

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

DIRECT TESTIMONY OF

TERRY BASSHAM

**ON BEHALF OF
KANSAS CITY POWER & LIGHT COMPANY**

**IN THE MATTER OF THE APPLICATION OF
KANSAS CITY POWER & LIGHT COMPANY
TO MODIFY ITS TARIFFS TO BEGIN THE
IMPLEMENTATION OF ITS REGULATORY PLAN**

DOCKET NO. 06-KCPE-____-____

- 1 **Q:** Please state your name and business address.
- 2 A: My name is Terry Bassham. My business address is 1201 Walnut, Kansas City, Missouri
- 3 64106-2124.
- 4 **Q:** By whom and in what capacity are you employed?
- 5 A: I am employed by Kansas City Power & Light Company (“KCPL”) as Chief Financial
- 6 Officer. KCPL is wholly owned by Great Plains Energy Inc. (“GPE”), where I am also
- 7 employed as Executive Vice President, Finance & Strategic Development, and Chief
- 8 Financial Officer.
- 9 **Q:** What are your responsibilities?
- 10 A: My responsibilities include the oversight of KCPL’s finance and accounting departments.
- 11 **Q:** Please describe your education, experience and employment history.

1 A: I hold a Bachelor of Business Administration degree in Accounting from the University
2 of Texas at Arlington and a Juris Doctor degree from St. Mary's University School of
3 Law in San Antonio, Texas. I have held my current position at KCPL since April of
4 2005. Prior to that time, I was employed by El Paso Electric for nine years in various
5 positions including General Counsel, Chief Administrative Officer and Chief Financial
6 Officer. The remainder of my work career I worked as an attorney in the primary
7 practice of regulatory law.

8 **Q: Have you previously testified in a proceeding at the State Corporation Commission**
9 **for the State of Kansas ("KCC" or "Commission") or before any other utility**
10 **regulatory agency?**

11 A: I have not previously testified before the KCC. I have testified before the Federal Energy
12 Regulatory Commission, the Public Utility Commission of Texas, the New Mexico
13 Public Service Commission and various legislative committees of the Texas and New
14 Mexico legislatures.

15 **Q: What is the purpose of your testimony?**

16 A: The purpose of my testimony is to discuss certain KCPL financial information pertinent
17 to this rate case and to summarize the relief KCPL requests in this rate case.

18 **Q: What is the amount of the rate increase KCPL is requesting in this case?**

19 A: The amount of the rate increase is approximately 10.56% or \$42.3 million dollars based
20 on test year revenue of approximately \$400 million.

1 **I. REQUESTED RETURN ON EQUITY**

2 **Q: What return on equity does KCPL request in this case?**

3 A: KCPL requests a return on equity of 11.5% based upon the Great Plains Energy (“GPE”)
4 capital structure of 53.81% equity of KCPL’s holding company.

5 **Q: What is the basis for the requested 11.5% return on equity?**

6 A: KCPL bases its request for an 11.5% return on equity on a baseline cost of equity capital
7 of 11.0%, adjusted to reflect certain investor risks associated with the implementation of
8 KCPL’s Regulatory Plan. For example, as explained in the direct testimony of KCPL
9 witness Samuel Hadaway, the risk premium associated with the construction component
10 of KCPL’s Regulatory Plan increases KCPL’s cost of capital by approximately 50 basis
11 points.

12 **Q: Are there other justifications for a baseline return of equity greater than 11%?**

13 A: Yes, there are. A return on equity greater than the baseline 11.0% is also justified by
14 KCPL’s utility performance, which has added substantial value to customers. KCPL
15 provides its retail customers with a very high level of service. As explained in the direct
16 testimony of KCPL witness Robert Camfield, of Christensen Associates Energy
17 Consulting (“CA Energy Consulting”), KCPL’s high level of performance results in
18 lower prices and higher levels of productivity, resource utilization and service.
19 Accordingly, KCPL respectfully requests that the KCC give consideration to KCPL’s
20 performance when establishing a rate of return on equity in this proceeding.

21 **Q. Did KCPL calculate its rate increase request based upon a performance allowance?**

1 A: No. As I mention above, a rate of return on equity level of 11.5% is fully justified given
2 the risks associated with the extensive, fast-paced construction component of KCPL's
3 Regulatory Plan.

4 **Q: Why is it important that KCPL earn a return on equity of at least 11.5%?**

5 A: An 11.5% return on equity is required to protect KCPL's shareholders. The construction
6 component of KCPL's Regulatory Plan is vital to the region served by KCPL. KCPL's
7 ability to access the capital markets at reasonable costs is necessary for the timely
8 completion of that construction. Acquiring capital on reasonable terms requires that
9 KCPL's holding company, GPE, continue to maintain the value of its common stock. To
10 this end, a return on equity of at least 11.5% is necessary. GPE will issue a substantial
11 amount of equity during the five-year Regulatory Plan. A return on equity less than
12 11.5% would be costly to retail customers and the Company because it would not
13 adequately compensate shareholders for their investment risks.

14 **Q: Does an 11.5% return on equity adequately address the substantial risk of KCPL's**
15 **off-system sales in the wholesale market?**

16 A: No, it does not. The risk of the off-system sales in the wholesale market consists of
17 several components, including market price, volumetric risk associated with generation
18 variable cost, generation unit outages, coal supply availability, and weather, as well as the
19 uncertainty of retail sales growth. KCPL believes that the most appropriate management
20 of this risk is a sharing between KCPL and its customers. KCPL has requested to hold
21 the rate of return request to 11.5%, and distribute the off-system wholesale sales risk
22 between its customers and shareholders. This issue is discussed in greater detail in the
23 direct testimony of KCPL witness Michael Schnitzer.

1 A: Maintaining high credit quality at KCPL is vital to debt and equity investors, banks, and
2 rating agencies for three primary reasons. First, KCPL and GPE will rely extensively on
3 capital markets to finance KCPL's obligations under the Regulatory Plan. Investors will
4 need to have confidence in KCPL's credit strength and financial strength to feel
5 comfortable making this capital available to KCPL on attractive terms, particularly given
6 the number of investment alternatives otherwise available to them. Second, KCPL has a
7 significant amount of debt subject to refinancing over the next five-year period. KCPL's
8 ability to refinance its debt efficiently and effectively will be heavily dependent on
9 bondholder and rating agency views of KCPL's creditworthiness. Finally, equity
10 investor views of KCPL's financial strength and credit quality will be a major influence
11 on the GPE stock (NYSE ticker: GXP) price for the next several years. Clearly, a
12 number of other factors will also impact the performance of GXP. However, because
13 KCPL constitutes a majority of GPE's core earnings and assets, assurance of KCPL's
14 continued strength is, and will remain, essential to GPE investors.

15 **Q: What is the purpose of the CIAC?**

16 A: The fundamental purpose of the CIAC is to ensure that KCPL achieves an amount of
17 Funds from Operations ("FFO") sufficient to sustain levels of certain financial ratios
18 above the low end of the top third of the range for BBB rated companies. Specifically,
19 KCPL will need to maintain at that level its FFO Interest Coverage ratio and its FFO as a
20 Percentage of Average Total Debt ratio. This issue is discussed in greater detail in the
21 direct testimony of Mr. Cline.

22 **Q: What is the actual amount of CIAC for which KCPL is filing in this rate case?**

1 A: Zero. Based on the components of KCPL's case, as described in the testimony of
2 numerous witnesses from the Company and experts testifying on the Company's behalf,
3 KCPL estimates that cash flow will be adequate to achieve the thresholds for the two key
4 financial ratios without the need for CIAC. CIAC may be required to achieve the
5 thresholds, however, if the KCC does not approve, or substantially modifies, KCPL's
6 requested rates.

7 **III. ACCOUNTING ORDERS AND OTHER RELIEF**

8 **Q: Is KCPL requesting the KCC's approval of certain accounting orders as part of this**
9 **rate case?**

10 A: Yes, it is. KCPL is requesting an accounting order with respect to the accrual level of the
11 Wolf Creek Nuclear Generating Station ("Wolf Creek") decommissioning trust fund and
12 with respect to pensions.

13 *Wolf Creek Decommissioning Trust Fund Accrual*

14 **Q: Please summarize your recommendation regarding the appropriate funding level**
15 **for the Kansas jurisdictional component of KCPL's trust fund for decommissioning**
16 **Wolf Creek.**

17 A: I recommend that the annual funding level for the Kansas jurisdictional component of
18 KCPL's trust fund for the decommissioning of Wolf Creek be set at \$2,392,460, as
19 shown in Schedule DAF-5 of the direct testimony of KCPL witness Don Frerking. This
20 funding level will begin in 2007 and continue at the same level through the first quarter
21 of 2045 unless it is changed in a future proceeding before the KCC. This issue is
22 discussed in more detail in the direct testimony of KCPL witness Don Frerking.

23 **Q: How does your recommended funding level compare to the existing funding level?**

1 A: The existing annual funding level for the Kansas jurisdictional component of KCPL's
2 decommissioning trust fund is \$1,248,732. The recommended annual funding level of
3 \$2,392,460 is \$1,143,728 greater than the existing annual funding level.

4 **Q: What is meant by the term "tax qualification" as it relates to nuclear
5 decommissioning trust funds?**

6 A: A "tax-qualified" nuclear decommissioning trust fund is a fund that meets certain criteria
7 as defined in Section 468A of the Internal Revenue Code ("Section 468A"). Tax-
8 qualified nuclear decommissioning trust funds are afforded favorable tax treatment as
9 compared to non-qualified funds.

10 **Q: Did the Energy Policy Act of 2005 include any modifications to the special rules for
11 nuclear decommissioning and Section 468A?**

12 A: Yes, the Energy Policy Act of 2005 included a number of modifications to the special
13 rules for nuclear decommissioning. Among the modifications were amendments to
14 Section 468A which governs the tax qualification of nuclear decommissioning trust
15 funds. These amendments are effective for taxable years beginning after December 31,
16 2005.

17 **Q: What were the requirements for tax qualification under Section 468A prior to the
18 changes resulting from the Energy Policy Act of 2005?**

19 A: In order to ensure the continued tax qualification of the fund, any change in the funding
20 levels had to be filed with and approved by the Internal Revenue Service ("IRS"). The
21 IRS required a statement in an order of the state commission (a) approving the schedule
22 of decommissioning cost accruals; (b) finding that the decommissioning cost accruals
23 were included in cost of service and were included in rates for ratemaking purposes; and

1 (c) finding that the earnings rate assumed for the trust takes into consideration the tax rate
2 change and the removal of the investment restrictions resulting from the Energy Policy
3 Act of 1992.

4 **Q: How have the requirements for tax qualification changed as a result of the changes**
5 **to Section 468A?**

6 A: There is no longer a cost of service requirement for tax-qualified funds. Previously,
7 deposits into a tax-qualified fund were limited by the amount included in cost of service
8 for ratemaking purposes so long as that amount did not provide greater than level (front-
9 loaded) funding. Regarding the allowed level of funding into a tax-qualified fund, the
10 revised Section 468A only states that “the amount which a taxpayer may pay into the
11 Fund for any taxable year shall not exceed the ruling amount applicable to such taxable
12 year.”

13 **Q: What was the rationale for the elimination of the cost of service requirement?**

14 A: The cost of service requirement was primarily eliminated to allow nuclear owners in
15 states that now have deregulated generation to maintain the tax-qualified status of their
16 trust funds in the absence of cost of service-based regulation.

17 **Q: How will the IRS determine the allowable level of funding to a tax-qualified fund if**
18 **it no longer has a state commission-ordered cost of service amount for**
19 **decommissioning funding upon which to rely?**

20 A: Because the elimination of the cost of service requirement has only recently become
21 effective it is not yet evident how the IRS will rule when it does not have state
22 commission-ordered funding amount.

1 **Q: Given the elimination of the cost of service requirement for tax-qualification of the**
2 **fund, what language would you request that the KCC put in its order regarding the**
3 **amount of decommissioning funding in cost of service for ratemaking purposes?**

4 A: KCPL respectfully requests that the KCC use the same language in the order approving
5 the decommissioning funding level that was required prior to the changes to
6 Section 468A. Because of the uncertainty at this time regarding potential IRS treatment,
7 use of the prior Section 468A language provides the greatest assurance of continued tax-
8 qualified decommissioning funding.

9 Pensions

10 **Q: What is the nature of the accounting order the Company requests regarding**
11 **pensions?**

12 A: The Company requests the Commission reaffirm its approval of the regulatory asset or
13 liability the Company records for the annual difference in Statement of Financial
14 Accounting Standards No. 87 ("FAS 87") pension expense recorded for financial
15 reporting purposes and the amount of FAS 87 pension expense calculated for ratemaking
16 purposes, as addressed in Appendix C, Section E of the Regulatory Plan Stipulation and
17 Agreement. The Regulatory Plan Stipulation and Agreement provided no rate base
18 recognition for this regulatory asset or liability. As indicated in the Regulatory Plan
19 Stipulation and Agreement, any difference between the two methods is merely a timing
20 difference that will eventually be recovered, or refunded, through rates under the method
21 used in setting rates over the life of the pension plans.

22 The Company also requests the Commission reaffirm its approval of the regulatory asset
23 or liability the Company records for the annual difference in FAS 87 pension expense

1 calculated for ratemaking purposes and the level of pension expense built into rates for
2 that period, as addressed in Appendix C, Section E of the Regulatory Plan Stipulation and
3 Agreement. The Regulatory Plan Stipulation and Agreement provided rate base
4 recognition for this regulatory asset or liability.

5 Unlike FAS 87, which allows for the delayed recognition in net periodic pension cost of
6 certain gains and losses, FAS 88 requires immediate recognition of certain gains and
7 losses arising from settlements and curtailments of defined benefit plans. The Company
8 requests Commission approval to set up a regulatory asset or liability to track the
9 difference in FAS 88 pension expense recorded for financial reporting purposes and the
10 level of FAS 88 expense built into rates. The regulatory asset or liability would be
11 applied as of the first day of the calendar year in which the rate and order are issued in
12 this case and would be included in rate base and amortized over five (5) years at the next
13 rate case.

14 **Q: Does that conclude your testimony?**

15 **A: Yes, it does.**

