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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

FILED

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Missouri Public
Service Commission

KANSAS CITY POWER AND LIGHT COMPANY

CASE NO. ER-2006-0314

Jefferson City, Missouri
October 2006

Denotes Highly Confidential Information

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Date 10-16-06 Rptr KF

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

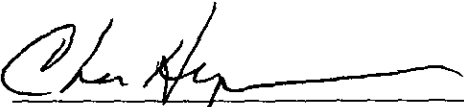
In the Matter of the Application of Kansas City)
Power & Light Company for Approval to Make)
Certain Changes in its Charges for Electric Service)
to Begin the Implementation of Its Regulatory Plan.)

Case No. ER-2006-0314

AFFIDAVIT OF CHARLES HYNEMAN

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Charles Hyneman, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 21 pages to be presented in the above case; that the answers in the foregoing Surrebuttal 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.



Charles Hyneman

Subscribed and sworn to before me this 5th day of October 2006.




ASHLEY M. HARRISON
My Commission Expires
August 31, 2010
Cole County
Commission #06898978

SURREBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

KANSAS CITY POWER AND LIGHT COMPANY

CASE NO. ER-2006-0314

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1 KCPL projects should be recovered over a five-year period, these expenses do not meet the
2 tests for rate base inclusion and should not be included in KCPL's rate base in this case.

3 Finally, I will respond to the comments of the Office of the Public Counsel (OPC)
4 witness Ryan Kind with respect to the Staff's proposed dollar amount of KCPL's emission
5 allowance regulatory liability (Account 254 Regulatory Liability) to include in KCPL's rate
6 base.

7 **SEVERANCE COSTS**

8 Q. What was the original revenue requirement impact of the severance issue?

9 A. In its direct filing KCPL proposed to include in its cost of service \$1.7 million
10 in severance costs. Since the Staff's recommendation to the Commission is that no severance
11 costs should be included in KCPL's cost of service, the revenue requirement impact of this
12 issue on a total Company basis was \$1.7 million (\$980,000 Missouri jurisdictional basis). In
13 its rebuttal testimony, KCPL revised its position on this issue.

14 Q. What is KCPL's revised position and what is the revised revenue requirement
15 impact of the severance issue?

16 A. In her rebuttal testimony, KCPL witness Lori Wright proposed a reduction in
17 KCPL's severance cost adjustment from \$1.7 million to \$897,040 on a total Company basis.
18 KCPL removed the severance payments made to two Great Plains Energy (GPE) executive
19 officers who left the Company in 2005. GPE is the parent company of KCPL. The severance
20 cost of these two former GPE executive officers is described at page 23 of my direct
21 testimony.

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1 Since the Staff is still proposing no recovery of severance costs, the value of the issue
2 is currently \$897,040 on a total company basis and \$512,000 on a Missouri jurisdictional
3 basis.

4 Q. What is the basis for KCPL's changed position on severance costs?

5 A. In her rebuttal testimony, Ms. Wright did not explain why KCPL changed its
6 position. In her revised adjustment she simply removed the 2005 severance payments made
7 to two former executive officers.

8 Q. What is the basis of the Staff's adjustment to remove all severance costs from
9 KCPL's cost of service?

10 A. The severance cost that KCPL is proposing to recover as a "normalized" cost
11 of service expense in this case is not a recurring cost of providing electric service. Normally
12 severance costs are incurred on an irregular basis. When severance costs are incurred, they
13 normally are incurred with the expectation of labor costs savings that will benefit both the
14 utility and its regulated customers. Such is not the case with KCPL's proposal. There is no
15 evidence that the act of incurring severance costs by KCPL will benefit any party other than
16 KCPL's shareholders.

17 There is evidence that the sole reason why KCPL pays severance to departing
18 employees is to protect the interests of its shareholders. These shareholder-protection costs
19 should be paid by the party who benefits - KCPL's shareholders, not the party who receives
20 no benefit - KCPL's customers.

21 Finally, because of the nature of severance payments, KCPL has likely recovered all
22 of its past severance costs through the ratemaking mechanism known as regulatory lag. I will

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1 address each of these reasons why the Staff opposes rate recovery of KCPL's severance costs
2 later in this testimony.

3 Q. What support for the inclusion of severance costs did Ms. Wright provide in
4 her rebuttal testimony?

5 A. Ms. Wright stated that KCPL incurs some amount of severance cost each year
6 and that there are many reasons why KCPL pays severance costs including changing job
7 requirements, corporate reorganization and downsizing.

8 Q. Has KCPL had corporate reorganizations, downsizings, or employees who
9 changed job requirements?

10 A. Every organization the size of KCPL has periodic corporate reorganizations.
11 Companies also change employee job requirements from time to time. KCPL did have a
12 reorganization in 2001 due to the creation of the GPE parent company. It also just completed
13 an employee realignment in 2006 in which is terminated approximately 120 employees.
14 However, corporate reorganizations and employee realignments are not, and should not, be
15 common occurrences.

16 KCPL is not in a downsizing mode of operation at this time and hasn't been for several
17 years. In fact, KCPL stated that the purpose of its 2006 employee reorganization was to
18 realign the Company's organization. It also stated that this realignment will not result in any
19 employee reductions or payroll savings. The employees who were terminated by KCPL in
20 2006 are expected to be replaced by new employees, many in time for the September 30,
21 2006, true-up audit.

22 Q. Has the Staff recommended recovery of certain types of severance payments in
23 past cases?

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1 A. Yes. When a utility company demonstrates that a corporate reorganization did
2 result in net payroll savings that would be passed through to customers, the Staff has
3 recommended rate recovery of the costs to achieve these savings. As recently as Aquila Inc.'s
4 last rate case, No. ER-2005-0436, the Staff recommended rate recovery of Aquila's transition
5 costs, including non-executive severance costs, it incurred in its acquisition of the former St.
6 Joseph Light & Power Company.

7 Q. Does KCPL have a written policy on providing severance payments?

8 A. No. When KCPL implemented a corporate reorganization in 2001 it created a
9 "guidance document" that discusses eligibility requirements for severance benefits in
10 connection with job eliminations caused by corporate reorganizations.

11 However, with respect to severance benefits paid outside of the context of corporate
12 reorganizations, KCPL has no written policy. KCPL explained in its response to
13 Data Request 521, that due to the varied circumstances under which an employee can leave
14 the Company, the decision by KCPL to offer severance benefits is made on a case-by-case
15 basis.

16 Q. Earlier you described how KCPL removed the cost of the severance benefits
17 paid to two former senior executive officers in 2005. Does the amount of KCPL's proposed
18 severance adjustment include payments to other senior executives?

19 A. Yes. On May 24, 2001, GPE's then Chairman, President and Chief Executive
20 Officer (CEO) Bernie Beaudoin announced the appointment of a new Vice President of
21 Human Resources. Mr. Beaudoin stated in a KCPL press release that after a nationwide
22 search, KCPL was extremely pleased to have this individual join its management team. Mr.
23 Beaudoin also stated that this individual had the necessary experience and leadership skills to

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1 support the Company's efforts to develop and implement policies that will continue to
2 promote diversity in the work place and to prosper in an increasingly competitive
3 environment.

4 In February 2004, after less than three years of employment with KCPL, this
5 individual resigned with a severance payment of ** _____
6 _____

7 _____ **

8 Q. What could be the business purpose of making this severance payment?

9 A. I cannot think of one. This is a situation where KCPL paid a lot of money to
10 hire a high-level corporate officer who was employed by KCPL for less than 36 months.
11 Either this was a bad hiring decision and this employee could not handle the job
12 responsibilities, or the individual just decided to leave the Company. Either way, there is no
13 reason why KCPL should charge its regulated customers for this severance payment.

14 Q. Please continue.

15 A. In addition to the GPE officer described above, KCPL is also seeking recovery
16 of \$1.2 million in severance paid to Mr. Beaudoin in December 2003. According to Exhibit
17 10.1k to GPE's 2004 SEC Form 10-K, Annual Report, this amount represents the value of 18
18 months of salary and benefits and 12 months of annual incentive payments.

19 As described above, Mr. Beaudoin is GPE's former Chairman and CEO. He retired
20 from GPE on December 31, 2003. According to pages 9 and 10 of KCPL's 2004 proxy
21 statement filed with the Securities and Exchange Commission, Mr. Beaudoin's total
22 compensation from KCPL in 2003 was \$4.1 million. This amount includes a base salary of
23 \$435,000, a bonus of \$391,300, restricted stock awards of \$348,386, lump sum retirement

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benefits of \$1,895,266 and \$998,111 in additional supplemental retirement benefits. On top of this compensation, KCPL wants its regulated utility customers to pay for Mr. Beaudoin's severance payment of \$1.2 million.

Q. Can the Staff think of any legitimate business reason why KCPL would pay its CEO a severance benefit of \$1.2 million at his retirement date?

A. No.

Q. Did Staff ask KCPL why it made such a payment?

A. Yes. The Staff asked the following question and received the following response in Data Request No. 517.

Q. In addition to his regular pension, SERP, stock options and other compensation paid to a former GPE CEO upon his retirement, please explain why it is reasonable to charge Missouri ratepayers for the \$1.2 million in severance payments paid to this former CEO and included in KCPL's severance adjustment as described on page 10 of Ms. Wright's rebuttal testimony.

A. The Company incurs severance cost each year. Severance payments will fluctuate from year to year and a three-year average compensates for spikes and valleys in severance payments. As stated in the rebuttal testimony of Lori Wright, the three-year average severance amount is representative of an ongoing level of severance costs.

Q. Do you consider KCPL's response to this question to be responsive to the question you asked in this data request?

A. No. Since KCPL did not answer the question, I have no explanation why KCPL believes it was reasonable to charge Missouri ratepayers for Mr. Beaudoin's \$1.2 million severance payment.

Q. Please elaborate on why KCPL's proposed severance adjustment is not a recurring cost to be included in utility rates.

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1 A. While KCPL believes that because it has had severance costs in the past, it will
2 necessarily have them in the future. However, severance costs are not a normal cost of
3 providing utility service. Severance expenses are different from normal recurring expenses
4 that are included in utility rates. For example, payroll will certainly be incurred every year, so
5 will fuel expense, taxes, pensions, and so on. But the act of incurring severance costs to
6 create a customer benefit, such as lower payroll costs, occurs infrequently. This occurrence is
7 primarily through major employee downsizings or corporate reorganizations resulting from a
8 merger that created merger synergies or savings.

9 The realignment that KCPL experienced during 2006 does not occur every year, nor
10 does the payment of severance to key senior management occur frequently. KCPL's position
11 seeking an on-going level in rates for severance payments indicates an expectation that the
12 events surrounding the need for past severance payments will occur on an annual basis. The
13 types of severance payments made by KCPL are not the types of severance payments that the
14 Staff has recommended being included in utility rates in the past. KCPL's severance
15 payments benefit no entity except KCPL's shareholders. To be considered for ratemaking
16 treatment, severance costs have to be incurred, not already recovered in rates, and directly
17 result in tangible customer benefits, such as reduced payroll costs.

18 Q. Is there evidence in this case that KCPL itself does not consider severance to
19 be a normal recurring cost?

20 A. Yes. Part of KCPL's incentive compensation plan is based on KCPL's
21 earnings. The higher the level of KCPL's earnings, the more KCPL's management is
22 compensated. To increase the level of earnings for incentive compensation purposes in 2005,
23 KCPL has decided to exclude its severance costs as a normal recurring expense in the

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1 calculation of earnings per share (EPS). In other words, KCPL believes its regulated
2 customers should be responsible for the payment of severance in rates, but its management
3 should not be held responsible for the level of severance the Company incurs each year. In
4 response to Data Request No. 471, KCPL explained why it excludes severance from EPS and
5 its incentive plan payouts.

6 Q. Provide the rationale for excluding severance costs in
7 determining the EPS for incentive plan payouts in 2005.

8 A. Severance costs are charges, which fluctuate annually, and
9 based on materiality may or may not be included in "core" earnings
10 used in calculating incentive plan payouts.

11 Q. Earlier you stated that because of the nature of severance payments, severance
12 expenses are often recovered in rates over and above the amount actually paid through
13 regulatory lag. Please explain.

14 A. Regulatory lag is the passage of time between when a utility's financial results
15 change, and when that change is reflected in the utility's rates. By proposing an adjustment to
16 recover a "normalized" level of severance costs, KCPL has decided to ignore the positive
17 regulatory lag financial benefits that continue to accrue to the Company as a result of
18 terminating an employee and paying severance benefits.

19 As an example, assume as a result of this rate case, KCPL recovers payroll, pension,
20 OPEB and other benefit costs for employee John Doe in the amount of \$150,000. After rates
21 are set from this case in January 2007, KCPL terminates Mr. Doe and provides severance
22 benefits to him in the amount of \$100,000. In the first 12 months that rates are in effect
23 KCPL will collect \$150,000 in utility rates for John Doe (payroll and other benefit costs) and
24 only pay out \$100,000 in severance. The Company has a net pre-tax gain of \$50,000 to
25 income. In the second year that these rates are in effect, all \$150,000 of Mr. Doe's salary and

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benefits that KCPL's regulated customers are paying in rates will accrue to the benefit of the shareholders.

This simple example shows how severance costs are often, at a minimum, recovered dollar for dollar in utility rates.

Q. Earlier in this testimony you stated that the reason for KCPL's payment of severance benefits is to protect its shareholders. Please explain.

A. In Data Request 521, the Staff asked KCPL to describe the circumstances under which KCPL will make or has made severance payments. KCPL's response was that "overall, the companies use severance agreements to extinguish all potential claims an employee may have had against the companies."

Q. Should regulated customers pay for protection against claims of improper conduct on the part of KCPL management?

A. No. Since regulated customers should not be charged for penalties, fines, or other damages that are incurred due to illegal actions by utility management, they should also not be charged for protection against such costs.

Q. Did KCPL pay its former Chairman and CEO Mr. Beaudoin more than what he was due in order to secure his agreement not to process any claims against the Company?

A. Yes it did. This is clearly stated in Paragraph 7 of Mr. Beaudoin's severance agreement:

** _____

** its affiliated entities, officers, directors, managers,
agents and employees ** _____
** including any and all liability, whether in
their personal or representative capacities, for claims or charges under
state or federal discrimination laws, including Title VII of the Civil

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1 Rights Act and the Age Discrimination in Employment Act, arising out
2 of his employment with the Company or the termination of that
3 employment or any other circumstances or events, whether known or
4 unknown, occurring up to and including the date of retirement
5 (emphasis added)

6 Q. Does KCPL's severance adjustment include very generous severance payments
7 made to other senior level officers in order to keep them from making claims against KCPL?

8 A. Yes. For example, in January 2004 KCPL paid over ** _____ **
9 to a former KCPL controller who worked for the Company for approximately 25 years, and
10 was eligible for retirement. In order for this individual to get this severance payment, ** __

11 _____ **

12 Q. Has the Commission previously ruled on the issue of rate recovery of
13 severance costs?

14 A. Yes. In its Report and Order in Case No. ER-97-394, Aquila Inc., the
15 Commission ruled that severance costs should not be recovered in rates. Specifically, the
16 Commission stated at page 45 of the Report and Order:

17 The Staff has proposed an approximate \$142,600 disallowance for test
18 year severance costs. The Staff witness states that such costs are
19 largely non-recurring and are quickly offset by savings in payroll
20 expense. The typical severance pay is six months salary.

21 UtiliCorp disagrees with the Staff's position. UtiliCorp states that
22 payroll savings are achieved, to the benefit of the ratepayers, by
23 severing employees. UtiliCorp believes that the concurrent severance
24 costs, therefore, should also be borne by the ratepayers.

25 UtiliCorp also points out that it regards severance pay as a management
26 tool and therefore seeks inclusion of what it considers an ongoing
27 amount of severance costs in rates. The test year severance expense
28 was a result of the UtiliCorp reorganization program, referred to as
29 "Building Tomorrow's UtiliCorp," or BTU. The UtiliCorp witness
30 explains that the BTU program is ongoing, along with a certain level of
31 severance costs. UtiliCorp maintains that these costs should properly
32 be reflected in rates.

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1 The Commission finds the weight of evidence in this issue indicates
2 that the severance costs in question were a one-time occurrence and not
3 an ongoing expense. In addition, while some benefit to the ratepayer
4 may accrue, the evidence is insufficient on that point.

5 Therefore, the Commission will adopt the proposed adjustment of the
6 Staff.

7 **CORPORATE PROJECTS AND STRATEGIC INITIATIVES**

8 Q. Please summarize this issue.

9 A. In its direct filing, the Staff removed the test year expenses KCPL charged to
10 Project LED-LDI (Leadership Development) and CORPDP-KCPL (Corporate
11 Development/Planning KCPL). These projects consist of payments to outside consultants and
12 are described in the direct testimony of Staff witness Graham Vesely. The Staff then
13 combined the test year cost of these projects (excluding internal payroll costs) with the cost of
14 the projects incurred in 2006 and amortized this amount to expense over a five-year period.
15 The Staff did not include the unamortized balance of these costs in its proposed rate base for
16 KCPL.

17 Q. Does KCPL agree with the Staff's proposal?

18 A. KCPL agrees with the five-year amortization but disagrees with the Staff's
19 exclusion of these costs from rate base. At page 13 of her rebuttal testimony, KCPL witness
20 Wright states that:

21 KCPL agrees the costs associated with these projects reflect KCPL's
22 efforts to reshape and align the Company to implement the CEP.
23 Therefore, KCPL is supportive of the Staff's proposal to amortize these
24 costs over 5 years. KCPL believes these amounts should be included in
25 rate base because these are cash expenditures, the recovery of which
26 Staff is proposing be deferred.

27 Q. What evidence does KCPL put forth to support rate base inclusion of these
28 costs?

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1 A. The only support put forth by KCPL can be found at page 14, line 8, of KCPL
2 witness Wright's rebuttal testimony. Ms. Wright states "these costs are cash expenditures for
3 which the Staff is proposing to defer recovery; therefore, KCPL believes the non-payroll costs
4 to be deferred and amortized should be included in rate base."

5 Q. Is a Staff proposal to defer costs for future recovery a standard for inclusion in
6 rate base?

7 A. No.

8 Q. What is the standard for inclusion in rate base?

9 A. To be included in rate base, a deferred cost, such as these project costs, has to
10 meet the definition of an asset. After it meets this test, the asset then has to meet the same
11 tests as KCPL's plant in service - used and useful in the provision of utility service.

12 Q. Please describe these standards.

13 A. In order for an item to be added to rate base, it must be an asset. Assets are
14 defined by the Financial Accounting Standards Board (FASB) as "probable future economic
15 benefits obtained or controlled by a particular entity as a result of past transactions or events"
16 (FASB Concept Statement No. 6, Elements of Financial Statements). Once an item meets the
17 test of being an asset, it must also meet the ratemaking principle of being "used and useful" in
18 the provision of utility service. Used and useful means that the asset is actually being used to
19 provide service and that it is actually needed to provide utility service. This is the standard
20 adopted by many regulatory jurisdictions, including the Missouri Public Service Commission.

21 Q. Does the Staff believe that the deferred costs of these two projects meet the
22 definition of an asset?

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1 A. No. The Staff does not believe that these project cost deferrals meet the
2 "probable future benefit" test of an asset. As discussed below, no material weakness in
3 KCPL's management existed to be corrected by these projects.

4 KCPL's management is tasked to ensure that the utility provides safe and adequate
5 service at reasonable prices. The Staff believes that KCPL has met this task. From the
6 comments of its Chairman and CEO described below, it appears that the Company also
7 believes it has accomplished this task very well. The lack of a management problem to
8 address with the expenditure of millions of dollars in outside consultant costs raises doubt as
9 to the existence of probable future economic benefits from the initiation of these projects.

10 Q. Why did Staff take the position that the KCPL should be allowed recovery of
11 these cost through an amortization to cost of service, but not a recovery on these costs by
12 inclusion in rate base?

13 A. The Staff concluded that some long-term benefits may or may not be realized
14 as a result of these projects. Given this possibility, the Staff believes the best rate treatment of
15 these costs in this case is to allow recovery over a finite period of time. Because these costs
16 do not meet the well-established tests for rate base inclusion, the Staff opposes any rate base
17 treatment of these costs.

18 The Staff does not believe it is appropriate to recommend disallowance of these
19 project costs on the basis that they were not necessary to provide electric service or that they
20 were a non-recurring cost. However, Staff also did not want to support a total and complete
21 recovery of those costs. The position taken by the Staff is a compromise between the extreme
22 positions of no recovery and a total recovery of and on these costs.

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1 Q. Would the Staff characterize these costs as meeting the used and useful
2 standard at this time?

3 A. No. The Staff believes that the costs incurred for these two projects were
4 incurred with the intention to improve the effectiveness and leadership skills of KCPL and
5 GPE management. These costs are similar to normal employee training costs that are
6 included in KCPL's cost of service, but not included in its rate base. Therefore, the Staff
7 would classify these costs as reasonable and recommends recovery of these costs over a five-
8 year period.

9 However, there is no evidence that KCPL's management lacked the leadership skills
10 necessary to provide safe and adequate service at a reasonable price prior to KCPL's
11 implementation of these two projects. In fact, there is strong evidence, put forth by KCPL
12 itself, that prior to the implementation of Projects LED-LDI and CORPDP-KCPL, KCPL had
13 a very solid management team in place that produced excellent financial and customer service
14 results.

15 Q. Please describe this evidence.

16 A. In Great Plains Energy's 2003 Annual Report at page 3, GPE's Chairman and
17 CEO, Mr. Michael Chesser made the following comments. Mr. Chesser became Chairman
18 and CEO in October 2003:

19 Great Plains Energy Plains Energy delivered a very solid performance
20 in 2003. Our electric utility operations excelled, and our energy
21 management business continued to grow in a disciplined manner.

22 Earnings and the value of our stock responded positively, as exhibited
23 by Edison Electric Institute ranking of Great Plains Energy Plains
24 Energy in the top 10 for total shareholder return.

25 Kansas City power & Light benefited from our low-cost coal and
26 nuclear generation fleet. This fleet allowed the Company to provide

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1 low-priced power to our customers and also drove strong margins on
2 wholesale power sales during off-peak times.

3 I am delighted with the skill, experience and depth of our management
4 team. I want to personally congratulate Bernie (GPE's former
5 Chairman and CEO) for his legacy in preparing Great Plains Energy for
6 future success.

7 As your new chairman, I come to Great Plains Energy Plains Energy
8 because I see opportunity. I feel extremely fortunate to take the helm
9 of a company with real strengths. Our employees are loyal, proud,
10 dedicated and talented. We have a competitive generation fleet, a
11 reliable transmission and distribution system, and one of the most
12 successful non-regulated business ventures in the industry.

13 This family of businesses has achieved solid results in the past and
14 holds promise to continue growing in the future.

15 Our total return to shareholders was 47 percent during the year,
16 representing a stock price increase of 39 percent, in addition to an
17 attractive dividend.

18 Distribution of electricity to our 490,000 KCP&L customers ranked in
19 the top tier of the Midwestern utilities with a very low frequency and
20 duration of interruptions.

21 We continued to upgrade customer service in 2003 through
22 enhancements in our call center, billing and web site.

23 Great Plains Energy achieved an average return on equity of 15
24 percent.

25 The Kansas City Star ranked Great Plains Energy No. 1 in its annual
26 "Star 50" performance review of public companies - highlighting our
27 focus on the core business, solid financial results and stable cash flows.

28 We also were rated one of Kansas City's "best places to work" by the
29 Business Journal, citing our commitment to employee training and
30 development.

31 We are in solid shape and prepared for the challenges of 2004 and
32 beyond.

33 Based on these statements by GPE's Chairman and CEO, it does not appear that there
34 was any problem with KCPL management's leadership skills prior to the creation and
35 implementation of these two management leadership projects.

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1 Q. Even if these project expenditures do not meet the used and useful test of rate
2 base inclusion, does the Staff believe that by making these expenditures, KCPL is making a
3 reasonable attempt to improve management leadership skills and this effort has the potential
4 for future benefits?

5 A. Yes. This is precisely the reason why the Staff is proposing that these project
6 costs be recovered over a five-year period. The Staff is not making any judgment that these
7 costs are imprudent or that they may not have some future benefit.

8 Q. Since KCPL wants to classify these project costs as rate base assets, is there a
9 glaring inconsistency between this classification and the accelerated recovery period of five
10 years KCPL is proposing?

11 A. Yes. One of the principles of accounting and ratemaking is referred to as the
12 matching principle. This principle requires costs incurred for current service to be "expensed"
13 in the current year. It also requires that those costs that are necessary to provide service over
14 future years are to be capitalized or deferred and recovered by a charge to expense over the
15 useful life of the underlying asset or the period in which the asset will provide benefits.

16 Applying this principle to KCPL's proposal, the only conclusion one can reach is that
17 KCPL expects that the benefits it obtains as a result of these projects will last no longer than
18 five years. This is the inconsistency. It is obvious that if actual benefits are created from
19 spending millions of dollar to improve the leadership skills of the Company's management,
20 these benefits should last well beyond five years.

21 Q. If the Commission decides that these project costs should be included in
22 KCPL's rate base in this case, what amortization period does the Staff recommend that the
23 Commission order for these assets?

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1 A. The Federal Energy Regulatory Commission (FERC) Uniform System of
2 Accounts defines the term amortization as follows:

3 Amortization means the gradual extinguishment of an amount in an
4 account by distributing such amount over a fixed period, over the life of
5 the asset or liability to which it applies, or over the period during which
6 it is anticipated the benefit will be realized.

7 The Staff believes that the Commission should order an amortization period of not less
8 than 15 years. This period would more closely match the benefits of the projects with their
9 costs.

10 Q. Has the Commission recognized the importance of matching costs with
11 benefits so that the utility customers who enjoy the benefits created by the costs are also the
12 customers who are responsible to pay the cost?

13 A. Yes. The Commission recognized this very important ratemaking principle in
14 its Report and Order on Remand in Case No. WO-2002-273, Missouri American Water
15 Company:

16 The AAO is one of the Commission's chief regulatory tools for
17 implementing another aspect of the Matching Principle. As discussed
18 above, one aspect of the Matching Principle is to match revenues and
19 expenses with the period in which they were incurred. However, under
20 another aspect of the Matching Principle, "ratepayers are charged with
21 the costs of producing the service they receive." [41] The purpose is to
22 match costs with benefits so that the ratepayers that enjoy the benefits
23 of utility property also bear the costs thereof. [42]

24 Q. Has the Commission recognized the importance of matching the amortization
25 period of a regulatory asset deferral to the period in which benefits are anticipated to be
26 realized?

27 A. Yes. In its Report and Order in Case No. GR-98-140, Missouri Gas Energy,
28 issued on August 21, 1998, the Commission recognized the importance of tying the

1 amortization period of a regulatory asset deferral to the period in which the benefits of the
2 expenditures that created the regulatory asset will be enjoyed:

3 The Commission finds that competent and substantial evidence has
4 been presented and adduced to support the Commission's approval of
5 the recovery of the SLRP carrying cost over a ten-year period.

6 Ten years relates better to the period in which it is anticipated the
7 benefits will be realized and ten years relates closer to the deferral
8 period itself, and is, therefore, just and reasonable.

9 The Commission does note that Staff has provided ample evidence to
10 show that its proposal of the 20-year amortization period was not
11 extreme as noted in the Commission's Report and Order in the prior
12 MGE rate case, Case No. GR-96-285.

13 While Staff has produced sufficient evidence to support its position, the
14 Commission finds that it is not necessary to relate the amortization
15 period for the deferral or carrying costs to the life of the property
16 constructed but rather to the deferral period or the period during which
17 it is anticipated the benefits will be realized.

18 The Commission clearly ties the amortization of cost deferrals included in rate base
19 to a period over which the benefits resulting from incurring the deferred costs are enjoyed.

20 **SO2 PREMIUMS**

21 Q. Please summarize this issue.

22 A. On July 28, 2005, in Case No. EO-2005-0329, the Commission issued a Report
23 and Order that approved KCPL's experimental regulatory plan. That order also approved a
24 Stipulation and Agreement (Stipulation and Agreement) which includes the following
25 language:

26 KCPL currently purchases coal from vendors under contracts that
27 indicate nominal sulfur content. To the extent that coal supplied has a
28 lower sulfur content than specified in the contract, KCPL may pay a
29 premium over the contract price. The opportunity to burn coal with
30 lower sulfur content is both advantageous to the environment and
31 reduces the number of SO2 emission allowances that must be used. To

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1 the extent that KCPL pays premiums for lower sulfur coal up until
2 January 1, 2007, it will determine the portion of such premiums that
3 apply to retail sales and will record the proportionate cost of such
4 premiums in Account 254. But in no event will the charges to the
5 Missouri jurisdictional portion of Account 254 for these premiums
6 exceed \$400,000 annually.

7 In its direct filing in this case, the Staff proposed to treat all SO2 premiums paid by
8 KCPL to its coal suppliers against the Account 254 Regulatory Liability in rate base instead
9 of charging these payments to fuel expense. The Staff also reduced KCPL's June 30, 2006,
10 balance in Account 254 by the annual amount of SO2 premiums KCPL is actually paying to
11 its coal suppliers. The Staff's reduction of the Account 254 Regulatory Liability has the effect
12 of increasing KCPL's rate base.

13 Q. At page 5 of his rebuttal testimony OPC witness Kind states that the Staff
14 proposed a ratemaking treatment for SO2 premiums that is not allowed by the Stipulation and
15 Agreement. Does the Staff agree Mr. Kind's assertion?

16 A. No. Mr. Kind reads the Stipulation and Agreement as barring the Staff from
17 proposing future ratemaking treatment of KCPL's SO2 liability in a different manner from
18 how KCPL is required to account for this liability on its books and records through the period
19 ending December 31, 2006. The Staff does not read the Stipulation and Agreement as barring
20 the Commission from ordering any type of ratemaking treatment of this liability as a result of
21 this rate case.

22 Q. What is the basis of Mr. Kind's position?

23 A. Mr. Kind states that the relevant portion of the Stipulation and Agreement
24 appears on pages 9 and 10 of the agreement and he quotes this language at page 5 of his
25 rebuttal testimony. He puts an emphasis on the Stipulation language that he feels has been
26 violated by the Staff proposal. The language Mr. Kind points to states: "But in no event will

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1 the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed
2 \$400,000 annually."

3 Q. How does the Staff interpret this requirement of the Stipulation?

4 A. The Staff views this requirement as simply preventing KCPL from charging
5 more than \$400,000 to this account on an annual basis up to and including calendar year
6 2006. The rates from this case do not go into effect until January 2007, which is after the
7 ending date of the period specified in the Stipulation and Agreement for this issue, December
8 31, 2006.

9 Q. Does KCPL agree with Staff's proposed treatment of SO2 emission
10 allowances?

11 A. Yes. KCPL has not identified any disagreement with the way Staff treated the
12 SO2 emission allowances in this case.

13 Q. Does this conclude your surrebuttal testimony?

14 A. Yes, it does.