BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service.	))))	Case No. ER-2010-0356

Proposed Findings of Fact and Conclusions of Law
of KCP&L Greater Missouri Operations Company

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KCP&L Greater Missouri Operations Company ("GMO" or "Company") submits the following Proposed Findings of Fact and Conclusions of Law:

I. Capacity Planning

a. Findings of Fact

1. The Company seeks recovery of costs associated with GMO's capacity planning, namely: (1) the construction of three 105 MW combustion turbines (CTs) at South Harper and a 200 MW system-participation based purchased power agreement (PPA) (collectively, the "First Decision"); and (2) adding Crossroads Energy Center to the MPS generation fleet (the "Second Decision"). Staff disputes the prudence of these decisions and their associated costs.

2. Regarding the First Decision, Staff contends that GMO should have pursued construction of five CTs in 2005 instead of the plan GMO pursued. Notably, Staff's conclusion is based on the same analysis as that developed and used by the Company in deciding to pursue the three CT/system-participation PPA.

3. The Company argues that GMO elected not to build five CTs, in favor of three CTs and a PPA that included base load capacity, in order to diversify its resource portfolio additions. "GMO concluded that it would be prudent to spread the execution and operating risks from the resource additions between building CTs and adding a PPA that contained some level of base load capacity." Hearing Exhibit GMO-11, Crawford Rebuttal at 4.

4. Nonetheless, Staff has imputed the cost of two additional 105 MW CTs to the Company. The Company denotes the addition of these two turbines as "phantom turbines." In the current case, Staff argues that its adjustments "reflect the continuation of Staff's position that GMO should have prudently addressed its capacity needs for MPS to replace the Aires PPA when it expired on May 31, 2005." Hearing Exhibit GMO-210, Staff Cost of Service Report at 103.

5. The Company states that the difference between Staff's preferred five CT plan and the Company's three CT/system-participation PPA plan is minimal. See Hearing Exhibit GMO-217, Featherstone Surrebuttal, Schedule 119. Further, when this difference in plan costs was presented to Staff witness Lena Mantle, she stated that she did not believe the cost difference between the Company's preferred plan and Staff's five CT option over 20 years was significant (Hearing Tr. at 4090), and that she did not find the Company's decision based on this difference to be imprudent. Id. at 4091.

6. Ultimately, the Company did not implement precisely its preferred plan. Based on the 2004 analysis, the preferred plan called for three 105 MW CTs and a 200 MW system PPA. The three CTs were completed in the summer of 2005, but the Company was unable to complete the system PPA. Instead, the Company entered into a 9-year 75 MW base load contract with the Nebraska Public Power District (NPPD).

7. The Company argues that Staff's "phantom turbines" adjustment is legally flawed pursuant to RSMo § 393.135, which precludes a party from including in the rates of an electrical corporation any charge for property before it is "fully operational and used in service." The Company reasons that Staff's two CTs are entirely imaginary and, therefore, are not, and cannot be, used in providing service to GMO's customers.

8. The Company further argues that although the Commission may regulate GMO's operations, it has no authority to manage the Company's business or to substitute its business judgment for that of GMO, so long as GMO is meeting its public service obligation to provide safe and adequate service to its patrons.

9. Regarding the Second Decision, the Company, after a thorough analysis of available options, argues that the addition of the 300 MW Crossroads Energy Center (Crossroads) was the lowest cost option for meeting GMO's requirements. Staff disputes this analysis and has presented four reasons for excluding the capacity and associated costs of Crossroads.

10. First, Staff argues there are affiliate transaction concerns related to Crossroads where Missouri's affiliate transaction rules are intended to prevent regulated utilities from subsidizing their non-regulated operations.

11. GMO disagrees with Staff's rationale. First, Crossroads was initially held by Aquila's unregulated merchant subsidiary. The plant was transferred by the unregulated subsidiary to the parent, Aquila, Inc. Aquila, Inc. later transferred Crossroads to the regulated utility, Missouri Public Service. Great Plains Energy assumed the contract as part of its acquisition of Aquila, Inc.

12. The Company opines that pursuant to Missouri law, "GMO obtained competitive bids to determine the fair market value of long-term capacity and energy. GMO documented the cost to provide long-term capacity and energy for itself. GMO's analysis shows that the cost of acquiring Crossroads is less than the fair market value of available alternatives and less than the cost of the regulated utility providing the capacity and energy for itself." Hearing Exhibit GMO-11, Crawford Rebuttal at 14. Thus, to the extent that the transfer of Crossroads to the regulated utility falls under the affiliate transaction rules, GMO has fully complied with the rules.

13. Next, Staff suggests that the delivered price of natural gas to Crossroads has been historically higher than the price of gas to South Harper. The Company argues in the first 10 months of 2010, the average commodity cost for natural gas shipped to Crossroads was less than gas shipped on Panhandle Eastern Pipeline to South Harper. Moreover, the average delivered cost of natural gas to Crossroads was about half the average delivered cost of natural gas to South Harper. Hearing Exhibit GMO-8, Blunk Rebuttal at 2.

14. Further, the Company argues that one of the benefits of Crossroads over the two phantom turbines at South Harper "is that natural gas shipped to Crossroads typically comes from a different supply region than natural gas shipped to South Harper. This allows the Company to take advantage of short-term pricing disparities." Id. at 4-5. With Crossroads in the portfolio, however, "the Company can choose to generate electricity from the region with the lower priced natural gas." Id. at 5.

15. Third, Staff argues that the cost of transmission to move energy from Crossroads in Mississippi to GMO's service territory justifies, in part, removing Crossroads from GMO's cost of service. The Company argues that the cost of transmission is offset by the lower gas reservation costs. In other words, it costs as much to bring natural gas to GMO's service territory to run a local plant as it does to acquire firm transmission to get the power from the Crossroads plant to GMO's service territory. In addition, the cost of transmission service for Crossroads was included in the 2007 analysis that demonstrated that Crossroads was the lowest cost solution in meeting the additional GMO resource needs.

16. Finally, Staff expressed concern with GMO's ability to provide appropriate management oversight of a plant located in Mississippi. The Company argues that the Generation Agreement between the Clarksdale Public Utilities Commission and GMO that "GMO has the right to review and approve the annual Operating Plan which constitutes a

comprehensive and detailed plan for operating the facility for [the] coming two-year period." Hearing Exhibit GMO-31, Rollison Rebuttal at 3. In addition, GMO has the authority to review and approve the annual plant budget, among other rights and authorities related to the plant. Id. The Company further argues that it has ownership interest in other generating facilities operated and managed by non-GMO employees. It is not uncommon in the industry to have plants run by someone other than the owner. For example, KCP&L runs plants for Westar, Empire, GMO and MJMEUC. Further, other utilities run Wolf Creek and Jeffrey Energy Center, of which KCP&L and GMO, respectively, are minority owners. This has not proven to be a problem, therefore location is not a basis to deny recovery.

17. Ultimately, the Company concludes that its addition of Crossroads was prudent noting that in 2010, per the Stipulation and Agreement in GMO's last rate case, GMO conducted a 20-year analysis to determine a preferred plan after reviewing and analyzing the responses from a 2007 Request for Proposals for supply resources. Hearing Exhibit GMO-11, Crawford Rebuttal at 8. The analysis showed that Crossroads would result in the lowest 20-year net present value of revenue requirements (NPVRR).

18. With regard to the valuation of Crossroads, Staff's primary recommendation is that Crossroads should be disallowed in its entirety (Hearing Exhibit GMO-210, Staff Cost of Service Report at 92), it argues alternatively that if the Commission decides to allow Crossroads in GMO's cost of service, then the value of Crossroads for ratemaking purposes is $51.6 million. The Company believes its valuation of Crossroads at $104 million is appropriate. Exhibit GMO-12, Crawford Surrebuttal at 3.

19. The Company responds that according to the alternative that the plant remained operational and GMO was able to obtain transmission from Crossroads to GMO, the value of the plant was $94.75 million, assuming that $20 million in transmission upgrades would be required.

GMO was ultimately able to obtain transmission service with only a minimal transmission investment of $145,000, bringing the estimated value of Crossroads to $114.60 million. Hearing Exhibit GMO-12, Crawford Surrebuttal at 3. This value is even more than the $104 million GMO has requested for ratemaking treatment in this case and highlights how unrealistic Staff's proposed salvage value of $51.6 million is.

20. Dogwood Energy, LLC (Dogwood) presented testimony in this case which described its interests as both a retail power customer of GMO and a wholesale power supplier to GMO. Hearing Exhibit GMO-3601, Janssen Rebuttal at 3. As a customer, Dogwood supported Staff's disallowance of Crossroads and imputation of two phantom turbines in order "to protect GMO's retail customers, including Dogwood, against exorbitant rates." Id. at 4. With regard to its interest as a wholesale supplier to GMO, Dogwood suggests that the Commission discourage GMO from using the Crossroads facility and instead replace it with a local unit -- such as Dogwood's combined cycle facility. Id.

21. Dogwood argues that the cost of natural gas to Dogwood is cheaper than to Crossroads, transmission service to Crossroads is problematic and the Company's resource planning analyses are flawed because the Company failed to contact Dogwood. In addition, Dogwood makes a number of legal challenges to inclusion of Crossroads in rates. However, the testimony and evidence presented in this case demonstrates that the delivered cost of natural gas is cheaper to Crossroads than to Dogwood, that GMO's firm transmission service is reliable and sufficient and that GMO has repeatedly considered Dogwood in its resource planning decisions, including the Company's recent 2010 Stipulation 8 Capacity Study. Dogwood has not been the lowest cost resource option. Further, Dogwood's legal arguments are baseless.

22. The Industrials mirrored the arguments of Staff, addressed above.

b. Conclusions of Law

1. The Commission concludes that the Company's 2004 decision to pursue the construction of three 105 MW CTs at South Harper and pursue a 200 MW system-participation based purchased power agreement, and the Company's decision to add the Crossroads generating facility to the MPS generation fleet were prudent and reasonable decisions.

2. The Commission rejects Staff's phantom turbine adjustments and allows GMO to fully recover the costs associated with its preferred resource plan, the construction of three 105 MW CTs and a purchased power agreement that includes base load generation.

3. The Commission rejects Staff's adjustment to disallow the recovery of Crossroads in the Company's cost of service. The Commission concludes that Crossroads should be included in rate base at its net book value of $104 million, and not its salvage value or at the value of other, unrelated plants.

4. The Commission rejects Dogwood's proposal because the Company has demonstrated that Crossroads is, in fact, a more cost-effective resource option than Dogwood and, as a result, results in a lower cost for ratepayers.

5. The Commission rejects the Industrials' position for the same reasons set out in response to Staff's arguments.

II. <u>Jeffrey Energy Center FGD Rebuild Project</u>

a. <u>Proposed Findings of Facts</u>

23. The Jeffrey Energy Center ("JEC") is a coal-fired electric generating facility consisting of three 720 MW units located in St. Marys, Kansas. GMO owns 8% of the JEC facility for a total of 172.8 MW, which is assigned to MPS. Westar is the operating partner who owns the remaining 92%. To comply with increased environmental regulations, Westar

made a decision to rebuild the flue gas desulfurization system, or "scrubbers" on all three JEC units.

24. Westar Energy is the primary owner and constructor of this project. GMO owns 8% of the plant. Monthly status reports and cost reports provided by Westar were reviewed and monitored by GMO for prudence and reasonableness.

25. In this proceeding, Staff is proposing a prudence disallowance of $59,110,980 total cost of the project which equates to $4,831,649 using GMO's 8% share. Staff witness Keith Majors is asserting that if Westar and GMO had required one of the construction contractors, Powerplant Maintenance Specialists, Inc. ("PMSI") to obtain a performance bond that the total cost of the project would have been reduced. (Hearing Exhibit GMO-210 (NP), pp. 42-47, COS Report; GMO-21 (HC), p. 3, Hedrick Rebuttal).

26. Staff's first argument is that: "Westar imprudently contracted with a vendor whose financial instability and poor performance report resulted in additional costs to the project." (Staff Initial Br. at 44). Secondly, Staff argues that "It was unreasonable of Westar and GMO not to require PMSI to obtain a performance bond, and this failure to require a performance bond exposed GMO to inappropriate, unreasonable and unnecessary level of financial risk, risk that materialized." (Staff Initial Br. at 47-48) Third, Staff argues that: "Westar failed to conduct proper due diligence when evaluating PMSI as a potential contractor." Staff also criticizes Westar for not applying the Federal Acquisition Regulations which Staff admits do not have any applicability to private industry. (Staff Br. at 48-49). Finally, Staff criticized Westar for failing to seek liquidated damages against PSMI. (Staff Br. at 50) For the reasons stated below, the Commission finds that none of Staff's arguments and criticisms of Westar's actions are well founded.

27. Mr. Terry S. Hedrick, KCP&L's Director of Supply Engineering, explained at length the reasons why Westar and GMO hired the contractor and did not require the contractor to obtain a performance bond. Much of the information was provided as confidential information. However, Mr. Hedrick explained that the contractor's bid was substantially lower than competing bids, and it made economic sense to accept the bid even though the contractor was unable to obtain a performance bond.

28. Mr. Leonard R. Ruzicka, an expert in construction law, was retained by KCP&L to review documents and interview individuals as necessary to determine the appropriateness of the awarding of a contract to PMSI for the general construction work on the rebuild of the scrubber systems on the three units of the Jeffrey Energy Center coal-fired generating station. Mr. Ruzicka is a partner in the law firm of Stinson Morrison Hecker LLP, and previously had 20 years experience as a Senior Vice President and General Counsel for Fru-Con Corporation, a large international company engaged in construction, engineering and real estate development. (Hearing Exhibit GMO-36 (NP), p. 1, Ruzicka Rebuttal; Hearing Tr. 4271-72, 4341) He was also retained to review the testimony of Mr. Keith Majors and give his assessment of the opinions expressed by Mr. Majors in that testimony.

29. Mr. Leonard Ruzicka, conducted an independent review of the facts and circumstances surrounding this project. He concluded that Westar/GMO had acted appropriately and reasonably in its decision to award the general construction contract to PSMI. (Hearing Exhibit GMO-36 (NP), pp. 2-5, Ruzicka Rebuttal). Mr. Ruzicka also explained the reasons why it was appropriate to award the contract as Westar/GMO did, based upon the facts and circumstances that were known at the time. Much of the information was provided as

confidential information, but the Commission finds that Mr. Ruzicka's review substantiates the prudence of Westar's decision to retain PSMI.

30. The record demonstrates that Westar performed reference checks on prior work performed by PMSI as well as obtained reports from Dun & Bradstreet. (Majors Surrebuttal, p. 37) In addition, Westar conducted an extensive evaluation of PMSI and was aware of the fact that it could not obtain a performance bond due to its financial condition. (Hearing Exhibit GMO-21 (HC), Hedrick Rebuttal, p. 3) However, given the substantial difference in the PMSI bid and the next lowest bid, the Commission finds that it was reasonable and prudent for Westar to proceed with the acceptance of the PMSI bid without a performance bond. (Hearing Tr. 4356-47).

31. Staff also criticizes Westar for not applying the Federal Acquisition Regulations which Staff admits do not have any applicability to private industry. (Staff Br. at 48-49). In addition, Staff criticizes Mr. Ruzicka for not following "any auditing standards when reviewing the work related to PMSI, thus creating serious concerns to the value of his opinion testimony." (Staff Br. at 49). The Commission finds that the evidence shows that it takes more than "auditing" expertise to judge the prudence of construction project decisions. Mr. Ruzicka is an experienced construction law expert, and did not conduct an audit. Instead he reviewed the prudence of the decisions made by Westar, based upon extensive documentary evidence and interview with Westar personnel. Ultimately, he concluded that Westar and GMO were indeed prudent in their decision-making related to the Jeffrey Energy Center FGD Rebuild Project. (Hearing Exhibit GMO-36 (NP), pp. 2-5, Ruzicka Rebuttal, pp. 2-3) The Commission finds the testimony of Mr. Ruzicka to be persuasive.

32. Staff asserts that "Mr. Ruzicka testified that PMSI could easily have been replaced." (Staff Br. at 49). However, on redirect, Mr. Ruzicka explained his answer and

indicated that it would have been very costly to replace the contractor at that point in the project. (Tr. 4343). Mr. Ruzicka also explained that there was no basis for asserting a claim for liquidated damages, and Staff's criticism was incorrect. (Hearing Tr. 4349-52; See also Hearing Tr. 4266; 4356-57)

b. Conclusions of Law

33. Based upon the competent and substantial evidence in the record, the Commission concludes that the Jeffrey Energy Center (JEC) Additions were prudent and should be included in rate base in this proceeding. The Commission concludes that Staff's proposed disallowance is based upon hindsight, is unreasonable and not supported by competent and substantial evidence. The Commission will therefore reject Staff's proposed prudence disallowance.

III. Allocation of Iatan 2 Between L&P and MPS Service Areas

a. Proposed Findings of Facts

34. GMO has allocated 41 MW of Iatan 2 to the L&P service area, and the remaining 112 MW to the MPS service area, based upon the balancing of the respective baseload capacity needs of L&P and the MPS service areas, as well as the resulting rate impacts upon its customers. (Hearing Exhibits GMO-33, pp. 10-12, Rush Rebuttal; GMO-5, pp. 7-10, Blanc Rebuttal; GMO-11, pp. 14-16, Crawford Rebuttal)

35. GMO's proposed allocation of Iatan 2 results in 60% of L&P's 2011 projected peak demand to be met with base load capacity, and 61% of MPS's projected peak to be met with base load capacity. As a result, both service areas would have nearly identical percentages of base capacity, using the GMO's allocation proposal for Iatan 2. (Hearing Exhibit GMO-11, pp. 15-16, Crawford Rebuttal) GMO's proposal also recognizes that Iatan 2 is jointly dispatched

between both the L&P and MPS service areas, based upon economics rather than previous corporate history. (Tr. 3847)

36. The Staff is recommending that a substantially larger share of Iatan 2 be allocated to the L&P service area than what GMO has requested. Staff proposes to allocate 100 MW of Iatan 2 to the L&P rate jurisdiction which is about 240% more of Iatan 2 than what GMO proposed. (Tr. 3853) Only 53 MWs would be allocated to MPS under Staff's proposal.

37. Staff's proposal would have 73% of L&P's peak met with base load capacity, and only 57% of MPS's peak would be met with base load capacity. (Tr. 3844) (Hearing Exhibit GMO-11, pp. 15-16, Crawford Rebuttal) Staff witness Mantle testified that Staff primarily based its position on St. Joseph Light & Power Company's resources when it merged with Aquila more than a decade ago. (Tr. 3845) (Hearing Exhibit, GMO-210 (NP), p. 94, COS Report) Staff looked back about a decade to make its determination about the proper allocation of Iatan 2 for the future.

38. The Iatan 2 Allocation issue is more akin to a rate design issue since it determines the relative amount of the rate increase that will be received by both the MPS and the L&P service areas rather than the overall revenue requirement impact of Iatan 2. (Tr. 3821)

39. Based upon the testimony of GMO witness Tim Rush, the Commission finds that Staff's proposed allocation will have adverse effects on the customers in the L&P service area, GMO's Fuel Adjustment Clause mechanism, and the appropriate amount of fuel and purchased power assigned to each of the service areas since base load, intermediate and peaking capacity have relatively different fuel costs. (Tr. 3820-21)

40. The Commission finds that Staff's proposal would increase the revenue requirement for the L&P service area by approximately $20 million above GMO's request. (Tr. 3820) GMO requested a $22 million total increase for the L&P area after considering all of the

other cost drivers in the case. By adding another $20 Million to account for Staff's proposed allocation of Iatan 2, the Commission finds it will have an adverse impact upon GMO's customers that live in the St. Joseph and other L&P service areas. (Tr. 3820)

41. Staff acknowledges that its proposed allocation of 100 MW of Iatan 2 "will potentially cause the rates increase to L&P customers to be almost four times the rate increase to MPS customers." (Hearing Exhibit GMO-210 (NP), p. 102, COS Report) The Staff's Report also states: "Staff realizes that economic conditions are tough and the rate impact of adding 100 MW of Iatan 2 investment and costs in L&P's revenue requirement will not be easy for many of its customers." (Hearing Exhibit GMO-210 (NP), p. 95, COS Report) In support of its proposed allocation, the Staff speculates that the L&P service area may benefit in the long term and that L&P might have ended up with a similar result had it not been acquired by Aquila in the Year 2000. (Hearing Exhibit GMO-210 (NP), p. 103, COS Report) However, the Commission finds that any long term benefits are speculative and do not offset the immediate adverse impact upon customers of Staff's proposal.

42. Staff recognized that there might be more than one allocation scenario for allocating Iatan 2 that would be reasonable. (Tr. 3851). In fact, Staff analyzed five (5) different scenarios in the Cost of Service Report. Ms. Mantle concluded that Scenarios 1, 2 and 3 were reasonable for GMO if the only consideration was L&P's needs as a stand alone company. (Scenario 2 represents the Staff's preferred allocation methodology). Scenario 5 allocated all of Iatan 2 to MPS, and would be most appropriate if the only consideration was MPS's needs as a stand alone utility. (Tr. 3851)

43. The St. Joseph Light & Power Company was acquired by Aquila Inc. more than a decade ago, and MPS and L&P are not stand alone companies anymore. (Tr. 3851)

44. The Commission finds that Scenario 4 (which is the scenario recommended by GMO) is the only scenario analyzed by Staff which finds some common ground and balances the interests of both MPS and L&P customers. (Tr. 3857)

45. The Commission finds that it is not reasonable to analyze the issue of the proper allocation of Iatan 2--based upon an assumption that St. Joseph Light & Power Company was still in existence as a stand alone company. The corporate world has changed, and the Commission has much more flexibility to properly balance the interests of all customers as a result. Instead, the Commission finds that it should analyze the issue based upon the electricity needs of the customers in the two service areas.

b. Conclusions of Law

46. The Commission concludes that it should equitably balance the interests of its MPS and L&P customers, and adopt GMO's proposed allocation of Iatan 2 in this proceeding.

IV. Rebasing of Base Energy Costs Above Costs That are Proposed for GMO's Base Rates

a. Proposed Findings of Facts

47. The Company did not propose to increase rates by rebasing or resetting its Base Energy Costs, as defined in its Fuel Adjustment Clause (FAC) tariff sheets. These base costs are the core energy costs to which are applied (a) variable fuel component costs, (b) purchased power energy charges, (c) emission allowance costs, (d) adjustments for recovery period sales variations, and (e) interest on deferred electric energy costs. See GMO Tariff Sheets 124-126.1, Proposed Tariff Change Schedules.

48. Staff, on the contrary, proposes to rebase Base Energy Cost and to increase rates equal to the normalized Based Energy Costs for fuel and purchased power costs, less off-system sales revenue in the 2009 test year, as trued-up, for both the MPS and the L&P Divisions. See Ex. 210, Staff Report at 199-201. Staff's proposal to rebase rates would raise MPS rates above

existing levels by 6.5% and raise L&P rates above existing levels by 21.2%. See Ex. 241, J. Rogers Surrebuttal at 8.

49. GMO decided to maintain the current base amounts for the MPS Division ($0.02348/KWh net system input) and the L&P Division ($0.01642/KWh net system input) in order to keep GMO's overall rate request to as low an amount as reasonable, yet still provide a fair return to the Company. See Ex. 33, Rush Rebuttal (cost of service) at 3; Ex. 34 Rush Rebuttal (rate design) at 26.

50. Because GMO has not rebased these Base Energy Costs and has, thus, not adjusted the FAC to reflect such rebasing, GMO has agreed to forego 5% of the increase in its future fuel and purchased power expenses under the current FAC that only allows it to recover 95% of its prudently incurred costs. See Ex. 33, Rush Rebuttal (cost of service) at 3-4.

51. The Company's decision in this case not to rebase its Base Energy Costs is consistent with the resolution of the Company's last rate case, Case No. ER-2009-0090. See Tr. 4443-46 (Rush).

52. Staff contends that in each general rate case customers should be assured that they receive the correct price signals through fixed rates as soon as possible. See Ex. 241, Rogers Surrebuttal at 7. However, the Commission finds that customers do receive sufficiently accurate price signals based upon the operation of the FAC, where the Company is permitted to recover 95% of its prudently incurred costs.

53. Staff additionally contends that under its proposal customers would not be subjected to paying interest charges which can occur if the FAC is not rebased. However, Staff failed to calculate or otherwise analyze what the difference would be between any additional interest costs under the existing FAC and the increase in fixed rates proposed by Staff. See Ex. 241, Rogers Surrebuttal at 7; Tr. 4484-85 (Rogers).

54. Staff additionally conceded that neither Section 386.266 nor the Commission's rules concerning fuel adjustment clauses and rate adjustment mechanisms require rebasing of Bare Energy Costs in a general rate case.

55. The Commission finds that there is no persuasive reason why it should rebase the Company's Base Energy Costs and further increase customers' rates, particularly when the Company did not request it and is willing to continue to absorb 5% of the increases in costs that it receives through the fuel adjustment clause.

b. Conclusions of Law

56. No provision in Section 386.266, the codification of Senate Bill 179, requires the rebasing of Base Energy Costs in general rate cases subsequent to the proceeding that implements an FAC or other rate adjustment mechanism.

57. The Commission's fuel adjustment clause regulations found in 4 CSR 240-3.161 and 4 CSR 240-20.090 do not require a rebasing of Base Energy Costs in an FAC when a utility files a general rate case that requests that its rate adjustment mechanism be continued.

58. There is no provision in the Company's fuel adjustment clause tariffs or any of its other tariffs that requires the rebasing of its Base Energy Costs when it files a general rate case.

V. Fuel Adjustment Clause Sharing Mechanism

a. Proposed Findings of Facts

59. GMO's Fuel Adjustment Clause was established and approved in the final rate case of its predecessor Aquila, where the Commission set forth the current sharing mechanism at a 95% to 5% ratio. In that decision the Commission found that allowing Aquila to pass 95% of its prudently incurred fuel and purchased power costs, above those included in its base rates, through an FAC is appropriate. The Commission stated that with the 95% pass-through Aquila would be protected from extreme fluctuations in fuel and purchased power costs, yet retain a

significant incentive to take all reasonable actions to keep its fuel and purchased power costs as low as possible, and still have an opportunity to earn a fair return on its investment. It concluded that a 95% pass-through would not violate Section 386.226.4(1) because it would still afford Aquila a sufficient opportunity to earn a fair return on equity. See In re Aquila, Inc., Report and Order, Case No. ER-2007-0004 (May 17, 2007) at 54-55.

60. Since the FAC was established, Aquila/GMO have made six Cost Adjustment Factor (CAF) filings which, in total, the parties agreed resulted in the under-collection of $121 million over a 3-year period. See Ex. 210, Staff Report at 196-97. Of this amount, approximately $6 million was absorbed by the Company pursuant to the 95/5 sharing mechanism. Id. at 197.

61. Staff now recommends that the sharing mechanism be adjusted to a 75% to 25% ratio whereby the Company would only be permitted to pass 75% of its prudently incurred fuel costs above those fuel costs included in base rates to customers. The remaining 25% would be borne by the Company itself. Intervenors AARP and Consumers Council recommend a 70/30 sharing mechanism.

62. The Staff Report filed in this case "found no evidence of imprudent decisions by the Company's management related to procurement of fuel for generation, purchased power and off-system sales." See Ex. 210, Staff Report at 193. At the evidentiary hearing, Staff's witness John Rogers confirmed that this was Staff's finding. Tr. 4476-77.

63. The Staff Report and Mr. Rogers stated that prior to the inception of the Company's FAC, Aquila/GMO had under-collected $116 million during 2004-06 "for which GMO's customers were responsible for paying $0." See Ex. 241, Rogers Surrebuttal at 17. Mr. Rogers stated on cross-examination that those losses contributed to Aquila's financial problems at the time. See Tr. 4486 ("I'm sure it did.").

64. Staff witness Rogers additionally stated that if Staff's recommended 75/25 ratio were adopted by the Commission, the Company would be returning to its previous circumstances of not being able to recover costs:

> Q: . . . so, Staff would like to go back to the days of at least greater under-collections that would not be recovered by the Company. Is that a fair statement?
>
> A: Yes.

[Tr. 4487]

65. Staff has conceded while it has "not found any imprudence in its reviews, the Company's reluctance to reset the Base Energy Cost indicates that the 5% that GMO does not recover is not large enough to mean much to GMO." See Ex. 241, Rogers Surrebuttal at 12. The Commission finds that the primary purpose of Staff's proposal is to increase the amount of prudently incurred fuel costs that GMO will not be able to recover under its FAC because it opposes Staff's proposal to reset Base Energy Costs in rates. See Staff Initial Brief at 12.

66. GMO Exhibit 51 summarizes the sharing mechanisms applicable to fuel adjustment clauses and off-system sales margin in eleven other Midwestern states. Based on that exhibit, other companies in the Midwest do not operate under a 95/5 sharing mechanism like GMO and other Missouri companies. Sharing mechanisms implemented by other Midwestern states relate to off-system sales margins and provide their utilities an incentive to engage in such sales. See GMO Ex. 51; Tr. 4448-51.

67. GMO Witness Gary M. Rygh, a Managing Director of Barclays Capital Inc., testified that there would be potential adverse effects of altering the 95/5 sharing mechanism to a 75/25 ratio. He was generally familiar with fuel adjustment clauses being utilized by integrated electric utilities in the United States, most of which do not have a sharing mechanism. See GMO Ex. 37, Rygh Surrebuttal.

68. The Commission finds Mr. Rygh's background and experience relevant to this issue, and finds that his opinions are authoritative and credible.

69. Given that there is no evidence in the record that GMO has not competently managed its fuel operating expense, the investment community would take a negative view of the proposals before the Commission to change the 95/5 sharing mechanism to 75/25 or 70/30. See Ex. 37, Rygh Surrebuttal at 11, 14.

70. Given the lack of findings of imprudence by GMO in its fuel procurement practices, there is no basis for changing the existing FAC and past-through mechanism so that GMO is not able to pass through to its customers 95% of its prudently incurred fuel and related costs.

71. Since the Company's acquisition by Great Plains Energy Inc., it has achieved an improved financial outlook with investment grade credit ratings. See Ex. 210, Staff Report at 18-19 and App. 2, Att. E (noting BBB credit rating). At this time there is no basis for changing the 95/5 sharing mechanism, which would otherwise bring uncertainty to the minds of investors and raise unnecessary questions for a company with a good operating record. See GMO Ex. 37, Rygh Surrebuttal at 11-16.

b. Conclusions of Law

72. Section 386.266 established the policy for Missouri that cost recovery for prudently incurred fuel expenses should occur through the use of "periodic" or "interim" adjustments to rates.

73. The Commission finds as a matter of law that any deviation from the 95/5 sharing mechanism at this time without any finding or allegation of imprudence in the Company's fuel procurement process related to its generation, purchased power and off-system sales would be contrary to the legislative intent of Section 386.266.

VI. **Basis for Setting Off-System Sales and Rates**

a. Proposed Findings of Facts

74. The Company used 2009 normalized test-year data produced through the use of the MIDAS™ model to set rates for off-system sales. This process was also used to normalize test-year fuel and purchased power costs. See GMO Ex. 10 (Crawford Direct) at 5-9.

75. In this case the Commission accepted the agreement of the parties to use 2009 as the test year, with a true-up as of December 31, 2010. See Order Approving Nonunanimous Stipulation and Agreement, Setting Procedural Schedule, and Clarifying Order Regarding Construction and Prudence Audit at 2, ¶ 3 (Aug. 18, 2010).

76. Staff proposes to set rates for off-system sales using historical data from 2007-08 based upon its view that GMO's off-system sales for the last two years did not represent an adequate level of off-system sales. Consequently, Staff witness V. William Harris recommended that sales levels from 2007-08 be used. See Ex. 210, Staff Report at 77-78; Ex. 220, Harris Rebuttal at 2-4.

77. Substantial changes have occurred in the wholesale electricity market in the prices for electricity from 2007-09 to the present time. The average market price during 2007-08 was approximately $50/MWh, and since that time, the average price has dropped to approximately $30/MWh. See Ex. 11, Crawford Rebuttal at 16.

78. Data supplied by Company witness Michael Schnitzer of the NorthBridge Group reviewed SPP-North sport market prices for electricity, and indicated that electricity prices were higher in 2007-08 than in the period from 2009 to the present. See KCP&L Ex. 122. For example, the average around-the-clock price of electricity in SPP-North for the second quarter of 2007 and 2008 were $49.79 and $61.23, respectively, whereas the average price for the same commodity in the second quarter of 2010 was $30.40. Id. at 1.

79. Additionally, the operating costs of the units from which excess generation is sold in the wholesale market have risen since 2007-08, and, consequently, with higher expenses and lower prices, margins have decreased. See Ex. 11, Crawford Rebuttal at 16.

80. With the expiration of GMO's purchased power contract with Nebraska Public Power District and the addition of 153 MW from GMO's share of Iatan 2, off-system sales in 2011, even based on a test year of 2009 (as trued-up), will not be similar to the 2007-08 historical levels utilized by Staff. See Ex. 11, Crawford Rebuttal at 17.

81. GMO's predecessor Aquila and KCP&L had different interpretations of what was permissible under their respective Federal Energy Regulatory Commission (FERC) tariffs regarding the use of network transmission service to facilitate off-system sales. Tr. 4221-22 (Crawford).

82. In 2005 FERC clarified that it is not appropriate for a utility to use network transmission service to facilitate purchases of energy for resale at a profit, and this largely eliminated GMO's ability to purchase power for resale. See Ex. 6, Blanc Surrebuttal at 6; Tr. 4425-26. Since the acquisition of Aquila by Great Plains Energy in 2008, both Aquila and KCP&L have adhered to FERC policy which has contributed to a decline in off-system sales. Tr. 4221-22 (Crawford); Tr. 4225-27 (C. Blanc).

83. Staff's recommendation to use 2007-08 historical data to set off-system sales is not based upon any analysis or research concerning energy prices in the SPP-North region. Tr. 4228-29 (Harris). Staff's witness Mr. Harris failed to observe that natural gas prices have declined since 2007-08, which is significant since electricity prices in SPP-North are primarily the product of natural gas prices. See Ex. 6, Blanc Surrebuttal at 6; KCP&L Ex. 58, Schnitzer Direct at 6-7. Mr. Harris also failed to note that the region has experienced less demand for wholesale power as a result of the economic recession. See Ex. 6, Blanc Surrebuttal at 6.

84. Staff did not conduct any research regarding the use of network transmission service to facilitate off-system sales, and its witness was not familiar with FERC policies that govern network transmission service. Id.; Tr. 4230-31.

85. Staff's proposal to set rates for off-system sales based upon data that does not reflect test-year data from 2009, as trued-up, or the decline in electricity prices since 2007-08 is contrary to the Commission's traditional reliance upon a test-year in deciding general rate cases.

b. Conclusions of Law

86. Staff's recommendation to use 2007-08 data, instead of 2009 test-year data is inconsistent with the Commission's preference for test-year data. The purpose of a test year is to provide a period for which complete data is available in order to permit review by Staff and others, as well as to provide the Commission with a basis to estimate future revenue requirements. See C. Phillips, The Regulation of Public Utilities, (1993) at 196. While information other than the "strict test year" concept is permitted, such data typically reflects "a change that actually took place during or after the test year" or "a forward-looking test year." Id.

87. Missouri has followed the test-year concept and has not departed from it, except to account for future developments or to normalize a level of revenue or expense that will be "most representative of future expenses." In re Union Elec. Co., Report and Order, Case No. ER-2010-0036 (May 28, 2010) at 50. See State ex rel. Missouri Power & Light Co. v. PSC, 669 S.W.2d 941, 945 (Mo. App. W.D. 1984); State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 887-90 (Mo. App. W.D. 1981).

88. FERC has clarified that it is not appropriate for a utility to use network transmission service to facilitate purchases of energy for resale at a profit. See Mid-American Energy Co., 112 FERC ¶61, 346, 2005 WL 2430182 (2005). FERC stated in this case that utilities are not to use network service to advance their own off-system sales, and that network

transmission service should only be used to satisfy a utility's native load. In Mid-American the Audit Report of FERC Staff described a variety of irregularities, which the utility settled by agreeing to construct $9.2 million of previously unplanned transmission upgrades, and to forego recovery of all costs associated with these projects for six years from the time the assets are placed in service. Id. at 2-3. FERC approved the Audit Rpoert "in its entirety without modification." Id. at 3.

89. Regarding transmission service and off-system sales, the Audit Report stated: "MidAmerican's wholesale merchant function (Electric Trading) used network transmission service to deliver short-term energy purchases to a generator in its control area when it concurrently made short-term off-system sales. Electric Trading is allowed to use network transmission service to deliver energy from designated network resources and to deliver economy energy purchases to their network load. However, Electric Trading may not use network transmission service to deliver energy that is used to support off-system sales." Id. at 6.

90. Staff's proposal to set off-system sales based on data from 2007-08 is beyond the test year, is not representative of current energy prices, and is rejected.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 4th day of April, 2011, to all counsel of record.

/s/ Roger W. Steiner

Attorney for KCP&L Greater Missouri Operations Company