Exhibit No.:	
Issues:	*Iatan 2 Advanced Coal Credit* *Interim Energy Charge* *Off-system Sales*
Witness:	*Cary G. Featherstone*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Rebuttal Testimony*
Case No.:	*ER-2012-0174*
Date Testimony Prepared:	*September 6, 2012*

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION
UTILITY SERVICES - AUDITING

REBUTTAL TESTIMONY

OF

CARY G. FEATHERSTONE

KANSAS CITY POWER & LIGHT COMPANY,

Great Plains Energy, Incorporated

CASE NO. ER-2012-0174

Jefferson City, Missouri
September 6, 2012

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

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REBUTTAL TESTIMONY

OF

CARY G. FEATHERSTONE

KANSAS CITY POWER & LIGHT COMPANY
Great Plains Energy, Incorporated

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Q. Please state your name and business address.

A. Cary G. Featherstone, Fletcher Daniels State Office Building, 615 East 13th Street, Kansas City, Missouri.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Are you the same Cary G. Featherstone who filed direct testimony in this proceeding?

A. Yes, I am. I filed direct testimony in this case on August 2, 2012 sponsoring Staff's Cost of Service Report for Kansas City Power & Light Company's ("KCPL" or "Company") rate case filed on February 27, 2012. I also filed direct testimony on August 9, 2012 sponsoring Staff's cost of service report for KCP&L Greater Missouri Operations Company's ("GMO") rate case filed on February 27, 2012.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of this rebuttal testimony is to address the direct testimony of the following KCPL witnesses for the areas of the Iatan 2 Advanced Coal Credits, Interim Energy Charge and off-system sales:

Iatan 2 Advanced Coal Credit

Melissa K. Hardesty—KCPL's Senior Director of Taxes

Salvatore P. Montalbano—Partner PricewaterhouseCoopers, LLP, Consultant

Interim Energy Charge and Off-System Sales

Terry Bassham- KCPL's President and Chief Executive Officer

Tim M. Rush- KCPL's Director of Regulatory Affairs

Michael M. Schnitzer- Director NorthBridge Group, Inc., Consultant

Specifically, Ms. Hardesty (page 9) proposes to allocate the entire Iatan 2 Advanced Coal Credit to KCPL, ignoring the fact that a portion of these coal credits rightfully belong to GMO for its participation in the Iatan 2 coal-fired generating unit. Mr. Montalbano has been engaged by KCPL in an attempt to justify the Company's improper actions regarding the coal credits using specific tax restrictions of the Internal Revenue Code to keep significant tax benefits from GMO and its customers.

With respect to the interim energy charge proposed by KCPL witness Tim M. Rush (pages 10-16), this mechanism is a violation of the terms of the 2005 Regulatory Plan agreed to by the Company in Case No. EO-2005-0329. Also, the terms of the 2005 Regulatory Plan do not permit the sharing proposal of off-system sales identified in the direct testimony of KCPL witnesses Tim M. Rush (pages 12) and Michael M. Schnitzer (pages 33–34).

Q. Is any other Staff witness addressing the interim energy charge?

A. Yes. Staff witness Lena Mantle is also providing rebuttal testimony on this subject.

EXECUTIVE SUMMARY

Q. Would you please summarize your rebuttal testimony?

A. Yes. I explain and recommend the following:

- The Commission should reject KCPL's requested treatment of not allocating the Iatan 2 Advanced Coal Credits to GMO as presented in the direct testimonies of Melissa K. Hardesty and Salvatore P. Montalbano

- The Commission should accept the recommendations made by Staff for the Iatan 2 Advance Coal Credits found at page 195 of Staff's Cost of Service Report for the KCPL rate case

- The Commission should reject KCPL's requested interim energy charge mechanism presented in the direct testimony of Tim M. Rush because it does not function even similarly to IEC mechanisms approved by this Commission in past cases.

- The energy markets currently do not support the need for an interim energy charge mechanism for KCPL because there is not now extreme volatility in natural gas and purchased power costs.

- The Commission should reject KCPL's requested interim energy charge mechanism as it does not rely on natural and purchased power sufficiently to be affected by those energy sources.

- The Commission should reject KCPL's requested interim energy charge mechanism presented in the direct testimony of Tim M. Rush because the 2005 Regulatory Plan requires KCPL to include all off-system sales in the determination of its rates as long as its investment in Iatan 2 investment is included in KCPL's regulated rate base.

- The Commission should not adopt KCPL's requested sharing mechanism for off-system sales presented in the direct testimonies of Tim M. Rush and Michael M. Schnitzer because the 2005 Regulatory Plan requires KCPL to include all off-system sales in the determination of its rates as long as its investment in Iatan 2 is included in KCPL's regulated rate base.

- The Commission should return to the ratemaking methodology for off-system sales that existed prior to the 2006 KCPL rate case and consistent with the terms of the 2005 Regulatory Plan.

- KCPL should continue to provide the monthly reporting of off-system sales that it has provided to Staff since the 2006 rate case.

IATAN 2 ADVANCED COAL CREDIT

Q. Please summarize KCPL's position regarding the Qualifying Advanced Coal Project Credit for the Iatan 2 Generating Unit.

In her direct testimony (at page 9), KCPL witness Hardesty indicates that she believes no portion of the Iatan 2 Qualifying Advanced Coal Project Credit (Coal Credit) for the Iatan 2 Generating Unit (Iatan 2) should be allocated to GMO. She refers to Mr. Montalbano for discussion of this position. In Mr. Montalbano's direct testimony, he indicates no allocation of these credits should be made to GMO because such action may constitute a tax normalization violation- either directly or indirectly.

Q. What are the Iatan 2 coal credits?

A. These coal credits were authorized by Congress in August 2005 to stimulate the building of coal generation using cleaner emission standards. The generating units had to meet specified emission criteria that were evaluated by the Department of Energy (DOE) and had to be approved by both the DOE and the Internal Revenue Service (IRS). The Coal Credits were treated like investment tax credits (ITC). The maximum amount authorized for each coal project was $125 million.

Q. Did KCPL apply for these coal credits?

A. Yes. KCPL applied for these coal credits for Iatan 2. KCPL, without the knowledge of and to the exclusion of all of the other Iatan 2 partners, applied for these coal credits (what can be referred to as tax benefits) in 2006, and after initially being rejected, applied again in 2007. On April 28, 2008, KCPL was notified that the Iatan 2 Project was given a full amount $125 million. None of the other Iatan 2 partners were initially granted any portion of the coal credits.

After an arbitration process, where an order of the Arbitration Panel was issued December 30, 2009 in favor of allocating a share of the coal credits to one of the other owners—The Empire District Electric Company ("Empire")—Empire received a proportionate share of these coal credits. On August 19, 2010, Empire was authorized its 12% share of the coal credits. However, GMO, also an Iatan 2 partner, was excluded from participating in this process by its owner, Great Plains Energy, Inc. (Great Plains Energy) and its affiliate, KCPL.

For a more detailed discussion of these coal credits, *see* the Staff's Cost of Service Report starting at page 195.

Q. Does Mr. Montalbano address any of the history of GMO being precluded from applying for these coal credits?

A. No. Nowhere in his direct testimony, nor in the direct testimony of Ms. Hardesty, is the subject of GMO not being able to receive the benefit of these coal credits addressed. Neither of these KCPL witnesses address the fact that GMO and its customers were not allowed by those who represented it to seek its proportionate share of these coal credits—benefits that GMO had every right to expect since they were required to pay for all the upgrades to Iatan 1 and all the construction costs of Iatan 2 that qualified for the coal credits.

Q. How do the upgrades to Iatan 1 affect the Iatan 2 coal credits?

A. Without a commitment by the joint owners of Iatan 1 to spend hundreds of millions of dollars for emission upgrades, Iatan 2 would have never been built. Installing an SCR and other costly environmental equipment at Iatan 1 permitted the opportunity to build Iatan 2. Thus, Empire and GMO had to make substantial investment in Iatan 1 just to be able to have the opportunity to participate in Iatan 2. Along with the costs of Iatan 1 upgrades, both Empire and GMO, in addition to the other Iatan 2 owners, paid significant costs for this unit to

have the latest technology to meet the new and more stringent environmental rules. This equipment provided the opportunity to meet the emission standards that qualified for the coal credits—credits that KCPL selfishly intended to keep for itself to the exclusion of all other owners.

Q. Mr. Montalbano states at page 3 of his direct testimony that his purpose "… is to support KCP&L's tax calculations in its rate filings as it relates to the potential imputation of advanced coal investment tax credits…" Has Staff imputed the coal credits in this case?

A. No. While Staff has reduced the amount of coal credits assigned to KCPL, it has not included these coal credits as a reduction to GMO's tax expense in GMO's rate case filing—Case No. ER-2012-0175.

Q. Mr. Montalbano indicates at page 3 that he addresses two potential issues. What are these issues?

A. Mr. Montalbano discusses what he refers to as "…propriety under the federal tax normalization rules of including an adjustment for imputed ITCs" in GMO rates and secondly he addresses the potential impact of the coal credits if KCPL and GMO merge. Neither of these two identified situations exist at present. As indicated above, Staff has not imputed the coal credits to GMO and, to Staff's knowledge, KCPL and GMO are not planning on merging any time soon.

Q. What are normalization rules?

A. Tax normalization rules relate to regulated utilities and the timing of when tax deductions and tax benefits are reflected in rates. In the late 1960s, Congress created certain restrictions in the tax code that restricted these deductions and benefits from being "flowed-through" to utility customers any faster than the amount of the cost reflected on the

utilities' financial statements. The utility industry, and many of its supporters, pressured Congress to place stringent and inflexible rules within the tax code to protect these deductions and benefits from being passed on to customers at the time the tax benefits were available to the companies.

Tax normalization essentially allows the utility to enjoy the benefits of tax deductions and tax credits prior to having to pass (or flow-through) those tax benefits to customers. While the utility can take the deductions and credits faster on its calculation of income taxes for tax purposes, customers must wait a substantial period of time before they are permitted to receive the tax benefits in the calculation of income tax expense for ratemaking purposes.

Under flow-through theory, customers receive the tax benefits at the same time as the utility company—when the company takes the deductions those are also flowed-through to the customers in determination of rates. Under flow-through, since the deductions for tax purposes are aligned with ratemaking there are no accumulated deferred taxes generated and used as an offset (reduction) to rate base.

Q. Did the Missouri Commission ever flow-through tax benefits to customers?

A. Yes. In the 1970s and 1980s, the Commission was regarded as a flow-through state utility commission. The Commission typically flowed-through all tax timing differences that were not required to be normalized—what was referred to as the unprotected or unrestricted tax benefits.

Unprotected tax timing differences flowed-though at the time were capitalized interest, capitalized payroll and capitalized property taxes. These costs were capitalized as part of construction projects. Utilities could take a tax deduction in the year the capitalized costs were incurred. Staff, generally in opposition of the utilities, but supported by the Commission,

included these tax deductions in calculation of income tax expense in developing rates in the year incurred.

Q. Were some companies given normalization treatment of all tax timing differences?

A. Generally, utilities with massive construction programs, such as the construction of nuclear power plants, were authorized to use normalization treatment of tax timing differences. KCPL and Union Electric Company — both building nuclear power plants – were allowed normalization treatment of tax benefits. The Commission typically determined to grant normalization if a company met certain cash flow guidelines. Those companies that had sufficient cash flow generally received flow-through treatment of their tax benefits.

Q. Does Staff still flow-through these tax deductions?

A. No. Most of these unprotected tax deductions were eliminated in the 1986 Tax Reform Act. As a result, these tax deductions are no longer available.

Q. To what tax timing differences do the tax normalization rules apply?

A. Tax normalization primarily applies to accelerated depreciation and the investment tax credits (ITC). Both of these types of tax benefits are specifically identified as having normalization restrictions. While the IRS does not preclude taking either of these deductions faster than permitted, the rules are in place so that if the deductions are taken faster than permitted there are severe consequences.

The IRS permitted two options for ITC treatment that utilities had to make elections— option 2 companies (which KCPL elected) took the ITC tax benefit as an amortization over life of asset with no rate base reduction while option 1 companies reflected a rate base offset

(reduction) throughout the life of the asset. Companies using option 1 had to restore the rate base as the offsets were reduced over the life of the asset.

The penalty for premature pass-through of ITC benefits to customers is such that there would be loss of the accelerated depreciation and loss of the accumulated deferred tax reserves to the utility, both of which are used as an offset to rate base. In the case of the ITC, using deductions not permitted by the IRS results in recapture of the tax benefits— repayment of the tax deductions taken and loss of amortization remaining for Option 2 companies, or a payment equal to the amount of un-restored rate base for companies electing Option 1. Consequently, because the losses were so severe, public utility commissions would not jeopardize the tax benefits by flowing through ITC benefits to customers faster than what the normalization rules allow.

Q. Is Mr. Montalbano aware of any instances where the IRS has required a recapture of tax benefits for violation of the normalization rules?

A. In a response to a data request, Mr. Montalbano indicated he was not aware of any time the IRS required such recapture (Data Request Nos. 318 and 322). He did reference a case in the 1970s where the IRS found a normalization violation relating to the California Public Utility Commission.

Q. Why is a discussion of tax normalization and flow-through theory important in this proceeding?

A. In order to understand the coal credits and impact on KCPL and GMO, it is important to understand the concept of normalization and whether the act of allocating GMO a proportionate share of the coal credits is allowed under the tax normalization rules. As discussed above, normalization rules restrict the timing of the tax deductions to customers. These

restrictions are intended to ensure that greater deductions than are permitted are not taken and those deductions or tax benefits are not provided to customers in rates faster (accelerated) than authorized. For example, accelerated depreciation is not allowed to be taken as a deduction in customer rates through the tax calculation faster than over the life of the plant investment. If taken on an accelerated basis, this would constitute a normalization violation. If the ITC were to be flowed-through to customers faster than over the life of plant investment, this too would violate the normalization rules and not be permitted.

Q. Is allocating a portion of the Iatan 2 Coal Credits to GMO a normalization violation?

A. It certainly does not meet the spirit of the normalization rules—taking a tax deduction faster than over the life of the plant investment or taking greater deductions than authorized. GMO would only take a portion of the $125 million based on its 18% ownership share—approximately $26.6 million (actually $26,562,000 but herein referred to as $26.6 million). Between the three tax-paying Iatan 2 owners (KCPL, Empire and GMO) the sum of the tax benefits would be $125 million. Thus, one of the purposes of the normalization rules is met.

From the perspective of Great Plains Energy, it would not take any greater tax benefit on a consolidated basis than the sum of the allocated amounts to KCPL and GMO—nothing greater. Again, the purposes of the normalization rule is met.

Staff would not recommend taking tax benefits for either KCPL or GMO faster than over the life of plant investment and would certainly would not recommend using any tax benefit amount greater than entitled for rate purposes.

Q. Does Mr. Montalbano state with certainty that assigning GMO its rightful ownership share of the coal credits would be a normalization violation?

A. No. He states at page 8 of his direct testimony that "…the imputation of credits and assumed amortization in GMO's rates could constitute a normalization violation and trigger penalties…" but does not say it will result in a violation. In discussing this with Ms. Hardesty, she indicated uncertainty of a tax normalization violation resulting from an imputation of coal credits to GMO as well. She said no one really knows for sure if allocating to GMO its share of the coal credits would constitute a normalization violation. Of course, KCPL's share of coal credits would be reduced without violating the normalization rules.

Q. Mr. Montalbano states at page 4 of his direct testimony that Congress provided an incentive to invest in utility assets through the investment tax credit and that "…Congress mandated a sharing of tax benefits between ratepayers and utilities from a regulatory perspective…" Do you agree?

A. No. While it is clear that the original intent of the investment tax credits and accelerated depreciation was to provide an incentive to high capital industries such as utilities to invest in plant and capital projects, with respect to the ITC there is no sharing of these tax benefits among utility companies and its customers. Customers do enjoy certain benefits to how accelerated depreciation is treated for tax purposes and ratemaking purposes because of the way the tax deductions are eventually reflected in utility rates and prior to that being treated as a reduction to rate base. However, again at the urging of the utility industry, Congress placed such restrictions on the ITC that rendered it very costly to the customers.

Accelerated depreciation provided this sharing of benefits because utilities could take higher tax deduction for depreciation on its tax returns than were reflected in the income tax

expenses in rates. Customers were forced to pay higher costs for income taxes than what the companies were actually paying for tax purposes. But the utilities had to accumulate the differences by each plant investment vintage and use those as an off-set to rate base—the accumulated deferred tax reserves. The interest free loan of the accelerated depreciation is treated as an offset to rate base which means customers do not have to pay a return on rate base for those amounts—clearly a benefit. But customers do not get that same benefit with ITC.

Consumers simply did not fare as well with respect to the ITC. As Mr. Montalbano explains in his direct testimony (page 4), regulated utilities were given an option that was far more restrictive in nature compared to the accelerated depreciation. The ITC rules were so restrictive that customers only received either the benefit of the ITC amortization over the life of the plant investment qualifying for the credit or the ITC rate base reduction, but not both, unlike accelerated depreciation. Utilities received an interest free loan for the ITC from government but did not have to share this benefit with its customers. Thus, ITC is very costly to consumers. There is nothing about the ITC that can be considered as "sharing."

With accelerated depreciation, utility customers received a rate base reduction for the accumulated deferred tax reserves and also eventually received the tax benefits of those deferrals as they turned around. Turn-around relates to the timing of when the tax deductions taken by the utility (protected by normalization rules) are eventually reflected in rates for customers.

Q. Mr. Montalbano refers to KCPL's request to the IRS on March 16, 2011 for allocation of coal credits to GMO at page 7 of his direct testimony. On page 8 he states the IRS denied such request on August 24, 2011. Is there anything else the Commission should know about the IRS rejecting KCPL's request?

A. Yes. What KCPL does not include in this discussion is that on September 21, 2011 during a teleconference with the IRS, ** _____ _____ _____ ** I reference this at page 198 of the Cost of Service Report filed on August 2, 2012 in KCPL's rate case and August 9, 2012 in the GMO rate case (*see* Staff's notes of the September 21, 2011 IRS conference call attached as Appendix 3, Highly Confidential Schedule CGF-3, to both reports).

To my knowledge, to date Great Plains Energy has not made any attempt to apply for allocation of these coal credits for GMO. Great Plains Energy, KCPL or GMO have not exhausted all options available to pursue this with the IRS.

Q. Should the IRS care if GMO receives its ownership share of the coal credits?

A. No. As discussed earlier, GMO getting its share of the coal credits will not result in greater tax benefits than the authorized $125 million project total amount nor will it result in tax deductions occurring any faster than over the life of the plant investment. If KCPL and GMO would have gone to the IRS to allocate the coal credits to GMO at the time when Empire approached the IRS for this purpose in 2010, the IRS would have had no reason to exclude GMO. Great Plains, KCPL and GMO could have gone to the IRS to include GMO after the July 2008 acquisition. Again, the IRS would have had no reason to exclude GMO.

Q. Mr. Montalbano indicates at page 6 of his direct testimony that in fall of 2008 Empire and GMO went to the IRS requesting coal credits but were rejected. Is this true?

A. While both Empire and GMO did make such a request, both were requesting additional amounts over and above the $125 million amount the IRS approved for the Iatan 2 Project in April 2008. ** _____

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Letters from the IRS relating to GMO's request as well as Empire's is attached as Highly Confidential Schedules CGF-REB-1 and CGF-REB-2 to this testimony.

Q. Mr. Montalbano discusses at page 7 of his direct testimony the original August 2008 memorandum of understanding (MOU) with the IRS to authorize the full $125 million coal credits to the Iatan 2 Project, and that GMO was not part of the August 2010 revision to the MOU. Did the IRS reject GMO from being part of the August 2010 MOU?

A. No. Great Plains Energy and KCPL, acting as the agent for GMO per the Joint Ownership Agreement (*see* Appendix 3, Schedule CGF 12 to Cost of Service Report), refused to include GMO in the request with the IRS to allocate any coal credits to GMO. ** _____

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_____ ** This was discussed at page 208 of the Cost of Service Report and the May 3, 2010 letter to the IRS was attached as Appendix 3, Highly Confidential Schedule CGF 11, to the Cost of Service Report.

Q. Does Mr. Montalbano believe that GMO should be given a portion of the Advanced Coal Credits?

A. Mr. Montalbano indicated he could not provide an opinion on this subject as he was not engaged to do so. In a series of data requests, Mr. Montalbano was asked if he thought it proper to allocate coal credits to GMO if GMO was required to pay costs associated with Iatan 2 that gave rise to the qualifying for these credits. (Attached as Schedule CGF-REB-3-- Data Request Nos. 336-340 and 343-346) He didn't have an opinion on these questions.

Q. Does Staff regard this as a tax matter?

A. While the mechanics of how the coal credits are implemented are tax related, the issue Staff has with KCPL and Great Plains Energy relates to its decision-making on excluding GMO from the benefits of these credits. This is a prudency issue. Neither Ms. Hardesty nor Mr. Montalbano provided any testimony on the decision-making aspects of not allocating any of these coal credits to GMO – an 18% owner of Iatan 2. Certainly GMO had to pay for its share of the Iatan 2 Project, but no one discusses in KCPL's testimony the justification for making such an exclusion and denying a tax-paying owner from the benefits of these important credits—credits that have the effect of lowering the costs of Iatan 2. No KCPL witness makes any attempt to provide an explanation or supply any justification for why it is proper having the

customers of St. Joseph, Warrensburg, Sedalia and their surrounding communities pay proportionately more for Iatan 2 than KCPL's Missouri and Kansas customers and the customers in Joplin receiving service from Empire.

Q. Does Staff believe the actions of KCPL constitute affiliate abuse toward GMO?

A. Yes. KCPL is the only voice who can represent GMO since 2008. GMO and its customers have placed its entire operations and all managerial decision-making in the hands of KCPL. KCPL and Great Plains had no fewer than six chances to "get it right" with respect to the coal credits for GMO and failed in every way possible (*see* pages 196-197 of Staff's Cost of Service Report to identify six opportunities to have this problem fixed). Mr. Montalbano makes no mention in his direct testimony about any decision-making regarding GMO's coal credits, just that any attempt to fix this bad situation will result in all kinds of tax consequences with tens of millions of dollars hanging in the balance. The following key facts are not addressed in KCPL's direct testimony on this issue:

- Neither Mr. Montalbano nor any other KCPL witness addresses that Aquila did not apply for coal credits
- Neither Mr. Montalbano nor any other KCPL witness addresses that Great Plains Energy and KCPL did not include GMO in the dispute when it learned of Empire wanting its share of the coal credits
- Neither Mr. Montalbano nor any other KCPL witness addresses that Great Plains Energy and KCPL did not include GMO in the allocation of the coal credits when they learned the IRS viewed these credits as being for the Iatan 2 Project
- Neither Mr. Montalbano nor any other KCPL witness addresses that Great Plains Energy and KCPL did not include GMO in the Arbitration process
- Neither Mr. Montalbano nor any other KCPL witness addresses that Great Plains Energy and KCPL did not include GMO in the request made to the IRS to allocate coal credits after the December 30, 2009 Arbitration decision
- Neither Mr. Montalbano nor any other KCPL witness addresses that Great Plains Energy and KCPL did not include GMO in the request to the IRS to allocate coal

credits in early 2010 at the time the IRS was considering the revision to include allocation to Empire

Thus, what Mr. Montalbano's testimony is really attempting to do is to scare the Commission about these alleged tax consequences of imputing coal credits to GMO and, accordingly, letting KCPL "off the hook." In essence, KCPL has paid a consultant to present a picture of dire consequences allowing KCPL and Great Plains Energy to hide behind the IRS on this issue.

The Commission should reject such a self-serving attempt on KCPL's part to deny GMO and its customers the Iatan 2 coal credits. Staff continues to support its recommendations presented in the Cost of Service Report beginning at page 195.

INTERIM ENERGY CHARGE

Q. KCPL is requesting an interim energy charge in this case. Please describe your understanding of KCPL's request.

A. Several KCPL witnesses refer to the interim energy charge (IEC) request in the Company's direct testimony. KCPL witness Terry Bassham in his direct testimony at page 8 states "the Company is also requesting an interim energy charge ("IEC") which includes a proposal to contain the off-system sales margin variances above or below the amount included in the rates established in this case with some specific sharing properties."

Mr. Tim M. Rush, KCPL's Director of Regulatory Affairs, presents in his direct testimony a novel proposal regarding off-system sales in combination with an IEC. Starting at page 10 of his direct testimony, Mr. Rush identifies the mechanism he calls an IEC.

Q. Please describe KCPL's "IEC."

A. As discussed in detail in Staff witness Mantle's rebuttal, while Staff has received conflicting descriptions in conversations with KCPL as well as in review of the specimen tariff sheets, at page 13 of Mr. Rush's direct testimony he provides an overview of the "IEC." KCPL requests to set the "IEC" "at zero price and remain at zero for two years." In this two year period, KCPL's "costs for variable fuel and purchased power costs to meet NSI [net system input] would be accumulated in a deferred account." Base fuel determined in this case would reduce the "IEC." KCPL also wants to deduct a portion of off-system sales from the "IEC."

Q. Does Staff believe what KCPL is requesting is an IEC?

A. No. To the extent Staff understands KCPL's request, it is unlike any previous IEC proposal of which I am aware. The Company's request does not have a defined floor or ceiling rate, and does not collect any amount interim subject to refund. Furthermore, none of the previous IEC mechanisms approved by the Commission permitted a reduction of off-system sales margins through a sharing calculation. More importantly, KCPL is not proposing its mechanism be interim rates, subject to refund. KCPL's proposal also includes a provision to share a portion of off-system sales.

Q. What is an IEC?

A. The IEC, as Staff has identified this fuel mechanism in prior rate cases,[1] included a base level of fuel and purchased power costs and a forecasted or projected level of costs, typically variable fuel and purchased power costs. The base costs represented a "floor" for the IEC, and the forecasted cost was the "ceiling" of the IEC. The total amount of IEC -- the increment from the base (floor) to the forecast (ceiling) -- resulted in a tariff filing that identified an amount that was to be collected interim and subject to refund. Specifically, the IEC has a

[1] Each of the three interim energy charge mechanisms—the 2001 and 2004 Empire District Electric Company (Empire) IECs and the 2004 Aquila, Inc. (Aquila) IEC—were agreed to through Stipulation and Agreements reached with certain parties, the companies and Staff. All three received Commission approval.

base amount of fuel and purchased power costs that is established in permanent rates, with an additional amount of fuel and purchased power costs set above the base levels in interim rates. This additional interim amount increases the overall revenue requirement built into rates, but this ceiling rate is subject to review. Ultimately, the interim amounts can be returned to customers through tariff provisions that are specifically identified as subject to refund.

The base costs in the floor rate were determined using traditional ratemaking procedures for fuel and purchased power costs, using historical and actual normalization and annualization techniques. The forecasted costs in the ceiling rate were generally developed from projected fuel and purchased power prices presented by the utility companies with some adjustment proposed by parties to the IEC agreements.

The IEC fuel mechanism is an approach that allows higher fuel and purchased power prices to be used in determining interim rates that would be subject to refund with interest. The amount of the fuel and purchased power costs that are in the interim tariff rates and are subject to the true-up process is the IEC mechanism.

Q. Can KCPL request an interim energy charge?

A. Yes, one that meets all of the requirements of the 2005 Regulatory Plan.

Q. Does KCPL's "IEC" meet all the requirements of the 2005 Regulatory Plan?

A. No. In addition to the requirements not met by KCPL's proposed IEC identified by Ms. Mantle in her rebuttal testimony, one key requirement it does not meet is that the 2005 Regulatory Plan obligates KCPL to include all off-system sales in the determination of its rates as long as its investment in Iatan 2 is included in KCPL's regulated rate base. KCPL is not proposing KCPL's investment in Iatan 2 be excluded from its regulated rate base, but its "IEC" proposal includes a sharing of off-system sales margin. Such a sharing would mean that KCPL

would not be including all off-system sales in the determination of its rates. I explain this further later in my testimony responding to KPCL's off-system sales sharing proposal.

Q. Can KCPL request a fuel adjustment clause mechanism?

A. No. Fuel adjustment clauses were made lawful under Section 386.266 RSMo, thus KCPL agreed to not seek a mechanism under that law until 2015 under the 2005 Regulatory Plan. Section III.B.1.c of the Case No. EO-2005-0329 Stipulation and Agreement, entitled "Single-Issue Rate Mechanisms" states as follows:

> KCPL agrees that, prior to June 1, 2015, it will not seek to utilize any mechanism authorized in current legislation known as "SB 179" or other changes in state law that would allow riders or surcharges or changes in rates outside of a general rate case based upon a consideration of less than all relevant factors. In exchange for this commitment, the Signatory Parties agree that if KCPL proposes an Interim Energy Charge ("IEC") in a general rate case filed before June 1, 2015 in accordance with the following parameters, they will not assert that such proposal constitutes retroactive ratemaking or fails to consider all relevant factors.

Q. Is what KCPL is requesting in this proceeding an IEC?

A. No. KCPL's request bears no resemblance to IECs the Commission has approved in the past. As described by Lena Mantle in her rebuttal testimony, Staff cannot conclude that the requested mechanism would be able to function. Staff does not believe what KCPL is proposing is what the Commission has approved in the past relating to an IEC.

Q. How did prior IECs function?

A. Staff, along with various parties including Empire, jointly developed the IEC in Empire's 2001 rate case. It has been used a second time by Empire in 2004 and once by Aquila in its 2004 rate case. Fundamental to the IEC was the establishment of a floor of base fuel and purchased power costs (herein referred to as just fuel costs) in permanent rates and a projected or

forecast ceiling amount subject to refund. KCPL is not proposing a "range of costs" to establish a maximum amount of fuel costs that would be reflected in retail electric rates.

Historical Use of Interim Energy Charge

Q. Has the Commission authorized the use of IEC mechanisms in past rate cases?

A. Yes. In addition to the Empire IEC's mentioned above, an IEC was used in GMO's predecessor's (Aquila) 2004 rate case, Case No. ER-2004-0034, for both the MPS and L&P divisions. In a Unanimous Stipulation and Agreement (Stipulation) (*see* Schedule CGF-REB-4) approved by the Commission in that case, the IEC was used during a time of high natural gas and purchased power costs.

That IEC was to operate for a two-year period from April 22, 2004 through April 21, 2006. A true-up audit was contemplated originally to determine if any portion of the revenues collected exceeded Aquila's actual and prudently incurred cost for fuel and purchased power during the interim period. As the result of negotiations in Case No. ER-2005-0436, the parties agreed to terminate the IEC created in Case No. ER-2004-0034.

Q. What caused the need for Aquila's IEC mechanism?

A. The volatility of energy costs in 2004 was high, but not like those that were experienced in 2005 energy markets. Natural gas declined significantly during much of 2006 compared to the 2005 energy markets. High natural gas and purchased power prices inflicted tremendous cost increases during much of 2003, 2004 and all of 2005, declining in 2006, increasing significantly in the summer of 2008, and declining since. Currently, natural gas prices are at the lowest levels they have been in many years.

Q. Was Empire's IEC similar?

A. Yes. The IEC mechanism was first used in Empire's 2001 general rate case, Case No. ER-2001-299, and again in Case No. ER-2004-0570 came at a time when Empire was experiencing significant increases in its natural gas and purchased power costs. Prices in the energy and power markets escalated dramatically in late 2000, during the time of Empire's 2001 rate case. While natural gas prices decreased in spring of 2001, the parties developed the IEC mechanism to address the energy markets volatility.

Since the energy markets prices declined in 2001 from the high levels reached in late 2000, all monies collected subject to refund from the IEC established in Case No. ER-2001-299 were flowed back to Empire's customers.

The Commission's Report and Order in Case No. ER-2006-0315 terminated Empire's IEC that was in place as the result of Case No. ER-2004-0570.

Q. Have you been involved with IEC mechanisms in the past?

A. Yes. I presented testimony on the use of the first IEC in the Empire's 2001 rate case approved by the Commission in Case No. ER-2001-299. I was also the witness presenting testimony on an IEC mechanism for the 2004 Aquila rate case approved by the Commission in Case No. ER-2004-0034. While I wasn't involved in the 2004 Empire rate case, the IEC used in Case No. ER-2004-0570 was the same type as used in the earlier Empire and the 2004 Aquila rate cases.

I was also involved with an earlier model of the IEC procedure for the electric utility industry in Missouri called a "forecasted fuel mechanism" in the early- to mid-1980s before the Commission.

Q. Are IEC mechanisms different from fuel adjustment clause procedures?

A. Yes. A fuel adjustment clause is a pass-through of the differences in prescribed costs such as fuel and purchased power as those costs are incurred versus the level of those costs included in base rates. With a fuel adjustment clause there is an opportunity for review and a process to address improper cost recovery through Commission oversight, and can result in refunds through the fuel clause mechanism, if warranted. The fuel clause allows periodic changes in rates, sometimes two or four times a year without a rate case. While all current Missouri fuel adjustment clauses allow only a percentage of the differences between incurred costs and base costs to be passed on to customers, none of the current fuel adjustment clauses have a limitation on what increases are passed on to customers and what savings are retained by shareholders.

An IEC is completely different. It is not a mere pass-through of fuel costs but represents costs collected on an interim, subject to refund provision, based upon a forecasted (projected) amount. Basically, an IEC works by setting two amounts in rates. First, variable fuel and purchased power costs are determined through traditional, historical test year ratemaking in order to set a floor to be collected in base rates. This base floor amount is not subject to refund. Second, the IEC sets a higher "ceiling" rate that represents a forecasted amount of fuel and purchased power costs. This ceiling rate is collected on an interim basis, subject to refund. In this way, the floor and ceilings limit the risk of what increases are passed on to customers and what savings are retained by shareholders, but there is no sharing within the floor and ceiling. Therefore the IEC represents a sharing of risk between the customer and the utility.

The interim rates that are subject to refund are determined and prescribed as part of the rate case process and cannot change during the duration of the IEC. The IEC is for a finite period of time (two or three years). After the IEC period ends, a prudency audit and true-up

review occurs, comparing what was collected from customers during the IEC to actual costs within the base - forecast range. During the life of the IEC, the utility collects the ceiling rate. Then, if actual fuel and purchased power costs fall above the ceiling, the utility must absorb the additional cost but retains all amounts collected under the IEC up to the forecast level. If actual costs fall in between the floor and the ceiling, the utility refunds the difference between the actual cost and the ceiling. The utility retains all amounts if actual fuel costs fall below the floor (base rate) amount. Thus, if the base level is set properly, there is an incentive built into the IEC for the utility to manage fuel costs to retain amounts below the floor. When the actual fuel costs falls below the floor, the full amount collected in the IEC is refunded to customers.

When the IEC period ends the IEC ends and thus the rates revert to base rates.

Q. How does an IEC allocate the risk of fuel and purchased power costs?

A. The risk sharing occurs in setting the proper base and forecast levels. The IEC is developed using forecasted pricing levels, based on existing market conditions for natural gas and purchased power pricing. Adjusting the forecasted projections slightly below market levels expected provides an incentive to the utility to keep fuel costs within the IEC band. Allowing the utility to retain any fuel costs below the base also provides an incentive for the utility to keep fuel costs as low as possible. Both incentives of such an IEC cause the company to stretch its management of fuel costs.

A reasonable base (floor) is developed that allows customers to enjoy the benefits of declining costs. If the floor is set at a level to motivate the utility to make good buying decisions, the utility can retain cost reductions below the floor, thereby benefiting the company. The customers benefit in this situation by having lower fuel costs in rates. Customers are protected from poor decision-making if fuel costs exceed the ceiling.

Q. Did the IECs approved by this Commission in the past collect an amount interim, subject to refund?

A. Yes. Unlike KCPL's requested mechanism, which does not have a base and forecast range. More importantly, KCPL is not proposing its mechanism be implemented through interim rates, subject to refund. KCPL's proposal also includes a sharing of off-system sales.

Q. Did the parties in the 2004 Aquila rate case agree to a true-up process for the IEC?

A. Yes. The true-up process was critical to a well-defined fuel mechanism, because that feature is what makes the IEC work. The difference between the base amount and the forecast amount is the level of the IEC that is subject to refund. The fuel and purchased power component to utility cost structure is difficult to determine, with a host of variables to consider. Such variables include plant availability for outages and maintenance schedules, heat rates, fuel and purchased power prices, the complexities of operating power plants, transmission issues, the dynamic of the market place for selling and purchasing power, and many other items. A true-up of the IEC amount is essential to determine what amount, if any, should be refunded back to customers and what level the utility should retain.

Paragraph 4 of Appendix A, attached to the Stipulation in Case No. ER-2004-0034, identified the true up process as follows:

> Subsequent to the expiration of the Interim Energy Charge, an IEC Audit will commence in which the Parties will have opportunity to audit Aquila's actual variable fuel and purchased power costs of serving native load, which will exclude fixed costs and the costs of fuel and purchased power from interchange (off-system) sales. The IEC Audit will be conducted under the same terms and conditions that apply to audits in general rate cases before the Commission. If the IEC Audit determines that all or a portion of the revenue collected by Aquila pursuant to the IEC mechanism exceeds Aquila's actual and prudently incurred variable costs for fuel and purchased power (as recorded in the FERC accounts 501, 547 and 555) for each

> operation on a Missouri retail basis during the period the IEC was in effect, Aquila will refund any excess up to the IEC Amount.
>
> For the true-up, Aquila's trued-up variable fuel and purchased power costs will be based on actual delivered coal costs, oil costs and natural gas costs, excluding fixed natural gas reservation charges, and actual purchased power costs, excluding demand charges relation to capacity purchases. The true-up will further exclude fixed costs charged to Accounts 501, 547 and 555 relating to fixed fuel components included in the permanent rates and to fuel and purchased power for interchange (off-system) sales.
> [Schedule CGF-REB-4]

Q. How were disputes concerning that IEC Audit to be resolved?

A. Under the Aquila IEC, any disputes in the IEC Audit that could not be resolved by the parties would be presented to the Commission for resolution. For illustrative purposes, Paragraph 5 of the IEC Stipulation in Case No. ER-2004-0034 identifies the dispute process Staff proposed in that case.

Q. Did Aquila's IEC procedure include refunds?

A. Yes. Another essential element of an IEC is that it contains a refund mechanism to handle over-collections by the utility for prudently incurred actual costs between the base amount and the forecast, or ceiling amount. The base amount was determined using actual natural gas and purchased power costs. The interim amount was determined using Aquila's forecasted natural gas and purchased power costs. Since there was a refund provision, the IEC Stipulation was intended to provide a "safety net" for both Aquila and its customers.

The true-up of the IEC determines actual fuel and purchased power costs. Any amount collected in excess of those actual costs would have been refunded back to Aquila's customers, up to the forecast levels. Amounts refunded to customers would include interest so that customers are protected from any over-collection.

Q. What language was used to set up the Aquila IEC?

A. Paragraph 1 of the 2004 Aquila Stipulation states the following:

> The Parties agree that resolution of the fuel and purchased power expense issues in Case Nos. ER-2004-0034 and HR-2004-0024 has been achieved as among themselves by an Interim Energy Charge ("IEC") mechanism of setting rates to include a specific amount of the Missouri jurisdictional electric cost of fuel and purchased power on a permanent (i.e., not subject to refund) basis and to include another additional amount of variable fuel and purchased power cost on an interim basis, subject to true-up and refund
>
> a. The specific amount to be included in the Missouri retail rates on a permanent basis for the Aquila Networks—MPS ("MPS") electric operations is $87,700,206 (1.6654 cent/kWh) and the additional amount to be included in Missouri retail rates on an interim basis, subject to refund, for the Aquila Networks---MPS electric operations is $16,100,000 (0.3057 cents/kWh) for an overall total of $103,800,206 (1.9712 cent/kWh). The actual agreed upon cents per kilowatt hour IEC for each customer class is shown in Appendix B.
>
> b. The specific amount to be included in the Missouri retail rates on a permanent basis for the Aquila Networks—L&P ("L&P") electric operations is $22,705,656 (1.2641 cent/kWh) and the additional amount to be included in Missouri retail rates on an interim basis, subject to refund, for the L&P electric operations is $2,400,000 (0.1336 cents/kWh) for an overall total of $25,105,656 (1.3977 cent/kWh). The actual agreed upon cents per kilowatt hour IEC for each customer class is shown in Appendix B.
>
> c. The specific annual amount to be included in Missouri retail rates on a permanent basis for the L&P industrial steam operations is $4,374,480 with no additional amount to be included in Missouri retail rates on an interim basis, subject to refund.
>
> d. These amounts are meant to include only the Missouri retail variable costs accumulated in the FERC account numbers 501, 547 and 555 and will be updated in the true-up portion of the case specified hereafter in this Agreement. The fixed costs in FERC account 501, 547 and 555 will be recovered in permanent rates and will not be updated in the true-up portion of the case. The portion subject to true-up and refund, referred to herein as the "IEC Amount," is explained in more detail herein and generally is designed to address the potential volatility in natural gas and wholesale electricity prices. This IEC Amount will be the basis of the IEC to be approved by the Commission. The IEC will be reflected separately on all MPS and L&P electric rate schedules expressed in cents/kWh. The agreed to IECs are shown in Appendix B. The IEC will be collected on an interim

> basis and will be subject to true-up and refund under the terms of this Agreement…
> [Schedule CGF-REB-4]

The specific terms of the IEC were set out in the "Interim Energy Charge Rider Electric" tariff sheet 109 of the Company's tariff sheets filed as result of the Commission's decision in Case No. ER-2004-0034.

Q. Was Empire allowed to keep any money collected as part of the IEC amount established in Case No. ER-2001-299?

A. No. Empire returned the entire $19 million with interest to its customers. Empire was able to retain any revenues in excess of fuel and purchased power costs below the base amount of the IEC. To the extent a utility can keep its fuel and purchased power costs below the base, or permanent level, it will retain those collected revenues for its shareholders. Thus, in Empire's 2001 IEC, it was able to "beat" the base IEC amounts, to the benefit of its shareholders.

Q. Is it expected that a utility may retain monies even though it has an IEC?

A. Yes. A primary feature of the IEC is that utilities get the potential to keep monies collected in excess of actual fuel and purchased power costs if those costs are below base rates. If the base IEC amount is developed properly, this provides utility companies using an IEC an economic incentive to drive fuel costs down sufficiently to keep some of the collected revenues, if possible. It is equally important to set the IEC forecast amount at an appropriate level. If the forecast amount is too low, in a rising energy market the company will not have a reasonable opportunity to collect sufficient revenues to cover its fuel and purchased power costs. If the forecast is set too high, the utility may not have necessary incentives to keep fuel and purchased power costs low. An IEC forecast amount set too high is nothing more than a pass-through of

fuel and purchased power costs. Thus, it is very important to establish the proper base and forecast amounts in the IEC mechanism.

Q. What amount did the IEC contribute to Empire's revenue requirement upon which its rates were set in Case No. ER-2004-0570?

A. In Case No. ER-2004-0570, Empire received an IEC amount of $8,249,000 (Missouri jurisdictional amount) for variable fuel and purchased power costs that went into effect March 27, 2005. The 2005 IEC was originally for three years for the period March 27, 2005 through March 26, 2008. The Commission's Report and Order in Case No. ER-2006-0315 terminated the 2005 IEC early. Empire's fuel costs exceeded the IEC amount and Empire was not required to refund any amount of the 2005 IEC. The Commission established Empire's fuel and purchased power costs in Case No. ER-2006-0315 using a traditional approach of determining those costs by setting base rates.

Q. Are forecasted fuel mechanisms another means of addressing rising fuel costs?

A. Yes. Forecasted fuel with a true-up provision was used in several electric cases in the early to mid-1980s. The forecast fuel process was developed as a result of high fuel prices caused by the 1973 oil embargo, and the late 1970's political unrest in the Middle East resulted double-digit inflation in the early 1980's. The forecasted fuel mechanism was developed and used as a means of addressing the rising fuel prices that the electric utility industry was experiencing, just as the IEC mechanism was developed more recently in the past ten years or more. While the forecasted fuel provisions were significantly different than the IEC mechanism, the processes have some similarities. There were two significant features that enabled the forecasted fuel mechanism to work to the satisfaction of various parties: 1) the forecasted fuel

prices and resulting fuel burns were developed in the context of a rate case; and 2) there was a true-up audit of the forecasted fuel prices only, with a refund provision.

KCPL was one of the first utilities to use this process. In each of KCPL's rate cases in 1981, 1982 and 1983, the forecasted fuel process was used. The following table identifies the rate cases where forecasted fuel was used along with the associated forecasted fuel true-up case number:

	Rate Case	Forecasted Fuel True-up Case
Kansas City Power and Light	ER-81-42	----
	ER-82-66	EO-83-9
	ER-83-49	EO-84-4

The first case in which forecasted fuel was used was in a Missouri Power & Light Company 1980 rate case—Case No. ER-80-286. Empire also used this process in one of its rate cases in the early 1980s. Several other utilities used this process during the high inflationary period of the early to mid- part that decade, as well.

Q. How did the forecasted fuel process work?

A. A forecasted level of fuel prices for coal and, on occasion, natural gas was determined in the rate case and included in rates. The period of the projection of the forecasted fuel prices was six months after the operation-of-law date of the rate case. When actual fuel prices became known, the Staff did a true-up audit to determine if the utility over- or under-collected in the forecasted fuel mechanism. The forecasted fuel prices were subject to refund with an interest provision for any amounts over-collected by the company. The tariffs filed by the company in the rate case were identified with a "subject-to-refund" provision. If the company over-collected any dollar amount of the base amount (floor) up to the forecasted fuel price level (ceiling), i.e., if actual fuel costs were less than the amount collected in rates, the

customers received a credit to their bills. Between the base and forecasted levels, the company would be able to retain any amounts of actual and reasonably incurred costs above the base levels. Any actual fuel cost amounts that the company under-collected over the forecast level was absorbed by the company. The forecasted fuel price set a maximum and minimum fuel price in rates. The base or permanent rates contained the base fuel price and the amount that was subject to refund was set at the forecasted fuel price. Fuel prices were set at the base level and the true-up could not go below that level once these fuel prices were set in the rate case.

KCPL's Fuel and Purchased Power Costs in the Current Case

Q. How did the Staff determine the natural gas and purchased power prices it is using in this case?

A. Staff used recent actual natural gas and purchased power prices KCPL incurred through March 31, 2012, for developing the natural gas and purchased power prices it is using in this case. Using the latest prices gives effect to the most recent market (lower) prices, during the period of declining natural gas and power markets. Staff will further update fuel and purchased power costs for KCPL through the end of the update period August 31, 2012. In effect, Staff's proposal is to ensure that KCPL's natural gas and purchased power costs will be indicative of the lower price market conditions that exist today.

When energy market conditions change resulting in higher prices, KCPL will incur higher fuel and purchased power price levels. IEC mechanisms were developed to address extreme market volatility and uncertain market conditions for natural gas and purchased power costs. IEC mechanisms, in effect, offer protection from over- and under-recovery of fuel costs when the proper safeguards are implemented.

The IEC mechanisms were not developed to respond to market conditions that exist currently for inexpensive natural gas and purchased power costs. Because of these current market conditions, the IEC mechanism is unnecessary.

Q. How does the IEC provide protection from over- and under-recovery of fuel costs?

A. Because a base using more conservative prices for natural gas and purchased power is determined and a ceiling, or cap, using higher forecasted prices for these commodities is determined, the IEC allows for the return of monies if the forecast amounts do not occur. In reality, the IEC ensures that the customers get benefit of any lower fuel costs to the base level if the energy market declines and the company is protected from the upside of higher fuel costs up to the ceiling (forecast) level if the energy market rises.

Q. Does KCPL currently face significant increases in its fuel costs?

A. No. As the above example indicates, KCPL could reap a benefit when fuel prices fall. Prices have already fallen to the lowest levels in years and are reflected in both KCPL and Staff's revenue requirement recommendations. Because KCPL has most of its fuel source purchased under contract its fuel costs are stable. KCPL also does not rely on purchased power to meet its retail load. Considering IECs were created to address uncertain and increasing market conditions that do not exist today, KCPL does not need an IEC.

Q. Have there been other times when energy costs were difficult to determine in the course of setting rates?

A. Yes. Unlike current market conditions of declining energy prices, during times of price extreme volatility for natural gas and power costs, where costs increased dramatically over historical levels, the task of computing fuel and purchased power costs in a rate case was

difficult. While the existing energy markets have substantially declined from levels seen in recent years, it is still difficult to determine the fuel costs because of the fear of understating these costs. The last decade is the latest example when the energy markets have been much higher at various times, and such conditions require diligence in identifying what level of fuel costs would be included in rates. During the 2000/2001 winter, natural gas prices hit unprecedented levels. In some cases, natural gas prices hit upwards of $12 mmBtu. In the fall of 2005, after two historic hurricanes hit the Gulf region, natural gas prices escalated to levels in the $14 per mmBtu range. In the summer of 2008 natural gas prices hit $9 to $10 per mmBtu. The IEC mechanism was specifically developed to address times of extreme volatile natural gas and purchased power.

Staff was interested in developing a process like a forecasted fuel mechanism that identified natural gas as the only fuel source that would form the basis for the forecasted mechanism. After extensive discussions in the 2001 Empire rate case, it became apparent that a broader forecasted fuel mechanism would be necessary because of the interrelationship between gas prices and wholesale electricity prices for purchased power. With the unprecedented and extraordinary high natural gas prices that had been experienced during much of the latter part of the year 2000 and the early part of 2001, it became apparent that a modification of the traditional and historical approach to determining fuel prices was necessary. A major contributing factor to the decision to depart from using historical costs only to determine the basis of the fuel prices used for fuel expense was Empire's generating plant addition of the State Line Combined Cycle Unit. The State Line Combined Cycle Unit went into service in June 2001. This generating facility burned only natural gas and therefore represented a significant increase to Empire's fuel burn using natural gas. Empire's exposure to the increase in natural gas fuel burn came at a time

when natural gas prices had been steadily rising. When the unit did go into service, natural gas prices were retreating but still higher than in previous periods. This placed significantly more risk on Empire than most of the other electric utilities operating in the state of Missouri.

Q. Did Aquila experience a similar increase in its natural gas consumption?

A. Yes, at the time the Staff agreed to an IEC for Aquila. Aquila, like Empire, had seen a significant increase in natural gas use (1) to fuel its generators and (2) indirectly through its purchased power agreements. In Aquila's 2004 rate case, one of the contributing factors for recommending an IEC was the exposure that Aquila had with the purchased power agreement for power from the Aries Combined Cycle Unit. Aquila executed a purchased power agreement to take power from the Aries unit through May 31, 2005. In that purchased power agreement, MPS supplied the natural gas to fuel the energy it received from the Aries unit. In partial replacement of the electricity it was receiving through the Aries contract, Aquila installed 315 megawatts of its own capacity at its South Harper facility. In much the same way as Empire, Aquila increased its dependence on natural gas, which in turn increased the company's exposure to the fluctuations of that very volatile energy market.

Q. You suggested earlier that the natural gas market affects purchased power prices. Please explain.

A. Equally important to the cost of fuel electric utilities burn to generate electricity are the effects high natural gas prices have on the price of purchased power. With the reduction of natural gas prices, purchased power costs have also declined. While certainly not the only factor, there is a relationship between natural gas prices and the cost of purchased power. To some degree purchased power prices track natural gas prices. Moreover, if a forecasted fuel mechanism was used that did not include purchased power costs, the utility could potentially

benefit from forecasting natural gas costs only. Forecasted natural gas prices may make the purchased power prices more economical, giving the utility an incentive to purchase power and not generate power from natural gas. If the purchased power costs were not included in the IEC, the company could "keep" the lower purchased power costs but reflect higher natural gas costs in its fuel that would be subject to the IEC mechanism. In other words, the utility could “game” or benefit from such a situation. The inclusion of purchased power costs along with the other fuel cost components in the forecasted fuel process would significantly reduce the risk of a utility “gaming” or taking advantage of the process.

It is not Staff’s intent that either the utility or its customers unduly benefit from the forecast fuel process. Utilities cannot be allowed to use this fuel and purchased power mechanism to reap windfall profits, nor can customers unduly benefit from being completely insulated from rising fuel and purchased power costs. In the development of the IEC mechanism for both Aquila and Empire, it was thought essential to include variable purchased power costs along with the costs of natural gas.

Q. Does KCPL use natural gas to the extent of GMO (formerly Aquila) and Empire?

A. No. Compared to either GMO or Empire, KCPL burns very little natural gas on its system. Staff’s fuel run does not have very much natural gas in its annualized fuel costs. Comparing actual generation in 2011, KCPL generated approximately 1 percent of its total megawatts using natural gas as a fuel source. KCPL primarily generates electricity using coal, approximately 79 percent, nuclear; approximately 17 percent; and wind, approximately 3%. Natural gas is not a significant fuel source for KCPL at 1% of total generation.

Q Does KCPL purchase much energy?

A. KCPL is a net seller of energy, unlike GMO.

Q. What is the significance of KCPL's reliance of natural gas and purchased power?

A. Compared to GMO and even Empire, KCPL relies very little on natural gas and purchased power. As explained above, both natural gas and purchased power costs played a significant role in the need for an interim energy charge for Aquila and Empire. Because KCPL does not rely on natural gas and purchased power to any significant degree for retail customers there is not a need for an IEC like it was several years ago for either Aquila or Empire. Taken together that lack of reliance on these two fuel sources along with the declining energy markets, an IEC is unnecessary for KCPL in this case. In other words, the very reasons for the use of an IEC several years do not exist for KCPL today.

Off-system Sales

Q. Mr. Bassham states at page 9 of his direct testimony he does not believe how the Commission has treated off-system sales margins has been fair to KCPL. What has been the treatment of off-system sales in the past?

A. Starting with the 2006 rate case, the Commission authorized a return to customers for off-system sales amounts in excess of levels included in rates. This treatment was made based on a recommendation of KCPL in Case No. ER-2006-0314.

Mr. Bassham states in his direct testimony (page 9) that "the Commission has recently set a flat amount for OSS margins as an offset in base retail rates, with any amount earned in excess of the base amount returned to customers. Any shortfall from the OSS margin offset in base retail rates has been unrecovered by the Company." Mr. Rush states at page 7 of his direct testimony that the mechanism used for off-system sales by the Commission "…would have been more appropriate to provide for a symmetrical method which provided for recovery of any under-recovery, as well as returning to customers any over-recovery of OSS Margin. Because

OSS Margin is such a critical component of the Company's overall revenue requirement, it would not be reasonable either to customers or to the Company to set the OSS Margin at a level and require the Company to absorb margins below the level that is set and the Company to keep anything above." The regulatory treatment afforded off-system sales that KCPL is now so critical of was actually based on a request by KCPL in the 2006 rate case. KCPL made the off-system sales tracking request ---at that time a tracking that included both over and under collection of actual sales-- to support its position of using a smaller amount of off-system sales than was being presented by other parties including Staff. While KCPL was advocating smaller off-system sales levels in the 2006 rate case, it presented its request to ensure that if KCPL's projections were understated, then there would be a mechanism to allow customers to benefit from the higher actual off-system sales. If the amounts were overstated, then there would be a recovery to the Company. During the rehearing process of the 2006 Order the Commission removed the under recovery portion of the off-system sales provisions. KCPL did not protest this action and, in fact presented this position in the next three rate cases. In this case, KCPL is critical of the treatment given to off-system sales as a one-sided and unfair process, yet it was the treatment recommended by the Company– a plan it advised the Commission to use and one which it supported over the past three rate cases. KCPL now requests to dramatically alter how off-system sales are used to determine rates. Staff believes this proposal should be rejected by the Commission.

Q. Did this asymmetric (one-way) rate mechanism provide incentives to the Company regarding off-system sales?

A. Yes. KCPL had every incentive to achieve a level of off-system sales as close to the amount built into rates in each of the four rate cases of the 2005 Regulatory Plan, regardless

of the upside or downside of the procedure put in place by the Commission. It was especially important for KCPL to achieve those levels in rates because the very tracking mechanism used in each of these rate cases under the 2005 Regulatory Plan required that if those levels were not met the Company would not recover any shortfalls, thus a powerful incentive to achieve the rate case off-system sales amounts.

Unfortunately, this one-sided approach used in previous rate cases proved to be a disincentive as well. KCPL had no incentive to achieve a greater level of off-system sales above those set in rates, because of the requirement to return any excess amounts to customers. While there may be other reasons for the decline in the off-system sales market, the Company simply did not have sufficient motivation to achieve success in making sales to other energy companies.

Q. What level of off-system sales were included in those rate cases?

A. In each of the first three rate cases KCPL's proposed amounts for off-system sales at the 25th percentile level was built in rates. The exception was the last rate case—the 2010 rate case that the Commission authorized using KCPL's requested 40th percentile level. The following table shows the off-system sales levels for each of the four rate cases:

Case No.	**Off-System Sales Amount Authorized in Rates**	**Off-System Sales Actual Amount**	**Off-System Sales Difference Between Authorized and Actual**
ER-2006-0314	** _____ **	** _____ **	** _____ **
ER-2007-0270	** _____ **	** _____ **	** _____ **
ER-2009-0089	$30.0 million	** _____ **	** _____ **
ER-2010-0355	** _____ **	** _____ **	** _____ **

NP

Q. What is KCPL's requested treatment for off-system sales?

A. KCPL proposes to implement a sharing mechanism for off-system sales. Mr. Rush describes the sharing proposal at page 12 of his direct testimony as follows:

> The Company proposes to include in base rates the 40th percentile of Off-System Sales Margin. The Company is proposing to include 100% of the OSS Margin as an offset to the fuel and purchased power costs attributable to Net System Input (NSI) when OSS Margin is between 40th and 60th percentile. If OSS Margin falls below the 40th percentile, the Company proposes to place 25% of the amount of OSS Margin in a deferred account to be recovered in the next rate case. The remaining 75% of the OSS Margin would be included as an offset to the fuel and purchased power costs to meet NSI. If the OSS Margin is greater than the 60th percentile, the Company would retain 25% of the amount of Margin and include the remaining 75% as an offset to fuel and purchased power costs.

Mr. Schnitzer further identified in his direct testimony at page 33:

> KCPL has proposed to establish the initial offset for off-system sales margin at the 40th percentile of my probability distribution. In a departure from past proposals for Margin during the past four rate cases, KCPL proposes to share 25 percent of the downside risk with customers below the 40th percentile, while retaining 75 percent of this risk at the Company. Between the 40th percentile and the 60th percentile, all of the excess of realized Margin over the 40th percentile value would be returned to ratepayers. Above the 60th percentile, KCPL proposes to share in 25 percent of the upside difference between realized Margin and the 60th percentile value. The customers would retain the other 75 percent.

This unique and unprecedented sharing approach to determining rates by removing or retaining a portion of off-system sales between certain ranges from the ratemaking process is contrary to the terms of the 2005 Regulatory Plan.

Q. Were you involved in the negotiations of the 2005 Regulatory Plan?

A. Yes. I participated in all of the workshops in 2004 and all discussions in 2005 respecting KCPL's Comprehensive Energy Plan and was part of the Staff group who worked on the regulatory plans for KCPL, Empire (Case No. EO-2005-0363) and then Aquila (Case No.

EO-2005-0293). While Aquila, given its financial circumstances, decided not to pursue a regulatory plan, the Commission approved the KCPL and Empire regulatory plans in July 2005.

Q. Did KCPL's Regulatory Plan include a sharing mechanism for off-system sales?

A. No. KCPL agreed to include all off-system sales in the determination of rates for as long as the Iatan 2 investment was to be included in the regulated rate base. KCPL agreed not to propose any adjustments to remove off-system sales from the ratemaking process.

Q. How were off-system sales identified in the 2005 Regulatory Plan?

A. The 2005 Regulatory Plan contemplated off-system sales be used as an offset (reduction) to future revenue requirements. The final outcome of the 2005 Regulatory Plan was that all off-system sales would be included in rates. In Case No. EO-2005-0329, the Commission's July 28, 2005 Report and Order at pages 18 and 19 states:

> Under the terms of the Stipulation, KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated "above the line" for ratemaking purposes. **KCPL will not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case.** KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process. During the hearing, KCPL also stipulated that it would agree to this ratemaking treatment for off-system sales as long as the Iatan 2 costs were included in KCPL's rate base. (Tr. 1037-38).4 [Emphasis added]

Footnote 4 found at bottom of page 19 of the Commission's July 28, 2005 Report and Order states:

> Also in their July 26 Response to Order Directing Filing, the Signatory Parties memorialized KCPL's agreement that all of its off-system sales would be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in determining those rates, and amended Section III.B.1.j. of the Stipulation and Agreement.

In the Findings of Fact portion of the Commission's July 28, 2005 Report and Order, the Commission states, in part, under section found at page 27 "The Proposed Regulatory Plan should result in lower rates":

> The Commission finds that the proposed Experimental Regulatory Plan provides a framework that should lead to reasonable rates during the expected 5-year duration of the construction period for the projects included in the Experimental Regulatory Plan. The Commission also agrees with Mr. Schallenberg and Mr. Trippensee that the **Stipulation contains provisions that facilitate lower rates for customers in the future that would not exist absent this Stipulation**
> (Ex. 39, pp. 5-8; Tr. 811-812) [Emphasis added.]

At page 28 the Commission further stated in its July 28, 2005 Report and Order:

> The Commission finds that the treatment of off-system sales is an important part of its conclusion that the Proposed Regulatory Plan is in the public interest. The signatory parities' recommendation states as follows:
>
> KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. **KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process.** KCPL agrees that all of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates **as long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates.**
>
> (Signatory Parties' Response to Order Directing Filing, July 26, 2005) (amending Section III.B.1.j. of the Stipulation and Agreement)
> [emphasis added]

The Commission issued its Order Directing Filing on July 26, 2005 in Case No. EO-2005-0329 and, in response, the Signatory Parties filed *SIGNATORY PARTIES' RESPONSE TO ORDER DIRECTING FILING*. The Signatory Parties stated at page 1 of their response:

> 1. On July 25, 2005, the Commission issued its Order Directing Filing that noted that:
>
> During the hearing, the parties to the non-unanimous stipulation and agreement state that they had reached certain agreements regarding off-

system sales. But the non-unanimous stipulation and agreement does not reflect the off-system sale agreement. In order to allow the Commission to consider the non-unanimous stipulation and agreement in its entirety, **the Commission will order the parties to submit language reflecting the off-system sales agreement no later that [sic] July 26**.

2. Under the terms of the Stipulation And Agreement filed on March 28, 2005, KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. According to the Stipulation And Agreement, **KCPL will not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process.** (Stipulation And Agreement, Section III.B.1.j.,p. 22). **However, the length of the term of this agreement related to the ratemaking treatment of off-system sales was not formally reflected in the Stipulation And Agreement**.

During the hearings conducted in this matter, KCPL's counsel stipulated on-the-record that KCPL would agree to this ratemaking treatment for off-system sales as long as the Iatan 2 costs were included in KCPL's rate base. (Tr. 1037-38). As a response to the Order Directing Filing, and in order to formally reflect in the Stipulation And Agreement KCPL's agreement that this ratemaking treatment for off-system sales will continue as long as the Iatan 2 costs are included in KCPL's rate base, **the Signatory Parties hereby amend the Stipulation And Agreement as stated below**:

Section III.B.1.j is amended to read as follows:

"j. Off-system Sales

KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. **KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process.** KCPL agrees that all of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates as **long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates.**" (The Staff will file a separate pleading on July 27, 2005 further addressing this off-system sales language.)
[Emphasis added]

The original language in the March 28, 2005 Regulatory Plan Stipulation And Agreement (page 22) contained the following prior to the amended agreed to language found above:

> **"j. Off-system Sales**
>
> KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. **KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process.**
> [Emphasis added]

The Commission denied motion for rehearing of Order in Case EO-2005-0329 on August 23, 2005. KCPL did not file for Rehearing in Case No. EO-2005-0329. On August 23, 2005, the Commission issued an Order Approving Amendments To Experimental Regulatory Plan. In Commissioner Steve Gaw's August 19, 2005 OPINION OF COMMISSIONER STEVE GAW CONCURRING IN PART AND DISSENTING IN PART—page 5:

> Finally, it is very important to note that Iatan 2 construction again creates capacity for potential off-system sales. The credibility of those sales to the benefit of KCPL customers is critical to the Staff's favorable recommendation in the Nonunanimous Stipulation. Mr. Schallenberg testified:
>
> Q. The off-system sales provisions, in regard to Iatan II, then, are very important – this provision is very important to what occurs with those – those sales, this provision. I mean, the one dealing with off-system sales and how long it goes?
>
> A. Its very important in terms of the consideration as to what cost of the consideration as to what the cost of Iatan II would be to customers.
>
> Q. Yes. And when you said earlier that off-system sales were very important in Staff signing off on this agreement, was Staff – did Staff make an assumption in regard to whether or not off-system sales from Iatan II would be credited to customers in signing the agreement?
>
> A. Yes. In fact, it would be used as an offset to the cost. When you put in the cost of Iatan II, in order to determine its true cost to customers

> off-system sales, and actually off-system sales margins would be used in that determination of ultimate cost would be passed through in rates.
>
> KCPL consumers who are paying for this plant deserve and will be credited for amounts representing any margins associated with off-system sales. If this were not so, this plan should not be approved. **If the credit for off-system sales is diverted from customers in the future, it will be in violation of the understanding of this Commissioner and will amount to taking from KCPL customers what is rightfully theirs**. [Emphasis added]

The above quotations from Commission Orders and pleadings filed with the Commission in Case No. EO-2005-0329 make it clear that the Signatory Parties including KCPL had made specific concessions regarding off-system sales and the ratemaking treatment of these critical revenues. More importantly, KCPL agreed that it would make no attempt to remove off-system sales from rates for the life of Iatan 2 as long as it was included in rate base.

Q. Does KCPL's proposed sharing mechanism attempt to remove off-system sales from rates?

A. Yes. Despite the clear language of the Commission's Report and Order in Case No. EO-2005-0329 and the agreement reached by KCPL for the 2005 Regulatory Plan, the Company is now wanting to "share" off-system sales. This sharing will result in a portion of the off-system sales being removed from the ratemaking process. In effect, KCPL's off-system sales will be reduced for ratemaking purposes through this proposal.

Q. Does Staff agree with KCPL's proposal regarding off-system sales?

A. No. Staff believes it is important to maintain the full effect of off-system sales, now and in the future for as long as Iatan 2 remains in regulated rates, as contemplated in the 2005 Regulatory Plan.

Q. Does Staff believe the one-way tracking mechanism should continue?

A. No. Staff recommends returning to traditional ratemaking for off-system sales that was in place prior to the 2005 Regulatory Plan. This method provides necessary incentives to the Company to achieve greater levels of off-system sales than amounts included in rates. KCPL would keep those amounts until the next rate case when the actual experience for the off-system sales market would be used to develop the amount placed in rates. The key to this approach would be to determine the proper level of off-system sales in any particular rate case.

Q. Would KCPL benefit from these off-system sales using the traditional method?

A. Yes. To the extent that there are increases in off-system sales that occur after rates are determined in any given proceeding, the Company will benefit from the growth and increase in net margins (off-system sales less fuel costs) throughout the period until rates are changed by the Commission in a general rate proceeding.

Q. What causes off-system sales to fluctuate?

A. There are many reasons why off-system sales levels change over different periods. The economy, weather, generating unit availability, new generating capacity additions and transmission availability all have a significant effect on the off-system sales market. But the most significant impact on off-system sales is the price of fuel, especially natural gas and the energy power market. Over the last several years, natural gas prices have caused the most impact on the off-system sales levels (volumes) and profitability (margin levels). Typically, higher natural gas prices provide greater opportunities for higher off-system sale margins and volume levels.

Q. Why is it proper to include off-system sales in the regulated revenue requirement?

A. Off-system sales are only possible because of the existence of rate base that is paid for by ratepayers. Off-system sales relate to sales of electricity made at times when utilities

have met all obligations to serve their native load customers and have excess energy to sell to other utilities. The off-system sale transactions occur between utilities resulting in profits (net margin) to the selling entity, in this case, KCPL.

Off-system sales are made from utility's generating and transmission assets that are paid for in retail rates by customers. Utility companies make off-system sales in two ways—generating energy from the utility's power plant fleet or purchasing power from other utility entities. Utility companies like KCPL design the electric network to meet its customers' load demands each hour of the day and throughout the entire year. There are many times when KCPL can sell power to other companies using existing generating and transmission assets while still meeting its first priority to retail customers. Because at various time there is idle generating capacity, KCPL can sell excess energy above the levels needed for the retail customers—referred to as "native load" customers—to other utilities and power markets.

The same generating facilities, equipment, and employee/personnel that are necessary to provide service to Missouri retail electric customers are also needed to make off-system sales. It is appropriate to include the off-system sales in this case because KCPL's customers are paying for all costs associated with the facilities to produce electricity for the firm retail customers, i.e., native load customers. To the extent that other sales can be made using those facilities, the customers should benefit from these sales. The off-system sales are made at a time when the generating facilities are not needed to serve the native load customers. Off-system sales represent an efficient utilization of the electric system that has been put in place to meet the native load customers' electricity needs. Off-system sales occur at a time when the production facilities and purchases are not needed for Missouri retail customers.

Other Off-System Sales Sharing Proposals

Q. Have other companies proposed to share off-system sales above a base level as part of its fuel clause proposal?

A. Yes. In Aquila's 2007 rate case it proposed a sharing mechanism between customers and shareholders for off-system sales when it requested its fuel clause.

Under traditional treatment of these sales, Aquila kept 100% of the off-system sales above the base level included in a rate case. This provided incentive for Aquila to pursue off-system sale transactions. In the 2007 Aquila rate case, Staff believed this approach was appropriate by including a normalized and annualized level of these sales in base rates. Aquila would keep any amount of off-system sales above this level until the time a rate case was filed when the base of off-system sales was re-determined.

Aquila proposed to share on a 50/50 basis any amounts of off-system sales over the level built in base rates. Staff opposed this proposal as being improper considering all costs of the generating and transmission assets were the responsibility of customers. Also, Staff was concerned that the sharing of off-system sales concept proposed by Aquila in its fuel clause request would be expanded to justify the "sharing" of all off-system sales. While the Commission approved Aquila's fuel clause request, it did not authorize the sharing proposal by Aquila.

In the 2007 rate case, it was important to make a distinction in between the base level of off-system sales that Aquila was not proposing to "share" and the amount above the base level Aquila was proposing to share on a 50% basis. In the past, Aquila had taken the position that all off-system sales should be split on a 50% basis between customers and shareholders. Staff also opposed that treatment.

Q. When did the Company first propose this treatment?

A. Aquila proposed to split all the off-system sales profits with customers in its 1997 general rate case, Case No. ER-97-394. It also made this same proposal before the Kansas Corporation Commission (Kansas Commission).

Q. How did the Commission decide how off-system sales should be treated for ratemaking purposes?

A. In Aquila's (then called UtiliCorp United, Inc.) 1997 general rate case, the Commission included off-system sales in the calculation of the rate level ordered in that case. The Commission stated, in part, as follows:

> The Commission finds the Staff provided competent and substantial evidence that all of the off-system sales revenue should be reflected in the test year revenue for the purposes of setting rates. The Staff is correct in stating that, since all of the costs of producing the off-system sales revenue were borne by the ratepayers, and since UtiliCorp has benefited from regulatory lag, the total amount of this revenue should be included in rates.

The Commission adopts the adjustment proposed by the Staff.

Q. Did Aquila attempt to make adjustments to remove off-system sales in any other rate case?

A. Yes. In Aquila's 2001 rate case, Case No. ER-2001-672, Aquila proposed the same treatment for off-system sales that it did in its 1997 rate case of removing 50% of these sales. Staff opposed this adjustment to reduce the level of off-system sales. That case resulted in a negotiated settlement that was approved by the Commission.

Q. How did the Kansas Commission treat off-system sales in rates?

A. In Aquila's rate application filed in Kansas on December 8, 2000, its West Plains Energy Kansas (West Plains) division proposed the same 50/50 "sharing" mechanism for

off-system sales before the Kansas Commission in Docket No. 01-WPEE-473-RTS. The Kansas Commission rejected this proposal stating:

> **F. Sharing of Off-System Sales Margins**
>
> 30. West Plains asks the Commission to reconsider its decision in Docket No. 99-WPEE-818-RTS to not allow West Plains to share in off-system sales margins. The [Kansas] Commission's decision was affirmed by the Kansas Court of Appeals in *UtiliCorp United, Inc. d/b/a West Plains Energy Kansas v. KCC,* slip op.85,716 (Kan.App.December 15, 2000). As discussed in Order Nos. 10 and 13 in Docket No. 99-WPEE-818-RTS, **the cost of off-system sales are borne entirely by the ratepayers, while the Applicant has enjoyed all of the benefits of the increased revenue.** If all of the costs are borne by the ratepayers, then **all of the benefits of increased revenues should be enjoyed by the ratepayers. The full measure of revenues and costs related to these sales should be reflected in the cost of service at test year levels.**
>
> 31. West Plains again asserts its proposed sharing mechanism provides incentive for West Plains to engage in off-system sales and compete in the marketplace. [Keith, Rebuttal at 17]. West Plains submits its proposed sharing mechanism is similar to the sharing mechanism allowed in another Commission proceeding, Docket No. 190,061-U. [Keith, Rebuttal at 17]. These arguments are the same arguments made by West Plains in Docket No. 99-WPEE-818-RTS. Consistent with the decision in Docket No. 99-WPEE-818-RTS, Staff made an adjustment to add back 50 percent of the sales margins that had been removed in the schedules filed by West Plains with its rate application.
>
> 32. The **Commission remains concerned about any sharing mechanism that allocates the sales margins where 100 percent of the costs are borne by the customers.** The Commission has not accepted a sharing mechanism, as proposed by West Plains, for any other electric public utility. The **Applicant has an incentive to continue making off-system sales because the Applicant would retain all profits exceeding the normalized level reflected in the Applicant's overall revenue requirement. The Commission finds no compelling argument has been advanced by the Applicant to justify the Commission's departure from the prior decision and adoption of a new policy regarding off-system sales. Staff's adjustment to off-system sales revenues is accepted.**
>
> [August 15, 2001 Order of KCC in Docket No. 01-WPEE-473-RTS, page 13-14; Emphasis added]

Thus, Aquila proposed this 50/50 "sharing" mechanism in Kansas on two occasions and the Kansas Commission rejected the proposal in both instances.

Q. Have off-system sales been included in rates in the past?

A. Yes. Staff has consistently included off-system sales in all of the electric cases that I am aware of, dating back to at least the early 1980s.

Q. Are all the costs that allow KCPL to make off-system sales paid for by customers?

A. All costs for investment and operating costs are included in retail rates that are charged to KCPL's customers. The costs of production and transmission plant, all costs to maintain and operate the electric system needed to provide the opportunity to make off-system sales are recovered in rates. All costs to be part of the Southwest Power Pool (SPP) are paid in retail rates. These costs are necessary to have sufficient transmission to make off-system sales. All payroll and employee benefit costs relating to personnel finding, negotiating and completing the off-system sales transactions are included in rates by KCPL's retail customers. Consequently, all off-system sales should be included in the consideration of the retail rates—no sharing or adjustment to reduce off-system sales is proper, considering how KCPL recovers costs in the ratemaking process for its existing cost structure.

Off-System Sales Margin Amounts in Current Case

Q. Have there been any changes to the level of off-system sales Staff is including in this case?

A. At the time of this filing KCPL is considering changes to its off-system sales calculation relating to the area of wind generation—referred to as the Wind Profile. It is my understanding there was a problem with the level of megawatt hours relating to wind energy used in the off-system sales model. The level of megawatt hours related to wind energy is shown

in the model as a curtailment for transmission line constraints. KCPL is planning on correcting these in a future model update.

Q. What is the effect on making this update?

A. My understanding is that there were higher than normal megawatts hours constricting the level of off-system sales for wind energy in the model. When the correction is made there will be a reduction to the megawatt hours curtailment allowing for greater megawatt hours for wind energy which will result in higher overall off-system sales. This is important because Staff relied on KCPL's model for its recommended level of off-system sales.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	))))	Case No. ER-2012-0174

AFFIDAVIT OF CARY G. FEATHERSTONE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Cary G. Featherstone, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 51 pages to be presented in the above case; that the answers in the foregoing Rebuttal 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.

Cary G. Featherstone

Subscribed and sworn to before me this 6th day of September, 2012.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

Notary Public

SCHEDULE CGF-REB-1

AND

SCHEDULE CGF-REB-2

HAVE BEEN DEEMED

HIGHLY CONFIDENTIAL

IN THEIR ENTIRETY

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0336

1. Does Mr. Montalbano believe it was prudent, reasonable, and consistent with its fiduciary responsibilities of Great Plains Energy and/ or Kansas City Power & Light officers not to seek a portion of the Iatan 2 Advanced Coal Tax Credit for KCP&L Greater Missouri Operations at the time it sought the Tax Credit for KCPL in 2006 and 2007? 2. If yes, at what point in time does Mr. Montalbano, consistent with Great Plains Energy and/ of Kansas City Power & Light fiduciary responsibility to GMO and its customers, believe it would have been appropriate for KCPL and/ or GPE to seek, in whatever form appropriate, a proportional ownership share of the Tax Credit for GMO? Please explain.

RESPONSE: (do not edit or delete this line or anything above this)

I have no opinion on the above matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge business decisions of KCPL or Great Plains Energy.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0336 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0336 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0337

1. Does Mr. Montalbano believe it was prudent, reasonable, and consistent with its fiduciary responsibilities of Great Plains Energy and/ or Kansas City Power & Light officers not to seek a portion of the Iatan 2 Advanced Coal Tax Credit for KCP&L Greater Missouri Operations at the time when Empire District Electric Company requested the Tax Credit from KCPL in 2008? 2. If yes, at what point in time does Mr. Montalbano, consistent with Great Plains Energy and/ of Kansas City Power & Light fiduciary responsibility to GMO and its customers, believe it would have been appropriate for KCPL and/ or GPE to seek, in whatever form appropriate, a proportional ownership share of the Tax Credit for GMO? Please explain.

RESPONSE: (do not edit or delete this line or anything above this)

I have no opinion on the above matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge business decisions of KCPL or Great Plains Energy.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0337 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0337 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0338

1. Does Mr. Montalbano believe it was prudent, reasonable, and consistent with its fiduciary responsibilities of Great Plains Energy and/ or Kansas City Power & Light officers not to seek a portion of the Iatan 2 Advanced Coal Tax Credit for KCP&L Greater Missouri Operations at the time when Empire District Electric Company gave notice of arbitration in July 2009 requesting an allocation of the Tax Credit? 2. If yes, at what point in time does Mr. Montalbano, consistent with Great Plains Energy and/ of Kansas City Power & Light fiduciary responsibility GMO and its customers, believe it would have been appropriate for KCPL and/ or GPE to seek, in whatever form appropriate, a proportional ownership share of the Tax Credit for GMO? Please explain.

RESPONSE: (do not edit or delete this line or anything above this)

I have no opinion on the above matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge business decisions of KCPL or Great Plains Energy.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0338 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0338 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0339

1. Does Mr. Montalbano believe it was prudent, reasonable, and consistent with its fiduciary responsibilities of Great Plains Energy and/ or Kansas City Power & Light officers not to seek a portion of the Iatan 2 Advanced Coal Tax Credit for KCP&L Greater Missouri Operations at the time when the arbitration panel decided in December 2009 in favor of Empire District Electric Company' request for a proportional ownership share of the Tax Credit? 2. If yes, at what point in time does Mr. Montalbano, consistent with Great Plains Energy and/ of Kansas City Power & Light fiduciary responsibility to GMO and its customers, believe it would have been appropriate for KCPL and/ or GPE to seek, in whatever form appropriate, a proportional ownership share of the Tax Credit for GMO? Please explain.

RESPONSE: (do not edit or delete this line or anything above this)

I have no opinion on the above matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge business decisions of KCPL or Great Plains Energy.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0339 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0339 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0340

1. Does Mr. Montalbano believe it was prudent, reasonable, and consistent with its fiduciary responsibilities of Great Plains Energy and/ or Kansas City Power & Light officers not to seek a portion of the Iatan 2 Advanced Coal Tax Credit for KCP&L Greater Missouri Operations at the time in early 2010 when a reallocation of the Tax Credits to Empire District Electric was made by KCPL to the Internal Revenue Service and the revised Memorandum of Understanding was agreed to with the IRS on September 9, 2010? 2. If yes, at what point in time does Mr. Montalbano, consistent with Great Plains Energy and/ of Kansas City Power & Light fiduciary responsibility to GMO and its customers, believe it would have been appropriate for KCPL and/ or GPE to seek, in whatever form appropriate, a proportional ownership share of the Tax Credit for GMO? Please explain.

RESPONSE: (do not edit or delete this line or anything above this)

I have no opinion on the above matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge business decisions of KCPL or Great Plains Energy.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0340 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0340 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0343

1. Does Mr. Montalbano believe that KCP&L Greater Missouri Operations is entitled to a share of the tax benefits relating to the Advance Coal Tax Credits based on its ownership share of Iatan 2? 2. If not, provide any and all reasons why GMO is not entitled to any of the tax benefits relating to the Advance Coal Tax Credits based on its ownership share of Iatan 2. 3. If yes, what is the proper benefit GMO is entitled based on its ownership of Iatan 2?

RESPONSE: (do not edit or delete this line or anything above this)

I have no opinion on the above matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge business decisions of KCPL or Great Plains Energy.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0343 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0343 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0344

1. With respect to Mr. Montalbano's direct testimony concerning the Advance Coal Tax Credit for Iatan 2, does Mr. Montalbano know if KCP&L Greater Missouri Operations was required to pay for its 18% ownership share of Iatan 2? 2. Does Mr. Montalbano know if Kansas City Power & Light was required to pay for its 54.71% ownership share of Iatan 2? 3. Does Mr. Montalbano know if Empire District Electric Company was required to pay for its 12% ownership share of Iatan 2? 4. Assuming each of the owners were required to make payments for their respective ownership shares of Iatan 2 then why would it not be proper for all benefits resulting from the ownership of Iatan 2 including the benefits of the Advanced Coal Tax Credits to be recognized / shared by all the tax-paying owners of Iatan 2 including GMO.

RESPONSE: (do not edit or delete this line or anything above this)

1.-3. I assume all parties were required to give some consideration for their respective ownership share in Iatan 2. 4. I have no opinion on this matter.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0344 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0344 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0345
Does Mr. Montalbano believe it is generally accepted in the regulatory framework used by public utility commissions including regulatory and ratemaking concepts used by the Missouri Public Service Commission that those who pay the costs should receive the benefits e.g., in this case that KCP&L Greater Missouri Operations customers are required to pay for the environmental equipment that allowed latan 2 to qualify for the Advance Coal Tax Credit should GMO customers also receive any benefits relating to latan 2 including any tax benefits that gave rise to the installation of the environmental equipment.

RESPONSE: (do not edit or delete this line or anything above this)
I have no opinion on in this matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge the regulatory framework.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0345 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0345 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response: 06/07/2012

Question No. :0346

1. Does Mr. Montalbano believe it would be proper for KCP&L Greater Missouri Operations customers not to have to pay in electric utility rates its 18% ownership share of the environment equipment installed at latan 2? 2. If so, please explain the circumstances GMO customers should not have to pay for the environmental equipment installed at latan 2. 3. If so, identify all the reasons why it is proper for GMO customers to have to pay for the environmental equipment installed at latan 2. 4. With respect to the environmental costs necessary for the operations of latan 2 that qualified this generating facility for the Advance Coal Tax Credit—does Mr. Montalbano believe it would be appropriate that some or all of the these costs relating to the installation and operation of environmental equipment not be recovered in rates from KCP&L Greater Missouri Operations? 5. If yes, under what circumstances would it be appropriate that customers of GMO not pay in rates costs relating to the installation and operation of environmental equipment? 6. Please give as many examples as Mr. Montalbano believes are appropriate where it would be proper for customers of KCP&L Greater Missouri Operations not to have to pay in rates costs relating to the installation and operation of environmental equipment.

RESPONSE: (do not edit or delete this line or anything above this)

I have no opinion on this matter. I have been asked to provide guidance on the tax normalization impact of the facts as they are presented in this rate case, not to judge business decisions of KCPL or Great Plains Energy or the regulatory framework itself.

Response prepared by: Salvatore Montalbano, Pricewaterhouse Coopers, LLP

Attachment:
Q0346 MO Verification.pdf

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0346 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: June 7, 2012

AQUILA, INC.
d/b/a AQUILA NETWORKS MPS

CASE NO. ER-2004-0034

STIPULATION AND AGREEMENT

APPENDIX A

AGREEMENT REGARDING FUEL AND
PURCHASED POWER EXPENSE - -
INTERIM ENERGY CHARGE

1. The Parties agree that resolution of the fuel and purchased power expense issues in Case Nos. ER-2004-0034 and HR-2004-0024 has been achieved as among themselves by an Interim Energy Charge ("IEC") mechanism of setting rates to include a specific annual amount of the Missouri jurisdictional electric cost of fuel and purchased power on a permanent (i.e., not subject to refund) basis and to include another additional amount of variable fuel and purchased power cost on an interim basis, subject to true-up and refund.

a. The specific annual amount to be included in Missouri retail rates on a permanent basis for the Aquila Networks—MPS ("MPS") electric operations is $87,700,206 (1.6654 ¢/kWh) and the additional amount to be included in Missouri retail rates on an interim basis, subject to refund, for the Aquila Networks—MPS electric operations is $16,100,000 (0.3057 ¢/kWh) for an overall total of $103,800,206 (1.9712 ¢/kWh). The actual agreed upon cents per kilowatt hour IEC for each customer class is shown in Appendix B.

b. The specific annual amount to be included in Missouri retail rates on a permanent basis for the Aquila Networks—L&P ("L&P") electric operations is $22,705,656 (1.2641 ¢/kWh) and the additional amount to be included in Missouri retail rates on an interim basis, subject to refund, for the L&P electric operations is $2,400,000 (0.1336 ¢/kWh) for an overall total of $25,105,656 (1.3977 ¢/kWh). The actual agreed upon cents per kilowatt hour IEC for each customer class is shown in Appendix B.

c. The specific annual amount to be included in Missouri retail rates on a permanent basis for the L&P industrial steam operations is $4,374,480 with no additional amount to be included in Missouri retail rates on an interim basis, subject to refund.

d. These amounts are meant to include only the Missouri retail variable costs accumulated in the FERC account numbers 501, 547 and 555 and will be updated in the true-up portion of the case specified hereafter in this Agreement. The fixed costs in FERC account numbers 501, 547 and 555 will be recovered in permanent rates and will not be updated in the true-up portion of the case. The portion subject to true-up and refund, referred to herein as the "IEC Amount," is explained in more detail herein and generally is designed to address the potential volatility in natural gas and wholesale electricity prices. This IEC Amount will be the basis of the IEC to be approved by the Commission. The IEC will be reflected separately on all MPS and L&P electric rate schedules expressed in ¢/kWh. The agreed to IECs are shown in Appendix B. The IEC will be collected on an interim basis and will be subject to true-up and refund under the terms of this Agreement.

2. The actual, hourly variable costs of fuel and purchased power will be determined for each of Aquila's Missouri divisions using a method agreed to by Staff, Public Counsel and Aquila that equitably allocates these costs to each division. Fuel costs will be allocated to Aquila's steam operations based on the allocation method approved by the Commission in Case Nos. EO-94-36 and EO-93-351.

3. The Parties agree that each applicable Aquila rate schedule will indicate that a portion of the charge thereon reflected for service is subject to refund pursuant to the terms of this Agreement and will be calculated and refunded to each customer, based on the amount of each customer's usage during the IEC Period, at a later date and that such rate schedule will expire no

later than 12:01 a.m. on the date that is two years after the original effective date of the tariff sheets in this case, Case No. ER-2004-0034, unless earlier terminated by order of the Commission. The two-year period during which the IEC is in effect is referred to as the "IEC Period."

4. Subsequent to the expiration of the Interim Energy Charge, an IEC Audit will commence in which the Parties will have the opportunity to audit Aquila's actual variable fuel and purchased power costs of serving native load, which will exclude fixed costs and the costs of fuel and purchased power for interchange (off-system) sales. The IEC Audit will be conducted under the same terms and conditions that apply to audits in general rate cases before the Commission. If the IEC Audit determines that all or a portion of the revenue collected by Aquila pursuant to the IEC mechanism exceeds Aquila's actual and prudently incurred variable costs for fuel and purchased power (as recorded in the FERC accounts 501, 547 and 555) for each operation on a Missouri retail basis during the period the IEC was in effect, Aquila will refund any excess up to the IEC Amount.

For the true-up, Aquila's trued-up variable fuel and purchased power costs will be based on actual delivered coal costs, oil costs and natural gas costs, excluding fixed natural gas reservation charges, and actual purchased power costs, excluding demand charges relating to capacity purchases. The true-up will further exclude fixed costs charged to Accounts 501, 547 and 555 relating to fixed fuel components included in the permanent rates and to fuel and purchased power for interchange (off-system) sales.

5. If a dispute arises in the IEC Audit as to the prudence of Aquila's fuel or purchased power costs subject to this Agreement, the Parties agree to present the dispute to the Commission in a timely fashion consistent with the due process rights of the Parties to adequately prepare their

case. Any refundable amount that is undisputed shall be refunded promptly; however, no refund shall be made as to the amount in dispute until there is a final determination of that dispute, but interest shall continue to accrue during the litigation of the dispute and will be payable by Aquila to the extent it is finally determined that Aquila is required to make a refund of all, or a portion of, the amount in dispute.

6. The amounts to be refunded pursuant to the IEC Audit will be determined as follows:

a. The total amount to be refunded by MPS and/or L&P will be determined as follows:

First, determine Aquila's trued-up variable fuel and purchased power expense on a ¢/kWh basis separately for MPS and L&P by dividing trued-up fuel and purchased power expense by sales to native load (retail and wholesale, but not off-system); then

Second, if Aquila's trued-up variable fuel and purchased power expense on a ¢/kWh basis for MPS is greater than or equal to 1.9712 ¢/kWh, there will be no refund to MPS customers; and if Aquila's trued-up variable fuel and purchased power expense on a ¢/kWh basis for L&P is greater than or equal to 1.3977 ¢/kWh, there will be no refund to L&P customers; otherwise, Aquila will refund all or a portion of the revenue collected by the IEC; then

Third, if Aquila's trued-up variable fuel and purchased power expense on a ¢/kWh basis for MPS is less than or equal to 1.6654 ¢/kWh, Aquila will refund to each MPS customer all revenue collected by the IEC, plus interest; and if Aquila's trued-up variable fuel and purchased power expense on a ¢/kWh basis for L&P is less than or equal to 1.2641 ¢/kWh, Aquila will refund to each L&P customer all revenue collected by the IEC, plus interest; otherwise, Aquila will refund only a portion of the revenue collected by the IEC, plus interest; then

b. The amount to be refunded to each customer shall be determined as follows:

First, calculate the Trued-up IEC for each class as follows:

(i) For the residential class (MPS rate codes MO860 and MO870; L&P rate codes MO910 & 911, MO913 & 914, MO915, MO920 & 921, and MO922) the Trued-up IEC for each division is Aquila's trued-up variable fuel and purchased power expenses on a ¢/kWh basis as determined in the first step of 6.a., less the amount included in permanent rates on a ¢/kWh basis for that division (1.6654 ¢/kWh for MPS and 1.2641 ¢/kWh for L&P).

(ii) For the large primary class (MPS rate codes MO735 and MO737; L&P rate code MO944) the Trued-up IEC for each division is calculated by the following formula:

$$((A / B) \times (C \times D)) / E$$

where: A is the IEC Period revenues of the large primary class.

B is the IEC Period revenues of the Aquila Division.

C is the Trued-up IEC of the residential class.

D is the IEC Period sales of the Aquila Division.

E is the IEC Period sales of the large primary class.

(iii) For the remaining classes the Trued-up IEC are calculated by the following formula:

$$((A \times B) - (C \times D) - (E \times F)) / G$$

where: A is the Trued-up IEC of the residential class.

B is the IEC Period sales of the Aquila Division.

C is the Trued-up IEC of the large primary class.

D is the IEC Period sales of the large primary class.

E is the Trued-up IEC of the residential class.

F is the IEC Period sales of the residential class.

G is the IEC Period sales of all remaining classes.

Second, calculate the Refund Factor for each class by subtracting the Trued-up IEC for that class from the IEC paid by that class.

Third, calculate each customer's refund by multiplying the Refund Factor for the class by the customer's kWh usage during the IEC Period, then add the amount of interest.

7. The interest rate to be used for purposes of this Agreement will be the same as the prime rate of interest (as found in the Money Rates section of the Wall Street Journal) in effect on the day the IEC Period expires and will be applied to the amount to be refunded. Interest (if there is a refund) shall be applied for the period from the end of the first twelve months of the IEC Period through the end of the calendar month prior to the billing month in which bill credits for the refund appear on customers' bills. In other words, it is assumed that the total amount of any refund accrues during the first year and interest applies thereafter.

8. All Aquila Missouri retail electric customers taking service at any time during the IEC Period are potentially eligible to receive a refund, including interest and all applicable taxes and fees consistent with the terms and conditions of this Agreement. Generally, any such refund will appear as a one-time credit on the customer's bill, except that a refund in an amount exceeding $1,000.00 may be issued by check when specifically requested by the customer, and in cases where a customer is no longer a customer in the billing month in which bill credits appear on the bills of remaining customers. In that instance, Aquila will mail to the last known address of such former customer a check for the amount of the refund owed that former customer. No such checks will be issued to a customer for a refund amount of less than $3.00. Aquila may set off the amount of any refund owed a particular former customer under this Agreement against any amount owed Aquila by that former customer. After the bill credits have been made and checks issued, any amount of the total refund plus interest that may remain in Aquila's possession six months after the end of the application of the bill credits, for example, due to the inability to

locate a former customer, shall be donated by the Company promptly to a Low-income assistance program to be agreed upon by the parties.

9. During the IEC Period, Aquila shall provide the Parties with the Company's routine monthly revenue and sales reports, which reports shall include the following data: (1) actual kWh sales for each Missouri retail rate code by calendar month, and (2) the revenues from kWh sales, exclusive of taxes, for each Missouri retail rate code by calendar month. The routine reports shall also specifically identify the revenues associated with the IEC Period and the status of the IEC mechanism in terms of the accrued refund obligation. Aquila shall submit this data in electronic format on a quarterly basis within forty-five (45) days after the end of each calendar quarter.

Aquila also agrees, for the purposes of the IEC Period and this Agreement, to, for the duration of this Agreement, submit the following information to the Commission's Auditing Department and to the Public Counsel:

a. Monthly operating reports;

b. Monthly fuel reports;

c. Monthly purchased power and interchange (off-system) sales reports. Purchases and sales to any affiliate excluding the L&P Division will be included in the Interchange Revenue and Cost Accounts. Transactions between MPS and L&P will be accounted for as transfers at cost under a Joint Dispatch assumption;

d. Monthly outage reports, including Jeffrey and Iatan outages;

e. Monthly fuel prices for a) coal and freight, b) natural gas (commodity and transportation separately) and c) oil; and

f. A monthly statement identifying significant changes in fuel/rail contracts, capacity agreements and unusual operating conditions such as significant power plant outages, unusually high purchased power prices and natural gas prices, etc.

10. Commencing with the calendar quarter beginning April 1, 2004, and continuing during the IEC Period, Aquila shall provide quarterly reports to the Parties relating to the Company's analysis and record-keeping for any and all natural gas capacity release and off-system natural gas sales opportunities and transactions. In this report, Aquila shall provide information showing the amount of natural gas capacity that was available for its own use, the amount used, the amount available for capacity release; and for each amount of capacity released, the party to whom the capacity was released, the price of the release, and its duration, together with any other relevant information related to the transaction. This quarterly report shall also provide information showing the total amount of off-system natural gas sales; and for each off-system sale, the party to whom the off-system natural gas sale was made, the price of the sale, and its duration, together with any other relevant information related to the transaction. This report will also include Aquila's analysis of the natural gas market conditions during the time period covered, with explanations as to why the Company did or did not make any natural gas capacity releases or off-system natural gas sales. Any revenues collected by Aquila due to the release of unused natural gas capacity or net revenues from off-system sales of natural gas during the duration of the Agreement will be used to offset the calculation of the cost of the fuel and purchased power supplied to the Company's ratepayers on a dollar-for-dollar basis.

11. In consideration of the implementation of the IEC mechanism in this proceeding, and for its duration, Aquila, with respect to its electric and industrial steam operations, agrees to voluntarily forego any right it may have to request the use of, or to use, any other procedure or

remedy, available under current Missouri statute or subsequently enacted Missouri statute, in the form of a fuel adjustment clause, a natural gas cost recovery mechanism, or other energy related adjustment mechanism to which the Company would otherwise be entitled. This temporary and limited waiver by Aquila shall not be construed to prevent the Company from utilizing a purchased gas adjustment with respect to its natural gas operations.

At its own expense, Aquila shall post a bond, escrow its refund obligation, or otherwise provide adequate assurance to the parties to guarantee that any refund amounts due to its customers upon the expiration of the IEC will remain unencumbered in the event Aquila becomes insolvent or reorganizes its corporate structure.

AQUILA NETWORKS MPS AND L & P

INTERIM ENERGY CHARGE TARIFF

EFFECTIVE: APRIL 22, 2004

FROM CASE NO. ER-2004-0034

Aquila, Inc., dba
AQUILA NETWORKS For All Territory Served by Aquila Networks – L&P and Aquila Networks – MPS
KANSAS CITY, MO 64138

RATES
ELECTRIC

Copies of the official tariff sheets are available at offices providing service under the tariffs, and at the governing state or national commission offices. The information available here attempts to be materially the same, but should there be any discrepancies, in all cases the official tariffs on file with the governing commission will hold over these documents.

P.S.C. MO. No. 1

AQUILA, INC.
d/b/a AQUILA NETWORKS,
AQUILA NETWORKS – L&P,
And AQUILA NETWORKS – MPS

SCHEDULE OF RATES FOR ELECTRICITY

APPLYING TO THE FOLLOWING TERRITORY

All Territory of
Aquila Networks – L&P
And
Aquila Networks – MPS

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ELECTRIC

Rate schedules are applicable to territory as noted in headers.

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ELECTRIC

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Aquila, Inc., dba
AQUILA NETWORKS For All Territory Served by Aquila Networks – L&P and Aquila Networks – MPS
KANSAS CITY, MO 64138

INTERIM ENERGY CHARGE RIDER
ELECTRIC

APPLICABLE

This rider is applicable to all Company's electric service billed under any electric rate schedule, metered or unmetered, subject to the jurisdiction of the Commission as reflected separately on each rate schedule. The revenue from this rider will be collected on an interim and subject to true-up and refund basis under the terms ordered in Case No. ER-2004-0034.

RATE

In addition to the charges that Company makes for electric service set forth in its approved and effective rate schedules, one (1) of the following amounts will be added as shown on each rate schedule:

Rate IEC-A, per kWh $0.003309
Rate IEC-B, per kWh $0.003057
Rate IEC-C, per kWh.....$0.002099
Rate IEC-D, per kWh.....$0.001745
Rate IEC-E, per kWh $0.001336
Rate IEC-F, per kWh.....$0.001010

CONDITIONS

This interim rider shall be in effect from April 22, 2004 through April 21, 2006. Subsequent to the expiration a true-up audit will determine if any portion of the revenues collected exceed Company's actual and prudently incurred cost for fuel and purchased power during the interim period, and refunds, if warranted, will be issued. Company shall refund the excess, if any, above the greater of the actual or the base, plus interest. Interest will be equal to the prime rate in effect on the day the IEC expires and will be applied to any amount to be refunded. No refund will be made if Company's actual and prudently incurred costs for fuel and purchased power during the IEC period equal or exceed the forecast amount.

Such refunds, if any, shall be based upon the billing units of the customer to which these amounts were applied. Any refund will appear as a one-time credit on the customer's bill.