based on a normalized test year of 2006 trued

1 up for certain items through September 30, 2007. Unusual non-
2 recurring events are excluded from test year data because they do
3 not reflect ongoing operating characteristics or cost of service of
4 the Company.

5
6 **Q. DOES KCPL RIGIDLY ADHERE TO ITS RATE PHILOSOPHY**
7 **QUOTED ABOVE FROM MR. GILES' REBUTTAL TESTIMONY?**

8 A. No. In general, if a transaction was, or is expected to be, a favorable transaction
9 to KCPL's bottom line net income, KCPL rigidly adheres to the stated
10 philosophy of removing the events because they are "non-recurring" and "do
11 not reflect ongoing operation characteristics or cost of service of the Company."
12 However, in general, if a "non-recurring" event is detrimental to KCPL's
13 bottom line, the Company carves out exceptions – either leaving the charge
14 unadjusted within the test year cost of service or proposing deferral and
15 amortization of the cost – but in any event, asking ratepayers to pay 100% of the
16 cost.

17
18 **Q. IS KCPL'S RATIONALE AS SIMPLE AS "IF IT'S GOOD FOR THE**
19 **BOTTOM LINE – TAKE IT OUT OF THE COST OF SERVICE, IF IT'S**
20 **BAD FOR THE BOTTOM LINE, LEAVE IN TEST YEAR EXPENSES**
21 **OR DEFER AND AMORTIZE THE COST?"**

22 A. No. KCPL offers some rationale for removing transactions that are favorable to
23 test year recorded operating results and leaving in unadjusted, and/or

1 amortizing, the cost of transactions that are detrimental to test year recorded
2 operating results. But in the end, the result is overwhelmingly – if it's bad for
3 test year operating results, leave it in; if it's good for test year operating results,
4 take it out.

5
6 In fairness, Staff and Intervenors in the current and previous KCPL rate case
7 have frequently argued for removal from test year operating expense "non-
8 recurring" costs and amortization of "non-recurring" transactions that are
9 favorable to KCPL's bottom line. Like KCPL, Staff and Intervenors argue for
10 "exceptions" for the way they are proposing to treat "non-recurring" events.
11 That stated, I believe Staff and Intervenors have been more balanced in the way
12 they have proposed to treat "non-recurring" events.

13
14
15 **Q. ON WHAT BASIS DOES MR. GILES PROPOSE TO EXCLUDE FROM**
16 **TEST YEAR COST OF SERVICE DEVELOPMENT "NON-**
17 **RECURRING" EVENTS THAT ARE FAVORABLE TO KCPL'S**
18 **BOTTOM LINE.**

19 **A.** Mr. Giles argues in large part that many of the favorable transactions that KCPL
20 proposes to exclude from cost of service development relate to prior periods.
21 Mr. Giles therefore argues that inclusion of the beneficial aspects of test year
22 events that have their origins stemming from transactions in prior periods
23 constitutes "retroactive ratemaking." Further, Mr. Giles goes on to opine that

1 neither I nor Staff have demonstrated that in the prior relevant periods that
2 KCPL was over earning. Therefore, according to Mr. Giles, all the favorable
3 transaction should be eliminated for cost of service development.

4
5 Specifically, when addressing a comment contained within my direct testimony
6 regarding relevant prior periods, Mr. Giles states the following:

7 Q. Mr. Dittmer states on page 19 of his testimony that “finally, I
8 note that KCPL’s earnings during the years 2000 through 2005
9 were adequate, if not robust, in relation to returns being
10 authorized by this as well as other state regulatory commissions
11 during the noted years. Thus, I do not believe that KCPL can
12 credibly argue that its shareholders are entitled to these credits
13 relating to prior years when it was already earning adequate if
14 not excessive rates of return during the relevant period.” Does
15 Mr. Dittmer provide any evidence or support for this statement?

16 A. No, he does not. He provides no evidence or support *and it is not*
17 *clear to me that he could.* KCPL did not file any rate cases
18 between 1999 and 2005. Although some parties may believe
19 information can be gleaned from annual surveillance reports to
20 determine whether KCPL was earning at an appropriate level, the
21 surveillance reports are not reflective of test year cost of service
22 analysis as is required in rate cases. In fact, surveillance reports
23 are utilized by the Staff to determine whether an audit is needed
24 in anticipation of a complaint case. During this time period 1999
25 through 2005, Staff conducted audits in various years and in
26 some years did not. However, Staff never filed a complaint case
27 stating KCPL should adjust rates. (Giles rebuttal testimony,
28 pages 4 – 5; *emphasis added*)

1 Q. WHAT DO YOU CONCLUDE FROM MR. GILES TESTIMONY
2 QUOTED ABOVE?

3 A. That Mr. Giles and the Company apparently believe the *only* way a party can
4 demonstrate that a utility was over earning is if that party undertakes a full and
5 complete rate case review, and either the Company enters into a stipulated
6 agreement and acquiesces that it is over earning, or that party fully litigates a
7 complaint case in which this Commission agrees that an over earnings situation
8 has existed or is expected to exist. To his credit, Mr. Giles readily admits that
9 "it is not clear" that I or any other party could ever provide the evidence that he
10 demands must be provided to prove an over earning situation.

11

12 Q. IS THIS COMPANY POSITION TROUBLING TO YOU?

13 A. Yes, very much so. And even more troubling is the fact that this Commission
14 apparently has bought into such argument.

15

16 Q. PLEASE EXPLAIN.

17 A. This Commission, as well as other state regulatory commissions, has with some
18 frequency allowed utilities to defer certain "non-recurring" costs experienced
19 within a given historical reporting period. The granting of an "accounting
20 authority order" is an extremely beneficial event available only to regulated
21 monopolistic utilities with certificated service territories. The issuance of an
22 accounting authority order provides a benefit to utilities that is simply not
23 available to unregulated companies operating in a competitive market.

1 Importantly, an accounting authority order is frequently issued outside the
2 context of a rate application proceeding *and with absolutely no demonstration*
3 *that a utility is not already in an over earnings situation.*

4
5 Specifically regarding KCPL and this Commission, in Case No. EU-2002-1048,
6 KCPL sought to defer and amortize abnormal and unusual costs incurred in the
7 clean up and repair of KCPL's distribution system stemming from a January
8 2002 ice storm. Within its application to defer ice storm costs, KCPL was silent
9 as to whether its earnings were excessive, deficient, or "about right." Following
10 KCPL's application for an accounting authority order the Missouri Office of the
11 Public Counsel filed a motion requesting that KCPL's application for deferral
12 accounting be adopted subject to certain conditions. One of the Public
13 Counsel's recommended conditions was that this Commission reserve the right
14 to consider whether KCPL actually suffered financial harm and whether
15 earnings were adequate during the storm incurrence period to absorb the
16 incremental clean up and repair costs that KCPL was requesting to defer.

17
18 As a result of Public Counsel's motion, KCPL, Staff and Public Counsel entered
19 into a stipulation. One element of the stipulation that was ultimately adopted by
20 this Commission was the following:

21 That in granting the requested AAO, the Commission makes no
22 findings as to whether deferred expenses are reasonable, whether
23 other factors contributed to the damage to the system and the

1 resulting repair/replacement costs incurred, or *whether KCPL*
2 *would have suffered financial harm (i.e. earnings during the*
3 *period were inadequate to compensate KCPL for the costs*
4 *incurred) absent deferral.* The Commission reserves the right to
5 consider in a future rate case the ratemaking treatment of the
6 costs deferred, as well as any assertions, including the
7 appropriate amortization period, made by parties thereto. (Order
8 Granting Authority Order, page 3, from Case No. EU-2002-
9 1048, *emphasis added*)

10
11 In KCPL's last Missouri rate case (ER-2006-0314) the ice storm costs deferred
12 pursuant to this Commission's order from Case No. EU-2002-1048 were still be
13 amortized on KCPL's books within the test year being employed in that case.
14 On behalf of DOE-NNSA I opposed cost of service inclusion of amortization of
15 the 2002 deferred ice storm costs arguing, among other points, that KCPL was
16 experiencing "robust earnings" during the relevant 2002 through 2004 time
17 period. Or in other words, I was arguing that earnings were, indeed, adequate to
18 absorb the incremental costs being incurred for the ice storm without KCPL
19 experiencing financial harm.

20
21 **Q. HOW DID THE COMPANY RESPOND TO YOUR ASSERTIONS OF**
22 **OVER EARNING IN KCPL'S PRIOR RATE CASE?**

1 A. Much as Mr. Giles is doing in the instant case, the Company did not offer one
2 piece of testimony countering my assertions of over earning. However, in its
3 brief the Company argued that 1) the earnings from KCPL's surveillance reports
4 were not normalized or audited and 2) the Staff had never brought a complaint
5 case against KCPL during the 2002 through 2004 time period. In essence
6 KCPL's brief from the prior proceeding espouses exactly the same position that
7 Mr. Giles very clearly states in this case – basically, that realistically there is no
8 way a party could ever demonstrate that KCPL was over earning or that there
9 were "offsets" to costs deferred with an accounting authority order.

10

11 **Q. DID THIS COMMISSION AGREE WITH KCPL'S REASONING**
12 **STATED IN BRIEF IN THE PRIOR CASE?**

13 A. Unfortunately, yes. Even though there was no demonstration of under earning
14 or financial harm when issuing the order in Case No. EU-2002-1048 which
15 would allow future recovery of ice storm costs, the Commission nonetheless
16 stated:

17 The Commission finds that the competent and substantial
18 evidence supports KCPL's position, and finds this issue in favor
19 of KCPL. DOE complains that KCPL has already recovered
20 those costs in rates. However, DOE witness Dittmer testified
21 that he was unaware of any Staff or Commission action to reduce
22 rates from 2002 because of overearnings, which would include
23 the recovery of ice storm costs from ratepayers. *Regardless of*
24 *KCPL's prior earning*, the Commission gave KCPL an
25 accounting authority order to defer and amortize its ice storm
26 costs through January 31, 2007, which includes the test year in

1 this case. Because Staff has no position on this issue, the
2 Commission finds that competent and substantial evidence exists
3 to show that KCPL's ice storm costs were prudent. (Case No.
4 ER-2006-0314, page 61, *emphasis added*)
5

6 **Q. YOU PREVIOUSLY STATED THAT KCPL ENTERED INTO A**
7 **STIPULATION IN CASE EU-2002-1048 WHEREIN IT AGREED THAT**
8 **THE COMMISSION COULD CONSIDER EARNINGS DURING THE**
9 **RELEVANT COST INCURRENCE PERIOD WERE ADEQUATE TO**
10 **ABSORB OR OFFSET THE INCREMENTAL COST OF THE ICE**
11 **STORM. WAS THIS A MEANINGFUL CONCESSION BY KCPL?**

12 A. This concession has virtually no value -- under KCPL's assertion as to burden of
13 proof. To again cite Mr. Giles' testimony in this case, realistically it simply
14 cannot be done. No party could audit and normalize a number of prior reporting
15 periods in the detail of a full blown rate case -- as Mr. Giles implies is the only
16 way an over earnings scenario can be demonstrated.
17

18 **Q. IS THIS A FAIR OUTCOME?**

19 A. Absolutely not. I respectfully ask this Commission to reconsider its position on
20 accounting authority orders -- and more pertinent to the case at hand -- its
21 position regarding how to treat favorable events recorded during the present test
22 period that relate in part to events occurring in prior periods. Specifically, I urge
23 this Commission to reject Mr. Giles' effective conclusion that no party could
24 ever demonstrate that the Company was over earning in prior periods. As a
25 corollary to that point, I would further urge that the Commission reject Mr.

1 Giles' position that refunds and litigation proceeds received during the test year
2 (or shortly thereafter) associated with transactions originating in prior periods
3 should always accrue exclusively to shareholders' benefits, while "non-
4 recurring" costs incurred during the test year be deferred and amortized for
5 future recovery from ratepayers.

6
7 Further, I ask the Commission to consider whether it is fair that, with absolutely
8 no demonstration that a utility is under earning, it allows a utility to defer for
9 future recovery costs claimed by a utility to be "extraordinary."

10

11 **Q. IS IT POSSIBLE THAT THIS COMMISSION'S LAST KCPL RATE**
12 **DECISION IS AFFECTING THE COMPANY'S POSTURING IN THE**
13 **CURRENT CASE?**

14 **A.** Yes. As noted near the outset of this surrebuttal testimony, KCPL's rate request
15 on a number of issue areas appears to be becoming ever bolder and more
16 asymmetrical. Many significant "non-recurring" test year costs are left
17 unadjusted (i.e., left in the test year operating expense used for cost of service
18 development) or proposed to be deferred with future recovery from ratepayers,
19 while many significant "non-recurring" beneficial transactions are eliminated by
20 KCPL from cost of service consideration.

21

22 **Q. WHAT ARE YOUR SPECIFIC RECOMMENDATIONS AND**
23 **REQUESTS OF THIS COMMISSION?**

1 A. I note and emphasize that I have not analyzed nor weighed in with testimony on
2 all “non-recurring” issues addressed by Company or Staff. Further, I am not
3 requesting *carte blanche* acceptance of all of my adjustments and Staff’s
4 adjustment wherein proposals are being made to amortize financial
5 events/transactions that are favorable to KCPL’s bottom line while rejecting
6 recovery of all “non-recurring” costs recorded during the test year. In other
7 words, unlike the Company I am not proposing to exclusively remove all “non-
8 recurring” *costs* within the adjusted test year cost of service and include all
9 “non-recurring” *proceeds* recorded within, or expected to be received shortly
10 following, the historic adjusted test year. Rather, I am simply requesting a
11 balanced, symmetrical and consistent approach as the Commission addresses all
12 the parties’ proposed treatment of “non-recurring” events – be they favorable or
13 unfavorable to KCPL’s bottom line.

14
15 Further, I specifically request that the Commission reject Mr. Giles’ conclusion
16 that no party has, *and that party ever could*, undertake an analysis to conclude
17 that KCPL was over earning in any prior period. Accordingly, this Commission
18 should consider amortizing transactions such as Hawthorn Unit 5 subrogation
19 proceeds, the DOE uranium enrichment refund, as well as federal income tax
20 refunds expected from filing amended returns for prior years as a result of
21 claiming R&D tax credits.

22

23

1 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

2 **A. Yes, it does.**

