Exhibit No.:
Issues: Incentive Compensation
Hawthorn No. 5 Litigation Recoveries
R&D Tax Credits
Witness: James R. Dittmer
Type of Exhibit: Direct Testimony
Sponsoring party: DOE-NSSA
Case No.: ER-2007-0291
Direct Testimony Date: July 24, 2007

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0291

PUBLIC VERSION

DIRECT TESTIMONY

OF

JAMES R. DITTMER

ON BEHALF OF

THE DEPARTMENT OF ENERGY – NATIONAL NUCLEAR SECURITY ADMINISTRATION

Kansas City, Missouri
July 2007

"[redacted]**" Designates that "Highly Confidential" or "Proprietary" information has been removed pursuant to the Standard Protective Order**

DIRECT TESTIMONY
OF
JAMES R. DITTMER
KANSAS CITY POWER AND LIGHT COMPANY
CASE NO. ER-2007-0291

Q. PLEASE STATE YOUR NAME AND ADDRESS.

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

Q. BY WHOM ARE YOU EMPLOYED?

A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a consulting firm engaged primarily in utility rate work. The firm's engagements include review of utility rate applications on behalf of various federal, state and municipal governmental agencies as well as industrial groups. In addition to utility intervention work, the firm has been engaged to perform special studies for use in utility contract negotiations.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Keres Consulting, Inc. holds a contract with the United States Department of Energy ("DOE") to provide a number of services, including assistance with utility procurement, contracts and rates administration, as well as intervention in utility rate proceedings that significantly impact large DOE facilities. Utilitech, Inc. is a subcontractor to Keres Consulting, Inc. Keres Consulting/Utilitech, Inc. have been retained by the United States Department of Energy to review

Kansas City Power and Light Company's ("KCPL" or "Company") application to the Missouri Public Service Commission ("MPSC" or "Commission") to increase Missouri electric retail rates. Thus, the testimony I am presenting is offered on behalf of the United States Department of Energy that is representing the interest of the National Nuclear Security Administration ("DOE-NNSA") and other affected Federal Executive Agencies.

Q. WILL DOE-NNSA BE ADDRESSING A BROAD NUMBER OF ISSUE AREAS?

A. No. I will be addressing only a limited number of revenue requirement issues in direct testimony.

Q. PLEASE BRIEFLY STATE THE ISSUES OR TOPICS YOU WILL BE ADDRESSING WITHIN YOUR DIRECT TESTIMONY?

A. First, consistent with the MPSC's order from KCPL's 2006 rate case, I am proposing that all incentive compensation linked to achieving earnings per share or total shareholder return, be eliminated from the adjusted test year cost of service. Second, I am proposing that certain litigation recoveries received by KCPL during the historic test year related to an explosion at Hawthorn Unit No. 5 in 1999, be amortized over a period of five years. Third, I am proposing that Research and Development Federal Tax Credits anticipated to be received by KCPL related to amended federal income tax returns filed for tax years 2000 through 2005 be amortized over a five year period. Finally, I am proposing that the outside services expense incurred in undertaking the analysis, and assisting in the filing of amended returns necessary to claim the Research and Development tax Credits, also be amortized over five years.

I. QUALIFICATIONS

Q. BEFORE DISCUSSING IN GREATER DETAIL THE ISSUES YOU BRIEFLY DESCRIBED ABOVE, PLEASE STATE YOUR EDUCATIONAL BACKGROUND?

A. I graduated from the University of Missouri - Columbia, with a Bachelor of Science Degree in Business Administration, with an Accounting Major, in 1975. I hold a Certified Public Accountant Certificate in the State of Missouri. I am a member of the American Institute of Certified Public Accountants.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.

A. Subsequent to graduation from the University of Missouri, I accepted a position as auditor for the Missouri Public Service Commission. In 1978, I was promoted to Accounting Manager of the Kansas City Office of the Commission Staff. In that position, I was responsible for all utility audits performed in the western third of the State of Missouri. During my service with the Missouri Public Service Commission, I was involved in the audits of numerous electric, gas, water and sewer utility companies. Additionally, I was involved in numerous fuel adjustment clause audits, and played an active part in the formulation and implementation of accounting staff policies with regard to rate case audits and accounting issue presentations in Missouri. In 1979, I left the Missouri Public Service Commission to start my own consulting business. From 1979 through 1985 I practiced as an independent regulatory utility consultant. In 1985, Dittmer, Brosch and Associates was organized. Dittmer, Brosch and Associates, Inc. changed its name to Utilitech, Inc in 1992.

My professional experience since leaving the Missouri Public Service Commission has consisted primarily of issues associated with utility rate, contract and acquisition matters. For the past twenty-eight years, I have appeared on behalf of clients in utility rate proceedings before various federal and state regulatory agencies. In representing those clients, I performed revenue requirement studies for electric, gas, water and sewer utilities and testified as an expert witness on a variety of rate matters. As a consultant, I have filed testimony on behalf of industrial consumers, consumer groups, the Missouri Office of the Public Counsel, the Missouri Public Service Commission Staff, the Indiana Utility Consumer Counselor, the Mississippi Public Service Commission Staff, the Arizona Corporation Commission Staff, the Arizona Residential Utility Consumer Office, the Nevada Office of the Consumer Advocate, the Washington Attorney General's Office, the Hawaii Consumer Advocate's Staff, the Oklahoma Attorney General's Office, the Oregon Citizens Utilities Board, the West Virginia Public Service Commission Consumer Advocate's Staff, municipalities and the Federal government before regulatory agencies in the states of Alaska, Arizona, Colorado, Florida, Hawaii, Indiana

Kansas, Maine, Michigan, Mississippi, Missouri, Nevada, New Mexico, New York, Ohio, Oklahoma, Oregon, Texas, Washington and West Virginia, as well as the Federal Energy Regulatory Commission.

II. INCENTIVE COMPENSATION

Q. PLEASE BRIEFLY DESCRIBE GPE'S AND KCPL'S INCENTIVE COMPENSATION PROGRAM.

A. First, GPE and KCPL have a Long-Term Compensation Plan for officers and other key employees of GPE and KCPL. Compensation under the Long-Term Compensation Plan is equity-based, consisting of performance share grants and time-based restricted shares. Compensation paid under the Long-Term Compensation Plan is linked exclusively to GPE's achievement of total shareholder return ("TSR") relative to other peer companies.

GPE and KCPL also have cash-based incentive compensation plans that are dependant upon achievement of annual – or shorter term – goals. Specifically, there is an Annual Incentive Plan for senior management that, for GPE executives for 2006, was dependant upon achievement of short term goals that were weighted as follows:

- 50% - achievement of an earnings per share goal
- 30% - achievement of Key Business Objectives consisting of the following subcomponents:

[redacted]**[redacted]

[redacted]

- ○ [redacted]**

- 20% - Individual performance

The 2006 goals for the KCPL executive short term incentive compensation was very similar to GPE, consisting of the following:

- 50% - achievement of an earnings per share goal
- 30% - achievement of Key Business Objectives consisting of the following subcomponents:

  [redacted]**[redacted]

  ○ [redacted]**

- 20% - Individual performance

GPE and KCPL also have a short term cash-based incentive compensation plan for non-union management employees that is referred to as "ValueLink." Compensation awarded under this plan is based 40% upon achievement of GPE or KCPL Key Business Objectives (delineated immediately above), 40% upon specific goals for various divisions, and 20% based upon individual employee evaluations.

Finally, KCPL also has a short term, cash-based incentive compensation plan for its union employee, referred to as the "Rewards Plan." Payments under this plan are based 50% upon achievement of KCPL Key Business Objectives (again, delineated above) and 50% based upon achievement of divisional goals.

Q. DO YOU BELIEVE THAT ALL OF THE COST OF THE NOTED INCENTIVE COMPENSATION PROGRAMS SHOULD BE INCLUDED WITHIN THE DEVELOPMENT OF KCPL'S COST OF SERVICE BASED RATES?

A. No. Incentive compensation tied primarily, if not exclusively, to achievement of earnings or returns to shareholders should not be included within the development of the cost of service underlying retail rates. Comparative earnings or returns to shareholders are not a criteria or element directly considered as a cost component in establishing electric utility rates. In and of itself, efforts to enhance earnings or returns may not be consistent with the interests of utility customers or reasonable pricing for the regulated business, where changes in the level of rate base assets and the cost of capital are more directly relevant to earnings achievable by the utility.

Therefore, as a matter of regulatory policy, I believe it is unwise to encourage incentive compensation programs that are entirely or even primarily driven by earnings achievements or total return to shareholders vis-à-vis allowing recovery of such plan costs through regulated utility rates. "Superior," "above authorized," "exceeding peers," or "above targeted" earnings can sometimes be achieved or influenced by short term management decisions that, while temporarily boosting earnings, may not encourage the development of safe and reliable service at the lowest long term achievable costs.

For instance, some maintenance may be deferred temporarily – thereby boosting earnings. But deferral of maintenance can lead to safety concerns or higher subsequent "catch-up" costs. Additionally, incentive compensation based on achievement of earnings can lead to exaggerated or aggressive rate filings which, under a best case scenario leads to extra audit and litigation work, and under a worst case scenario leads simply to unnecessarily high utility rates. In short and in sum on this point, rate recovery of incentive compensation that is based entirely upon earnings or stock performance is simply bad regulatory policy.

Q. IS YOUR POSITION AND REASONING CONSISTENT WITH THE CONCLUSION OF THIS COMMISSION'S LAST RATE ORDER FOR KCPL?

A. Yes, I believe so. Specifically, in this Commission's rate order from KCPL Case No. ER-2006-0314 the Commission stated and found the following regarding the issue of incentive compensation:

> <u>Incentive Compensation</u>
>
> *What amount, if any, of incentive compensation should be included in rates?*
>
> KCPL requests that all of its incentive compensation be included in cost of service. Staff objects, stating that roughly 35% of the cost should be disallowed on the grounds that it is either tied to earnings per share (EPS), and thus has negligible, if any, benefit to ratepayers, or is awarded for vague reasons.
>
> The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As far as compensation tied to EPS, the Commission notes that KCPL management has the right to set such goals. However, because maximizing EPS could compromise service to ratepayers, such as by reducing customer service or tree-trimming costs, the ratepayers should not have to bear that expense. What is more, because KCPL is owned by Great Plains Energy, Inc., and because GPE has an unregulated asset, Strategic Energy L.L.C., it follows that KCPL could achieve a high EPS by ignoring its Missouri ratepayers in favor of devoting its resources to Strategic Energy.
>
> KCPL's attempt to state that Staff has no evidence to support its theory that maximizing EPS might not benefit KCPL shareholders misses the point; KCPL has the burden to prove that the Commission should approve the tariffs. Further, KCPL's argument that disallowing any of its incentive compensation costs would put it at a competitive disadvantage fails. KCPL management is free to offer whatever compensation packages it

> wants. Nevertheless, if the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then these costs should be borne by shareholders, and not included in cost of service. (KCPL Rate Order, Case No. ER-2006-0291)

Q. WHAT ARE YOUR SPECIFIC RECOMMENDED ADJUSTMENTS REGARDING INCENTIVE COMPENSATION IN THE INSTANT CASE?

A. First, as previously described, awards under GPE's Long Term Incentive Plan are dependant upon GPE's total shareholder return in relationship to an industry peer group. Since this element of incentive compensation is tied exclusively to achievement of returns to shareholders, I am recommending that all of the cost of Long Term Incentive Compensation be eliminated from KCPL's Missouri jurisdictional cost of service.

Second, I am recommending that the portion of GPE's and KCPL's officers' and executives' Annual Incentive Plan compensation that is weighted for achievement of Earnings per Share goal also be disallowed. Additionally, I am recommending that the portion of officers' and executives Annual Incentive Plan compensation that is purely "discretionary" also be eliminated from cost of service development.

Q. YOU HAVE PREVIOUSLY DISCUSSED WHY YOU DO BELIEVE THAT INCENTIVE COMPENSATION TIED TO EARNINGS OR

RETURNS FOR INVESTORS SHOULD NOT BE INCLUDED IN THE DEVELOPMENT OF COST OF SERVICE. WHY ARE YOU ALSO RECOMMENDING THAT INCENTIVE COMPENSATION THAT IS "DISCRETIONARY" BE DISALLOWED?

A. By definition, compensation that is "discretionary" is not tied to achievement of specific goals or targets. As such, it is impossible to draw a correlation between this "cost" and ratepayer benefits. Accordingly, this component of incentive compensation should also be disallowed.

Q. HAVE YOU PREPARED A SCHEDULE SHOWING THE DEVELOPMENT OF THE SPECIFIC INCENTIVE COMPENSATION ADJUSTMENTS THAT YOU ARE PROPOSING?

A. Yes, I have affixed as Schedule JRD-1 the calculations eliminating the various components of incentive compensation that I have discussed. As shown on the top of Schedule JRD-1, removal of all Long Term Incentive Plan costs consists of merely eliminating 2006 test year actual recorded Long Term Incentive Plan costs charged to expense.

Removal of just certain elements of the executive and officers' Annual Incentive Compensation Plan costs is undertaken in two steps. After identifying the various subcomponents that contribute to the total amount of Short Term Incentive Compensation it was necessary to develop factors that appropriately allocate those elements of the Short Term Incentive Compensation that were driven by achievement of earnings.

I would note that the incentive compensation adjustment reflected on Schedule JRD-1 is an *incremental* adjustment that should be posted to KCPL's "as adjusted" updated cost of service study. More specifically, KCPL posted an adjustment to reflect the true-up of 2006 incentive compensation costs that occurred in March 2007. I am not taking issue with this KCPL adjustment. My adjustment, therefore, should be posted to the "as adjusted" or "as annualized" level of incentive compensation that KCPL is proposing within its updated cost of service.

Q. ARE YOUR RECOMMENDATIONS IN THIS CASE CONSISTENT WITH THIS COMMISSION'S FINDINGS IN KCPL'S 2006 RATE CASE?

A. With regard to the Annual Incentive Compensation Plan, I note that the goals and weightings of goals changed from the plan that was in effective for calendar year 2005 (i.e., the prior case test period). Thus, while the disallowance percentages have changed from the prior case due to the changes in the plan goals between the two test years, I believe I have calculated an Annual Incentive Compensation Plan adjustment that is consistent conceptually with what this Commissioned ordered in KCPL's prior Missouri retail rate case.

Regarding the Long Term Incentive Plan, I note that this issue was raised by Staff in the prior case. However, it is my understanding that this issue was settled along with a number of other issues, such that this Commission was not required to make a determination as to cost of service inclusion for the cost of GPE's and KCPL's Long Term Incentive Plan. That stated, I believe the arguments supporting disallowance, and this Commission's reasoning for disallowing, elements of GPE's and KCP's Annual Incentive Plan are consistent and equally applicable for disallowing all of the cost of GPE's and KCPL's Long Term Incentive Plan.

III. RECOVERIES FROM HAWTHORN NO. 5 EXPLOSION LITIGATION

Q. PLEASE DISCUSS YOUR NEXT ADJUSTMENT REGARDING RECOVERIES FROM LITIGATION SURROUNDING AN EXPLOSION AT KCPL'S HAWTHORN UNIT NO. 5.

A. The Commission will no doubt recall that KCPL's Hawthorn Unit No. 5 experienced a significant explosion in 1999 that caused that unit to go out of commercial operation from February 1999 through June 2001. This event has been the subject of a great deal of litigation that is summarized as follows within GPE's 2006 Annual Report to Shareholders:

> **Hawthorn NO. 5 Subrogation Litigation**
> KCP&L filed suite in 2001, in Jackson County, Missouri Circuit Court against multiple defendants who are alleged to have responsibility for the 1999 Hawthorn No. 5 boiler explosion. KCP&L and National Union Fire Insurance Company of

> Pittsburgh, Pennsylvania (National Union) have entered into a subrogation allocation agreement under which recoveries in this suit are generally allocated 55% to National Union and 45% to KCP&L. Prior to 2006, certain defendants were dismissed from the suit and various defendants settled, with KCP&L receiving a total of $38.2 million, of which $18.5 million was recorded as a recovery of capital expenditures. Trial of this case with the one remaining defendant resulted in a March 2004 jury verdict finding KCP&L's damages as a result of the explosion were $452 million. In May 2004, the trial judge reduced the award against the defendant to $0.2 million. Both KCP&L and the defendant appealed this case to the Court of Appeals for the Western District of Missouri, and in May 2006, the Court of Appeals ordered the Circuit Court to enter judgment in KCP&L's favor in accordance with the jury verdict. The defendant filed a motion for transfer of this case to the Missouri Supreme Court, which was denied. After deduction of amounts received from pre-trial settlements with other defendants and an amount for KCP&L's comparative fault (as determined by the jury), KCP&L received proceeds of $38.9 million in 2006 pursuant to the subrogation allocation agreement after payment of attorney's fees. The proceeds reduced purchased power expense by $10.8 million and fuel expense by $3.7 million. The proceeds also increased wholesale revenues by $2.5 million and included $6.1 million of interest that increased non-operating income. The remaining $15.8 million of proceeds were recorded as a recovery of capital expenditures.

I am proposing that the proceeds received by KCPL in the 2006 historic test year, described in the 2006 Shareholder's Report, that were effectively recorded as "negative" expense be amortized over a five year period.

Q. WHY IS IT APPROPRIATE THAT RECOVERIES RESULTING FROM LITIGATION SURROUNDING THE 1999 HAWTHORN NO. 5 EXPLOSION BE AMORTIZED AS A CREDIT TO THE COST OF SERVICE AT THIS POINT IN TIME?

A. This Commission has often allowed Companies – including KCPL – to amortize "extra-ordinary", "non-recurring" or "infrequently occurring" *costs* over a multi-year period so that shareholders are not required to bear the entire cost of such events. The "negative" expense or "income" recorded as a result of receiving recoveries from the Hawthorn litigation can also be characterized as "extra-ordinary", "non-recurring" or "infrequently occurring". Consistent with this Commission's past precedent of amortizing significant or extraordinary "costs" over a multi-year period, I am recommending that this significant and extraordinary *negative expense* or *income* similarly be amortized over a multi-year period.

Q. HAVE YOU PREPARED A SCHEDULE THAT REFLECTS THE TEST YEAR ADJUSTMENT THAT YOU ARE PROPOSING WITH REGARD TO AMORTIZING HAWTHORN NO. 5 LITIGATION RECOVERIES?

A. Yes. On attached Schedule JRD-2 I show the *incremental* adjustment to the Company's proposed adjusted test year cost of service to reflect the five-year amortization of the Hawthorn litigation recoveries. I emphasize that the calculations reflect the *incremental* adjustment to the Company's *adjusted* cost of service. It should be remembered that when calculating its proforma fuel and purchased power expense adjustment that the Company effectively eliminated all Hawthorn litigation recoveries that had been recorded during the test year as negative expense. Accordingly, the adjustment reflected on attached Schedule JRD-2 adds back one-fifth of the test year recoveries from Hawthorn litigation that, before elimination by KCPL through its normalization adjustments, had been recorded as negative expense within the historic test year.

IV. AMORTIZATION OF RESEARCH AND DEVELOPMENT TAX CREDITS

Q. PLEASE DISCUSS YOUR NEXT ADJUSTMENT TO TEST YEAR OPERATING EXPENSE.

A. I am proposing that tax credits anticipated to be received by KCPL related to filing amended federal income tax returns for calendar years 2000 through 2005 be deferred and amortized as a credit to the cost of service over a five-year period.

Q. WHAT IS THE NATURE OR ORIGIN OF TAX CREDITS ANTICIPATED TO BE RECEIVED BY KCPL THROUGH THE FILING OF AMENDED FEDERAL INCOME TAX RETURNS?

A. The tax credits appear to arise from increasing research activities. In 2006 KCPL retained the accounting firm of Ernst & Young to assist the Company in determining what research and development ("R&D") tax credits could be claimed for tax years 2000 through 2005 pursuant to Internal Revenue Code Section 41. Additionally, Ernst & Young was retained to assist KCPL in establishing criteria for claiming research and development credits prospectively.

Q. WHY WERE THESE CREDITS NOT TAKEN WHEN THE ORIGINAL TAX RETURNS WERE FILED FOR YEARS 2000 THROUGH 2005?

A. I do not know, though additional discovery on this topic has recently been submitted. By way of background, I first became aware of the Company's intentions to file amended federal tax returns when discovery was submitted regarding test year expenditures for Ernst & Young outside services (DOE-NSSA Data Request No. 53). The studies that accompanied the Company's response to DOE-NSSA Data Request No. 53 have been marked by KCPL as "Confidential." However, I have affixed as Schedule JRD-3 the non-confidential narrative response to DOE-NSSA Data Request No. 53 that briefly describes the work undertaken, and the nature of the Research and Development Tax Credits analyzed by, Ernst & Young.

Q. WHY ARE YOU RECOMMENDING THAT THE RESEARCH AND DEVELOPMENT TAX CREDITS RESULTING FROM FILING AMENDED RETURNS FOR TAX YEARS 2000 THROUGH 2005 BE AMORTIZED AS A CREDIT TO KCPL'S RETAIL COST OF SERVICE OVER A FIVE-YEAR PERIOD?

A. These tax credits have never before been reflected within KCPL's cost of service. As such, ratepayers have never received credit for these newly-claimed tax credits which KCPL is receiving.

Further, KCPL has proposed to include the full cost of the Ernst & Young services undertaken so that KCPL may avail itself of the noted tax credits within the development of its retail cost of service. It would be unfair to charge ratepayers for the "cost" of obtaining these tax credits without concurrently reflecting the attendant benefits derived from the Ernst & Young efforts within the retail cost of service being established within this proceeding. I note that I am separately proposing to amortize the cost of the Ernst &Young efforts over a five-year period consistent with my recommendation regarding the amortization of the R&D tax credits.

I also note that amortization of significant, non-recurring or infrequently-recurring events, has been authorized by this Commission for KCPL as well as other Missouri utilities. For instance, in 2002 KCPL was authorized to amortize over five years the cost of cleaning up a significant ice storm that occurred in January 2002. The treatment that I am proposing for these tax credits is consistent with this Commission's amortization treatment of extraordinary costs.

Finally, I note that KCPL's earnings during the years 2000 through 2005 were adequate, if not robust, in relation to returns being authorized by this as well as other state regulatory commissions during the noted years. Thus, I do not believe that KCPL can credibly argue that its shareholders are entitled to these credits relating to prior years when it was already earning adequate if not excessive rates of return during the relevant period.

For all the reasons noted, I believe it is appropriate to amortize the Research and Development Tax Credits expected to be received for years 2000 through 2005 over five years.

Q. HAVE YOU CALCULATED THE AMOUNT OF TAX CREDIT AMORTIZATION THAT SHOULD BE REFLECTED WITHIN THE RETAIL JURISDICTIONAL COST OF SERVICE IN THE INSTANT CASE?

A. No. As previously noted, I have only recently become aware of the Company's filing of amended federal tax returns. Follow up discovery has been submitted on the topic which should provide for a precise quantification of the appropriate amount to credited to the cost of service. However, based upon the confidential attachments included within the Company's response to DOE-NSSA Data Request No. 53, I estimate the credit to be amortized as a reduction to the test year Missouri jurisdictional cost of service will be approximately $**[redacted]**. I am ultimately recommending that the total R&D tax credit for years 2000 through 2005 be quantified within the true-up phase of this proceeding.

Q. HAS THE COMPANY REFLECTED AN ONGOING AMOUNT OF RESEARCH AND DEVELOPMENT TAX CREDITS TO BE INCLUDED WITHIN THE DEVELOPMENT OF THE COST OF SERVICE IN THIS CASE FOR CALENDAR YEARS 2006 AND BEYOND?

A. The Company did not reflect any Research and Development Tax Credit within the retail cost of service that it originally filed on February 1, 2007. However, within the Company's "update" prepared in recent weeks I observe a line item within the cost of service income tax calculation entitled "WIND PROD/R&D TAX CREDIT" that replaces a similar line within the Company's original cost of service income tax calculation that was only labeled as "WIND PRODUCTION TAX CREDIT." Further, the amount included in the "update" filing as a credit to the cost of service income tax calculation has been increased. Thus, it would *appear* that the Company is now advocating reflection of an "ongoing" Research and Development Tax Credit within its cost of service income tax expense calculation. Follow up discovery should clarify the Company's position. In any event, I would definitely recommend that an ongoing level of Research and Development Tax Credit be included in the cost of service income tax calculation *in addition to* the five-year amortization of Research and Development Tax Credits that I am proposing for credits anticipated to be received for years 2000 through 2005.

V. ERNST & YOUNG OUTSIDE SERVICES EXPENSE

Q. IN AN EARLIER RESPONSE YOU BRIEFLY DISCUSSED THE RATE TREATMENT THAT YOU ARE RECOMMENDING FOR THE TEST YEAR COST OF THE ERNST & YOUNG TAX RESEARCH. PLEASE EXPAND UPON THAT RECOMMENDATION.

A. During the historic test year KCPL paid Ernst & Young $700,000 relating to the work on the Research and Development Tax Credit. In response to DOE-NSSA Question No. 55 (affixed as Schedule JRD-3) KCPL indicated that 1) it had not incurred any cost for comparable work in any of the three previous calendar years, and 2) it was only budgeting $40,000 per year for related follow up tax services work for calendar years 2007 and 2008. Thus, the cost incurred for the Ernst & Young work undertaken during the historic test year is largely non-recurring. Inasmuch as I am recommending that the "benefits" in the form of anticipated federal tax credits be amortized over five years in this case, I am concurrently and consistently recommending that the extraordinary costs incurred in obtaining the tax refunds also be amortized over five years.

Q. HAVE YOU PREPARED AN ADJUSTMENT TO REFLECT THE RATE TREATMENT YOU ARE PROPOSING FOR THE ERNST &YOUNG TEST YEAR COSTS INCURRED?

A. Yes. On Schedule JRD-4 I reflect the calculation of the adjustment required to amortize the non-recurring Ernst & Young costs over a five-year period.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT

STATE OF MISSOURI)
) SS.
COUNTY OF JACKSON)

BEFORE ME, the undersigned notary public, this day personally appeared JAMES R. DITTMER, to me known, who being duly sworn according to law, deposes and says:

"My name is JAMES R. DITTMER. I am of legal age and a resident of the State of Missouri. I certify that the foregoing testimony and exhibits, offered by me on behalf of the Department of Energy – National Nuclear Security Administration, are true and correct to the best of my knowledge and belief."

James R. Dittmer

SUBSCRIBED AND SWORN to before me, a notary public, on this 20th day of July, 2007.

TAMARA M. JONES
Notary Public - Notary Seal
State of Missouri, Jackson County
Commission # 06954511
My Commission Expires Oct 17, 2010

Notary Public in and for the State of Missouri

My Commission Expires: 10-17-2010

Witness: J. Dittmer

KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2007-0291
ADJUSTMENT FOR INCENTIVE COMPENSATION LINKED TO
ACHIEVEMENT OF EPS OR SHAREHOLDER RETURN

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	**Long Term Incentive Compensation:**		
2	Eliminate Equity-Based Long Term Incentive Compensation	KCPL Updated Payroll	
3	Charged to KCPL FERC Account 920 in Historic Test Year	Adjustment Workpapers 20a	$ (2,435,212)
4	**Short Term Incentive Compensation:**		
5	GPE Executive Annual Incentive Plan Costs Based Upon		
6	Earnings and Key Business Objectives	Staff DR 0205	** [redacted] **
7	Percentage Related to Core Earnings	Staff DR 0205	50.0%
8	Percentage Related to Key Business Objectives	Staff DR 0205	30.0%
9	Subtotal:	Line 7 + Line 8	80.0%
10	Core Earnings/Sum of Core Plus KBO Scorecard	Line 7 / Line 9	62.5%
11	Total GPE Disallowance of Executive Short Term Incentive		
12	Based Upon Achievement of Earnings Per Share	Line 6 X Line 10	** [redacted] **
13	Discretionary Bonus Portion of GPE 2006 Executive Short		
14	Term Incentive Plan	Staff DR 0205	** [redacted] **
15	Total GPE Disallowance of Executive Short Term		
16	Incentive Plan	Line 12 + Line 14	** [redacted] **
17	Percentage of GPE STI Allocated to KCPL	KCPL Payroll Workpapers	67.25%
18	Disallowance of GPE Executive Short Term Incentive		
19	Compensation Allocated to KCPL	Line 16 X Line 17	** [redacted] **
20	KCPL Executive Annual Incentive Plan Costs Based Upon		
21	Earnings and Key Business Objectives	Staff DR 0205	** [redacted] **
22	Percentage Related to Core Earnings	Staff DR 0205	50.0%
23	Percentage Related to Key Business Objectives	Staff DR 0205	30.0%
24	Subtotal:	Line 22 + Line 23	80.0%
25	Core Earnings/Sum of Core Plus KBO Scorecard	Line 22 / Line 24	62.5%
26	Total KCPL Disallowance of Executive Short Term Incentive		
27	Based Upon Achievement of Earnings Per Share	Line 21 X Line 25	** [redacted] **
28	Discretionary Bonus Portion of KCPL 2006 Executive Short		
29	Term Incentive Plan	Staff DR 0205	** [redacted] **
30	Total KCPL Disallowance of Executive Short Term		
31	Incentive Plan	Line 27 + Line 29	(2,159,832)
32	**Total KCPL Disallowance of GPE and KCPL Executive**		
33	**Short Term Incentive Compensation Before Capitalization**	**Line 19 + Line 31**	**(2,362,005)**
34	KCPL Percentage Allocated to Expense	KCPL Payroll Workpapers	75.00%
35	Total Company Disallowance of Executive Short Term		
36	Incentive Plan Costs Charged to Expense	Line 33 X line 34	(1,771,504)
37	**Total KCPL Disallowance of Long Term and Short Term**		
38	**Incentive Compensation - Expense Portion**	**Line 3 + Line 36**	**(4,206,716)**
39	Missouri Jurisdictional Allocation Factor	Salary and Wages	54.0031%
40	**Missouri Jurisdictional Disallowance of Long Term and Short**		
41	**Term Incentive Compensation Linked to Achievement of**		
42	**Earnings and/or Shareholder Return**	**Line 38 X Line 39**	**$ (2,271,757)**

KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2007-0291
ADJUSTMENT TO AMORTIZE HAWTHORN NO. 5
LITIGATION RECOVERIES OVER FIVE YEARS

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	Credits to FERC Expense Account Nos.:		
2	547 Fuel Expense	Staff DR 0228	$ 3,589,704
3		Staff DR 0228	77,735
4		Staff DR 0228	10,765
5	Total Account 547- Fuel Expense	Sum Lines 2 - 4	$ 3,678,204
6	555 Purchased Power Expense	Staff DR 0228	10,544,755
7		Staff DR 0228	228,346
8		Staff DR 0228	31,622
9	Total Account 555 - Purchased Power Expense	Sum Lines 6 - 8	10,804,722
10	447 Off-System Sales	Staff DR 0228	$ 2,467,921
11		Staff DR 0228	53,443
12		Staff DR 0228	7,401
13	Total Account 447 - Off-system Sales	Sum Lines 10 - 12	$ 2,528,765
14	419 Other Interest Income	Staff DR 0228	$ 6,104,025
15	Total Test Year Credits Charged to Operating		
16	Revenues and Expense in 2006 Historic Test Year	Lines 5+9+13+14	$ 23,115,716
17	Amortization Period Proposed - Years		5.00
18	Total Company Amortization Credit Adjustment	Line 16 / Line 17	4,623,143
19	Missouri Jurisdictional Allocation Factor	D1	53.569%
20	Missouri Retail Jurisdictional Adjustment to Amortize		
21	Hawthorn No. 5 Litigation Recoveries Recorded as		
22	Negative Expense Within the Historic Test Year		
23	Over Five Years	Line 18 x 19	$ (2,476,572)

DATA REQUEST– Set DOE_20070606
Case: ER-2007-0291
Date of Response: 06/27/2007
Information Provided By: Lori Wright
Requested by: Campbell Lewis

Question No. : 55
Please provide the following regarding Ernst & Young "R&D Tax Credit Services" provided during the historic test year that was noted in response to DOE Data Request No. 37:a. Explain in greater detail what services were providedb. Provide any studies or reports prepared pursuant to this engagement.c. Provide amounts paid in years 2003, 2004 and 2005 for comparable services and provide budgeted/forecasted amounts for 2007 and 2008.

Response:
Ernst & Young was engaged to provide the following R&D tax credit services during 2006:

- Assist the company in applying for the 2005 through 2009 Pre-filing agreement (PFA) with the Internal Revenue Service (IRS) related to the research credit under IRC Code Section 41 and the deduction for research and experimental expenditures under IRC Code Section 174, including pre-PFA planning.
- Assist the company in co-developing the PFA process guidelines with the IRS.
- Assist the company in facilitating and working with the IRS through the PFA process. This included assisting with qualitative and quantitative data gathering and analysis, computation of the research and experimentation credit, negotiating with the IRS, and executing the closing agreement.
- Subject to the PFA agreement with the IRS, assist the company in filing and sustaining refund claims for Section 41 and 174 on an expedited basis with the IRS and the states of Missouri and Kansas for any open year, utilizing the methodology developed in the 2005 PFA process for the Company's tax years ended December 31, 2000 through December 31, 2004.

The costs incurred in 2006 related to tax years 2000-2005. Therefore, no amounts were paid in 2003, 2004, and 2005 for comparable services. Budgeted amounts for 2007 and 2008 are $40,000 a year for Ernst & Young to provide services under the PFA negotiated with the IRS during 2006.

The following paper copies of Ernst & Young Studies are provided as part of this response:

2005 R&D Tax Credit Study (in draft form)
2000-2004 R&D Tax Credit Study

Due to the nature of the sensitive financial information contained in the studies, the studies have been marked "**CONFIDENTIAL**".

Attachments – Hard Copy only:
2005 R&D Tax Credit Study (in draft form)
2000-2004 R&D Tax Credit Study

KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2007-0291
ADJUSTMENT TO AMORTIZE OUTSIDE SERVICES INCURRED
TO ACHIEVE REFUNDS FOR R&D TAX CREDITS

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	Total Company Charges for Ernst & Young Outside		
2	Services Related to Facilitating Refunds for Prior		
3	Year Reseach and Development Tax Credits;		
4	Charges to FERC Account 923 Outside Services	USDOE-NSSA No. 37	$ 700,000
5	Proposed Period to Amortize - Years		5
6	Total Company Amortization Expense Proposed	Line 4 / Line 5	140,000
7	Total Company Adjustment to Amortize Test Year		
8	Outside Services Costs Incurred to Facilitate		
9	Federal Tax Refunds for Claiming Research and		
10	Development Tax Credits	Line 6 - Line 4	(560,000)
11	Missouri Retail Jurisdictional Allocation Factor	E2	56.9315%
12	Missour Retail Jurisdictional Adjustment to		
13	Amortize Test Year Outside Services Costs Incurred		
14	to Facilitate Federal Tax Refunds for Claiming		
15	Research and Development Tax Credits	Line 10 X Line 11	($318,816)