

Exhibit No.: Report on Cost of Service
Issues: Overview of Staff's Filing
Preliminary Reconciliation,
Incentive Compensation,
Witness: Steve M. Traxler
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: ER-2007-0291
Date Testimony Prepared: July 24, 2007

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

STEVE M. TRAXLER

KANSAS CITY POWER AND LIGHT COMPANY

CASE NO. ER-2007-0291

Jefferson City, Missouri
July 2007

****Denotes Highly Confidential Information****

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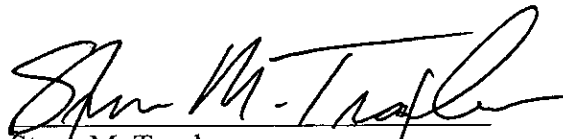
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas)
City Power and Light Company for) Case No. ER-2007-0291
Approval to Make Certain Changes in its)
Charges for Electric Service To Implement)
Its Regulatory Plan.)

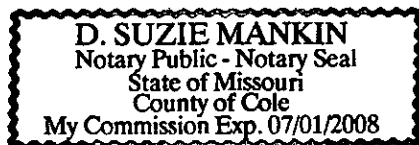
AFFIDAVIT OF STEVE M. TRAXLER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Steve M. Traxler, being of lawful age, on his oath states: that he has participated in the preparation of the following Direct Testimony in question and answer form, consisting of 32 pages to be presented in the above case; that the answers in the following Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.


Steve M. Traxler

Subscribed and sworn to before me this 24th day of July, 2007.



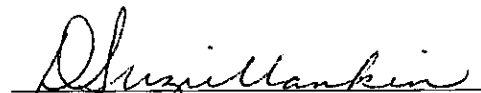

Notary Public

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DIRECT TESTIMONY OF

STEVE M. TRAXLER

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2006-0314

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1 December 1989. My current position is a Regulatory Auditor V with the Commission's Audit
2 Department.

3 Q. What is the nature of your current duties at the Commission?

4 A. I am responsible for assisting in the audits and examinations of the books and
5 records of utility companies operating within the state of Missouri.

6 Q. Have you previously testified before this Commission?

7 A. Yes, I have. A list of cases in which I have filed testimony is shown on
8 Schedule SMT 1 of this direct testimony.

9 Q. Have you filed testimony in rate proceedings involving a regulated utility
10 company in any jurisdictions besides Missouri?

11 A. Yes, I have also filed testimony in Kansas, Minnesota, Arizona, Indiana, Iowa
12 and Mississippi, while in the employ of United Telephone Company of Missouri and
13 Dittmer, Brosch and Associates.

14 Q. To which of the Kansas City Power & Light Co.'s (KCPL) operations are you
15 directing your testimony?

16 A. This testimony addresses the electric operations of KCPL in Missouri.

17 Q. What are your principal areas of responsibility in Case No. ER-2007-0291?

18 A. As the Regulatory Auditor V assigned to this case, I have oversight
19 responsibility regarding areas assigned to other auditors on this case, an Application to
20 increase rates filed by KCPL. In addition, my direct testimony will address the specific areas
21 listed below:

22 (1) Staff Report on Cost of Service as of March 31, 2007

23 (2) Overview of Staff's Revenue Requirement

(3) Short-Term Incentive Compensation

(4) Long -Term Incentive Compensation

Q. What knowledge, skill, experience, training, or education do you have with regard to the areas you have been assigned?

A. I have approximately 30 years of experience in utility regulation. My experience includes 23 years with the Missouri Commission, four years with United Telephone Company of Kansas and three years as a regulatory consultant with the former Dittmer, Brosch and Associates. I have provided expert testimony on regulatory matters in six other state jurisdictions. For most of my career, I have had responsibility for supervising other auditors on major rate cases. With specific regard to my areas in this case, I have presented expert testimony on these issues in prior cases and have had responsibility for providing training on these areas for the Commission's Audit Department.

EXECUTIVE SUMMARY

Q. In summary, what does your testimony cover?

A. As addressed in a cover pleading accompanying the Staff's direct testimony and direct case audit report, the Staff is taking a different approach to the filing of its direct case in an effort to make the Staff's filing more coherent and manageable. The cover pleading states that without sacrificing the quality of the evidence presented, the Staff will be utilizing fewer witnesses filing the Staff's case in testimony and a report format that is intended to present the Staff's case more clearly.

I will provide in my direct testimony an overview of the Staff's revenue requirement determination. The Staff has conducted a review of all cost of service components (capital structure, return on rate base, rate base, depreciation expense and operating expenses) which

1 | comprise KCPL's Missouri jurisdictional revenue requirement. My testimony will provide an
2 | overview of the Staff's work in each area. In addition, I will provide a preliminary
3 | Reconciliation of the significant differences between the Staff's direct case and KCPL's
4 | updated case. KCPL has updated its filed case to substitute actual data for budgeted data for
5 | the last three months of the 2006 test year and made additional changes in annualization and
6 | normalization adjustments to reflect more current data and projections to September 30, 2007.

7 | I am also sponsoring the Staff's Cost of Service Report as of March 31, 2007. For
8 | areas of the case having a methodology difference with a material dollar difference, there is a
9 | related section in the Cost of Service Report that provides a more detailed explanation of the
10 | issue. For areas of the case with no significant methodology and dollar difference between
11 | KCPL and the Staff, the explanation provided in the Cost of Service Report is generally
12 | presented in a much more abbreviated format. Although with this new format the Staff is
13 | endeavoring to better explain its case and the ratemaking principles and processes comprising
14 | its case, the Staff will try to not give equal emphasis to portions of the Staff's audit where the
15 | Staff does not believe there is an "issue" between itself and KCPL or between itself and an
16 | intervenor that is likely to go to hearing. (Usually, the reason why there may not be an issue
17 | between the Staff and the utility, or an issue, that is, that goes to hearing, is even though there
18 | may be a methodological difference, the dollar difference is not material and, as a
19 | consequence, the dollar difference is resolved by the utility and the Staff without going to
20 | hearing.)

21 | My testimony also addresses two significant issues between the Staff and KCPL:

22 | 1) Short-Term Incentive Compensation. The Staff has a significant issue with
23 | KCPL regarding short-term incentive compensation paid to Great Plains Energy Inc. (GPE)

1 and KCPL executive management which is tied to an earnings per share (EPS) goal and to
2 discretionary bonuses included in short-term incentive compensation which are not supported
3 by achievement of any well defined goal/objective that benefits ratepayers.

4 2) Long-Term Incentive Compensation. The Staff also has a compensation issue
5 with KCPL regarding cost of service recognition for long-term incentive compensation to
6 GPE and KCPL executive management which is paid in stock and/or stock options based
7 upon achievement of financial goals which, in Staff's view, benefit the shareholders of GPE
8 and not KCPL's ratepayers. The Staff's position on both short-term and long-term incentive
9 compensation is consistent with the Staff position presented to the Commission in
10 KCPL's recent rate case, Case No. ER-2006-0314. The Staff's position on short-term
11 incentive compensation was adopted by the Commission in its Report and Order in Case
12 No. ER 2006-0314.

13 **REPORT ON COST OF SERVICE AS OF MARCH 31, 2007**

14 Q. Does the Staff's Cost of Service Report eliminate the need for all traditional
15 Question and Answer (Q&A) direct testimony and supporting schedules?

16 A. No, it does not. The amount of Q&A direct testimony has been significantly
17 reduced by generally limiting it to issues where a significant difference exists in the
18 methodology and dollar value of the issue between the Staff and KCPL as of the date of the
19 Staff's direct filing. These issues generally will be supported in the Staff's direct case by both
20 an explanation in the traditional Q&A testimony and the Cost of Service Report. Three
21 examples of these issues which are addressed both in traditional Q&A testimony and the Cost
22 of Service Report are Rate of Return (Staff witness Matt Barnes), Incentive Compensation

1 (Staff witness Steve Traxler) and Talent Assessment Severance Costs (Staff witness Charles
2 Hyneman).

3 Q. Is the Staff's view that a certain subject area or issue is not likely to go to
4 hearing intended to indicate any party's view other than the Staff's view?

5 A. No, The Staff's view often reflects the Staff's view based upon
6 communications with KCPL which cause the Staff to believe that the Staff and KCPL will be
7 able to resolve any differences they have between themselves. The Staff is not seeking to
8 speak on behalf on any other party unless that party has authorized the Staff to do so. Also, as
9 the Commission knows, because there is no dispute between the Staff and KCPL does not
10 mean that no other party has an issue with KCPL on that subject matter. The Staff is not
11 aware of what other parties are filing as their direct cases.

12 Q. Please explain the organizational format of the Staff's Cost of Service Report.

13 A. The Staff's Cost of Service Report has been organized by topic as follows:

14 I. Summary & Overview

15 II. Rate of Return

16 III. Rate Base

17 IV. Jurisdictional Allocations

18 V. Income Statement

19 a) Revenues

20 b) Fuel and Purchase Power

21 c) Depreciation Expense

22 d) Payroll and Employee Benefit Costs

23 e) Maintenance Expense

1 d) Other Non-Labor Expenses

2 e) Income Taxes

3 VI. Reliability and Customer Service

4 This organizational format has been condensed for ease of explanation. The Rate
5 Base, Revenue, Fuel and Purchase Power, Payroll & Benefit and Other Non-Labor Expense
6 sections have numerous subsections which explain each specific adjustment made by Staff to
7 the 2006 test year. The Staff member responsible for writing each subsection of the Cost of
8 Service Report is identified in the write up for that section.

9 **OVERVIEW OF STAFF'S RECOMMENDED REVENUE REQUIREMENT**

10 Q. In its audit of KCPL for this case, Case No. ER 2007-0291, has the Staff
11 examined all of cost of service components comprising the revenue requirement for KCPL's
12 electric operations in Missouri?

13 A. Yes.

14 Q. What are the cost of service components that comprise the revenue
15 requirement for a regulated utility?

16 A. The revenue requirement for a regulated utility can be defined by the following
17 formula:

18 Revenue Requirement = Cost of Providing Utility Service

19 or

20 $RR = O + (V - D)R$ where,

21 RR = Revenue Requirement

22 O = Operating Costs (Fuel, Payroll, Maintenance, etc.), Depreciation and Taxes

23 V = Gross Valuation of Property Required for Providing Service

D = Accumulated Depreciation Representing Recovery of Gross Property
Investment.

$V - D = \text{Rate Base (Gross Property Investment less Accumulated Depreciation = Net
Property Investment)}$

$(V - D)R = \text{Return Allowed on Net Property Investment}$

The “revenue requirement” addressed by this formula is the utility’s total revenue requirement. In the context of Commission rate cases, the term “revenue requirement” is generally used to refer to the utility’s necessary incremental change in revenues as measured from the utility’s existing rates and cost of service.

Q. What objectives must be met during the course of an audit of a regulatory utility in determining the revenue requirement components identified in your last answer?

A. The objectives required for determining the revenue requirement for a regulated utility can be summarized as follows:

1) Selection of a Test Year. The test year income statement represents the starting point for determining a utility’s existing annual revenues, operating costs and net operating income. Net operating income represents the return on investment based upon existing rates. The test year selected for this case, Case No. ER-2007-0291, pursuant to the KCPL Regulatory Plan, is the year ended December 31, 2006. “Annualization” and “normalization” adjustments are made to the test year results when the unadjusted results do not fairly represent the utility’s most current annual level of existing revenue and operating costs. Examples of annualization and normalization adjustments are explained more fully later in this direct testimony.

1 2) Selection of a “known and measurable date” or “known and measurable period.”
2 A proper determination of revenue requirement is dependent upon matching all components,
3 rate base, return on investment, existing revenues and operating costs at the same point in
4 time. This ratemaking principle is commonly referred to as the “matching” principle. The
5 known and measurable date established for this case, ER-2007-0291, is March 31, 2007. The
6 Staff’s direct case filing represents a determination of KCPL’s revenue requirement based
7 upon known and measurable results as of March 31, 2007 with an estimate for the revenue
8 requirement impact for known and measurable changes through the September 30, 2007 true-
9 up agreed to for this case, ER-2007-0291.

10 3) Selection of a “true-up date” or “true-up period.” A true-up date generally is
11 established when a significant change in a utility’s cost of service occurs after the known and
12 measurable date but prior to the operation-of-law date and the significant change in cost of
13 service is one the parties and/or Commission has decided should be considered for cost of
14 service recognition in the current case. A true-up date of September 30, 2007 was selected for
15 this case, pursuant to the KCPL Regulatory Plan. KCPL requested a true-up for this case in
16 order to reflect significant plant investment in selective catalytic reduction (SCR) equipment
17 to be installed at LaCygne Unit 1 and transmission and distribution infrastructure. A true-up
18 audit will be conducted to match all of KCPL’s cost of service components as of
19 September 30, 2007. The results of the true-up audit will be the basis for the Staff’s final
20 revenue requirement recommendation for KCPL in this case.

21 4) Determination of Rate of Return. A cost of capital analysis must be performed to
22 determine a fair rate of return on investment to be allowed on KCPL’s net investment

1 (rate base) used in the provision of utility service. Staff witness Matt Barnes has performed a
2 cost of capital analysis for this case.

3 5) Determination of Rate Base. Rate base represents the utility's net investment used
4 in providing utility service. For its direct filing, the Staff has determined KCPL's rate base as
5 of March 31, 2007 consistent with the known and measurable date established for this case.
6 The Staff will determine KCPL's Rate Base as of September 30, 2007 during the true-up audit
7 ordered for this case.

8 6) Determination of Net Income Required. The net income required for KCPL is
9 calculated by multiplying the Staff's recommended rate of return times the rate base
10 established as of March 31, 2007. The result represents net income required. Net income
11 required is then compared to net income available from existing rates to determine the
12 incremental change in KCPL's rate revenues required to cover its operating costs and provide
13 a fair return on investment used in providing electric service. Net income from existing rates
14 is discussed in the next paragraph.

15 7) Net Income from Existing Rates. Determining net income from existing rates is the
16 most time consuming process involved in determining the revenue requirement for a regulated
17 utility. The starting point for determining net income from existing rates is the unadjusted
18 operating revenues, expenses, depreciation and taxes for the test year which is the
19 twelve month period ending December 31, 2006 for this case, Case No. ER-2007-0291. All of
20 the utility's specific revenue and expense categories are examined to determine whether the
21 unadjusted 2006 results require an annualization or normalization adjustment in order to fairly
22 represent the utility's most current level of operating revenues and expenses.

1 Numerous changes occur during the course of any year which impact a utility's annual level
2 of operating revenues and expenses.

3 8) The final step in determining whether a utility's rates are insufficient to cover its
4 operating costs and a fair return on investment is the comparison of net Operating income
5 required (Rate Base x Recommended Rate of Return) to net income available from existing
6 rates (Operating Revenue less Operating Costs, Depreciation and Income Taxes). The result
7 of this comparison represents the recommended increase and/or decrease in the utilities net
8 income. This change in net income is then grossed up for income tax to determine the
9 recommended increase and/or decrease in the utilities operating revenues
10 (Revenue Requirement).

11 Q. Please identify the four types of adjustments which are made to unadjusted test
12 year results in order to reflect a utility's current annual level of operating revenues and
13 expenses.

14 A. The four types of adjustments made to reflect a utility's current annual
15 operating revenues and expenses are:

16 1) Normalization adjustment. Utility rates are intended to reflect normal ongoing
17 operations. A normalization adjustment is required when the test year reflects the impact of an
18 abnormal event. One example in the revenue area is the Staff's weather normalization
19 adjustment made in all electric rate cases. Actual weather conditions in the test year are
20 compared to a 30 year normal. The weather normalization adjustment restates the test year
21 revenue and kWh sales to reflect normal weather conditions. Another example which applies
22 to this current case is the normalization adjustment for major turbine overhaul maintenance on
23 KCPL's generating units. Major turbine overhauls are scheduled on average every seven years

1 for KCPL's coal fired generating units. Without a normalization adjustment, KCPL's rates
2 would likely be significantly overstated if the unadjusted test year reflected a higher than
3 average amount of maintenance related to turbine overhauls occurring during the year
4 selected for the test year. Conversely, KCPL's rates could be significantly understated if the
5 test year reflects a below average level of maintenance related to major turbine overhauls.

6 2) Annualization adjustment. Annualization adjustments are the most common
7 adjustment made to the test year results to reflect the utility's most current annual level of
8 revenue and expenses. Annualization adjustments are required when changes have occurred
9 during the test year and/or known and measurable period and true-up period if applicable,
10 which are not fully reflected in the unadjusted test year results. For example if a 3% pay
11 increase occurred on August 1, 2006, the 2006 test year will only reflect five months of the
12 impact of the payroll increase. An annualization adjustment is required to capture the payroll
13 increase for the other eight months of the year. If the payroll increase were effective
14 March 1, 2007, then the 2006 test year would not reflect any of the annual cost of the
15 3% payroll increase.

16 KCPL has a payroll increase effective in February 2007 and March 2007 for its
17 management and union Local 412 employees. The Staff's payroll annualization, based upon
18 employee levels and wage rates as of March 31, 2007, restates the 2006 test year to reflect the
19 annual cost for these two payroll increases.

20 3) Disallowance adjustment. Disallowance adjustments are made to eliminate costs in
21 the test year results which are not considered appropriate for recovery from ratepayers. Two
22 examples in this case, Case No. ER-2007-0291, are short-term incentive compensation tiled to
23 an EPS goal and severance costs related to KCPL's talent assessment program. These costs

benefit and/or protect shareholder interests and do not benefit ratepayers. Therefore, these costs should not be included in cost of service for recovery from ratepayers and the Staff has disallowed them from recovery in rates.

4) Proforma adjustment. Proforma adjustments are made to reflect a cost increase that results entirely from increasing or decreasing the utility's annual revenue as a result of a rate increase or rate reduction. The most common example of a proforma adjustment is the grossing up of net income deficiency for income taxes. The example below illustrates this proforma adjustment:

Net Income Required based upon Staff's Rate Base and Rate of Return	\$ 1,000,000
Net Income Available based upon Existing Rates	<u>\$ 600,000</u>
Additional Net Income Required	\$ 400,000
Tax Gross Up Factor based upon a 38.39% Effective Tax Rate	<u>x 1.6231</u>
Recommended Revenue Requirement Increase	<u>\$ 649,240</u>

In this example the utility must increase its rates \$649,240 in order to generate an additional \$400,000 in after tax net income required to provide the return on investment considered reasonable by the Staff. The example reflects \$249,240 in additional revenue to pay the current income tax which applies to any increase in KCPL's operating revenue. Another example using the same assumptions will clarify the need for this proforma adjustment for additional income tax:

Additional Revenue Collected in Rates from Rate Increase	\$ 649,240
Less Income Tax Due the IRS Based Upon a 38.39% Tax Rate	<u>\$ (249,240)</u>
Additional Net Income for Return on Investment	<u>\$ 400,000</u>

1 Q. What return on equity and overall rate of return is the Staff recommending for
2 KCPL in this case, ER 2007-0291?

3 A. The Staff is recommending a midpoint return on equity of 9.72% and a
4 midpoint weighted cost of capital of 8.35% calculated by Staff witness Matthew Barnes:

Weighted Cost of Capital Using Common Equity Return of:			
Capital Component	Percentage of Capital	Embedded Cost	9.72%
Common Stock Equity	66.01%	-----	6.42%
Preferred Stock	1.67%	4.29%	0.07%
Long-Term Debt	32.32%	5.77%	1.86%
Short-Term Debt	0.00%		
Total	100.00%		8.35%

The Staff's recommended low and high end return on equity and weighted cost of capital is reflected in the direct testimony of Staff witness Mathew Barnes.

Q. What are the significant adjustments the Staff made in determining KCPL's revenue requirement for this case, Case No. ER-2007-0291?

A. A summary of significant adjustments made by the Staff in determining KCPL's revenue requirement follows:

Rate Base – All rate base items were determined as of the known and measurable date of March 31, 2007. These rate base items included:

- Plant in Service
- Accumulated Reserve for Depreciation
- Cash Working Capital
- Materials and Supplies and Prepayments
- Prepaid Pension Asset
- Regulatory Asset – FAS 87 Pension Cost
- Fuel Inventories
- Customer Deposits

- Advances for Construction
- Accumulated Regulatory Plan Amortization
- Accumulated Deferred Tax Reserve

Operating Revenues

- Retail Revenues adjusted for customer growth, weather and rate switching.
- Firm Off-System Energy Sales annualized to reflect contract changes.
- Firm Capacity Sales annualized to reflect current contract provisions.
- Non-Firm Off-System Sales adjusted to reflect the net margin at the 25th percentile reflected in the analysis of KCPL witness Michael M. Schnitzer.

Depreciation and Amortization Expense

- Depreciation Expense annualized based upon existing rates and plant in service as of March 31, 2007.
- Regulatory Plan Additional Amortization – increased to reflect the additional cash flow required to meet the credit metric for Cash Flow = to 25% Percent of Average Total Debt.
- Depreciation Expense on Transportation Equipment – Depreciation expense on transportation equipment is charged to Operation and Maintenance (O&M) accounts. The amount charged to O&M in 2006 was eliminated in order to avoid duplicate recognition of this cost which has been annualized in Staff's adjustment to annualize depreciation expense.
- Amortization of Amounts Recovered for Hawthorn 5 Subrogation Costs – 5 year amortization of cash recovered in 2006 resulting from litigation related to the Hawthorn 5 plant explosion in 1999.

Fuel and Purchase Power Costs

- Annualized based upon Staff's annualized KWH sales and prices for coal, gas, oil and purchase power energy costs as of March 31, 2007.
- Purchased Power Capacity Contracts – demand costs annualized based upon contract provisions as of March 31, 2007.

Payroll and Employee Benefit Costs

- Payroll cost annualized based upon employee levels and wages as of March 31, 2007.
- Payroll taxes and 401 K benefits annualized as of March 31, 2007.
- FAS 87 Pension Cost annualized based upon the 2007 actuarial valuation.
- FAS 88 Pension Cost amortized over 5 years consistent with the Stipulation and Agreement in Case No. ER-2006-0314.
- Regulatory Asset – FAS 87 – amortized over 5 years consistent with the Stipulation and Agreement in Case No. ER-2006-0314.
- Short Term Incentive Compensation – disallowance for executive incentive compensation tied to earnings per share (EPS) and discretionary bonuses unsupported by defined goals and not of benefit to ratepayers.
- Long Term Incentive Compensation – disallowance of equity based compensation to executive management tied to earnings beneficial to shareholders and lack of any cash outflow requirement by KCPL.
- Severance Costs – disallowance of both regular severance costs and severance costs tied directly to KCPL's Talent Assessment Program. Severance costs

are intended to protect shareholders from litigation costs by discharged employees.

Maintenance Expense - normalized to reflect an ongoing level of non-labor production, transmission and distribution maintenance. The method used is considered by the Staff to be consistent with the method adopted by the Commission in its Report and Order in Case No. ER 2006-0314.

Other Non-Labor Expenses

- Property Taxes – annualized based upon plant in service as of January 1, 2007. The method used by the Staff was adopted by the Commission in its Report and Order in Case No. ER 2007-0291.
- Bad Debt Expense – annualized based upon the Staff’s annualized level of Missouri rate revenue.
- Surface Transportation Board Litigation Costs – 5 year amortization of litigation costs consistent with the Stipulation and Agreement in Case No. ER 2006-0314.
- Demand Side Management Costs – 10 year amortization of project costs based upon the Regulatory Plan Stipulation and Agreement in Case No. EO 2005-0329.
- Wolf Creek Decommissioning Cost – The 2006 test year level was adjusted to reflect the annual level agreed to in the Stipulation and Agreement in Case No. ER 2006-0314.
- Wolf Creek Refueling Outage – The 2006 test year level was adjusted to reflect a level based upon the traditional accrual accounting method.

- 1 • 2001 Ice Storm Costs – The 5 year amortization of the 2001 ice storm costs
2 was eliminated to reflect the expiration of the amortization period in January of
3 2007.
- 4 • Bank Fees – Sale of Accounts Receivable – An annual level of bank service
5 fees has been included in the income statement related to KCPL's sale of its
6 accounts receivable for the purpose of improving cash flow. The bank fees are
7 more than offset by the reduction in Cash Working Capital resulting from
8 recognizing a lower revenue collection lag in the calculation.
- 9 • Interest on Customer Deposits – The 2006 test year income statement was
10 adjusted to reflect an annual level of interest accrued on customer deposits.
- 11 • Advertising Expense. – The 2006 test year income statement was adjusted to
12 eliminate advertising costs that do not meet the Staff's criteria for rate
13 recovery.
- 14 • Corporate Project Costs – ER 2006-0314 – A Stipulation and Agreement in
15 Case No. ER 2006-0314 provided for the deferral and amortization of specific
16 corporate projects costs. The 2006 test year amount was adjusted to reflect a
17 5 year amortization of these costs.
- 18 • Business Meals and Entertainment costs – The 2006 test year amount was
19 adjusted to eliminate in town business meals and entertainment costs. PSC
20 Assessment – The 2006 test year amount was adjusted to reflect KCPL's PSC
21 Assessment for 2007.

22 Q. What is Staff's recommended revenue requirement increase based upon its
23 midpoint return on equity?

1 A. The Staff is recommending a \$ 14.7 million increase in KCPL's annual
2 Missouri jurisdictional rate revenues based upon the Staff's midpoint return on equity and
3 weighted cost of capital recommendation.

4 Q. Does the Staff's recommended increase in KCPL's annual Missouri
5 jurisdictional revenues at March 31 include an increase in the Regulatory Plan Additional
6 Amortization amount and an estimate for known and measurable changes expected between
7 March 31, 2007 and the September 30, 2007 true-up ordered for this case?

8 A. The Staff's recommended revenue increase for KCPL includes \$21.7 million
9 for the Regulatory Plan Additional Amortization amount granted in KCPL's recent rate case,
10 Case No. ER-2006-0314. No increase in the Regulatory Plan Additional Amortization above
11 the \$21.7 million level approved in Case No. ER-2006-0314 is justified as of March 31, 2007.
12 The need for an increase in the Regulatory Plan Additional Amortization amount will be
13 reevaluated during the Staff's true-up audit based upon known and measurable results as of
14 September 30, 2007. Staff expects an increase in the Regulatory Plan Additional Amortization
15 as a result of the change in GPE's capital structure at September 30, 2007.

16 The Staff's recommended \$14.7 million revenue increase includes \$14 million as the
17 estimated impact on the Staff's case resulting from reflecting changes through
18 September 30, 2007 and providing for movement in the Staff's direct case based upon
19 KCPL's review.

20 Q. What reliance did you place on other staff members?

21 A. An expert determining the revenue requirement for a regulated utility must rely
22 on the work from others responsible for developing specific inputs into the cost of service
23 calculation. I relied on the work from numerous other staff members is calculating a

1 revenue requirement for KCPL in this case, Case No. ER-2007-0291. The annualized level of
2 fuel and purchase power costs, weather normalized sales, revenue impact of KCPL's rate
3 increase in Case No. ER-2006-0314, recommended rate of return and jurisdictional
4 allocations are some examples of data supplied to the Audit department as inputs into the
5 Staff's cost of service calculation (EMS run). In my opinion, the impact of these inputs on
6 KCPL's Mo. jurisdictional revenue requirement appear to be reasonable based upon my prior
7 experience in other cases. The qualifications for all Staff members, not filing testimony, who
8 provided sections to the Staff's Cost of Service Report are attached as an appendix to the
9 report.

10 **STAFF'S PRELIMINARY RECONCILEMENT OF KCPL'S UPDATED REVENUE**
11 **REQUIREMENT**

12 Q. Have you prepared a preliminary Reconciliation of the Staff's direct filing
13 with KCPL's updated cost of service calculation?

14 A. Yes. The Reconciliation between the Staff's direct filing at March 31, 2007
15 and KCPL's updated cost of service projected at September 30, 2007 is reflected below.

1

Reconcilement - Staff Direct - KCPL Update
ER 2007-0291

	<u>\$ Value</u>	<u>Rev. Req.</u>	
	(000's)	(000's)	
1 KCPL Revenue Requirement - Projected to Sept.30,2007		42,163	
<u>Contested Issues</u>			
2 Return on Equity	(21,735)		
<u>Income Statement Issues</u>			
3 Recognition of Hawthorn Subrogation Proceeds	(2,617)		
4 Talent Assessment Severance Costs	(1,322)		
5 Short Term Executive Incentive Compensation	(972)		
6 Long Term Equity Compensation	(1,314)		
7 Property Tax	(426)		
8 Advertising Disallowance	(416)		
9 Dues & Donations Disallowance	(137)		
<u>Rate Base Issues</u>			
10 Deferred Rate Case Expense	(250)		
11 Deferred Surface Transportation Board Costs	(198)		
12 Deferred Demand Side Management Costs	(840)		
13 Sub-Total - Contested Issues		(30,227)	
<u>Differences Expected to be Resolved in Sept.True-Up</u>			
14 Capital Structure	20,593		
15 Regulatory Plan Amortization	(17,783)		
16 Rate Base - Net Plant & Other Rate Base	(6,992)		
17 Annualized Revenue - Customer Growth	7,116		
18 Fuel Expense	(3,729)		
19 Fuel Additives - New LaCygne SCR	(1,102)		
20 Purchase Power Demand and Energy Costs	(3,153)		
21 Payroll Expense	(1,665)		
22 Depreciation Expense	(1,529)		
23 SPP Transmission Fees	(758)		
24 Rate Case Expense	(819)		
25 Other Employee Benefit Costs	(1,471)		
26 Bad Debt Expense	(343)		
27 Other Miscellaneous Adjustments	371	(11,264)	(2)
28 Staff Revenue Requirement - March 31, 2007		672	(1)
29 Allowance for Changes through Sept.30, 2007		14,000	
30 Staff Rev.Req.with Projected Changes at 9/30/2007		<u>14,672</u>	(3)

Staff Revenue Requirement Projected at September 30, 2007 <u>Excluding Increase in Regulatory Plan Amortization</u>			
31	Staff Revenue Requirement -Results through March 2007	672	(1)
32	Total Issues Expected to be Resolved in True-Up Less Change in Regulatory Plan Additional Amortization	(11,264)	(2)
33	Issues Resolved at True Up - Excluding Reg. Plan Amortiz.	<u>17,783</u> 6,519	
34		<u>(6,519)</u>	
Staff's Projected Rev.Req.- Sept.30			
35	Excluding Reg. Plan Amortization	(5,847)	
36	Increase in Regulatory Plan Amortization - KCPL	17,783	
37	Allowance for Contingencies to Staff's Case	<u>2,736</u>	
38	Staff Total Rev. Requirement - Projected to Sept.30,2007	<u>14,672</u>	(3)

Q. Does KCPL's updated revenue requirement differ from its revenue requirement in its February 1, 2007 direct filing?

A. Yes. In its February 1, 2007, filing, KCPL seeks an increase in Missouri retail rates of \$45.4 million, including \$9.3 million related to Regulatory Plan Additional Amortization. KCPL's updated revenue requirement totals \$42,163,104, including \$17,783,104 related to Regulatory Plan Additional Amortization.

Q. Please identify the difference in return on equity which has been valued at \$21.7 million on line 1 of the Reconciliation.

A. The value of the return on equity issue represents the difference between 11.25% requested by KCPL and the Staff's midpoint recommendation of 9.72%.

Q. Please identify the Staff witness responsible for addressing each contested issue identified in the Reconciliation.

A. The Staff witness for each contested issue is as follows:

<u>Issue</u>	<u>Staff Witness</u>
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1	Return on Equity	Matt Barnes
2	Hawthorn Subrogation Proceeds	Chuck Hyneman
3	Talent assessment Severance Costs	Chuck Hyneman
4	Short Term Executive Compensation	Steve Traxler
5	Long Term Equity Compensation	Steve Traxler
6	Property Tax	Graham Vesely
7	Advertising Disallowance	Graham Vesely
8	Dues & Donations Disallowance	Graham Vesely
9	Rate Base – Deferred Rate Case Expense	Chuck Hyneman
10	Rate Base – Deferred Surface Transportation	Chuck Hyneman
11	Board Costs	
12	Rate Base – Deferred Demand Side	Steve Traxler
13	Management Costs	

14 Q. For each Staff member identified in your last answer, please identify where the
15 explanation of the Staff's position can be found.

16 A. The return on equity issue is addressed in detail in the direct testimony and
17 supporting schedules of Staff witness Matt Barnes. An overview is also provided in the Staff
18 Cost of Service Report.

19 Both incentive compensation issues are addressed in the next section of my direct
20 testimony and in the Staff Cost of Service Report.

21 The three issues identified for Graham Vesely are addressed in the Staff Cost of
22 Service Report.

23 Chuck Hyneman addresses the Hawthorn Subrogation Proceeds and Talent
24 Assessment Severance Costs in his direct testimony and in the Staff Cost of Service Report.

1 The rate base issues for deferred rate case, deferred surface transportation board (STB) and
2 deferred demand side management (DSM) costs are addressed in the Staff Cost of Service
3 Report.

4 Q. Provide a brief explanation for the Reconciliation differences on lines 14 – 28
5 above which the Staff's believes will be resolved in the Staff's true-up of KCPL's cost of
6 service through September 30, 2007.

7 A. Line 14 – Capital Structure – The equity ratio in the Staff's capital structure as
8 of March 31, 2007 is 66.0% compared to KCPL reflecting GPE's projected equity ratio of
9 53.0% at September 30, 2007. GPE plans to issue an additional ** ____ ** million in long
10 term debt between March 31 and September 30, 2007. When Staff updates its capital structure
11 as of September 30, 2007, there will be no significant difference between KCPL and Staff
12 related to the capital structure used in determining the weighted cost of capital for KCPL.

13 Line 15 – Regulatory Plan Amortization – The Staff's direct filing does not include an
14 increase in the Regulatory Plan Additional Amortization as a result of the debt ratio in the
15 Staff's capital structure for GPE at March 31, 2007. The higher debt ratio reflected by KCPL
16 for events that will occur by September 30, 2007 results in an increase in the Regulatory Plan
17 Additional Amortization.

18 Line 16 – Rate Base – Net Plant – KCPL is reflecting new investment in selective
19 catalytic reduction (SCR) equipment at LaCygne Unit 1 and additional transmission and
20 distribution infrastructure that was not in service as of March 31, 2007, the known and
21 measurable date used for the Staff's direct filing. This new plant investment, which is or will
22 be in service by the end of the true-up period, will be included in the Staff's rate base in the
23 September 30, 2007 true-up.

1 Line 17 – Annualized Revenue – Customer Growth – KCPL is projected to experience
2 customer growth between March 31 and September 30, 2007. The actual customer growth
3 that occurs through September 30, 2007 will be reflected in the Staff’s cost of service true-up
4 as of September 30, 2007.

5 Line 18 – Fuel Expense - KCPL is reflecting fuel expense to meet a higher level of
6 kWh sales due to customer growth projected through September 30, 2007. The Staff’s fuel
7 expense will increase to reflect the additional kWh sales from customer growth through
8 September 30, 2007.

9 Line 19 – Fuel Additive – New LaCygne SCR – The LaCygne Unit 1 plant requires
10 ammonia as a fuel adder after the SCR becomes operational. The Staff will reflect this
11 additional cost in the September 30 true-up.

12 Line 20 – Purchase Power Demand and Energy Costs – KCPL is reflecting an increase
13 in purchase power demand and energy costs based upon capacity contract changes and
14 customer growth through September 30, 2007. The Staff’s cost of service will be updated
15 during the true-up to reflect these changes from March 31 to September 30, 2007.

16 Line 21 – Payroll Expense – KCPL is reflecting payroll salary and wage rate increases
17 and changes in employee levels through September 30, 2007. The Staff’s payroll
18 annualization will be updated during the true-up to reflect all changes through
19 September 30, 2007.

20 Line 22 – Depreciation Expense – KCPL’s is reflecting depreciation expense based
21 upon projected plant in service as of September 30, 2007. The Staff’s true-up cost of service
22 will reflect the additional annual depreciation expense on plant additions in service through
23 September 30, 2007.

1 Line 23 – SPP Transmission Fees – KCPL is reflecting a significant increase in the
2 fees paid to the Southwest Power Pool (SPP). The Staff’s true-up cost of service will reflect
3 this cost increase assuming it occurs by September 30, 2007.

4 Line 24 – Rate Case Expense – The Staff’s true-up cost of service will reflect
5 consideration of additional data supporting KCPL’s requested level of rate case expense for
6 this case, Case No. ER-2007-0291.

7 Line 25 – KCPL is reflecting an increase in the cost of employee benefits which
8 include medical, dental, vision and other miscellaneous benefit costs. The Staff will reflect an
9 increase for these benefits if the increase can be supported by actual data through
10 September 30, 2007.

11 Line 26 – Bad Debt Expense – The Staff’s adjustment for bad debt expense will be
12 updated in the September 30 true-up audit based upon annualized rate revenue and the Staff’s
13 recommended revenue requirement increase consistent with the Commission’s Report And
14 Order in Case No. ER 2006-0314.

15 Q. Has the Reconciliation provided in this direct testimony been calculated with
16 the same precision as the Reconciliation that will be filed with the Commission after the Staff
17 completes its true-up audit of KCPL based upon actual results through September 30, 2007?

18 A. No. There was not sufficient time to enter the Staff’s direct case and KCPL’s
19 updated case in the Staff’s Reconciliation model prior to filing this testimony. However I
20 believe the issue values provided are good approximations at this time for the major
21 differences between the Staff’s direct filing based on actual data as of March 31, 2007 and
22 KCPL’s projected cost of service through September 30, 2007.

1 Q. Is a Staff recommendation for a revenue increase for KCPL in this case
2 dependent upon the accuracy of KCPL's projected costs and new investment between
3 March 31 and September 30, 2007, the true-up period?

4 A. Yes it is. As a result of the significant difference between KCPL's and the
5 Staff's recommended ROE and the debt ratio in KCPL's capital structure at March 31, 2007
6 than what is expected at September 30, 2007, the Staff's case does not reflect any significant
7 need for a rate increase or increase in the Regulatory Plan Additional Amortization based
8 upon KCPL's results as of March 31, 2007. The Staff's recommended \$14.7 million rate
9 increase for KCPL is dependent upon projected changes occurring by the September 30, 2007
10 true-up end date. This amount is based on a Staff current projected KCPL revenue
11 requirement of in excess of \$11 million becoming reality by September 30, 2007 plus several
12 additional million dollars are provided in the \$14.7 million number to cover contingencies,
13 items the Staff may need to correct, revise or reconsider that KCPL may bring to the Staff's
14 attention after KCPL has an opportunity to review the Staff's case.

15 Q. Does the Staff's \$14.7 million recommended rate increase for KCPL include
16 the Regulatory Plan Additional Amortization approved by the Commission in Case
17 No ER-2006-0314?

18 A. Yes. The Staff's cost of service calculation includes \$21.7 million for the
19 Regulatory Plan Additional Amortization approved in Case No. ER 2006-0314, and the
20 Staff's \$14.7 million recommended rate increase is comprised entirely of an additional
21 Regulatory Plan Additional Amortization amount.

1 Q. Does the Staff expect its revenue requirement recommendation after the true-up at
2 September 30, 2007 to be negative prior to reflecting an increase in the Regulatory Plan
3 Additional Amortization?

4 A. Yes, due to the \$22 million issue value for return on equity and expected change to
5 the GPE's capital structure at September 30, 2007 the Staff's case is projected to be negative
6 by (\$5.8) million at September 30, 2007 reflected on line 35 of the reconciliation above, prior
7 to recognition for an increase in the Regulatory Plan Additional Amortization.

8 **SHORT-TERM INCENTIVE COMPENSATION**

9 Q. What issue does the Staff have with KCPL's 2006 short-term incentive
10 compensation plan?

11 A. The Staff has two issues with KCPL's ratepayers being charged in rates short-
12 term incentive compensation paid to GPE and KCPL executive management employees in
13 2006:

14 1) 50% of the short-term incentive compensation paid to GPE and KCPL executive
15 management in 2006 was tied to an earnings per share (EPS) goal for GPE. Consistent with
16 its position in KCPL's last case, ER 2006-0314, the Staff considers incentive compensation
17 based upon achievement of an EPS goal to be beneficial to GPE's shareholders, not KCPL's
18 ratepayers. GPE's shareholders should therefore be assigned the cost of incentive
19 compensation based upon an EPS goal.

20 2) 20% of the short-term incentive compensation paid to GPE and KCPL executive
21 management in 2006 represents a discretionary bonus. The discretionary bonuses are not tied
22 to any well-defined goals which would demonstrate a benefit to KCPL's ratepayers.
23 Consistent with its position in KCPL's last rate case, the Staff is recommending a

1 disallowance of discretionary bonuses which are unsupported by well-defined goals that
2 benefit KCPL's ratepayers.

3 Q. Did the Commission's Report and Order in KCPL's last rate case, Case
4 No. ER-2006-0314, include a decision on short-term incentive compensation?

5 A. Yes it did. The Commission's decision on incentive compensation is
6 addressed on page 58 of its Report and Order in Case No. ER-2006-0314. The following
7 quote appears in the Report and Order:

8 . . . KCPL management is free to offer whatever compensation packages it
9 wants. Nevertheless, if the method KCPL chooses to compensate
10 employees shows no tangible benefit to Missouri ratepayers, then those
11 costs should be borne by shareholders, and not included in cost of service.

12 Q. Does the Commission's rationale for adopting the Staff's position on incentive
13 compensation in Case No. ER-2006-0314 apply to the issue in this case as well?

14 A. Yes. The Staff's issue in this case with KCPL's short-term incentive
15 compensation paid to executive management is identical to the issue in Case
16 No. ER-2006-0314.

17 **LONG-TERM INCENTIVE COMPENSATION**

18 Q. What form of long-term incentive compensation do GPE and KCPL provide
19 for executive management?

20 A. Long-term incentive compensation provided to the executive management of
21 GPE and KCPL is in the form of three types of equity compensation (compensation tied to
22 GPE's common stock), all of which, are intended to award shares of GPE stock:

23 1) Restricted Stock is stock which must be held for a specified period of time
24 before it can be sold.

2) Performance Shares is stock awarded based upon the achievement of goals which are entirely or primarily the achievement of EPS and return on total capital.

3) Stock Options provide the potential opportunity to buy GPE stock at a discount.

Q. Does any form of equity compensation result in a cash outlay by KCPL similar to other expenses included in cost of service, such as payroll or fuel costs?

A. No. KCPL's 2006 test year reflects recognition of \$2,433,537 (total Company) in long-term incentive compensation as an expense. KCPL is requesting \$2,433,537 in cash recovery from ratepayers for an expense that will never require a cash outlay by KCPL.

Q. When equity compensation results in the issuance of additional GPE stock to GPE and KCPL executive management, will KCPL be required to pay a return on these outstanding shares?

A. No. Any additional stock issued as equity compensation to GPE and KCPL executive management will be treated like any other outstanding stock. It will be included in the weighted cost of capital collected from ratepayers in rates.

Q. Please summarize the Staff's position on long-term incentive compensation.

A. The Staff is recommending that the cost of long-term incentive compensation reflected in KCPL's books for 2006 be excluded from rate recovery on the rationale that:

1) Equity compensation is awarded based upon goals which are entirely or primarily tied to EPS and return on total capital goals beneficial to GPE shareholders, not KCPL's ratepayers.

1 2) Unlike other forms of employee compensation, equity compensation does not
2 require a cash outlay by KCPL. KCPL is requesting cash recovery for \$2.4 million (total
3 Company) in equity compensation which will never require a cash outlay by KCPL.

4 3) The shares of GPE stock held by GPE and KCPL executive management will earn a
5 return based upon the return on equity collected from ratepayers through rates. If KCPL had
6 issued long-term debt in lieu of issuing additional equity to executive management, the cost of
7 capital required from ratepayers would be lower.

8 Q. Does this conclude your direct testimony?

9 A. Yes, it does.

10

Steve M. Traxler

SUMMARY OF RATE CASE INVOLVEMENT

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	
1978	Case No. ER-78-29	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979	Case No. ER-79-60	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979		Elimination of Fuel Adjustment Clause Audits Due to Missouri Supreme Court Decision (all electric utilities)		
1980	Case No. ER-80-118	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1980	Case No. ER-80-53	St. Joseph Light & Power Company (electric)	Direct	Stipulated
1980	Case No. OR-80-54	St. Joseph Light & Power Company (transit)	Direct	Stipulated
1980	Case No. HR-80-55	St. Joseph & Power Company (industrial steam)	Direct	Stipulated
1980	Case No. TR-80-235	United Telephone Company of Missouri (telephone)	Direct Rebuttal	Contested
1981	Case No. TR-81-208	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1981	Case No. TR-81-302	United Telephone Company of Missouri (telephone)	Direct Rebuttal	Stipulated
1982	Case No. ER-82-66	Kansas City Power & Light Company	Rebuttal	Contested
1982	Case No. TR-82-199	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal	Contested
1982	Case No. ER-82-39	Missouri Public Service	Direct Rebuttal Surrebuttal	Contested
1990	Case No. GR-90-50	Kansas Power & Light - Gas Service Division (natural gas)	Direct	Stipulated

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	
1990	Case No. ER-90-101	UtiliCorp United Inc., Missouri Public Service Division (electric)	Direct Surrebuttal	Contested
1991	Case No. EM-91-213	Kansas Power & Light - Gas Service Division (natural gas)	Rebuttal	Contested
1993	Case Nos. ER-93-37	UtiliCorp United Inc. Missouri Public Service Division (electric)	Direct Rebuttal Surrebuttal	Stipulated
1993	Case No. ER-93-41	St. Joseph Light & Power Co.	Direct Rebuttal	Contested
1993	Case Nos. TC-93-224 and TO-93-192	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1993	Case No. TR-93-181	United Telephone Company of Missouri	Direct Surrebuttal	Contested
1993	Case No. GM-94-40	Western Resources, Inc. and Southern Union Company	Rebuttal	Stipulated
1994	Case Nos. ER-94-163 and HR-94-177	St. Joseph Light & Power Co.	Direct	Stipulated
1995	Case No. GR-95-160	United Cities Gas Co.	Direct	Contested
1995	Case No. ER-95-279	Empire Electric Co.	Direct	Stipulated
1996	Case No. GR-96-193	Laclede Gas Co.	Direct	Stipulated
1996	Case No. WR-96-263	St. Louis County Water	Direct Surrebuttal	Contested
1996	Case No. GR-96-285	Missouri Gas Energy	Direct Surrebuttal	Contested
1997	Case No. ER-97-394	UtiliCorp United Inc. Missouri Public Service (electric)	Direct Rebuttal Surrebuttal	Contested
1998	Case No. GR-98-374	Laclede Gas Company	Direct	Settled
1999	Case No. ER-99-247 Case No. EC-98-573	St. Joseph Light & Power Co.	Direct Rebuttal Serrebuttal	Settled
2000	Case No. EM-2000-292	UtiliCorp United Inc. and St. Joseph Light & Power Merger	Rebuttal	Contested

<u>Year</u>	<u>Case No.</u>		<u>Utility</u>	<u>Type of Testimony</u>	
2000	Case No. EM-2000-369		UtiliCorp United Inc. and Empire Electric Merger	Rebuttal	Contested
2000	Case No. EM-2000-369		UtiliCorp United Inc. and Empire Electric District Co.	Rebuttal	Contested
2001	Case No. TT-2001-328		Oregon Mutual Telephone Co.	Direct	Settled
2002	Case ER-2001-672	No.	UtiliCorp United Inc.	Direct, Surrebuttal	Settled
2002	Case No. EC-2002-1		Union Electric Company d/b/a AmerenUE	Surrebuttal	Settled
2003	Case Nos. ER-2004-0034 HR-2004-0024 (Consolidated)	and	Aquila, Inc., d/b/a Aquila Networks-MPS and Aquila Networks-L&P	Direct	Stipulated
2004	Case Nos. ER 2005-0436 HR 2005-0450		Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks-L&P	Direct Surrebuttal	Settled