PUBLIC VERSION

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan.	)))))	**Case No. ER-2010-0355**
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**

POST HEARING BRIEF OF KANSAS CITY POWER & LIGHT COMPANY AND KCP&L GREATER MISSOURI OPERATIONS COMPANY

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BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan.	)))))	Case No. ER-2010-0355
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

POST HEARING BRIEF OF KANSAS CITY POWER & LIGHT COMPANY AND KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City Power & Light Company ("KCP&L") and KCP&L Greater Missouri Operations Company ("GMO")(collectively "the Companies") submit this Post Hearing Brief ("Brief") in the above-captioned proceedings.

1. Over the last five years, KCP&L has embarked upon a series of infrastructure and customer enhancement projects valued at over $2.64 billion, thereby fulfilling the commitments that it made in the Regulatory Plan approved by the Public Service Commission of the State of Missouri ("Commission") as part of the 2005 Stipulation and Agreement in Case No. EO-2005-0329 ("Stipulation" or "Regulatory Plan").[1] This is last of four rate cases contemplated by the Stipulation, in which KCP&L seeks a decision that appropriately reflects the risks KCP&L has

[1] More than six years ago, KCP&L, the Commission, the Staff of the Commission ("Staff"), the Office of Public Counsel ("OPC"), and various other parties actively participated in an extensive, collaborative process analyzing the long-term supply, delivery and pricing options available to KCP&L. This process culminated in a joint stipulation and agreement that set forth a comprehensive energy plan requiring KCP&L to make substantial investments in its electric infrastructure over a five-year period. The Stipulation may alternatively be referred to throughout this brief as the "Regulatory Plan," "Resource Plan" or "CEP".

undertaken in this endeavor, grants necessary increases in revenue, and sets a rate of return that will permit KCP&L and GMO to remain financially healthy.

2. In this case, the Companies have requested inclusion in permanent rates of their investments in the Iatan 1 Air Quality Control Systems ("AQCS"), the newly constructed supercritical coal-fired unit at the Iatan Station (referred to as "Iatan 2" and together referred to as the "Iatan Project"), and KCP&L's completion of 48 MW of additional wind turbines located at Spearville, Kansas. While the prudence of KCP&L's management decisions regarding these projects is the critical issue in this proceeding, there are also traditional rate case issues such as Cost of Capital, Rate Base Issues, including Crossroads and Jeffery, Fuel and Purchased Power, including off-system sales, other Operating and Maintenance Expenses, Taxes and DSM Issues that affected the Companies that must be decided by the Commission.[2]

3. KCP&L and GMO respectfully request that the Commission issue a fourth rate order that correctly balances the risks with the benefits as they affect customers, shareholders and creditors. The major factors affecting both KCP&L and GMO are the completion of the multi-billion dollar construction projects, including the Iatan 1 AQCS and the supercritical coal-

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[2] Many of the smaller traditional rate case issues have been settled among the parties. KCP&L, GMO, Staff and various other parties have filed Stipulations and Agreements which resolve the following issues: Depreciation and Regulatory Amortizations; Economic Relief Pilot Program (ERPP), Severance Expenses, Supplemental Executive Retirement Pension (SERP), Advertising, including the Connections Program issue, Bad Debts, Cash Working Capital–Gross Receipts Taxes and Injuries and Damages (KCP&L issue only), Cash Working Capital—Imputed Accounts Receivable Program (GMO issue only), Production Maintenance, Allocation of Off-System Sales Margins, Talent Assessment Program, Proposition C, Call Center Reports, Tracker for Iatan 2 and Iatan Common Operations and Maintenance Expenses, Transmission Expense and Revenue Tracker, SO2 emission allowance regulatory liability. *See* Non-Unanimous Stipulation and Agreement Regarding Depreciation and Accumulated Additional Amortization (filed February 2, 2011); Non-Unanimous Stipulation and Agreement as to Miscellaneous Issues (filed February 3, 2011); Settlements have also been filed among some of the parties resolving the Class Cost of Service and Rate Design Issues, Residential Space Heating Rates (MGE issue), Wagner and Outdoor Lighting issues. *See* Non-Uanimous Stipulation And Agreement As To Class Cost Of Service /Rate Design (filed February 4, 2011); Non-Unanimous Stipulation And Agreement As To Rate Design Issue (filed February 4, 2011); Non-Unanimous Stipulation And Agreement As To Outdoor Lighting Issue (filed February 3, 2011). KCP&L and GMO respectfully request that these Stipulations and Agreements be approved as submitted.

fired Iatan 2 unit. Specific issues to KCP&L only are the additional wind generation and the risk and uncertainty of the off-system sales ("OSS") market which in recent years have accounted for a substantial amount of KCP&L's revenues. Specific issues to GMO only include the Crossroads generating units and the Jeffery Energy Center construction improvements. Additionally, because GMO serves two rate jurisdictions, the allocation of the Iatan 2 costs between the two rate jurisdictions is also an issue in this proceeding. This allocation affects both the rate base determinations and the fuel and purchased power, including OSS, and other expenses attributable to each jurisdiction. Several issues exist with the Fuel Adjustment Clause ("FAC") at GMO, including whether fuels should be included in the rate adjustment determination and the percentage of cost sharing above the base fuel. The GMO-only issues will be addressed in a separate brief.

4. All of these issues pose major risks to the Companies. In particular, dollars associated with Staff's and MRA's proposed prudence disallowances of Iatan 1 and 2 and Staff's proposed adjustments related to the Merger Transition Costs, Hawthorn 5 Settlement, Cross Roads, Jeffery Energy Center, Rate Case Expenses and Iatan Regulatory Assets, that may be adopted by the Commission will mean that the Companies will have to permanently write off the amounts of the disallowances from their books. Unlike other rate case adjustments which may be only in effect until the next rate case, prudence disallowances of power plant expenditures are a permanent write-off of actual dollars spent to build the plant. This will have a material financial impact to the Companies' net income and its retained earnings in the period in which any such decision would be made final. Such an impact would weaken the Companies' business and financial risk profiles which could negatively affect Great Plains Energy's ("GPE") corporate credit rating and, by extension, the senior unsecured debt ratings of KCP&L and

GMO. As a result, these prudence issues in this case are extremely important to the Companies and their investors who will be called upon to put up additional funds for future projects that will need to be constructed to serve the customers. However, both KCP&L and GMO believe that if the Commission continues the policies established in the previous rate cases on these issues and other traditional issues, a proper balance will be struck that will permit both Companies to receive fair and reasonable treatment addressing both customer and shareholder interests.

5. The Companies are requesting a Return on Equity ("ROE") of 10.75%, based upon the upper end of Dr. Sam Hadaway's recommended range of ROEs. In his updated analysis, Dr. Hadaway is recommending an ROE in the range of 10.2% to 10.8%, based upon the most recent market data. *See* Hearing Exhibit KCP&L-28, Hadaway Rebuttal Testimony at pp. 2, 22, and Schedule SCH2010-11. Based upon Dr. Hadaway's updated analysis, the Companies have reduced their ROE requests in this case from 11.0% to 10.75%. The Companies continue to request, however, an ROE commensurate with the top of Dr. Hadaway's range to reflect the Companies' reliability and customer satisfaction achievements.

6. The Companies' T&D systems continued to perform at Tier 1 reliability levels. In addition, the PA Consulting Group awarded KCP&L the ReliabilityOne best performer award for the Plains Regions for the fourth consecutive year in 2010, as well as the National Reliability Excellence award in 2007.

7. In addition, the Companies are ranked as one of the highest-rated electric utilities in Customer Satisfaction, according to JD Power and Associates. In 2010, JD Power recognized the Companies as No. 1 in Customer Satisfaction among business customers in the Midwest Large electric utilities. Based upon these results, the Companies believe the Commission should utilize the top end of Dr. Hadaway's range.

8. The Additional Amortization mechanism for KCP&L (which has acted like accelerated depreciation) which has been used in previous cases, will not be utilized in this case. *See* Stipulation, § III (B)(1)(i) at 19. Instead, the Additional Amortizations that have accrued from previous cases will be used as an off-set to rate base in this case.

9. With regard to the OSS margin issue, KCP&L is advocating the continued use in this case of the methodology that has been adopted by the Commission for the OSS issue in the past three KCP&L cases. KCP&L proposes to establish the OSS Contribution Margin at the 25th percentile level of Michael Schnitzer's probabilistic analysis for the May 1, 2011 - April 30, 2012 period, with the tracking mechanism previously approved by the Commission. This approach to OSS has proven to be critically important as the OSS markets have continued to be very volatile. OSS Margins at GMO and all other Missouri utilities are included in the FAC mechanism and are not affected in the same way.

10. Proper consideration of these issues (as well as the issues discussed below) will lead to a decision that sets just and reasonable rates that properly balances the interests of shareholders and customers, and will give the Companies an opportunity to earn a reasonable rate of return following the conclusion of the Regulatory Plan.

I. INTRODUCTION

11. This case is the fourth and final rate case in the series of four rate applications that were contemplated in the Stipulation that was approved by the Missouri Public Service Commission in Case No. EO-2005-0329 ("329 Docket"). As demonstrated herein, the Stipulation established in the 329 Docket created a transparent, long-term process requiring KCP&L, Staff, the OPC, Missouri Department of Natural Resources ("MDNR"), Praxair, Inc. ("Praxair"), Missouri Industrial Energy Consumers ("MIEC") (collectively "Signatory Parties"), and other parties to this proceeding to work collaboratively over a five-year period to strengthen

the energy infrastructure needed to reliably serve KCP&L's Missouri consumers. This rate case is the pinnacle of that collaborative process. Notably, the regulatory road map for KCP&L in the Stipulation was comprehensive, addressing much more than just the construction of AQCS at Iatan 1 and the new generation at Iatan Unit 2.

12. KCP&L diligently executed the Regulatory Plan on a collaborative basis with all of the Signatory Parties. In the 329 Docket, KCP&L, the Commission, the Staff and the Signatory Parties had the foresight to address many of the issues presented in this proceeding affecting the investments made by KCP&L. Moreover, the 329 Docket established an unprecedented method for providing a continuous flow of information between the Signatory Parties that resulted in all parties' understanding every aspect of KCP&L's management of the successful completion of Iatan Units 1 and 2.

A. The Parties' commitments in the Stipulation

13. The Stipulation included commitments and rights accruing to all Signatory Parties. KCP&L committed to undertake commercially reasonable efforts to make the following investments:

- To build 100 MW of wind generation in 2006;
- To explore the potential for an additional 100 MW of wind in 2008;
- Proceed with environmental investments related to Iatan 1 and LaCygne 1 for accelerated compliance with environmental regulations;
- To invest in Transmission and Distribution facilities and upgrades; and
- To build 800-900 MW of new coal-fired generation at the Iatan Station, including state-of-the-art environmental equipment.

14. In addition, KCP&L agreed to:

- Propose a portfolio of Demand Response, Energy Efficiency and Affordability Programs for approval by the Commission;

- Monitor the reasonableness and adequacy of the Resource Plan throughout its implementation;

- Reassess the Resource Plan if changed circumstances arose that could impact the reasonableness and adequacy of the Plan;

- Provide quarterly reports to Staff and other Signatory Parties on the status of the Regulatory Plan's implementation, including the construction of Iatan Units 1 and 2;

- Impose a rate moratorium through December 31, 2006 and agree not to seek to utilize any mechanism authorized in legislation known as "SB 179" or other change 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;

- File a rate case in the first year and in the last year of the Regulatory Plan (with options to file rate cases in the second and third years);

- Not initiate a proceeding at the Commission to change KCP&L's rates during the term of the Plan except for the rate cases indicated in the Plan, unless a listed contingency occurred;

- Develop and implement a cost control system that would identify and explain cost overruns above the definitive estimate during the construction period of the Iatan 2 project, the wind generation projects and the environmental investments;

- Impute into rates the amount of reduced revenues related to discounts on special contracts with any customers;

- Record sales proceeds of SO_2 allowances as a regulatory liability and offset to rate base for ratemaking purposes to be reflected in rates beginning with the rates resulting from the final rate case;

- Agree that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes;

- Reduce the equity portion of the AFUDC rate for Iatan Unit 2 by 250 basis points;

- Give the Commission notice of any debt securities issued during the Plan;

- Not voluntarily incur material capital investment or expenses beyond those contemplated in the Stipulation without explicit approval by the Commission; and

- Take prudent and reasonable actions that do not place its investment grade debt rating at risk, an obligation that was heightened by the Stipulation;

15. The other Signatory Parties committed to the following:

- To support an amortization accounting in KCP&L's rate cases during the Plan designed to allow KCP&L's cash flow to meet financial ratios tied to the ratings for an investment grade company;

- To allow KCP&L to include in rate base in its rate cases filed under the Plan new investment anticipated to be in-service by the time rates from an anticipated case were to become effective;

- To not initiate a proceeding at the Commission to change KCP&L's rates during the term of the Plan except for the rate cases indicated in the Plan, unless a listed contingency occurred;

- To allow KCP&L to treat pension expense in a manner set forth in the Agreement, including allowing a regulatory asset for excess contributions to be included in rate base; and

- So long as KCP&L implemented the Regulatory Plan, and met its monitoring obligations under the Agreement, signatories agreed not to take the position that the investments under the Plan should be excluded from rate base on the ground that the projects were not necessary or timely, or that alternative technologies or fuels should have been used by KCP&L.

16. KCP&L has undertaken significant risk and responsibility in order to comply with all of its commitments made under the Commission-approved Stipulation. By all objective standards, the Stipulation has been a successful agreement, one that has resulted in KCP&L providing its customers with renewable energy, reliable transmission and distribution, programs to manage their energy usage, environmental upgrades to existing coal-fired generating facilities, and a significant base load supply of electricity for decades at the lowest possible cost.

B. KCP&L's Compliance with the Resource Plan

17. Under the terms of the Stipulation, KCP&L agreed to an unprecedented level of transparency in reporting on the building of these investments. KCP&L followed the requirements and met each of its obligations enumerated in the Stipulation. KCP&L provided

quarterly "Strategic Infrastructure Investment Status Reports" to the Staff, OPC, and the Signatory Parties, (the "Quarterly Reports"), and participated in meetings to explain the reports and to provide the parties an opportunity to raise questions or concerns (the "Quarterly Meetings"). KCP&L's team attending the Quarterly Meetings included key members of the Iatan Project team, who both presented information regarding the Iatan Project's status and answered any questions that arose. As an example, KCP&L reported in the third quarter of 2007 that it discovered the Iatan Project's Control Budget Estimate ("Control Budget Estimate" or "CBE") would have to increase due to prudently incurred costs. KCP&L reported such to Staff and the other Signatory Parties in the ensuing Quarterly Reports and Quarterly Meetings, and KCP&L was completely transparent in the execution of its reforecast of the Iatan Project's costs. There were no surprises to Staff and the Signatory Parties related to the Iatan Project as KCP&L had been reporting the status, and concerns, of the project in its Quarterly Reports since first quarter 2006.

18. The Stipulation gave Staff (and other Signatory Parties) the ability to challenge the Resource Plan if a change in circumstances occurred, including increased costs of Iatan 2, that Staff believed affected the reasonableness and adequacy of the Regulatory Plan, or if Staff believed that KCP&L had failed to comply with the Regulatory Plan. *See Stipulation Section III. B. 1. 0. XI11 (p. 26, ¶ II to p. 27, ¶ III).* No such action was ever taken by any Signatory Party, even in light of the increased costs for Iatan 2. As explained herein, KCP&L met all of its obligations under the Stipulation and the Resource Plan continued show that KCP&L's investments were reasonable and necessary.

1. KCP&L complied with the reporting requirements contained in the Stipulation and was transparent in its reporting of key events and risks as they became known.

19. Section III.B.4. of the Stipulation identifies the required level of KCP&L's reporting of the CEP Projects:

> KCPL shall provide status updates on these infrastructure commitments to the Staff, Public Counsel, MDNR and all other interested Signatory Parties on a quarterly basis. Such reports will explain why these investment decisions are in the public interest. In addition, KCPL will continue to work with the Staff, Public Counsel and all other interested Signatory Parties in its long-term resource planning efforts to ensure that its current plans and commitments are consistent with the future needs of its customers and the energy needs of the State of Missouri.

See Stipulation and Agreement at III.B.4, p. 46.

20. KCP&L complied with this requirement by providing nineteen (19) written Quarterly Reports to Staff, OPC, and any other interested party, starting with the first quarter of 2006 through the third quarter of 2010. *See* Hearing Tr. pp. 1160-64; Evidentiary Hearing Exhibits 69, 70 and 71; Giles Direct Testimony at p. 19, ln. 20, to p. 24, ln. 5; Giles Rebuttal Testimony at p. 2, ln. 18-19; p. 4, ln. 4-7; p. 8, ln. 15-20; p. 38, ln. 1 to p. 39, ln. 19. KCP&L recently submitted the 20th Quarterly Report on February 15, 2011. Those Quarterly Reports discuss the status of the Regulatory Plan infrastructure investments, and other specific significant issues existing during the reporting period. KCP&L also met regularly with Staff, OPC, and representatives of the Signatory Parties to discuss the contents of the Quarterly Reports, as well as provide more current information if available at the time of the meeting. *See* Hearing Tr. pp. 1160-64. Several witnesses discussed KCP&L's transparent reporting of the CEP's costs and schedule status. *See* Hearing Tr. p. 1022 ln. 3-10 (Giles); p. 1111, ln. 17 to p. 1113, ln. 1 (Giles); p. 1165, ln. 5-17 (Giles); Hearing Exhibits KCP&L-4, Archibald Rebuttal Testimony at pp. 41-46; KCP&L-24, Giles Direct Testimony at pp. 18-24; KCP&L-25, Giles Rebuttal Testimony at pp. 8-9; 20-27; 38-39; KCP&L-43, Meyer Direct Testimony at pp. 36-38; *see also* Exhibit KCP&L-66. KCP&L also provided Staff with ongoing access to its project management team,

and provided Staff with private facilities on-site and at its corporate offices. This transparency was an integral part of KCP&L's agreement in the Stipulation, as it permitted all Signatory Parties the opportunity to monitor first-hand the progress of the Resource Plan.

21. In addition, the Missouri Retailers Association's ("MRA") consultant, Walter Drabinski and his colleagues from Vantage Consulting, also received the Quarterly Reports and attended the Quarterly Meetings that KCP&L held with the Kansas Corporation Commission ("KCC") Staff. Mr. Drabinski visited the Iatan Project site and met with KCP&L on seventeen (17) separate occasions. KCP&L responded to Mr. Drabinski's data requests and provided to Mr. Drabinski unfettered access to KCP&L's project personnel, its consultants, and the Iatan Project documentation. Mr. Drabinski agreed that the information provided was sufficient for him to perform a prudence analysis. *See* Hearing Tr. p. 1586, ln. 22 to p. 1590, ln. 25.

22. The Quarterly Reports identified the Iatan Project's risks as they were known throughout the Project and KCP&L's strategy for mitigating those risks. In the first quarter 2007 Quarterly Report, KCP&L began including a specific section entitled "Identification of Project Risks" to describe the key issues recognized by management regarding Iatan Unit 2. *See* Exhibit KCP&L-71, Report Dated May 17, 2007; *see also* Hearing Exhibits KCP&L-24, Giles Direct Testimony at pp. 18-26; KCP&L-25, Giles Rebuttal Testimony at pp. 37-41. The risks identified and tracked in the Quarterly Reports were primarily the same risks that KCP&L identified in the analysis of contingency that was performed in establishing the Control Budget Estimate in December 2006.[3] *See* Hearing Exhibits: KCP&L-24, Giles Direct Testimony at p 20, ln. 1, to p. 24, ln. 5; KCP&L-25, Giles Rebuttal Testimony at p. 39, ln. 12-19; and p. 40, ln. 10 to p. 41, ln.

[3] The Control Budget Estimate is the Project's Definitive Estimate and this Brief will use these terms (Control Budget Estimate and Definitive Estimate) interchangeably.

14. Mr. Giles describes in his testimony the risks and mitigation plans that KCP&L was tracking throughout the life of the Project. *See* Hearing Exhibit KCP&L-24, Giles Direct Testimony at p. 20, ln. 3 to p. 24, in. 5.

2. KCP&L complied with the Cost Control Process for Construction Expenditures.

23. KCP&L diligently complied with the requirements in the Stipulation regarding the cost control process for construction expenditures. Section III.B.1.q. of the Stipulation requires that KCP&L do the following:

> KCPL must develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate during the construction period of the Iatan 2 project, the wind generation projects and the environmental investments.

See Stipulation, Section III.B.1.q. at p. 28.

24. KCP&L met this obligation under the Regulatory Plan. The plain language of the Stipulation requires KCP&L to: (1) develop a cost control system with the capabilities of identifying and explaining cost overruns above the Project's Definitive Estimate; (2) develop a Definitive Estimate; and (3) report on the progress of the Iatan Project based on the Definitive Estimate, which KCP&L has also called its Control Budget Estimate.

25. KCP&L has complied with each of these requirements. First, KCP&L developed a comprehensive Cost Control System which provides key guidance to each of the CEP Projects governed by the Stipulation. *See* Hearing Exhibit KCP&L-38, Jones Direct Testimony at Schedule SJ2010-1. KCP&L's Cost Control System, which was transmitted to the Staff and the other Signatory Parties' representatives on July 10, 2006, "describes the governance considerations, management procedures, and cost control protocols for the CEP Projects" including the Iatan Project. *See* Hearing Exhibits: KCP&L-25, Giles Rebuttal Testimony at p. 21, ln. 9-11; KCP&L-38, Jones Direct Testimony at Schedule SJ2010-1, p. 3. On July 11, 2006,

KCP&L representatives met with members of the Staff and the other interested parties. Mr. Giles testified that the meeting went very well and Staff raised no concerns. *See* Hearing Exhibit: KCP&L-25, Giles Rebuttal Testimony at p. 22, ln. 17-19. Additionally, KCP&L has conducted quarterly meetings addressing Project issues, including costs, and provided Staff with thousands of well-organized and detailed documents describing and explaining the cost overruns and has explained to Staff multiple times in face-to-face meetings how the documents can be used to identify and explain the overruns on the Iatan Project. *See* Hearing Exhibit: KCP&L-25, Giles Rebuttal Testimony at p. 4, ln. 4-7. Further, the Cost Control System states that the Iatan Project's cost performance would be measured against the Project's Control Budget Estimate (i.e. Definitive Estimate), and to do so, the Iatan Project's Control Budget "will identify the original budget amount (whether contracted or estimated) for each line item of the Project's costs and will track those budget line items against the following:

- Costs committed to date
- Actual paid to date
- Change orders to date
- Expected at completion, based on current forecasts."

See Hearing Exhibit KCP&L-38, Jones Direct Testimony at Schedule SJ2010-1, at p. 17. The Cost Control System also identified the Iatan Project's actual and budgeted costs would be tracked in comparison to Iatan Unit 1 Project's and Iatan Unit 2 Project's respective Definitive Estimates. The Cost Control System states that:

> The Project Team will develop a Definitive Estimate for each Project that will provide an analytical baseline for evaluating Project costs. The estimate will establish anticipated costs for individual work activities and all procurements,...The Definitive Estimate will be used to establish each Project's Control Budget.

See Hearing Exhibit KCP&L-38, Jones Direct Testimony at Schedule SJ2010-1, at p. 8.

26. Second, KCP&L created a Definitive Estimate. KCP&L's pre-filed Testimony describes in detail the process KCP&L used for developing the Control Budget Estimates for both Iatan 1 and 2. *See* Hearing Exhibits KCP&L-24, Giles Direct Testimony at p. 15, ln. 14 to p. 18, ln. 15; KCP&L-43, Meyer Direct Testimony at p. 6, ln. 12 to p. 16, ln. 3. Both Staff and KCP&L agree that for purposes of the Stipulation, the Control Budget Estimate would serve as the baseline budget for the Projects and the Definitive Estimate from which the Iatan Units 1 and 2 Projects would be measured. *See* Hearing Tr. pp. 1095-97 (testimony of Chris Giles), Hearing Tr. pp. 2643-44 (testimony of Charles Hyneman), and Staff's Position Statement, p. 9.

27. Third, KCP&L met its obligation to report on the status of the Definitive Estimate. Once each Project's Control Budget Estimate was in place, the Iatan Project team began tracking costs in the manner described in the Cost Control System. *See* Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony at p. 20, ln. 15 to p. 22, ln. 19. As the Iatan Project progressed, KCP&L met its obligation to "identify and explain" all cost overruns on the Iatan Project. KCP&L's prefiled testimony and hearing testimony demonstrates that KCP&L complied with this requirement. With the Definitive Estimate in place, the Iatan Project team developed a "Cost Portfolio" which it uses for day-to-day tracking and management of Iatan Project's costs. *See* Hearing Exhibit KCP&L-4, Archibald Rebuttal Testimony at p. 3, ln. 19 to p. 4, ln. 10. KCP&L's Cost Portfolio comprises the necessary management reports and information needed for cost tracking, cash flow, change order tracking and management. *Id.* Within the Cost Portfolio, there is a specific report entitled the "K-Report" which is the report that delineates discrete line items of cost including each and every budget change that has occurred along with all costs actually expended. *Id.* KCP&L has provided this report to Staff in summary form each quarter since the creation of the Control Budget Estimate in the first quarter

of 2007, and has provided Staff with access to the detailed Cost Portfolio on a monthly basis since that time. *See* Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony at p. 22, ln. 26 to p. 23, ln. 6.

28. In fact, Forrest Archibald testified that KCP&L's Cost Control System is so robust that it allows any interested party to this matter to track every dollar that KCP&L spent on the Iatan Project, regardless of whether the costs were anticipated in the Control Budget Estimate or constitute a cost overrun to the Control Budget Estimate: "Our system allows you to track through every dollar that's spent from cradle to grave and understand where it was spent and wherever the overrun occurred." *See* Hearing Tr. pp. 2176-77. Two of KCP&L's expert witnesses, Dr. Kris Nielsen of Pegasus-Global and Mr. Daniel Meyer, a sub-consultant to Schiff Hardin, each testify that KCP&L's cost control system is consistent with industry best practices. *See* Hearing Exhibits KCP&L-43, Meyer Direct Testimony at p. 5, ln. 10; KCP&L-46, Nielsen Rebuttal Testimony at p. 249, ln. 23 to p. 250, ln. 5.

29. Staff admits that KCP&L's cost control system has the ability to track cost overruns. As the Staff's own report states: "KCPL's control budget is very detailed with hundreds of line items. It is clear that KCPL has the ability to track, identify and explain control budget overruns." *See* Hearing Exhibit KCP&L-205, Staff's November 3, 2010 report titled "Construction Audit and Prudence Review – Iatan Construction Project For Costs Reported as of June 30, 2010" ("Staff's November 2010 Report"), at p. 37, ln. 10-12.

30. In keeping with the collaborative process that KCP&L began when it negotiated the Stipulation, KCP&L made every effort at every stage of the process to be fully transparent and accommodating for all the Signatory Parties to access its records and information to ensure that the Iatan Project stayed on track, as well as self-reporting all variances in cost and schedule.

See Hearing Exhibits: KCP&L-25, Giles Rebuttal Testimony at p. 20, ln. 7 to p. 25, ln. 6; KCP&L-44, Meyer Rebuttal Testimony at p. 9, ln. 11 to p. 11, ln. 4. Moreover, KCP&L transparently reports each and every major decision that KCP&L makes, the basis for those decisions, the risks both real and perceived and the implications to those decisions to the Project's cost and schedule so that Staff could render its own independent assessment to the Commission regarding KCP&L's prudence. *See* Hearing Exhibits: KCP&L-25, Giles Rebuttal Testimony at p. 20, ln. 22 to p. 23, ln. 14; *see also* KCP&L-4, Archibald Rebuttal Testimony at p. 14, ln. 20 to p. 15, ln. 2. As a prime example of this transparency, KCP&L invited the Staff to participate in the 2008 cost reforecast process (*see* Hearing Tr. pp. 1092-92), and all of the documents that KCP&L generated in each cost reforecast (collectively the "Cost Reforecasts") were timely provided to Staff for its review. KCP&L also met with Staff at the conclusion of each of the Cost Reforecasts to discuss the resultant changes to the Iatan Project's projected estimate at completion ("EAC"). *See* Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony at p. 24, ln. 16 to p. 25, ln. 6.

II. ANALYSIS OF ISSUES IN THIS RATE CASE

A. Prudence Analysis

31. Over the last five years, KCP&L has diligently worked to build 100.5 MW of wind power in Spearville, retrofit environmental AQCS controls on Iatan Unit 1, complete the LaCygne Unit 1 SCR project, and design, build and start-up Iatan Unit 2—the largest construction project in the State of Missouri in over a decade—as agreed upon in the Stipulation. The Iatan Project team worked through an economic boom followed by a deep global recession, an enormously challenging construction environment, and extreme weather conditions to finish the Iatan Project. The result of these efforts is the completion of Iatan 2, a high efficiency 850 MW power plant with state-of-the-art environmental equipment, within 16% of its original

Control Budget Estimate and within three months of an aggressive target completion date set over five years ago.

32. KCP&L has presented in its pre-filed testimony abundant evidence of its prudent management and decision-making throughout the entirety of the Iatan Project that was not rebutted by Staff or MRA. Much of that testimony was ignored, and in its place, Staff and MRA have engaged in a hindsight review, claiming that the mere fact that cost overruns occurred is sufficient proof of KCP&L's imprudent management.

33. Based on Staff's November 2010 Report and as updated by the True-Up proceeding, Staff has recommended that the Commission order a $186,554,799 disallowance of the total cost of Iatan 2 (or $54,604,310 KCP&L Missouri Jurisdictional share and $33,579,864 GMO share) and a $73,255,114 disallowance of the total cost of Iatan 1 (or $27,434,040 KCP&L Missouri Jurisdictional share and $13,185,921 GMO share)[4]. These amounts represent the actual cost that KCP&L has expended for both Units that are above the Control Budget Estimate as of October 31, 2010, the cut-off date for Staff's True-Up testimony.

34. Staff's disallowance recommendations can be divided into two categories: (1) specific enumerated adjustments in the amount of $51,092,048 for Unit 1 ($19,133,972 KCP&L Missouri Jurisdictional share and $9,196,569 GMO share) and $81,103,094 for Unit 2 ($23,738,754 Missouri Jurisdictional share and $14,598,557 GMO share; and (2) a bucket of

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[4] For ease of reference, KCP&L has provided the Commission with the updated amounts for each of Staff's disallowances from its November 2010 Report as updated in the True-up proceeding. These amounts and all references to the dollar amounts of Staff's recommended disallowances herein reflect the issue that Staff initially raised in its report and the actual costs expended by KCP&L as of October 31, 2010 for those items. There are certain other revisions to Staff's November 2010 Report that were reflected in the True-up case which will be noted herein. In addition, KCP&L provides the Missouri Jurisdictional and GMO shares of these proposed disallowances and the remaining amounts referenced herein on the initial discussion of these amounts in this Brief only. All other references to the amounts of Staff's or MRA's recommended disallowances will be "whole plant" numbers, or the sum and total of the proposed disallowances without regard to these jurisdictional amounts.

"unexplained/unidentified" cost overruns in the amount of $22,163,066 for Iatan 1 ($8,300,068 KCP&L Missouri Jurisdictional share and $3,989,352 GMO share) and $105,451,705 for Iatan 2 ($30,865,556 Missouri Jurisdictional share and $18,981,307 GMO share).

35. The MRA, based upon the analysis of its prudence consultant, Mr. Walter P. Drabinski of Vantage Energy Consulting, LLC, has recommended that the Commission order a $13,938,795 disallowance for Iatan 1 (or $5,220,079 KCP&L Missouri Jurisdictional share and $2,508,983 GMO share) and a $230,955,466 disallowance of the total cost of Iatan 2 and Common Plant (or $67,600,318 KCP&L Missouri Jurisdictional share and $41,571,983 GMO share).

36. On the ultimate issue of KCP&L's prudent management of the Iatan Project, KCP&L advocates the Commission utilize the following analysis in its decision-making process:

- Staff has recommended a disallowance of 100% of the costs above the Definitive Estimate, a budget that was set in December 2006 when the project was 20-25% engineered. In making its recommendation, Staff has not performed a proper prudence analysis or provided sufficient evidence to support such a disallowance under Missouri law.

- As a subset of its recommended disallowances, Staff has failed to factually support the specific disallowances for Iatan 1 totaling $51 million (whole plant) and $81 million (whole plant) specific disallowances for Iatan 2.

- MRA's recommendation to the Commission is based on Mr. Drabinski's recommended disallowance of $231 million for Iatan 2 (whole plant). That analysis is mathematically and substantively incorrect. As discussed herein, KCP&L vehemently disagrees with Mr. Drabinski's opinions, both on prudence and on quantification of the disallowance.

- KCP&L's independent expert Dr. Nielsen determined that a maximum of $18 million (KCP&L Missouri jurisdictional share $5,286,324 million and GMO share $3,250,916) should be disallowed by the Commission. KCP&L agrees that Dr. Nielsen followed appropriate processes in coming to his opinions, though disagrees with Dr. Nielsen regarding the prudence of decisions underlying his recommended disallowances.

- KCP&L has provided credible, substantive and competent evidence that all of its expenditures on the Iatan Project have been prudent.

37. In order to determine whether the utility's costs were appropriately incurred, the Commission uses a prudence standard. *See State ex re. Associated Natural Gas Co. v. Public Service Commission*, 954 S.W.2d 520, 523 (Mo. App. 1997). Under the prudence standard, the Commission looks at whether the utility's conduct was reasonable at the time, under all the circumstances. *Id.* at 529. In applying this standard, the Commission presumes that the utility's costs were prudently incurred until a serious doubt is created with regard to the prudence of an expenditure. *Id.* at 528. Therefore, Staff and MRA bear the burden to "raise a serious doubt" as to the imprudence on the part of KCP&L.

38. However, Staff has failed to meet this burden with respect to several of its specific disallowances as well as the catch-all category of its "unidentified/unexplained" cost overrun adjustment. In the event that the Commission believes that Staff has raised a serious doubt, KCP&L has fully justified the prudence of those specific expenditures. MRA has failed to meet this burden in its "holistic" approach to evaluating prudence and the disallowance amount. Neither Staff nor MRA has demonstrated that their proposed prudence disallowances are supported by facts or a competent analysis as required by Missouri law.

39. Moreover, Staff's proposed prudence disallowances are not based on the type of analysis and findings that supported prior Commission findings concerning prudence disallowances, as discussed at length in the Commission's orders concerning the Wolf Creek Nuclear Generating Facility (*In Re Kansas City Power and Light Company et al.*, 75 P.U.R. 4th 1 (1986)) and the Callaway Nuclear Plant (*In Re Union Electric Company et al.*, 66 P.U.R.4th 202 (1985)). Staff and MRA have failed to provide causation or a nexus between any alleged imprudence by KCP&L and the recommended costs which they are advocating the Commission

to disallow. In essence, Staff is proposing that KCP&L's shareholders should be responsible for costs that Staff has not proven, nor can it prove, were caused by KCP&L's allegedly imprudent actions.

40. Staff and MRA have failed to demonstrate that the prudence disallowance for the Iatan Project should equal or exceed the disallowances assessed in either Callaway and Wolf Creek. Staff's and MRA's proposed prudence disallowances in this case are unreasonable when compared to the Commission's findings in the Wolf Creek and Callaway cases. Until now, Staff has never suggested – and the Commission has certainly never previously adopted – an approach that would disallow every expenditure a utility makes in excess of a project's control budget estimate. In both Callaway and Wolf Creek, the original control budget estimates for each project was approximately $1 billion. Ultimately, each plant cost nearly $3 billion. To do what Staff proposes here, the Commission would have disallowed nearly $2 billion in cost overruns on each of the Wolf Creek and Callaway projects. That would have been unreasonable, and it is not what occurred.

41. In *Wolf Creek,* for example, the Staff performed a comprehensive construction audit and prudence review involving numerous witnesses covering numerous disciplines to arrive at a recommended prudence disallowance of approximately $200 million—about 7% of total project costs and only about 11% of the excess costs above the control budget estimate. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 16, ln. 15 to p. 18, ln. 9. Below is a side-by-side comparison of the Callaway, Wolf Creek and Iatan 2 projects.

Callaway/Wolf Creek/Iatan Unit 2 Disallowance Comparison			
	Callaway	**Wolf Creek**	**Iatan 2**
Definitive Estimate	$1,088,000,000	$ 1,033,000,000	$ 1,685,000,000 (Dec. 2006 Control Budget Estimate)
Cost at Completion	$2,987,248,000	$ 2,900,000,000	$ 1,948,000,000 (estimated)
Difference (Definitive Estimate to Cost at Completion)	$1,899,248,000	$ 1,867,000,000	$ 303,000,000
Cost Increase over Definitive Estimate (%)	175%	181%	15.6%
Schedule	Approx. 3 years (33 month delay)	>2 years late	< 3 months after Regulatory Plan Target Date
Total Disallowance (Staff's Proposal)	$383,716,000	$ 200,000,000	$186 million based upon Staff's true-up number and potentially up to $263 million
Disallowance (% of Costs to Complete)	12.8%	7%	7% (potentially 14%)
% of Cost in Excess of the Definitive Estimate Disallowed	20%	11%	100%

1. The Prudence Standard, the Applicable Burden of Proof

(a) The Prudence Standard.

42. The prudence standard is articulated in the *Associated Natural Gas Case* as follows:

> [A] utility's costs are presumed to be prudently incurred.... However, the presumption does not survive "a showing of inefficiency or improvidence."
>
> ...[W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling

> these doubts and proving the questioned expenditure to have been prudent. (Citations omitted).
>
> In the [Union Electric] case, the PSC noted that this test of prudence should not be based upon hindsight, but upon a reasonableness standard:
>
> [T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.

See State ex. Re. Associated Natural Gas v. Public Serv. Comm'n, 954 S.W.2d 520, 528-529 (Mo. App. W.D. 1997).

43. Furthermore, in order for the Commission to disallow a utility's recovery of costs from its ratepayers, the Commission must apply the following two pronged test: (1) evaluate whether the utility acted imprudently (that is, did not act reasonably at the time under the applicable circumstances); and 2) evaluate whether such imprudence was the ***cause*** of the harm (increased costs) to the utility's ratepayers. *See* Hearing Exhibit KCP&L-205, Staff November 2010 Report at p. 10, ln. 1-4; s*ee also Associated Natural Gas*, 945 S.W.2d at 529.

44. This two-pronged analysis is especially important in light of Staff's focus on cost "overruns"—the amount that the Iatan Project exceeded the Definitive Estimate. The fact that a particular estimate, particularly an early estimate, did not contain every single design element or project scope is not imprudent. As the design of a project progresses and matures, it is not unreasonable or imprudent for costs to increase based on additional scope added as the project's design becomes more defined. The industry terminology for this concept is known as "betterment" also known as "added first benefit rule" and "added value." Courts have held that an entity that provides cost estimates based on a design that is not complete is not responsible for increased costs if those costs would have been incurred by the project if the design had been perfect from the outset. *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 23,

ln. 6-14. That is, a Project's ultimate cost cannot be deemed imprudent because an initial estimate did not include all project elements.

45. One of the most-cited cases regarding this issue is that of *St. Joseph Hosp. v. Corbetta Constr. Co., Inc.*, 21 Ill. App. 3d.925 (1st Dist. 1974). *Corbetta*, stands for the proposition that if a project does not include certain design elements, even if it should, liability for the increased costs associated with those design elements on the entity who developed the cost estimate is not appropriate merely due to the fact that the cost estimate was low. Such costs, according to *Corbetta* and other, similar case law, would unjustly enrich the party that would have had to pay for those design elements had they been known prior to the issuance of the estimate. Other cases include *Lochrane Engineering, Inc. v. Willingham Real-Growth Investment Fund*, Ltd., 552 So.2d 228 (Fla. App., 1989), rev. denied, 563 So.2d 631 (Fla. 1990) (design engineer not responsible for additional costs if the owner would have paid for omitted items had those items been in the original design); *see also* BRUNER, PHILIP L. & O'CONNOR, PATRICK J., BRUNER AND O'CONNOR ON CONSTRUCTION LAW §§ 19.7, 19.8, 19.26 to 19.29 (2010); *see also Ben Patrick, the Added first Benefit Rule*, 24 CONSTR. LAW. 26 (Summer 2004).

46. The concept of betterment is particularly well-suited for a prudence analysis. Simply because the costs of the Iatan Project exceeded the Definitive Estimate, does not, by itself, mean that KCP&L acted imprudently. Staff has the burden to establish that the additional costs to the Iatan Project were avoidable, and ultimately were incurred as a result of the imprudent actions of KCP&L. Under the theory of betterment, the Definitive Estimate, which was developed at 20-25% engineering, did not include the full scope or design of the completed project. As a result, additional costs were incurred for items necessary to complete the design.

Mistakes or omissions in an estimate are not "avoidable" costs. These costs would have been incurred even if there had been no mistakes or omissions in the Definitive Estimate and as a result were not incurred unnecessarily due to KCP&L's imprudent actions.

47. In the *Union Electric* case, the Commission stated that in determining prudence on a large construction project there were two central questions: 1) Did the utility properly manage this complex project?; and 2) Did the utility properly manage matters within its control? *See Union Electric* 66 P.U.R.4th at 213. This question of control is a particularly important one, because in some instances KCP&L had limited ability to influence the performance of the contractors on site. Therefore, as long as KCP&L did everything in its control to prudently manage the contractors and encourage performance under the contracts, KCP&L has prudently managed the project despite the contractor's failure to perform. KCP&L used every means at its disposal to prudently manage the contractors including daily and weekly meetings, evaluation of performance data, active contract managers and contract administration, mediation, settlements, and incentives to manage the Iatan Project to the lowest possible cost and shortest possible schedule.

48. It does not appear that there is any disagreement among the parties regarding the definition of prudence, as both Staff and KCP&L have cited the same applicable case law. Where the parties disagree, however, is whether Staff can, in addition to (or even in lieu of) a prudence analysis, expand its analysis to look at whether a specific construction expenditure is a "benefit to rate payers." Staff is arguing that even though an expenditure might be prudent, unless Staff agrees that there is a benefit to rate payers, then the costs cannot be allowed. In the context of a construction project, this is a highly subjective notion and is not part of the prudence

analysis. Staff's position clearly goes against settled law. The Companies are entitled to put into rate base all Iatan Project costs that were prudently spent.

(b) Burden of Proof

49. As stated above, under the prudence standard, the Commission presumes that the utility's costs were prudently incurred. *See State ex. Re. Associated Natural Gas v. Public Serv. Comm'n,* 954 S.W.2d 520 (Mo. App. W.D. 1997); *State ex rel. GS Technologies Operating Co. Inc. v. Public Serv. Comm'n,* 116 S.W.3d 680 (Mo. App. W.D. 2003) (citations omitted). *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 9, ln. 26-29. This means that utilities seeking a rate increase are not required to demonstrate their cases-in-chief that all expenditures were prudent. *See Union Electric,* 66 P.U.R.4th at 212.

50. Staff or any other party can challenge the presumption of prudence by creating "a serious doubt" as to the prudence of an expenditure. Once a serious doubt has been raised, then the burden shifts to KCP&L to "dispel those doubts" and prove that the questioned expenditure was prudent. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 9, ln. 6-11.

51. Missouri case law has described the showing necessary to create a serious doubt sufficient to shift the burden back to the utility. In the *Associated Natural Gas* case, the Missouri Court of Appeals held that the Staff must provide evidence that the utility's actions caused higher costs than if prudent decisions had been made. *See Associated Natural Gas*, 945 S.W.2d at 529. Substantive and competent evidence regarding higher costs includes evidence about the particular controversial expenditures and evidence as to the "amount that the expenditures would have been if the [utility] had acted in a prudent manner." *See id.* In other words, Staff or the other parties must satisfy the following two-pronged evidentiary test to support a disallowance: 1) identify the imprudent action based upon industry standards and the circumstances at the time the decision or action was made; and 2) provide proof of the increased costs caused by KCP&L's

imprudent decisions. To meet this standard, a party must provide substantive, competent evidence establishing a causal connection or "nexus" between the alleged imprudent action and the costs incurred.

52. If Staff or MRA succeed in creating a serious doubt through the requisite showing of evidence, then the burden shifts back to KCP&L to provide specific evidence that the expenditures were in fact prudent. Simply stating, as Staff does, that a party *believes* the costs to be higher due to KCP&L's actions, without evidence, is not sufficient to raise a serious doubt of imprudence on the part of KCP&L. Neither Staff nor MRA have met their burden of proof in order to raise a serious doubt.

53. As discussed in more detail in subsequent sections of this Brief, Staff has failed to raise a serious doubt by any of its disallowances. A good example of Staff's failure to create a serious doubt (which will be discussed in more detail in a subsequent section of the Brief) is the proposed disallowance titled "Unexplained Cost Overruns." This category is comprised of $22,163,066 for Iatan 1 and $105,451,705 for Iatan 2. Staff 's categorical disallowance of these costs is based on the erroneous assumption that KCP&L has the burden of proof of explaining and supporting each and every cost overrun on the Iatan Project in its case-in-chief. However, KCP&L possesses the benefit of a presumption of prudence under Missouri law. KCP&L's Regulatory Plan required KCP&L to implement a cost control system that identified and explained cost overruns above the Definitive Estimate. KCP&L has provided ample evidence that its cost control system does this, and such information was either provided to or made available to Staff. This does not change the burden of proof.

54. Similarly, MRA, who hired an independent consultant, Walter Drabinski, has also failed to meet its burden to raise a serious doubt with respect to any of its proposed

disallowances. Mr. Drabinski's proposed disallowances are based on a hindsight analysis, which is prohibited by Missouri law. Mr. Drabinski has also failed to provide causation or a nexus between any alleged imprudence by KCP&L and the recommended disallowances. In essence, Mr. Drabinski is proposing that KCP&L's shareholders should be responsible for cost overruns even when it has not been proven that KCP&L acted imprudently..

2. KCP&L's Actions and Decisions in the Construction of Iatan 2 Were Prudent

55. As demonstrated in KCP&L's Direct Testimony, Rebuttal Testimony, Surrebuttal Testimony and during the evidentiary hearing, based on the applicable standard for prudence as well as previous court and Commission decisions, KCP&L has made reasonable and prudent decisions in the development and management of the Iatan Project.

56. The Iatan Project was a complex project that required KCP&L to establish new processes, procedures, governance and oversight to ensure that KCP&L met its commitments. *See* Hearing Exhibits KCP&L-21, Downey Direct Testimony at p. 2, ln. 21 to p. 8, ln. 19; KCP&L-38, Jones Direct Testimony at p. 3, ln. 20 to p. 12, ln. 8; KCP&L-50, Roberts Direct Testimony at p 6, ln. 18 to p. 19, ln. 3.

57. KCP&L has presented significant and competent evidence showing that its actions were transparent and consistently just, reasonable and prudent. KCP&L instituted management oversight through the Executive Oversight Committee ("EOC") which is comprised of key members of KCP&L's Senior Management. *See* Hearing Exhibit KCP&L-21, Downey Direct Testimony at p. 2, ln. 15-18. The EOC required the project management team to implement the proper tools and to provide accurate, unbiased and timely information at all times needed for proper decision-making. *See* Hearing Exhibit KCP&L-21, Downey Direct Testimony at p. 3, ln. 21 to p. 8, ln. 7.

58. KCP&L also employed the services of Schiff Hardin, LLP ("Schiff Hardin"), a law firm and its team of highly experienced consultants that specializes in providing oversight, project controls and legal advice to utility owners engaged in large, complex construction projects, and Ernst & Young to provide oversight of the development of the Iatan Project's processes and procedures. *See* Hearing Exhibit KCP&L-21, Downey Direct Testimony at p. 8, ln. 10 to p. 10, ln. 4.

59. KCP&L put into place the proper tools to properly manage the work and to ensure that any issues or problems were immediately recognized, reported, and addressed and that decisions were made utilizing the best information available. As noted, KCP&L established at the outset of the Iatan Project a Cost Control System that provided guidance to the Iatan Project and the other CEP Projects regarding the tools needed to manage and report progress and maintain proper controls during the performance of the work. *See* Hearing Exhibit KCP&L-38, Jones Direct Testimony at p. 3, ln. 13 to p. 12, ln. 8 and Schedule SJ2010-2; Hearing Exhibit KCP&L-43, Meyer Direct Testimony at p. 15, ln. 8-14; Hearing Exhibit KCP&L-4, Archibald Rebuttal Testimony at p. 6, ln. 9 to p. 7, ln. 8. These tools include a Definitive Estimate (the Control Budget Estimate), against which all costs were tracked and documented, a detailed construction schedule that tracked each contractor's progress using the Earned Value System, and the utilization of industry consultants and auditors. *See* Hearing Exhibit KCP&L-50, Roberts Direct Testimony at p. 6, ln. 18 to p. 9, ln. 2; Hearing Exhibit KCP&L-21, Downey Direct Testimony at p. 2, ln. 15 to p. 10, ln. 4; Hearing Exhibit KCP&L-4, Archibald Rebuttal Testimony at p. 6, ln. 20 to p. 7, ln. 8. KCP&L presented both the Cost Control System itself and the resultant processes and reports developed following the Cost Control System's guidance to Staff and other Signatory Parties, and continued to report the Iatan Project's progress to Staff

and other parties in the Quarterly Reports and Quarterly Meetings. *See* Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony p. 19, ln. 1 to p. 24, ln. 5.

60. KCP&L's contracting strategy for the Iatan Project was properly developed and all options and risks were carefully weighed before a course of action was determined. *See* Hearing Exhibit KCP&L-21, Downey Direct Testimony at p. 11, ln. 5 to p. 12, ln. 20; Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 55, ln. 8 to p. 61, ln. 9; Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 102, ln. 7 to p. 164, ln. 5.

61. At each stage of the Iatan Project, KCP&L ensured that the management team was staffed with an appropriate number of skilled individuals needed for the work that was being undertaken at the time. These individuals possessed the necessary qualifications including those with substantial engineering and power construction experience. Similarly, KCP&L brought on nationally-recognized industry experts to provide support and experience. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 22, ln. 17 to p. 30, ln. 13, p. 104, ln. 10 to p. 107, ln. 18.

62. Consistent with and guided by the Cost Control System, KCP&L implemented at appropriate times during the Iatan Project rigorous controls, processes and procedures to ensure the proper schedule and cost control. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at p. 76, ln. 3 to p. 80, ln. 22; KCP&L-38, Jones Direct Testimony at p. 3, ln. 7 to p. 12, ln. 20 and Schedule SJ2010-1; KCP&L-50, Roberts Direct Testimony at p. 17, ln. 23 to p. 22, ln. 14; KCP&L-19, Davis Rebuttal Testimony at p. 103, ln. 21 to p. 105, ln. 16; KCP&L-43, Meyer Direct Testimony at p. 36, ln. 8 to p. 38, ln. 4. These various controls, processes and procedures were ultimately memorialized in the Iatan Unit 2 Project Execution Plan ("PEP"), which provided a comprehensive guidance document for the Iatan Project. *See* Hearing Exhibits

KCP&L-19, Davis Rebuttal Testimony at p. 25, ln. 3-9, p. 74, ln. 9-12, p. 80, ln. 7-18, p. 106, ln. 18 to p. 107, ln. 2.

63. The Control Budget Estimates for the Iatan 1 and Iatan 2 were prepared on the basis of the best information KCP&L possessed as of December 2006. *See* Hearing Exhibit KCP&L-43, Meyer Direct Testimony at p. 15, ln. 6-10. At that time, design of the Iatan Project was approximately 20-25% complete. *Id.* As the design of the Iatan Project matured, KCP&L determined that the contingency in the Control Budget Estimate would not fully cover the estimated cost at completion. Accordingly, the Iatan project team initiated the first of four project Cost Reforecasts, the results of which projected Iatan 1's and Common's EAC at $484 million and the EAC of Iatan 2 and Common Plant at $1.901 billion. *See* Hearing Exhibits: KCP&L-4, Archibald Rebuttal Testimony at p. 21, ln. 14 to p. 23, ln. 17; KCP&L-43, Meyer Direct Testimony at p. 24. At the time of the May 2008 Cost Reforecast, the Iatan Project's design had advanced significantly, to approximately 90% complete on Iatan 1 and 70% complete on Iatan 2. *Id.* KCP&L's project team prepared documentation for each of its Cost Reforecasts that identified each and every cost variance (overrun or underrun) and explained the reasons for those variances in detail. *See* Hearing Exhibits: KCP&L-4, Archibald Rebuttal Testimony p. 17, ln. 20 to p. 18, ln. 15; KCP&L-44, Meyer Rebuttal Testimony at p. 14, ln. 8-21. The project team presented the results of the Cost Reforecasts to the EOC for management review and approval, and the Cost Reforecasts were essential for setting and controlling the Iatan Project's budget. *See* Hearing Exhibits: KCP&L-4, Archibald Rebuttal Testimony at pp. 17-36, 41-46; KCP&L-43, Meyer Direct Testimony at pp. 36-38. Despite the increases in the Iatan Project's budget as a result of the Cost Reforecasts, the project team maintained the visibility of the Control Budget Estimate as the baseline for measuring all cost variances throughout the Iatan

Project in its Cost Portfolio. *See* Hearing Exhibit KCP&L-4, Archibald Rebuttal Testimony at p. 4, ln. 23 to p. 5, ln. 3.

64. Because of KCP&L's prudent actions, and despite the significant unforeseeable changes that have occurred in the U.S. and global economy, Iatan Unit 2 was completed and placed in-service on August 26, 2010, which was 86 days later than the original target completion date of June 1, 2010, and will be within 16% of the Definitive Estimate (or the CBE). If the final costs of Iatan Project are gauged against the projections of the May 2008 Cost Reforecast when design had significantly advanced, the results are an underrun of 4% on Iatan 1 and Common Plant and an overrun of 2% on Iatan 2 and Common Plant. These are good results for a project of this length and technical complexity, particularly when the Iatan Project is measured against the utility construction market as a whole and compared to the schedule and budget success of other similar projects completed over the same timeframe. *See* Hearing Exhibit KCP&L-50, Roberts Direct Testimony at p. 22, ln. 16 to p. 28, ln. 5; Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at pp. 23, ln. 17 to p. 24, ln. 3; Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony at p. 3, ln. 22 to p. 8, ln. 5, p. 19, ln. 10-23; Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 4, ln. 1-8.

65. KCP&L's prudent management of the Iatan Project is supported by the Staff's engineering review, which in Staff's November 2010 Report was sponsored by Mr. David Elliott of the Utility Operations Division. In the four year review of the Iatan Project, Mr. Elliott and the Engineering Staff reviewed and vetted the changes that KCP&L needed to make as the Iatan Project's design matured and found that each and every one of those changes was required in order to make the plant work. Mr. Elliott's conclusions are contained in sections of Staff's November 2010 Report and its predecessor, Staff's Construction Audit and Prudence Review of

Iatan 1 Environmental Upgrades for Costs Reported as of April 30, 2010 (referred to as "Staff's Unit 1 Report") where Elliott noted that "Staff has determined that there are no engineering issues regarding the change orders reviewed." *See* Staff's Unit 1 Report at p. 10, ln. 28-29.

66. In Staff's November 2010 Report on Iatan 2, as with Staff's Unit 1 Report, Mr. Elliott concluded that, "[b]ased on its Engineering Review of KCP&L's change orders, Engineering Staff found no engineering concerns with any of the Iatan 2 or Iatan common plant change orders reviewed." *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 29, ln. 11-12. In other words, Mr. Elliott agrees that the work identified in the change orders KCP&L executed on the Iatan Project was needed from a technical standpoint for the construction, operation or maintenance of Iatan Units 1 or 2. Mr. Elliott also approved the in-service criteria for both Iatan 1 and Iatan 2 on behalf of Staff.

3. Prudence Disallowances Proposed by Staff and Missouri Retailers' Association on Iatan 1 and 2

67. As stated above, Staff has recommended that the Commission order a $186,544,799 disallowance of the total cost of Iatan 2 (or $54,604,310 KCP&L Missouri Jurisdictional share and $33,579,864 GMO share) and a $73,255,114 disallowance of the total cost of Iatan 1 (or $27,434,040 KCP&L Missouri Jurisdictional share and $13,185,921 GMO share). Staff's total proposed disallowance includes recommendations for specific enumerated adjustments in the amount of $51,092,048 for Iatan 1 ($19,133,972 KCP&L Missouri Jurisdictional share and $9,196,569 GMO share) and $81,103,094 for Iatan 2 ($23,738,754 Missouri Jurisdictional share and $14,598,557 GMO share) and a catch-all category titled "unexplained/unidentified cost overruns" in the amount of $22,163,066 for Iatan 1 ($8,300,068 KCP&L Missouri Jurisdictional share and $3,989,352 GMO share) and $105,451,705 for Iatan 2 ($30,865,556 Missouri Jurisdictional share and $18,981,307 GMO share).

68. The MRA, based upon the testimony of Mr. Drabinski, has recommended that the Commission order a $13,938,795 disallowance for Iatan 1 (or $5,220,079 KCP&L Missouri Jurisdictional share and $2,508,983 GMO share) and a $230,955,466 disallowance of the total cost of Iatan 2 and Common Plant (or $67,600,318 KCP&L Missouri Jurisdictional share and $41,571,983 GMO share).

69. KCP&L believes that neither Staff nor MRA have presented substantial, competent evidence that raises a serious doubt as to KCP&L's prudent management of the Iatan Project.

(a) Overview of Staff's Recommended Disallowances

70. In this case, Staff has issued a report that purports to summarize its findings of its prudence and construction audit of Iatan 1 and 2. In Staff's November 2010 Report, Staff recommended specific disallowances related to these construction projects. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at Schedule 1-1. Staff has made specific allegations of imprudence, unreasonableness, or lack of benefit to the ratepayers related to certain of the Iatan 1 and 2 construction costs. *See* Hearing Exhibits: KCP&L-224, Hyneman Direct Testimony at p. 2, ln. 21 to p. 3, ln. 7; KCP&L-215, Featherstone Direct Testimony at p. 6, ln. 7 to p. 7, ln. 5. While KCP&L does not believe that Staff has succeeded in raising a serious doubt as to each of these specific disallowances, particularly given Staff's lack of expertise in this area, KCP&L has nonetheless provided testimony and documentation proving the prudence of these specific expenditures. KCP&L believes that it has provided competent and substantial evidence demonstrating that KCP&L's construction expenditures for Iatan 1 and 2 have been prudent and necessary to complete the construction projects, and should therefore be included in rates in this case.

71. In addition, the Staff has recommended that any remaining costs (e.g. Iatan Project costs in excess of Staff's specific disallowances) that exceed the Control Budget Estimate be disallowed as a "Unidentified/Unexplained Cost Overrun" adjustment. These "plug" adjustments for Iatan 1 and Iatan 2 are approximately $22 Million and $105 Million, respectively, as of October 31, 2010 true-up. The net effect of Staff's recommended disallowances, when added to Staff's other disallowances,, is to exceed the $30 million cap the Commission placed on Staff in its Unit 1 Order and deny KCP&L ***every dollar*** KCP&L spent over the Iatan 2 Control Budget Estimate of $1.685 billion, which would currently projected to be a recommended disallowance of approximately $293 million once all of the Iatan Unit 2 costs are known. As explained in more detail below, there are myriad reasons that the Commission should reject the proposed disallowance for "Unidentified/Unexplained Cost Overruns."

(b) Staff is not qualified to opine on several of the issues raised in Staff's November 2010 Report and the related testimony.

72. The Commission should give very little weight to the Staff's November 2010 Report because the witnesses sponsoring the adjustments are unqualified to provide the required supporting expert opinion. During the hearing, KCP&L objected to the admission of Staff's November 2010 Report on the basis that Staff did not have the requisite qualifications, experience, or training to opine on the facts or data underlying their report and recommended disallowances. *See* Hearing Tr. pp. 2557-62. As explained in more detail below, Staff's November 2010 Report should be disregarded because Staff has not provided testimony from qualified witnesses based upon facts or data that are of the type reasonably relied upon by individuals in the relevant field, nor do they cite or even acknowledge the applicable industry standards. Additionally, the Commission ordered the Staff to comply with generally accepted auditing standards issued by the American Institute of Certified Public Accountants Standards,

which requires that the auditors have expertise in and be adequately trained in the areas in which they are auditing. Staff has admitted that it did not have either expertise in construction or provide the necessary training to comply with the relevant auditing standards. Finally, Staff had access to the members of the Utility Operations Division, who have the requisite construction auditing expertise, but chose not to use them as a resource in determining appropriate disallowances for the Iatan Project. As a result, Staff's November 2010 Report does not constitute substantive, competent evidence in these proceedings, and should not be given any weight by the Commission.

1. Staff Has Not Complied With Missouri Law on Expert Testimony

73. Under R.S. Mo. § 490.065.3 (2010), the evaluation of the underlying facts or data on which an expert's opinion is based requires a two-part test. First, there must be a finding that the facts or data are of the type reasonably relied on in the relevant field. Second, the court, or in this case, the Commission, must itself accept the facts or data as otherwise reasonably reliable. As a result, the relevant scientific community must be defined in every case. In all cases, the underlying facts or data "must be ... reasonably relied upon" by the appropriate "field," and even if a court finds that those in the appropriate field rely on the facts or data, the court itself must make the final determination that the testimony offered is "otherwise reasonably reliable." *State Board of Registration for Healing Arts v. McDonagh*, 123 S.W.3d 146 (Mo. banc 2003).

74. Mr. Hyneman, while a CPA, does not have an engineering or a construction background or sufficient experience/training necessary to conduct a construction prudence audit. *See* Hearing Tr. p. 2566, ln. 10 to 2567, ln. 7. Prior to the Iatan Project, Mr. Hyneman admitted that he had never performed a construction audit or a prudence audit, nor had he ever audited a construction project in any manner. *Id.* Mr. Hyneman's training and experience is limited to an

on-line course in project management sometime in 2009 and a two-day course in St. Louis in the fall of 2010. *Id.* at pp. 2567-8. Mr. Hyneman did not consult with the Utility Operations Staff or anyone qualified to offer an engineering opinion. *See id.* at pp. 2633-34, 2636-37, 2654-55, 2659. Additionally, Mr. Hyneman does not have sufficient knowledge to offer an expert opinion regarding legal fees. Mr. Hyneman is not a lawyer, does not have experience purchasing legal services, or have any bases to give an opinion regarding the quality of legal services. *See* Hearing Tr. p. 2649, ln. 24 to 2650, ln. 7.

75. Mr. Keith Majors, who assisted in the Staff's November 2010 Report and sponsored proposed disallowances related to AFUDC, also lacked any training, formal or otherwise, in performing construction prudence audits, and has no experience in construction whatsoever. *See* Hearing Tr. p. 2532, ll. 6-25 to Hearing Tr. p. 2533, ll. 1-7. Mr. Majors stated that his training is limited to an afternoon seminar on construction management in "Late 2010" or after the Staff's November 2010 Report was issued. Mr. Majors raised a question of the educational value of this seminar by failing to recall any information that he received in this one afternoon seminar that he didn't know before attending. *Id.* p. 2533, ll. 18-25 to p. 2534, ll. 1-17. Mr. Majors did not seek the advice or opinions of any qualified engineers and could not describe any authoritative texts or industry standards upon which he relied or utilized in formulating his opinions. *See* Hearing Tr. p. 2535, ln. 3-11; and p. 2540, ln. 5 to p. 2541, ln. 18.

76. Neither Mr. Majors' lack of experience in conducting a prudence audit nor the fact that he did not sponsor any of the recommended disallowances deterred Mr. Majors from providing an opinion that KCP&L failed to comply with the Stipulation. In his Surrebuttal Testimony, in which he alleges that KCP&L "refused to provide the information that supports the contingency levels contained in the Iatan 1 AQCS and Iatan 2 control budget estimate (CBE)

or Definitive Estimate as specified in the KCPL Regulatory Plan" and as a result, "no one aside from KCPL can identify which budget variances were provided for in the contingency versus the budget variances that were not considered." *See* Hearing Exhibit KCP&L-231, Majors Surrebuttal Testimony at p. 21, ln. 8-12. When asked at the hearing why he provided this testimony, Mr. Majors testified that he did so, in essence, because no one else from Staff was responding to testimony from Mr. Meyer and Mr. Archibald. *See* Hearing Tr. p. 2536, ln. 16 to p. 2539, ln. 10.

77. The members of Staff offering opinion testimony in support of disallowances in this case are devoid of the type of experience needed for rendering an expert opinion without input from the Utility Operations Division engineers ("Engineering Staff"). In prior cases before the Commission, engineering conclusions have guided all of Staff's audit reports and associated disallowance recommendations. Mr. Elliott testified that an engineering background is helpful to understand the prudence of construction costs. *See* Hearing Tr. pp. 2428-30. Mr. Drabinski stated that a prudence evaluation on a construction project would require a mix of accounting expertise and engineering expertise, and having construction management expertise "allows you to better understand the thought process of the people providing the documentation for the change orders and other support data." *See* Hearing Tr. p. 1738, ln. 9-25. However, the Audit Staff did not consult the Engineering Staff in developing its recommended disallowances. *See* Hearing Tr. pp. 2633-34, 2636-37, 2654-55, 2659. Mr. David Elliott is a highly experienced Engineering Staff auditor. *See* Hearing Tr. pp. 2370-72. Mr. Hyneman did not consult with Mr. Elliott and did not have any knowledge of the work that Mr. Elliott performed. *See* Hearing Tr. p. 2400, ln. 12-20, p. 2412 ln. 3-18, p. 2421, ln. 2-21, p. 2633, ln. 24 to p. 2634, ln. 8, p. 2636, ln. 23 to p. 2637 ln. 2, p. 263, ln. 20 to p. 2654, ln. 3, p. 2661, ln. 2-11. As explained more fully in

subsequent sections of this Brief, Staff's opinions fail the *McDonagh* two-part test and must be rejected.

2. Staff Did Not Comply With the GAAS Requirements as Ordered by the Commission

78. Pursuant to the Commission's Order Regarding Construction and Prudence Audits dated July 7, 2010 in Case Nos. ER-2010-355 and ER-2010-356, Staff was required to conduct all auditing activity "in accordance with generally accepted auditing standards issued by the American Institute of Certified Public Accountants Standards." *See* the Commission's Order at p. 3, Hearing Exhibit KCP&L-82. Staff has failed to perform its prudence audit in accordance with generally accepted auditing standards ("GAAS Standards") because in order to do so, it would have utilized individuals specifically trained to plan, execute and report on complex construction issues.

79. KCP&L witness Dr. Nielsen, a renowned expert in the performance of prudence audits, examined whether, under GAAS Standards, the Audit Staff had the necessary qualifications to perform the type of audit required by the Commission's orders. Staff admits in its Direct Testimony that they did not follow the GAAS Standards. *See* Hearing Exhibit KCP&L-224, Hyneman Direct Testimony at p. 5, ln. 11–15. Based on this admission that the Staff failed to undergo the training necessary to comply with GAAS, Dr. Nielsen concludes that Staff was not qualified to perform a prudence audit. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 246, ln. 16 to p. 247, ln 2.

80. Based on his reading of Staff's multiple reports and testimony and independent review of the Iatan Project's documentation, Dr. Nielsen concludes that, "Staff's audit team either did not have the experienced personnel to understand the KCP&L cost control system, or was unwilling to take the time necessary to conduct its own of analysis of the cost reports made

available to it." *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 247, ln. 18-23. In his pre-filed Rebuttal Testimony, Dr. Nielsen explains in detail how the Audit Staff could have used the information provided by KCP&L to perform its audit. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at pp. 250, ln. 13 to p. 258, ln. 6. Dr. Nielsen notes that Staff, namely Mr. Elliott, had full access to the change orders, from which they could readily determine the reasons why there were cost overruns. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 256, ln. 3-7. Dr. Nielsen concludes, "Pegasus-Global could find no reason why the Staff would say that the KCP&L cost control system does not identify and explain any cost overrun above the definitive estimate." *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony, p. 257, ln. 22 to p. 258, ln. 1. Similarly, as Dr. Nielsen noted, had Staff only paid attention to the data it was generating, it would have had a platform with which it could have examined the cost overruns on the Iatan Project. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 250, ln. 13 to p. 258, ln. 6.

81. Mr. Hyneman was responsible for sponsoring all of the proposed disallowances, including many that require specific industry or technical knowledge in order to offer an opinion regarding prudence. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report and Hearing Tr. pp. 2633-34, 2636-37, 2654-55, 2659. Mr. Hyneman admits that he has no relevant experience in construction management or engineering, and that even his knowledge of procurement and contracting is limited, at best. *See* Hearing Tr. pp. 2566-67. Yet, Mr. Hyneman was assigned to sponsor each of the disallowances that Staff recommends to the Commission, including the unprecedented disallowance of every dollar over the Iatan Project's Control Budget Estimate. *See* Hearing Tr. pp. 2334, ln. 14 to p. 2335, ln. 8. Staff's failure to assign a qualified team to conduct the audit that complied with GAAS Standards means that they

are unqualified to perform a prudence audit and provide substantial, competent evidence to support the recommended disallowances.

3. Staff Abandoned Its Coordination Procedure Prior to the Iatan Audit.

82. Staff's decision not to integrate its Auditing Staff with its Engineering Staff is not the way Staff has historically performed prudence audits. Staff Auditor Mr. Cary Featherstone appeared at the hearing as an overview witness on Staff's behalf. In his career with Staff, which includes his work as an auditor on the Wolf Creek rate case in the 1980's, Mr. Featherstone could not recall Staff ever recommending the disallowance of all cost overruns over a Definitive Estimate of a new power plant, let alone on grounds similar to what Staff alleges in this case, that KCP&L's cost control system did not identify and explain cost overruns over the Control Budget Estimate, nor could he recall Staff seeking disallowance of all costs of a new power plant from rates on the ground that the final cost of the plant exceeded the definitive estimate or other budget estimate. *See* Hearing Tr. p. 319, ln. 6-17.

83. Mr. Featherstone testified as to how Audit and Engineering Staff collaborated in prior rate cases. In the Wolf Creek case, Mr. Featherstone recalled that "the auditors worked very closely with the engineers." *See* Hearing Tr. p. 332, ln. 22-23. Mr. Featherstone and Mr. Elliott were paired together for approximately ten separate audits, with Featherstone representing the Audit Staff and Elliott from the Engineering Staff. In those cases, Mr. Featherstone described how he and Mr. Elliott, "worked jointly" in a "partnership" in performing these audits:

> We went to the audit sites or to the plant sites. We were – the effort was coordinated, I think jointly. So it was – I would characterize it more of a partnership. And we would interview Company personnel. We would look at documents, change orders, and certainly high on the list, contracts. We would do tours of the plant and interview construction management. We would get an overview of how the projects were first structured and then defined how they were -- how they were managed.

See Hearing Tr. p. 337, ln. 15-24.

84. Mr. Featherstone stated that when he and Mr. Elliott partnered on audits, they would both review change orders and make site visits in a coordinated fashion, and Mr. Featherstone relied on Mr. Elliott's change order analysis. Mr. Featherstone testified that Mr. Elliott, "would call me. We would talk as the rate case approached or as it was filed, and then we would work together on coordinating the effort, coordinate the meetings and certainly coordinating the document review, which would include change orders." *See* Hearing Tr. p. 339, ln. 8-15. For reasons that KCP&L certainly cannot explain, Staff chose to abandon this collaborative approach for this rate case.

85. Mr. Henderson, who has ultimate authority over Staff's recommendations to the Commission in this case, testified that Staff chose to abandon Staff's former coordination procedure in which construction audits were led by the Staff Engineers for the one used in this case. *See* Hearing Exhibit KCP&L-83; Hearing Tr. pp. 2300-08. Mr. Henderson left it to Mr. Schallenberg to assemble the audit plan and staff, and Mr. Schallenberg selected Mr. Hyneman as the lead auditor. *See* Hearing Tr. p. 2299, ln. 16 to p. 2300, ln. 6.

86. Mr. Elliott testified that he was not consulted by the Audit Staff regarding his engineering audit. *See* Hearing Tr. p. 2400 ln. 12-20. Mr. Hyneman testified that he was unaware that Mr. Elliot had even generated work papers regarding his analysis of the Iatan Project's change orders. *See* Hearing Tr. p. 2661, ln. 2-11. Mr. Henderson admitted that Mr. Elliott did not attend the meetings with Audit Staff at which the disallowances were discussed. *See* Hearing Tr. p. 2313, ln. 23 to p. 2314, ln. 14. While Mr. Henderson believes that the Audit Staff could make expert judgment on disallowances without Staff engineers being involved in the decisions, he admits that Staff auditors would have had to talk to the engineers to make expert judgments on disallowances. Nonetheless, Audit Staff ignored Mr. Elliott despite the fact

he is a highly experienced Staff auditor with 16 prior audits under his belt, and as an engineer, he has the ability to discern the reasonableness of changes in scope that generated cost overruns on the Iatan Project.

87. If the auditors communicated with Mr. Elliott and reviewed his work papers, they would know that Mr. Elliott's analysis included the majority of the cost increases on the Iatan Project. *See* Hearing Tr. p. 2387. Had the two divisions of Staff merely spoken to one-another, as required by the rescinded coordination procedure, Staff could not have asserted its unexplained overruns adjustment. Had the Audit Staff merely asked Mr. Elliott to provide them with the same documents that he and his team reviewed and a copy of Mr. Elliott's work papers, it would have been impossible for Staff to conclude that KCP&L has unexplained cost overruns on the Iatan Project. Moreover, the Audit Staff had access to the same information and personnel that Mr. Elliott did. The fact that Mr. Elliott was not part of the "Band of Brothers" that Mr. Schallenberg described in his testimony before the Commission should not be held against KCP&L. *See* Hearing Tr. p. 2828.

(c) Staff's Proposed Disallowance for "Unexplained Cost Overruns" (Staff Proposed Disallowance: $22,163,066 - Unit 1, $105,451,705 - Unit 2) is Not Based Upon a Prudence Analysis and Should be Disregarded by the Commission

88. As stated above, Staff seeks to disallow $22,163,066 from Iatan 1 and $105,451,705 for Iatan 2 on the basis that "KCPL has not even identified or explained the cost overruns, nor did it manage them or even demonstrate that it took positive steps to mitigate them." *See* Hearing Exhibit KCP&L- 205, Staff's November 2010 Report at p. 37, ln. 27-30.

89. Staff's position is premised on its interpretation of the Stipulation and its belief that KCP&L failed to provide sufficient Iatan Project documentation. There is no evidentiary support for Staff's contention that KCP&L has somehow failed to provide all relevant

documentation. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 33, ln. 26-27. KCP&L has provided or made available to Staff all of the documentation and information that "identifies and explains" the Iatan Project's cost overruns.

90. Staff's disallowance is based on its interpretation of the meaning of the single sentence from the Stipulation which Staff believes to require KCP&L to provide a "list" of cost overruns of an undefined nature with undetermined parameters. *See* Hearing Tr. pp. 2643-44. However, the plain language of the Stipulation cited above does not specify the method or format in which the information related to cost overruns is conveyed. It is upon this misreading of the Stipulation that Staff supports an unprecedented disallowance of all of KCP&L's prudently expended costs that exceeded the Iatan Project's Definitive Estimate or Control Budget Estimate.

91. KCP&L witness Mr. Giles testified in the hearing that this provision was the least negotiated provision in the Stipulation. *See* Hearing Tr. pp. 1133-34. Even at this late date, Staff remains unable to indentify the form and format of the "list" and/or what KCP&L failed to do to comply with the above provision of the Stipulation. *See* Hearing Tr. pp. 2328-29, 2679-80. Staff witness Mr. Wess Henderson admitted that this is the first time in his 30-year career that Staff has made such a recommendation to the Commission. *See* Hearing Tr. p. 2295, ln. 21 to p. 2296, ln. 3. Mr. Henderson also admitted that he allowed Staff witness Mr. Hyneman to make this recommendation to the Commission based on Mr. Hyneman's personal opinion. *See* Hearing Tr. pp. 2566, 2633-34, 2636-37, 2653-55, 2661-62.

92. Staff's proposed disallowance of "unexplained cost overruns" fails to meet every test of the applicable prudence standards governing this case. *See* Hearing Exhibit KCP&L-205, Staff November 2010 Report at p. 10, ln. 1-4; *see also Associated Natural Gas*, 945 S.W.2d at 529. Staff's allegation fails to meet the first test of prudence because Staff fails to link this

allegation to any specific imprudence for which the Staff holds KCP&L responsible. KCP&L witness Dr. Nielsen testifies, "Although later in its report, the Staff alludes to decisions and actions taken by KCP&L which it finds questionable, nowhere within the body of the Staff's November 2010 Report did the Staff cite a clearly imprudent decision or action, and then calculate a specific dollar amount flowing from that imprudent decision or action which should be disallowed by the MPSC." *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 243, ln. 1-6.

93. Staff's argument that the burden of proof shifts to KCP&L to provide an explanation of each and every cost increase over the Definitive Estimate also fails. As previously established, it is well settled law that Staff has the burden of first creating a serious doubt before the burden would shift to KCP&L to establish that the expenditures were in fact prudent. Staff asserts that because KCP&L has not provided Staff a list that "identifies and explains" its cost overruns on the Iatan Project that KCP&L has not met its obligations under the Regulatory Plan. Despite KCP&L's continuous efforts throughout the Project to provide Staff with sufficient information to support its prudent actions, Staff, for reasons neither KCP&L nor Staff itself can explain, apparently chose to selectively examine this documentation. Thus, Staff argues, that despite the volume of documents such as change orders, contracts, purchase orders, invoices and the various summaries and reports provided to Staff over the last five years, Staff can choose to ignore this information and state that because no "list" has been provided. However, Staff's position is not factually correct. As explained in a previous section, KCP&L has complied with both the plain language of the Regulatory Plan and the intent of the parties who executed it. *See* Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony at p. 3, ln. 22 to p. 4, ln. 18.

94. KCP&L has provided Staff with all of the information it needed to perform its own review and audit of the costs overruns on the Iatan Project. *Id.* Including the Quarterly Meetings, the meetings in which the Cost Reforecasts were discussed, and other informal meetings that occurred over the life of the Iatan Project, KCP&L met with Staff on over 41 separate occasions to discuss the Iatan Project's cost status. *See* Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony at p. 38, ln. 13-19, p. 39, ln. 6-7. KCP&L provided Staff with copies of all of the documents that were created in each of the Cost Reforecasts, access to all of its executed purchase orders, change orders and contracts, and all invoices and accounts payable records. *See* Hearing Exhibits KCP&L-25, Giles Rebuttal Testimony at p. 24, ln. 16 to p. 25, ln. 6; KCP&L-4, Archibald Rebuttal Testimony at p. 14, ln. 20 to p. 15, ln. 2. These records fully identify the amount of changes to the Iatan Project's Control Budget Estimate and provide explanation for the reasons for those changes. *See* Hearing Exhibits: KCP&L-44, Meyer Rebuttal Testimony at p. 8, ln. 7 to p. 9, ln. 9; KCP&L-4, Archibald Rebuttal Testimony at p. 14, ln. 9-17, p. 14, ln. 20 to p. 15, ln. 2. In its Report, Staff agrees that, "KCP&L's control budget is very detailed with hundreds of line items. It is clear that KCPL has the capability to track, identify and explain control budget cost variances. This is the type of information that is critical to Staff's audit." *See* Hearing Exhibit KCP&L-205, Staff November 2010 Report at p. 37, ln. 10-12.

95. Moreover, Staff has failed to articulate any deficiencies in KCP&L's Cost Control System that prevented Staff from performing a prudence audit of the Iatan Project. KCP&L's witnesses Mr. Archibald, Mr. Meyer and Dr. Nielsen, as well as MRA's witness Mr. Walter Drabinski and Staff's Mr. Elliott each showed that the Cost Control System that KCP&L

developed for the Iatan Project allowed for any interested party to fully examine the costs incurred on the Iatan Project.

96. Mr. Archibald testified that KCP&L's Cost Control System provided the guidance needed to establish the Iatan Project's Cost Portfolio, which it uses for day-to-day tracking and management of Iatan Project's costs. *See* Hearing Exhibit KCP&L-205, Archibald Rebuttal Testimony at p. 10, ln. 10-16. The Cost Portfolio comprises the necessary management reports and information needed for cost tracking, cash flow, change order tracking and management, and provides all other cost-related information used in day to day management of the Iatan Project. *Id.* Mr. Archibald describes in detail how the Cost Control System contains all the information needed to both identify and explain each of the overruns to the Control Budget Estimate that occurred on the Iatan Project. *See* Hearing Exhibit KCP&L-205, Archibald Rebuttal Testimony at p. 11, ln. 15 to p. 13, ln. 14.

97. KCP&L witness Mr. Meyer testifies at length as to how KCP&L's Cost Control System could be used to understand the amount of any cost overrun and the reasons such overruns occurred. *See* Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 11, ln. 7 to p. 12, ln. 20. Schiff Hardin, as part of its services to KCP&L, monitored costs from the inception of the Iatan Project. Schiff Hardin also contributed to the formation of the Cost Control System and monitored its efficacy in identifying and explaining the Iatan Project's cost performance. In his Rebuttal Testimony, Mr. Meyer analyzed the Iatan Project's costs and showed how the cost overruns from the Control Budget Estimate can be explained in detail. *See* Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 3, ln. 14-19, p. 10, ln. 1-10; Schedules DFM2010-17 to DFM2010-24. Mr. Meyer concludes that cost increases to the Iatan Project were discernable and reasonable, and the effective management of the Iatan Project

resulted in a mitigation of the overall costs of the Iatan Project. *See* Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 30, ln. 10-17. Mr. Meyer placed KCP&L's Cost Control System in the top quartile of those he has seen, and believes this system has allowed for the effective cost management of the Iatan Project. *See* Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 3, ln. 6-10, p. 7, ln. 23 to p. 8, ln. 4.

98. Dr. Nielsen also utilized the Iatan Project's Cost Control System and as part of his independent prudence audit. Dr. Nielsen testifies that, "the Staff incorrectly states that KCP&L has neither identified the cost overruns nor provided any explanation of the cost overruns on the Iatan Project,... Pegasus-Global was able track cost overruns back to root causes for those overruns through the project records maintained by KCP&L during the execution of the project." *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 26, ln. 16-20.

99. With respect to KCP&L's cost controls on the Iatan Project, Dr. Nielsen also concludes the following:

- KCP&L's Project Controls systems were consistent with industry standards;
- The estimating and budgeting process KCP&L utilized was reflective of reasonable and prudent utility management practice, including the reforecasting the Iatan Project's estimate at completion was evidence of prudent management;
- KCP&L reasonably and prudently implemented and managed a cost system that identified cost variances on the Iatan Project; and
- The cost changes on the Iatan Project compare favorably with other similar facilities constructed in the same time frame.

See Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at pp. 20-25.

100. Mr. Drabinski utilized KCP&L's Cost Control System to perform his prudence analysis for the 0089 and 0355/6 dockets and the Kansas Corporation Commission docket

numbers 09-KCPE-246-RTS and 10-KCPE-415-RTS. Mr. Drabinski visited the Iatan Project site seventeen times and met with members of the Iatan Project Team each time. Mr. Drabinski agrees that KCP&L provided him with access to all of the documents described herein: change orders, purchase orders, R&O's, CPs, contracts, invoices, K-Reports; and that information both identified and provided justifications for increases the Control Budget Estimate. *See* Hearing Tr. pp. 1586-1587. Mr. Drabinski agreed that the K-Report was a project reporting tool that identified changes to the Project's cost categories and to ascertain the reasons for such changes, one had to "drill down" into other documents that were part of the Cost Control System. *See* Hearing Tr. pp. 1589-90. Mr. Drabinski noted that Mr. Archibald was available to him when he had questions or needed detailed information, and that Mr. Archibald was cooperative in providing this information. *Id.* Mr. Drabinski was able to utilize KCP&L's Cost Control System to develop his prudence analysis. *Id.* While KCP&L thoroughly disputes the conclusions Mr. Drabinski drew related to KCP&L's management of the Iatan Project, Mr. Drabinski was able to establish his own view of the cost overruns on the Iatan Project based on the documentation that Staff complains does not exist.

101. In many ways, Staff's Mr. Elliott provides the most illustrative example of how KCP&L's Cost Control System clearly identifies and explains the cost overruns on the Iatan Project. As part of his engineering review for Staff's November 2010 Report, Mr. Elliott was tasked with determining whether the changes in scope to the Iatan Project as represented by change orders and purchase orders that increased the Project's costs were necessary from an engineering perspective. *See* Hearing Tr. pp. 2398, ln. 21 to p. 2400, ln. 11.

102. Mr. Elliott describes his review of the change orders to Iatan Unit 1 in his section of Staff's Unit 1 Report, in which he reveals that he and his team: (1) visited the site 11 times

and "discussed construction progress and future milestones, and reviewed any relevant documentation" (2) received and reviewed 227 change orders with a value over $50,000, from which he culled 126 change orders relating to "engineering issues" from which he reviewed a sample of 79 in detail that represented $34.1 million in additional costs; (3) reviewed the reasons for these change orders and found they include "design maturation, design changes, interference issues and improved operation/maintenance." As stated, Mr. Elliott's primary finding was, "Staff has determined that there are no engineering issues regarding the change orders reviewed." *See* Hearing Exhibit KCP&L-205, Staff's Unit 1 Report at p. 10, ln. 28-29.

103. With respect to Iatan Unit 2, Mr. Elliott identified that he and Mr. Shawn Lange visited the site 20 separate times and engaged KCP&L's project team in discussions of the Iatan Project's cost and schedule status. KCP&L witness Brent Davis testifies that there were some questions raised by Mr. Elliott and Mr. Lange in these meetings regarding the circumstances on which certain change orders were necessitated. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 10, ln. 14 to p. 12, ln. 19. These questions were immediately answered by the project team to Mr. Elliott and Mr. Lange's satisfaction. *Id* In all, Mr. Elliott and Mr. Lange reviewed 647 change orders over $50,000, of which Staff narrowed its review to a sample size of 222 representative change orders for analysis. Mr. Elliott and Mr. Lange identified and categorized these 222 change orders into six different categories as follows:

> *Type 1: Change Orders associated with final design changes or final engineering changes.*
>
> > KCPL awarded some contracts before completion of final design. Therefore, there were changes due to work that started before the final design, or the final engineering was completed. Also during construction, additional work was added to the contractor/engineer/consultant contracts.
>
> *Type 2: Change Orders associated with changes made by KCPL*

KCPL made changes for more efficient or safer operation and/or maintenance of Iatan 2 and the associated common plant after construction started. This category also includes change orders due to the selection of a particular design by KCP&L during construction.

Type 3: Change Orders associated with field design

This type of change was made due to final design decisions left to be worked out during actual construction, and design changes made in the field. This type also includes changes in the way work was to be done in order to avoid potential problems and moving work from one contractor's work scope to another contractor's work scope.

Type 4: Change Orders associated with field construction issues

These changes were made due to unforeseen problems or obstacles encountered during actual construction. This would include changing the design, making repairs, and/or modifying material/equipment to make it work as required. This category also includes changes due to moving contractors, or equipment, and adding equipment for easier access to work areas.

Type 5: Change Orders associated with contracts that specify the actual amounts and/or prices would be determined at time of the work.

Some contracts were written such that the final cost would be determined at a later date. Either the amount of work, or number of items purchased, or the prices were trued-up with change orders at some point during the construction project.

Type 6: Change Orders associated with changes to the type of contract

The type of contract changed e.g., a time-and-material contract was converted to a fixed-price contract.

See Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 30, ln. 22 to p. 31, ln. 30.

104. Mr. Elliott submitted his work papers for this section of Staff's November 2010 Report. Schedule CBG2010-2 is a chart that was produced to KCP&L from Mr. Elliott's work papers entitled "Investigation Change Order List" dated September 18, 2010, which appears to be the list of the 222 change orders Mr. Elliott reviewed for Staff's November 2010 Report. *See* Hearing Exhibit KCP&L-25, Giles Rebuttal Testimony at p. 14, ln. 25-28. As is explained in

Mr. Elliott's section of Staff's November 2010 Report, each of the change orders he reviewed is in excess of $50,000. In total, the 222 change orders he and Mr. Lange closely examined total $150,801,534. For each of the 222 change orders, Mr. Elliott identified the change order number, the contractor who received the change order, the amount of the change order and brief explanation of each change orders' purpose. Mr. Elliott testifies that there was not a single change order he and Staff reviewed that lacked proper description or documentation.

105. Mr. Elliott's review necessarily involved his utilizing KCP&L's Cost Control System to identify and explain the cost overruns that occurred on the Iatan Project. Mr. Elliott used the Cost Control System to identify the change orders and then used the explanatory documents from the Cost Control System to categorize the change orders into the six "buckets" described in Staff's November 2010 Report. Moreover, the categories Mr. Elliott established for his review and ultimate justification of the engineering necessity of the Iatan Project's change orders provide further proof that these change orders were the result of the maturation of the Project's design, not management imprudence or some other undefined cause.

106. The Commission should reject the disallowance for "Unidentified/Unexplained Cost Overruns." Staff witnesses' testimony does not establish any imprudence with respect to these costs. Indeed, Staff's witness testimony merely establishes that they do not know whether these costs are imprudent, unreasonable, inappropriate, or of benefit to the customer. Staff's position is that these costs should be disallowed by the Commission simply because they exceeded the original Definitive Estimate and Staff believes that KCP&L has not sufficiently explained the cost overruns. The mere fact that KCP&L exceeded its Definitive Estimate does not create serious doubt and does not overcome the legal presumption of prudence. *See Report and Order, Re AmerenUE,* Case No. ER-2007-002 at 69, as affirmed in *State ex rel. Public*

Counsel v. PSC, 2009 WL 68124 (Mo. App. W.D., Jan. 13, 2009). Staff's evidence regarding this adjustment does not raise a serious doubt as to the expenditures. Indeed, Staff's recommended disallowances for "Unexplained" cost overruns are not supported by facts, are arbitrary and capricious, and do not comply with the prudence standard that governs this Commission's rulings.

(d) Specific Disallowances Proposed by Staff[5]

107. As of November 3, 2010, Staff has proposed disallowances in the amount of $51 million for Unit 1 and $81 million for Unit 2 for specific expenditures. KCP&L has provided its response to each proposed disallowance below.

1. ALSTOM Unit 1 Settlement Agreement

108. Staff has proposed a **[redacted]** disallowance based upon the ALSTOM Unit 1 Settlement Agreement. It is important to note that as of June 30, 2010, the total projected overrun from the ALSTOM contract based upon the Definitive Estimate was only **[redacted]** (including contingency)[6]. *See* Hearing Exhibit KCP&L-44 at Schedule DFM2010-13. This disallowance accounts for approximately 86% of Staff's total proposed disallowances on Unit 1, not including Staff's $22 million "plug" number for alleged "Unidentified/Unexplained" Cost Overrun Adjustment. The **[redacted]** consists of two separate items: 1) **[redacted]** as the actual amount paid to ALSTOM under the Settlement Agreement; and 2) **[redacted]** in alleged "foregone" liquidated damages Staff asserts KCP&L should have assessed against ALSTOM. With respect to both proposed disallowances, Staff has failed to "raise a

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[5] Staff has proposed three new additional disallowances as a part of its True-Up case. These include ALSTOM liquidated damages for Unit 2, additional Schiff Hardin fees for work performed on the Spearville Wind Project and the proposed disallowance of additional Common Costs. Those additional disallowances are not included in this Brief but will be discussed in detail in the Companies' Rebuttal/True-Up Brief.

[6] The attached Schedule reflects the amounts as of the June 30, 2010 cut-off date. As of the October 31, 2010, the ALSTOM contract value for Iatan Unit 1 had been reduced by $1.2 million, which only increases this disparity.

serious doubt" that would override the presumption of prudence. Furthermore, KCP&L has presented substantial competent evidence proving that based on the circumstances known at the time, KCP&L's decision to enter into the Settlement Agreement and pay ALSTOM a settlement amount was prudent. Furthermore, at the time of the Settlement Agreement, no liquidated damages had accrued against ALSTOM, and as a result, KCP&L did not have a right to collect such damages under its Contract with ALSTOM. Therefore, KCP&L did not "forego" its rights to any owed amounts by ALSTOM, and any argument that KCP&L would have been able to collect such damages is purely speculative.

a) Adjustment for ** [redacted] ** Settlement Amount

109. Staff has recommended the disallowance of 100% of the amount paid to ALSTOM, the contractor who provided and installed the environmental control equipment on Iatan Units 1 and 2 and the boiler for Unit 2, under a settlement agreement that was executed by the parties on July 18, 2008.

110. As an initial matter, Staff has failed to raise a serious doubt which would defeat the presumption of prudence afforded to KCP&L. At the hearing, Mr. Hyneman testified that Staff's reasoning for disallowing the costs of the Unit 1 Settlement Agreement was not because the decision to enter into the Settlement Agreement by KCP&L was imprudent, but because it was *inappropriate* to charge the cost of the Settlement to rate payers. Specifically, Mr. Hyneman testified to questions posed by Commissioner Kenney as follows:

> Q. Okay. I want to ask you -- I was not clear and I may have just misheard. I think – and I'm not going to refer to any numbers, but we were talking about those various settlements and you said that the costs of the settlement shouldn't be borne by the ratepayer because it's inappropriate. Is that --did I hear you correctly?
>
> A. Yes, sir. That's correct.

Q. So are you meaning that the actual dollar amount that was paid in the settlement shouldn't be borne by the ratepayers? Is that what you're referring to?

A. Yes. For unit 1, Iatan 1, both the actual dollar amount of the settlement, for example, that KCPL paid to Alstom and the liquidated damages that KCPL gave up should not be charged to Missouri ratepayers. And Staff is not --

Q. But -- but you're not -- but the act of entering into the settlement itself, have you formed an opinion about whether that was prudent or imprudent?

A. We have not come to an explicit decision.

See Hearing Tr. p. 2768, ln. 4-25 (emphasis added). By making no determination on prudence, Staff has not overcome the presumption of prudence afforded to KCP&L with respect to this expenditure, as it has failed to raise a serious doubt as to the prudence of the cost of the ALSTOM Settlement Agreement.

111. In its pre-filed testimony and November 2010 Report, Staff's reasoning for its proposed disallowance, was that "Staff is not convinced that ALSTOM's claims against KCPL were not the fault of KCPL's project management, raising the question of KCPL's prudence and whether KCPL's ratepayers should be responsible for these costs." *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 56, ln. 19-22. Furthermore, nowhere in Staff's November 2010 Report, in its pre-filed testimony or in its hearing testimony does Staff provide any competent evidence that the amounts paid by KCP&L were due to the fault of KCP&L's project management. In fact, Staff's only evidence is simply a complaint that "KCP&L made no attempt to quantify the costs that may have been caused by its own project management team or the owner-engineering firm it hired, Burns & McDonnell ("B&McD"), or any other Iatan 1 contractor or subcontractor." *See id.* at p. 57, ln. 11-14. KCP&L does not believe, nor does Staff provide any evidence, that KCP&L's project management team is responsible for the amount

paid to ALSTOM under the Settlement Agreement, and as a result, would have no basis for performing such a calculation.

112. Nor does Staff provide any evidence that KCP&L's engineer, Burns & McDonnell, is ** [redacted] ** *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 57, ln. 29-30. In fact, the use of the word "likely" indicates that Staff has not performed any evaluation of this hypothesis and is simply speculating. The only evidence provided by Staff is excerpts from an Ernst & Young ("E&Y") Risk Assessment which was performed in November 2006 (the written report was finalized and released several months later in March, 2007), almost two years prior to the ALSTOM Settlement Agreement. *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 9, ln. 11-13. As stated by Mr. Roberts in his Rebuttal Testimony:

> Staff makes no attempt to determine if the issues raised in this Risk Assessment were subsequently addressed by KCP&L or if any of those issues actually had any impact on a settlement agreement that occurred almost two years later. The whole purpose of this Risk Assessment was for Ernst & Young to help KCP&L identify risks early in the Iatan Project so that KCP&L could address and mitigate those risks. Obtaining this information is both prudent and good practice. Staff is now attempting to use these internal audits against KCP&L by only pointing to the risks that were identified without determining if the Company addressed these issues, let alone whether there were any cost impacts. A disallowance based on this misuse of internal audits constitutes bad public policy. Staff is taking advantage of KCP&L's transparency which will discourage companies from attempting to identify these issues in the first place on future projects.

See Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 9, ln. 13 to p. 10, ln. 2.

113. Staff offers no evidence that KCP&L ignored or did not take action to mitigate the risks identified in the E&Y report. In fact, testimony from KCP&L's witnesses establishes that all audit findings were all addressed by KCP&L. As testified by KCP&L witness Mr. Downey:

> The "Audit Reports" prepared by KCP&L's Internal Audit Department, as supplemented by Ernst & Young ("E&Y"), provided both Senior Management

> and the KCP&L Board of Directors with feedback regarding the effectiveness of the processes that were put into place in order for the EOC and Senior Management to engage in a dialogue with the Iatan project management team to mitigate risk and increase the team's management effectiveness. Staff had the opportunity to review all of the Audit Reports on the Project. It is important to note that the Audit Reports contain both positive findings as well as areas for improvement. Staff has chosen to merely selectively quote individual passages of our Audit Reports without identifying: (1) whether or how KCP&L addressed these findings; (2) whether these findings resulted in any specific impact to the Project; and (3) any linkage between these findings and the recommended disallowance. Our process requires that management put an action plan in place to respond to any unsatisfactory audit result. To date, KCP&L's management has dispositioned each and every audit finding from our Internal Audit team to the satisfaction of the Board of Directors' Audit Committee.

See Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 35, ln. 17 to p. 36, ln. 8.

114. Staff also relies heavily on another audit report, which was performed in the fall of 2008 and released in January of 2009, titled the "ALSTOM Power Contract Audit." Staff cites portions of the audit out of context and leaves out positive findings related to KCP&L's management of ALSTOM. In particular, page 6 of the Audit states: **

[redacted]**

See Hearing Exhibit KCP&L-51 at Schedule KMR2010-11, p. 6. The auditors found that KCP&L's overall management of ALSTOM was prudent, though there was room for improvement—which, as discussed by KCP&L witness Mr. Downey, is precisely the point of the audits. KCP&L utilized its external advisors to identify areas of improvement to better the organization. This is the very essence of prudent management.

115. KCP&L's pre-filed testimony discusses KCP&L's active management of its contractors and ALSTOM in particular. *See* Hearing Exhibits: KCP&L-21, Downey Direct Testimony at p. 13, ln. 19 to p. 14, ln. 9; KCP&L-50, Roberts Direct Testimony at p. 15, ln. 20 to

p. 16, ln. 16; KCP&L-18, Davis Direct Testimony at p. 20, ln. 4 to p. 21, ln. 6; *see also* KCP&L-22, Downey Rebuttal Testimony at p. 25, ln. 6 to p. 28, ln. 9; KCP&L-51, Roberts Rebuttal Testimony at p. 7, ln. 15 to p. 9, ln. 7; KCP&L-19, Davis Rebuttal Testimony at p. 47, ln. 11 to p. 51, ln. 6, p. 110, ll. 9-15; and KCP&L-46, Nielsen Rebuttal Testimony at p. 127, ln. 16 to p. 132, ln. 11. Using the management tools available to it, such as the schedule, KCP&L could constantly evaluate the contractors performance. KCP&L then met with the contractors on a weekly and when necessary, daily basis in order to resolve any coordination issues and discuss improvement of the contractor's productivity to support the schedule. *See* Hearing Exhibit KCP&L-18, Davis Direct Testimony at p. 20, ln. 15-21. Additionally, KCP&L utilized a very sophisticated and robust dispute resolution process. KCP&L organized and participated in several facilitation sessions with a nationally-renowned mediator in order to help find reasoned solutions and remediation plans to help keep the project on track. *See* Hearing Exhibits KCP&L-22, Downey Rebuttal Testimony at p. 40, ln. 7 to p. 41, ln. 7; KCP&L-51, Roberts Rebuttal Testimony at p. 8, ln. 12-14.

116. KCP&L has provided Staff with all necessary documents related to the ALSTOM Unit 1 Settlement. Staff had access to KCP&L project management and senior project staff, and KCP&L has filed extensive testimony regarding this issue in the 0089 Docket. *See* Davis Rebuttal Testimony (0089 Docket) at pp. 3-6 and 19-20 (discussing the Unit 1 Outage and the Tiger Team Schedule and describing meeting with the MPSC Staff that occurred on September 23, 2008 where the Unit 1 Settlement was discussed in detail and relevant documents were provided); Downey Rebuttal Testimony (0089 Docket) at p. 17 ln. 20 to p. 20, ln. 23.

117. As explained above, there is no evidence in the record that Mr. Hyneman, the Staff sponsor of this disallowance, is qualified to provide an opinion as to the prudence or reasonableness of this expenditure.

118. To the extent that the Commission believes that Staff or some other party has raised a serious doubt as to the prudence of the ALSTOM Unit 1 Settlement Agreement, KCP&L has substantive, competent evidence through the testimony of its witnesses and experts which meet KCP&L's burden of establishing the prudence of the ** [redacted] ** KCP&L has put forth the testimony of industry experts such as Dr. Nielsen and Mr. Roberts who have testified that the ALSTOM Unit 1 Settlement was a prudent expenditure on the part of KCP&L. *See* Hearing Exhibits: KCP&L-46, Nielsen Rebuttal Testimony at p. 263, ln. 4 to p. 275, ln. 12; KCP&L-51, Roberts Rebuttal Testimony at p. 7, ln. 15 to p. 12, ln. 12. KCP&L's decision to settle with ALSTOM was prudent in light of all of the circumstances and information known to KCP&L's senior management at the time.

119. KCP&L's witnesses have testified that the purpose of the ALSTOM Unit 1 Settlement Agreement was to resolve the following issues:

- A team led by KCP&L that included members of Burns & McDonnell, Kiewit and ALSTOM determined the most advantageous Unit 1 completion and Outage Schedule was "the Tiger Team Schedule." *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 29, ln. 4-10. The Tiger Team ultimately recommended an extension to the Unit 1 Outage to a duration of seventy-three (73) days and a delay to the start of the Unit 1 Outage by approximately one month (the "Tiger Team Schedule"). *Id.* Implementation of this schedule would have a financial impact on ALSTOM for which it was entitled to be compensated under the Contract. KCP&L needed ALSTOM to agree to extend the Unit 1 Outage in accordance with the Tiger Team Schedule. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 28, ln. 12 to p. 29, ln. 10.

- ALSTOM agreed to a series of specific interim dates called "construction turn-over" ("CTO") dates to ensure timely completion of ALSTOM's work. *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 10, ln. 6-18.

- ** [redacted] ** *See* Hearing Exhibit KCP&L-22 at Schedule WHD2010-05 (Copy of the ALSTOM Unit 1

Settlement Agreement). **[redacted]** *Id.*

120. KCP&L witness Mr. Downey explains in his pre-filed testimony the circumstances and information that were known and considered by KCP&L's management at the time KCP&L was negotiating and entered into the ALSTOM Settlement Agreement:

> **Q: Describe the events and circumstances KCP&L considered in deciding to negotiate the ALSTOM Unit 1 Settlement Agreement.**
>
> A: KCP&L recognized that since it had entered into the Contract with ALSTOM at the end of 2006, the complexity of the work on the Iatan Unit 1 Outage had increased significantly as KCP&L recognized the opportunity to use this outage to optimize the unit's performance and reduce future performance risk. The added Unit 1 Outage scope included: (1) economizer surface area addition, necessary for the Unit 1 SCR installation; (2) installation of turning vanes in the existing ductwork; (3) upgrades and replacement of the DCS controls; (4) refurbishment of the submerged and dry flight conveyors; and (5) addition of the low NOx burners. In addition, Tiger Team 1 was concerned about the DCS change out, which creates added risk to the unit's start-up. These additions added to the work ALSTOM had to complete within the time frame of the outage as well as added to the general congestion in relatively tight spaces. . . .
>
> . . .Additionally, despite the Project Team's efforts, there were a number of open commercial and technical issues that could not be resolved at the Project level. The potential impacts from these unresolved issues were beginning to manifest themselves and it was clear that we would not be able to resolve them without executive-level involvement. The Quarterly Reports submitted to Staff from the 1st and 2nd quarter of 2008 reflect these discussions with ALSTOM's management and our approach to these issues. *See* Downey Rebuttal Testimony, Docket 0089, at p. 18. . .

See Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 28, ln. 10 to p. 29, ln. 17.

121. KCP&L fully evaluated the benefits and risks associated with the ALSTOM Unit 1 Settlement Agreement. A large part of this evaluation consisted of KCP&L's potential exposure of having to expend even higher costs to complete the Project and potentially complete

later than the Tiger Team Schedule. This evaluation is discussed in detail by Mr. Downey in his Rebuttal Testimony. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 31, ln. 13 to p. 34, ln. 12. In summary, KCP&L had evaluated the value of the total benefits received under the Settlement Agreement at approximately [redacted] for which KCP&L resolved with ALSTOM for [redacted] *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 32 ln. 8-10. Additionally, there were added non-monetary benefits including heightened cooperation among the parties and [redacted]

122. It is important to note that, as stated above, Staff's basis for disallowing the [redacted] settlement payment, is that Staff "is not convinced that ALSTOM's claims against KCP&L were not the fault of KCP&L's project management, raising the question of KCP&L's prudence and whether KCP&L's ratepayers should be responsible for these costs." *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 56, ln. 19-22. However, as discussed by Mr. Downey, "ALSTOM's [redacted] claim was a consideration but never the primary driving factor for the ALSTOM Unit 1 Settlement. . . KCP&L was more concerned about the Unit 1 Outage schedule and ensuring maximum cooperation for coordination of the outage work." *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 34, ln. 20 to ln. 23. KCP&L needed ALSTOM's agreement to implement the Tiger Team Schedule in order to accomplish this goal. Staff either ignores, or was unable to evaluate all of the information KCP&L provided, including KCP&L's evaluation of the Tiger Team Schedule concluding that it was the most prudent success path for the Unit 1 Outage. Based on this fact alone, KCP&L's evaluation established that ALSTOM's agreement to work to the Tiger Team Schedule was worth almost [redacted] by itself. The inclusion in the Settlement Agreement of [redacted]

[redacted]** was an additional value to KCP&L. KCP&L's decision to settle these issues with ALSTOM for **[redacted]** is well documented and establishes KCP&L's prudence with respect to this expenditure.

(b) Adjustment for "Foregone" Liquidated Damages (Staff Proposed Disallowance: **[redacted] Unit 1)**

123. In Staff's November 2010 Report, Staff argues that an additional **[redacted]** should be disallowed based on KCP&L's **[redacted]** *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 59, ln. 15-16.[7] However, Staff is mistaken in its belief that KCP&L ever had a right to collect such liquidated damages under the Contract.

124. Under Missouri Law, the term "liquidated damages" refers to "that amount which, at the time of contracting, the parties agree shall be payable in the case of breach." *See Goldberg v. Charlie's Chevrolet, Inc.*, 672 S.W.2d 177, 179 (Mo. App. 1984). Under ALSTOM's original Contract, KCP&L would be entitled to collect liquidated damages from ALSTOM on Unit 1 ***only*** if ALSTOM was unable to meet its "Provisional Acceptance Date" (for Unit 1, the definition of Provisional Acceptance is the same as the "in-service date") for Unit 1 as required by the Contract. The Unit 1 Provisional Acceptance Date in the ALSTOM Contract was December 16, 2008. *See* Hearing Tr. pp. 1816, ln. 25 to p. 1817, ln. 5. This means that KCP&L was not entitled to collect liquidated damages until after that date had passed. However, KCP&L and ALSTOM negotiated the Unit 1 Settlement Agreement in the first half of 2008 and it was executed on July 18, 2008, several months before the Provisional Acceptance Date.

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[7] In its true-up testimony, Staff has added a similar disallowance for Unit 2 in the amount of $34 million. While KCP&L will address this new argument in its Rebuttal/True-Up Brief, the arguments made for Unit 1 are largely applicable to Unit 2.

Accordingly, at the time of the Settlement Agreement, no breach of contract could be declared and no liquidated damages had accrued.

125. Once KCP&L and ALSTOM entered into the Settlement Agreement and agreed to modify the Provisional Acceptance date, any discussion about what KCP&L "could have" potentially collected under the original December 2008 contractual date is highly speculative, and completely unrealistic. A contractor is not going to attempt to meet (much less spend additional money to meet) a contractual date that is no longer valid. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at p. 36, ln. 12 to p. 38, ln. 2; KCP&L-19, Davis Rebuttal Testimony at p. 59, ln. 3 to p. 60, ln. 7; KCP&L-51, Roberts Rebuttal Testimony at p. 11, ln. 6 to p. 12, ln. 12; and KCP&L-46, Nielsen Rebuttal Testimony at p. 266, ln. 11 to p. 268 ln. 16. Additionally, Staff's theory ignores many things *could* have happened, including intervening delays that were not the fault of ALSTOM. It is at best idle speculation to guess what "would" have happened, but because the Provisional Acceptance date was modified by the Settlement Agreement, Staff's calculation of liquidated damages based on the December 2008 date is irrelevant.

126. Furthermore, even if KCP&L had not modified the original contractual Provisional Acceptance date, and simply done nothing and waited for ALSTOM to complete its work, there is no guarantee that even if ALSTOM was late that KCP&L would have been able to collect liquidated damages from ALSTOM. As stated by Dr. Nielsen:

> . . .[T]o impose LDs on a contracting party the owner must prove that the contracting party is solely and completely responsible for the delay events or issue which can be proven to have been the direct cause of those delays. By disallowing the entire ** [redacted] ** of LDs the Staff has taken the position that Alstom was solely and completely responsible for every issue or event which may have ultimately impacted the critical path of Alstom's schedule; this is simply not a creditable position in the real world of construction and, in particular, construction claims and disputes. Imposition of LDs almost always leads to

> disputes, which then places the owner in the position of proving its right to impose those LDs under the contract which means that KCP&L would have to undertake a very expensive and time consuming analysis to achieve that level of proof. None of the money spent on that analysis is recoverable from the contractor given that the owner bears the burden to prove its allegations. Because every event or issue must have a direct impact on the contractors critical path, simply saying a contractor was late in doing something is not good enough and in more instances than not the contractor can point to some concurrent delay for which the owner was responsible which the contractor will assert were the "real" cause of the delay to achievement of the critical path of the project.

See Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 267, ln. 15 to 268, ln. 11. As an example, KCP&L witnesses Mr. Davis and Mr. Downey discussed two issues that occurred during the Unit 1 outage that most likely would have been deemed to be "concurrent delays," meaning that even if ALSTOM had been late in completing its Unit 1 work, KCP&L would not have been able to collect liquidated damages. These events were the economizer casing repair and the turbine rotor repair.

127. During the Unit 1 Outage, the construction team discovered a latent defect in the economizer casing. This defect and the necessary repairs impacted the duration of the Unit 1 Outage by thirty-two (32) days. *See* Hearing Exhibits: KCP&L-19, Davis Rebuttal Testimony at p. 59, ll. 20-23; KCP&L-71, 4Q 2008 Strategic Infrastructure Investment Status Report.

128. Additionally, during the start-up after the Unit 1 Outage, a vibration event with the turbine caused an additional delay to start-up of the Unit. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at pp. 60. ** [redacted] ** The effect of the economizer incident and the turbine not only would have made it impossible for ALSTOM to achieve its original contractual dates, but also extended the revised dates under the Settlement Agreement. These two events added ** [redacted] ** weeks to the schedule, for which ALSTOM was not responsible. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 59, ln. 20 to p.

60, ln. 17. As a result, ALSTOM was entitled to an adjustment of its contractual Provisional Acceptance Date and KCP&L would not have been able to impose liquidated damages on ALSTOM.

129. Finally, Staff's calculation of the ** [redacted] ** is based upon two Risk and Opportunity items ("R&O items") that were discussed as part of KCP&L's May 2008 reforecast. *See* Hearing Exhibit KCP&L-22 at Schedule WHD2010-7. Those two R&O items identify potential liquidated damages somewhere in the range of ** [redacted] ** However, a close reading of those documents establishes that KCP&L considered the possibility of collecting liquidated damages ** [redacted] ** In other words, if ALSTOM's performance did not improve after the Unit 1 Settlement Agreement, then ALSTOM could have exposure to KCP&L for liquidated damages. *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 11, ln. 22 to p. 12 ln. 8. The R&O was discussing the possibility of future liquidated damages that *could* accrue, not liquidated damages that had accrued. *Id.* at ln. 8-10. As a result, Staff's proposed disallowance for liquidated damages is speculative and for reasons explained in more detail above, is wholly inappropriate.

2. ALSTOM Unit 2 Settlement Agreement (Staff Proposed Disallowance: ** [redacted] **)

130. Staff also argues that KCP&L should not be entitled to recover any amounts it paid to ALSTOM under the Unit 2 Settlement Agreement. A copy of the "ALSTOM Unit 2 Settlement Agreement" is attached as Schedule WHD2010-7. *See* Hearing Exhibit KCP&L-22. While Staff's November 2010 Report only valued this disallowance at ** [redacted] ** Staff's revised disallowance as of the True-up includes all amounts KCP&L paid ALSTOM under the terms of the Settlement Agreement, or ** [redacted] **.

131. Staff's argument in its November 2010 Report as to the basis of the disallowance for the ALSTOM Unit 2 Settlement Agreement is based upon the testimony of Dr. Nielsen, who states: **[redacted]** *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 232, ln. 12-14. This quote, however is taken out of context. Dr. Nielsen was explaining his reasoning behind the WSI disallowance for specialty welding, not the ALSTOM Unit 2 Settlement Agreement. Staff has provided no substantive or competent evidence as to why it believes KCP&L's decision to enter into this Settlement Agreement was imprudent. Staff has not provided any analysis of the circumstances surrounding KCP&L's decision to raise a serious doubt or support its conclusion that it was not a reasonable decision at the time.

132. The circumstances surrounding the ALSTOM Unit 2 Settlement Agreement are discussed in detail by several KCP&L witnesses, including Mr. Downey, Mr. Roberts and Dr. Nielsen. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at pp. 39, ln. 7 to p. 47, ln. 6; KCP&L-51, Roberts Rebuttal Testimony at p. 12, ln. 17 to p. 18, ln. 12; and KCP&L-46, Nielsen Rebuttal Testimony at p. 275, ln. 15 to p. 285, ln. 11. There were two main reasons KCP&L decided to enter into a Settlement Agreement with ALSTOM. First, ALSTOM had presented KCP&L with a significant delay claim. Regardless of whether ALSTOM's claim had merit, defending against the claim would be both expensive and time consuming. *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 15, ln. 14-17. Additionally, it would mire the KCP&L and ALSTOM project teams down in a commercial dispute at a time when it was important to focus on the cooperative completion of the project. Second, Kiewit had told

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KCP&L that it would cost an additional ** [redacted] ** to support the dates in ALSTOM's schedule. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 41, ln. 10-16.

133. It should be noted that despite ALSTOM's delay claim, KCP&L did not simply pay ALSTOM a lump-sum amount. Instead, KCP&L negotiated a series of critical interim milestones for ALSTOM to meet to ensure cooperation and an orderly transition from construction to Start-Up. Additionally, during the settlement negotiations, ALSTOM experienced a significant crack in the boiler that led to the discovery and investigation of what has become known as the "T-23 issue." *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 16, ln. 13-16. KCP&L took advantage of the on-going settlement negotiations to resolve what could have been a very significant commercial issue. ** [redacted] ** In his pre-filed testimony, Kenneth Roberts describes all of the benefits KCP&L received in the ALSTOM Unit 2 Settlement Agreement:

> **Q: What benefits did KCP&L receive as a result of the ALSTOM Unit 2 Settlement Agreement?**
>
> A: Under the ALSTOM Settlement Agreement, KCP&L was able to secure the following protections from ALSTOM:
>
> - ** [redacted]

134. *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 16, ln. 17 to p. 18, ln. 9. It is estimated that while KCP&L paid ALSTOM ** [redacted] ** in incentive payments, KCP&L received at least ** [redacted] ** in value for the benefits it received. *See* KCP&L's Post Hearing Exhibit filed on February 22, 2011.

135. KCP&L considered and balanced both cost and schedule in creating a revised schedule and fostering cooperation between the main contractors to complete Iatan Unit 2. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 40, ln. 7-8. Based upon a prudence analysis, KCP&L's decision to enter into the ALSTOM Unit 2 Settlement Agreement

was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

3. Schiff Hardin Adjustments (expense, project management labor rate/legal services rate adjustment).

(a) Summary of Staff's Recommended Disallowances for Schiff Hardin (Staff Proposed Disallowance: $1,425,251 - Unit 1; $7,149,169 - Unit 2).

136. Approximately 25% of Staff's November 2010 Report is devoted to the fees of Schiff Hardin, which amounts to less than 1% of the total cost of the Iatan Project. As detailed in the pre-filed testimony of many of KCP&L's witnesses, Staff's level of interest regarding Schiff Hardin is difficult to reconcile given the amount of the proposed disallowance. *See* Hearing Exhibits: KCP&L-8, Blanc Rebuttal Testimony at p. 32, ln. 17 to p. 33, ln. 2; KCP&L-22, Downey Rebuttal Testimony at p. 48, ln. 3-12; KCP&L-25, Giles Rebuttal Testimony at p. 56, ln. 17 to p. 57, ln. 2. KCP&L's witnesses also discussed the value that Schiff Hardin brought to the Iatan Project, from the initial set-up of the commercial strategy and strategic schedule, the negotiation of the Iatan Project's contracts through the Project itself, all the while providing KCP&L's senior management team information it needed to oversee the Iatan Project's management. *See* Hearing Exhibits: KCP&L-8, Blanc Rebuttal Testimony at p. 22, ln. 9 to p. 23, ln. 5; KCP&L-22, Downey Rebuttal Testimony at p. 6, ln. 15-17; KCP&L-25, Giles Rebuttal Testimony at p. 16, ln. 2-6; KCP&L-19, Davis Rebuttal Testimony at p. 5, ln. 12-19; KCP&L-6, Bell Rebuttal Testimony at p. 2, ln. 12-16.

137. Staff's recommended disallowance from Schiff Hardin's fees is based, first, on the allegation that KCP&L did not follow an appropriate process for selecting Schiff Hardin to perform on the Iatan Project, and second, that once on board, KCP&L failed to manage Schiff

Hardin's work. Staff's calculation of these adjustments to Schiff Hardin's fees and expenses is as follows:

	Unit 1	Unit 2	Total
Schiff Hardin Expense adjustment	$196,534	$985,831	$1,185,365.00
Schiff Hardin Project Mgt labor rate adjustment	$1,045,819	$5,245,909	$6,291,728.00
Schiff Hardin legal services rate adjustment	$182,898	$917,429	$1,100,327.00
Schiff Hardin unsupported charges (no invoices)	0	0	$0.00
	$1,425,251	$7,149,169	$8,574,420

138. As an initial matter, with the true-up, Staff has dropped its allegation from its November 2010 Report regarding "unsupported charges (no invoices)" for Schiff Hardin's fees and adjusted its other categories of disallowance accordingly.

139. Staff's remaining recommended disallowance of nearly 40% of Schiff Hardin's fees for the Iatan Project is not supported by competent evidence or expert opinion. These disallowances are sponsored by Mr. Hyneman, who admits he is not qualified to evaluate Schiff Hardin's work, does not have the expertise to opine regarding the appropriateness of legal fees and whose opinion is based on a mischaracterization of nearly every important fact regarding Schiff Hardin's hiring and the actual work that Schiff Hardin performed during the Iatan Project.

(b) Staff's Mr. Hyneman is Not Qualified to Sponsor Disallowances of Schiff Hardin's Fees

140. In its November 2010 Report and testimony, Staff provides scant evidence questioning any of the work that Schiff Hardin performed. Staff doesn't question what Schiff Hardin did; Staff just believes that KCP&L paid Schiff Hardin too much money. In fact, Mr.

Hyneman agrees that he is not offering an opinion regarding the quality of Schiff Hardin's work. *See* Hearing Tr. p. 2650, ln. 2-7. Mr. Hyneman agrees that the Staff's "primary focus on Schiff Hardin was its cost." *See* Hearing Exhibit KCP&L-226, Hyneman Surrebuttal Testimony at p. 34, ln. 14-15. However, Mr. Hyneman's inability to opine regarding the nature and quality of Schiff Hardin's services inherently undermines the evidentiary basis of his proposed disallowance of Schiff Hardin's cost.

141. As previously addressed, Mr. Hyneman lacks the necessary experience in performing a construction audit, this being his first one. *See* Hearing Tr. pp. 2594-8; p. 2749. Mr. Hyneman does not believe there is even an authority that provides guidance for a construction audit. *Id.* As a result, Mr. Hyneman lacks the qualifications to provide an expert opinion of the amount of money that is recommended or even typically spent of projects of this size and complexity for oversight and legal services.

142. Furthermore, Mr. Hyneman has none of the qualifications needed to opine relative to the market rates for attorneys. He is not an attorney himself, and has not presented any evidence that he has ever contracted for legal services at any point in his career. *See* Hearing Tr. p. 2589, ln. 17-22. Mr. Hyneman admits that he is not an expert at evaluating the quality of legal work and he is not offering an opinion as to the quality of Schiff's work on the Iatan Project. *See* Hearing Tr. pp. 2649-50.

143. The disallowances offered by Mr. Hyneman regarding Schiff Hardin are not an auditing exercise. Mr. Hyneman is not offering a disallowance because someone from Schiff Hardin charged the wrong rate for their work or he can prove that individuals billed time but didn't work. His disallowances require the knowledge of the legal industry and the ability to

judge the work that Schiff Hardin did in exchange for the fees charged. Mr. Hyneman admits he is not qualified in either respect.

144. As an example, in Staff's November 2010 Report, Mr. Hyneman utilized an inappropriate index—the Laffey Matrix—for calculating his proposed disallowance of Schiff Hardin's lawyer's hourly rates. Mr. Hyneman opined that the fee structure in the Laffey Matrix was "probably pretty reasonable" and at the "high end" of what attorneys charge. *See* Hearing Tr. p. 2754, ln. 7-10. However, the Laffey Matrix is not remotely applicable to the services that Schiff Hardin has provided to KCP&L on the Iatan Project. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 21, ln. 13-15. Yet, Mr. Hyneman did not know any limitations to the applicability of the Laffey Matrix. *See* Hearing Tr. p. 2650. Mr. Hyneman admits that he did not look at a single market survey of lawyers' fees in developing his opinion. *See* Hearing Tr. pp. 2754 – 5. Mr. Hyneman admits he has never heard of one such survey of legal fees, AmLaw 200 and never knew that Missouri Lawyers Weekly Annual Survey of Missouri Hourly Rates existed, nor did he consult with any attorneys regarding rates for attorneys in Missouri. *Id.* Because he is not qualified to assess either the quality or the reasonableness of Schiff Hardin's work, factors which are inherently related to the value of Schiff Hardin's work, Mr. Hyneman cannot offer a credible expert opinion to provide evidentiary support for his disallowance or raise a serious doubt of KCP&L's expenditure.

145. Even if Mr. Hyneman were competent to opine regarding the reasonableness of Schiff Hardin's fees, the rate comparisons, specifically to the Laffey Matrix and to the hourly rates of Kansas City law firms, are not reasonable benchmarks against which to measure Schiff Hardin's fees. The Iatan Project is among the largest and most complex construction projects the region has seen for many years. Recognizing that fact, it would not have been prudent for

KCP&L to hire the least cost construction counsel or favor local counsel without regard to their knowledge or experience. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 34, ln. 6-21.

(c) Procurement and Management of Schiff Hardin's Services followed a recognized process

146. Mr. Hyneman alleges in his Surrebuttal Testimony that, "the facts are that KCPL hired Schiff Hardin based on a phone call recommendation of Mr. Downey's former boss at Commonwealth Edison, Mr. Tom Maiman." *See* Hearing Exhibit KCP&L- 226, Hyneman Surrebuttal Testimony at p. 32, ln. 22-23 He also alleges that, "KCPL paid $20 million dollars to Schiff Hardin without ever doing any analysis whatsoever of the rates charged by Schiff Hardin or ever soliciting any bids or proposals for any other firm capable of providing the same or similar services as Schiff Hardin." *See* Hearing Exhibit KCP&L- 226, Hyneman Surrebuttal Testimony at p. 33, ln. 1-3.

147. While it is true that KCP&L did not solicit bids through a formal request for proposal process (RFP) for the work Schiff Hardin ultimately performed, KCP&L's processes do not require that all services it procures must be subjected to a competitive bidding process. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 20, ln. 22 to p. 21, ln. 2. Moreover, Mr. Blanc and other KCP&L witnesses testified to the considerable vetting of Schiff Hardin and its fees, not just at the outset of the Project but also as the Project progressed. *See* Hearing Tr. pp. 496-503; also *see Id.* pp. 1860-62.

148. In response to questions from Commissioner Gunn, Mr. Downey describes the KCP&L's senior leadership team members who participated in the decision to hire Schiff Hardin including KCP&L's chairman, chief financial officer, and head of generation. "I didn't do this independently and unilaterally." *See* Hearing Tr. p. 1437, ln. 6 to p. 1436, ln. 2. Mr. Downey

also described the vetting process of other potential firms for this scope of work, and the "dog and pony shows" in which he and other executives at KCP&L engaged. *See* Hearing Tr. pp. 1439 to 1441. In particular, Mr. Downey testified that KCP&L went to the offices of Duane Morris, another law firm who specializes in construction law, to see what they could offer, and concluded that Duane Morris did not have the "robust mixture" of skills necessary to support the Iatan Project. *See* Hearing Tr. p. 1439, ln. 10 to p. 1440, ln. 2. Mr. Downey also testifies that KCP&L examined the qualifications of Kansas City firms as part of this process. *See* Hearing Tr. p. 1440.

149. Staff's position is also inconsistent with the testimony of KCP&L's outside expert witness on the Jeffrey prudence issue, Mr. Leonard Ruzicka. 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 FruCon Corporation, a large international company engaged in construction, engineering and real estate development. *See* Hearing Exhibit GMO-36 (NP), Ruzicka Rebuttal at p.1. As an in-house lawyer for FruCon, Mr. Ruzicka spent twenty years hiring law firms with very specialized construction law expertise similar to Schiff Hardin's experience. Mr. Ruzicka testified that it was very common in the industry to hire law firms with specialized construction law expertise without the use of an RFP process. In fact, Mr. Ruzicka testified that in his twenty years with FruCon, he never utilized an RFP process when hiring specialized construction law firms. *See* Hearing Tr. 4341.

150. Ultimately, the question of how KCP&L procured Schiff Hardin should be based on whether Schiff Hardin was the appropriate choice for the work. Staff never alleges that Schiff Hardin did not possess the skills that resulted in KCP&L's selection. MRA's expert Mr. Drabinski agrees that Schiff Hardin was very qualified and provided good information and

advice throughout the Iatan Project. *See* Hearing Tr. p. 1644; also *see* Drabinski Direct Testimony at p. 82. KCP&L's executive team settled on Schiff Hardin because of its combination of skills – the fact that Schiff Hardin's oversight of the Iatan Project could include both legal and non-legal advice was very attractive and ultimately essential to KCP&L's ability to successfully complete the Iatan Project. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 34, ln. 11-14; Hearing Tr. p. 511 ll. 5-25 to p. 512, ll. 1-12 .

151. Without citing to a single fact, Staff claims that Schiff Hardin's work was not well-managed by KCP&L. However, Schiff Hardin only performed the work that KCP&L requested it perform, and the quality of their work and their advice is not being questioned by Staff. With respect to Staff's claims regarding the management of Schiff Hardin's work, in response to Commissioner Gunn's questions, Mr. Downey testified, "[A]s you pointed out, they're expensive. And I can tell you that that was always in our mind. And there wasn't a year that went by—maybe even a month early on—that we didn't challenge our own assumption about that." *See* Hearing Tr. p. 1437. Mr. Roberts also testified that KCP&L maintained tight control over the work that Schiff Hardin performed and that KCP&L utilized a number of individuals to review both the work that Schiff Hardin was performing and the associated costs. *See* Hearing Tr. pp. 1990-1994. Among those to whom Mr. Roberts regularly reported included Mr. Riggins (KCP&L's General Counsel), Mr. Reynolds (KCP&L's Assistant General Counsel) and Ms. Lora Cheatum (KCP&L's Vice President of Supply Chain). *See* Hearing Tr. p. 1865 Mr. Downey stated that Mr. Reynolds was in the field with Schiff Hardin on a daily basis. *See* Hearing Tr. pp. 1439-40. Mr. Davis testifies at length to the work that Schiff Hardin's team performed throughout the Iatan Project at the site; that work included both legal and non-legal work from Schiff Hardin's highly experienced group of consultants. *See* Hearing Exhibit

KCP&L-19, Davis Rebuttal Testimony at p. 61, ln. 17 to p. 66, ln. 10. Mr. Blanc testified that the individuals who reviewed Schiff Hardin's work, including himself, worked with Schiff Hardin's personnel in real-time. *See* Hearing Tr. p. 499.

152. Staff's claim that KCP&L failed to enforce the terms and conditions of its contract with Schiff Hardin or violated its own procurement practices by not requiring Schiff Hardin to provide copies of receipts with its invoices is also not correct. On this basis alone, Staff proposes to disallow 100% of Schiff Hardin's out-of-pocket expenses. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 79, ln. 1 to p. 80, ln. 17. Staff's recommendation is unreasonable and extreme. Staff is in essence saying that not a single penny of Schiff Hardin's expenses should be recovered, not because they were imprudent or excessive, but because Staff did not have receipts to look at. Staff ignores the testimony of Mr. Blanc, who testifies that the information provided by Schiff with respect to its expenses is very detailed:

> Each invoice submitted by Schiff Hardin included a section itemizing expenses, including the date incurred, description of the expenditure, person incurring the expenditure, city in which incurred, and the amount. Descriptions included local travel, telephone tolls, duplicating and binding, meals, and other travel expenses for air/lodging/car rental/parking/taxi.

153. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 36, ln. 19-23. KCP&L reviewed each item for reasonableness. *Id.* at p. 36 ln. 24 to p. 37 ln. 1. Mr. Blanc further stated that KCP&L audited two months of Schiff Hardin's travel receipts and found nothing out of the ordinary. Those receipts were also shared with Staff. *Id.* at p. 37, ln. 1-3.. It is typical for law firms not to provide copies of expense receipts with their invoices. *Id.* at ln. 5-7. Because information related to expenses was provided in Schiff Hardin's invoices, it would have been redundant to provide Staff with the actual receipts for its prudence audit.

154. Staff's assertion that KCP&L should have obtained a discounted fee arrangement is similarly arbitrary and unsupported. Mr. Roberts testifies that Schiff Hardin would not have

accepted such an arrangement. *See* Hearing Tr. p. 1915, ln. 13-25 to p. 1916, ln. 1. Nonetheless, Schiff Hardin did provide KCP&L with a number of very lucrative concessions. Mr. Downey testifies that Schiff Hardin does not charge KCP&L for its travel time to and from Chicago, and that Schiff Hardin has had a moratorium on rate increases since 2009. *See* Hearing Tr. p. 1442, ln. 23-25 to p. 1443, ln. 1-4. Mr. Roberts testified to the extent that he discounted Schiff Hardin's fees to KCP&L in advance of billing. Hearing Tr. p. 1861, ln. 2-25.

(d) Staff's Calculation of its Recommended Disallowance of Schiff Hardin's Fees is Arbitrary

155. Mr. Hyneman's calculation of the recommended disallowance of Schiff Hardin's fees is fatally flawed because: (1) Mr. Hyneman's split of hours which he believes Schiff Hardin spent on legal work versus "project management" – something Schiff Hardin did not do - is completely without basis; and (2) Staff's disallowances neither take into account the value that Schiff Hardin has provided nor evidence regarding the reasonableness of Schiff Hardin's fees. Instead, as with the example provided above, Mr. Hyneman leaps to conjecture based on little or no evidence, his personal non-expert opinions and often on a complete misunderstanding of the facts. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 31, ln. 5-7.

156. Mr. Hyneman testifies that it is Staff's belief that "80 percent of the work performed by Schiff Hardin employees were [sic] related to construction project management, including project controls." *See* Hearing Exhibit KCP&L-226, Hyneman Surrebuttal Testimony at p. 22, ln. 14 to p. 24, ln. 2. Mr. Hyneman testified that he determined his 80/20 split of Schiff Hardin's services based on "Mr. Downey's testimony and the type of work that Schiff Hardin performs." *See* Hearing Tr. p. 2750, ln. 20-21. However, Mr. Downey testified that he considered approximately 65-70% Schiff Hardin's work was, in fact, legal in nature. *See* Hearing Tr. p.1343, ln. 12.

157. Non-legal work provided by Schiff was performed by non-lawyers. *See* Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at pp. 18-19. This adjustment is strictly an invention of Mr. Hyneman. It is not based on an analysis of Schiff Hardin's invoices or any other facts. However, Mr. Hyneman's theory regarding Schiff Hardin's time split between legal and "project management" allows him to apply a much lower rate for those individuals who did not provide legal services on the Iatan Project. *See* Hearing Tr. pp. 2747-9. Mr. Hyneman's analysis completely ignored the facts and the testimony that legal work made up the majority of Schiff Hardin's fees as explained by Mr. Roberts', Mr. Blanc's and Mr. Downey's testimony.

4. Campus Relocation Adjustment (Staff Proposed Disallowance: **[redacted])**

158. The "Campus Relocation" issue was the move of construction trailers in response to a request from Kiewit, the Balance of Plant Contractor, for additional laydown space close to the turbine building to streamline its assembly and installation of the steam turbine generator. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 55, ln. 14-16. In his Rebuttal Testimony, Mr. Davis provides a very thorough explanation as to KCP&L's decision-making process with respect to both the original campus design as well as KCP&L's decision to move the campus. *See id.* at p. 55, ln. 14 to p. 58, ln. 19. As stated by KCP&L in Data Request No. 730:

> The original campus design and location was developed in the summer and fall of 2006. Facility construction began in the summer of 2006. The initial trailers on site were for KCP&L, Kissick, Pullman and ALSTOM, each of whom mobilized to the site in late-summer and fall of 2006.
>
> In the summer of 2007, the Balance of Plant contractor, Kiewit, developed a revised plan for laydown space needed for access to the turbine generator building. This plan included providing a new path for unloading the turbine generator to the turbine bay. Kiewit's plan necessitated the moving of the existing campus trailers to provide the area for laydown space. Additionally,

> Kiewit's plan of where it wanted to locate erection cranes caused safety concerns because Kiewit would be lifting loads near or over the campus.

See Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 44, ln. 14-25.

159. Staff states that the reason for its proposed disallowance is that "the cost appears to be a significant design error. The most appropriate method for KCP&L to recover these costs is to seek backcharges for the cost of this work from the entity who was responsible for the design of the construction campus laydown area." *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 44, ln. 27-30. First, the MPSC Engineering Staff, led by Mr. David Elliott, has not indicated that these additional costs were the result of a "significant design error." Nor does it appear that Staff has ever asked Mr. Elliott's opinion on this issue. On this point, Mr. Hyneman testified at the hearing as follows:

> Q. Okay. So from the engineering perspective, from what I understand -- I don't know if you were in the room for Mr. Elliott -- is the risk of moving it over was greater than moving the campus to the side?
>
> A: Yes. He did not take issue with the fact that they should move the campus.

See Hearing Tr. p. 2816, ln. 21 to p. 2817, ln. 2.

160. Second, Mr. Hyneman is neither a construction professional nor an engineer and therefore he is not qualified to provide an opinion regarding the existence of a design error. Such an opinion must be offered by a competent expert based on an engineering review of the initial campus drawings and an analysis of the Balance of Plant contractor's means and methods for constructing the turbine building. Accordingly, Staff's has failed to offer competent evidence regarding this disallowance.

161. Finally, Staff has not performed a prudence analysis on these costs to determine if KCP&L's original campus plan was reasonable under the circumstances. Instead, Staff only states that the costs of the campus move are "inappropriate," a conclusion based on an

unqualified hindsight interpretation of the Balance of Plant contractor's request to move the campus. Because Staff has not made a determination on the prudence of KCP&L's original site plan, it has not raised a serious doubt as to the prudence of the campus relocation expenditures.

162. KCP&L provided substantial evidence that the campus relocation was prudent. KCP&L's prudence expert, Dr. Nielsen testified as follows:

> In reviewing the issue Pegasus-Global found nothing in the project record which pointed to any imprudent decision or action by KCP&L. The original site layout was completed in the fall of 2006, well in advance of any detailed design having been received from either Toshiba or Alstom, which means that at the time the campus location planned by KCP&L was based on very preliminary and limited information relative to the size of the various structures and facilities which would ultimately be constructed to house the boiler or the turbine generator. By the time that information had been received (in 2007) much of the trailer campus had been located and set. As the plans for construction of the facilities were prepared (by KCP&L early and later Kiewit) Kiewit was concerned that the location of the campus posed difficulties to both the turbine equipment movement (access) and the safety of site personnel (crane siting and load swing paths). Such issues are normal in projects which are large, complex and involve multiple contractors, vendors and suppliers. Pegasus-Global found nothing that would lead it to believe that the original siting of the campus was imprudent and certainly found nothing imprudent in either improving equipment access or improving site safety in moving the campus.

See Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 260, ln. 1-16.

163. KCP&L had the responsibility to coordinate many contractors on site. If KCP&L had rejected Kiewit's proposal, KCP&L believed it would have made Kiewit's assembly and installation of the turbine more time consuming, risky, costly, and complicated, as well as increasing the risk of delays, damage, and other issues. It is reasonable for the owner to set the contractors up for success and accommodate design maturation issues to facilitate the contractor's productivity. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 58, ln. 14-19. Accordingly, KCP&L's decision to move the campus was a reasoned and prudent risk mitigation strategy, not one of cost savings.

164. Although KCP&L does not believe that Staff has adequately "raised a serious doubt" as to the expenditures associated with the campus relocation, KCP&L has nonetheless offered substantial and competent evidence as to the prudence of these costs. As a result, the Commission should deny Staff's recommended disallowance for these costs.

5. JLG Accident Adjustment (Staff Proposed Disallowance: ** [redacted] **)

165. Staff believes that KCP&L was unreasonable for executing the JLG Settlement Agreement with ALSTOM. Staff is recommending this proposed disallowance based on its belief that "KCP&L developed a strong case of why it bore no responsibility for the cost of this accident." *See* Hearing Exhibit KCP&L-205, Staff November Report at p. 46, ln. 29-32. While it is true that KCP&L asserted a defense to ALSTOM's position as part of a negotiation, it would have been imprudent for KCP&L to not defend its commercial position. The nature of Staff's disallowance ignores the circumstances of the claim itself and the context within which it was resolved.

166. Mr. Davis testifies regarding the JLG incident and the claims that were submitted by ALSTOM. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 51, ln. 10 to p. 55, ln. 11. Mr. Davis testifies that KCP&L and ALSTOM chose to escalate this issue for resolution as part of a broader commercial strategy, and that this issue was one of several that KCP&L and ALSTOM ultimately resolved in this manner. Mr. Davis noted that, ** [redacted]

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[redacted]** *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 54, ln. 17 to p. 55, ln. 11. These costs were ultimately split between the two units.

167. In its November 2010 Report, Staff has failed to raise a serious doubt as to the prudence of KCP&L's settlement of the JLG accident costs. Moreover, KCP&L has provided substantial evidence of the prudence of its decision to settle this dispute with ALSTOM. As a result, the Commission should deny Staff's recommended disallowance for these costs.

6. Construction Resurfacing Project Adjustment (Staff Proposed Disallowance: ** [redacted] **)

168. Staff is recommending the disallowance of ** [redacted] ** paid to ALSTOM as a result of a claim of delay and disruption made by ALSTOM due KCP&L's "Construction Resurfacing Project." The Construction Resurfacing Project came about in the late summer of 2007 after the JLG tipped over as discussed above. As stated by Brent Davis in his pre-filed testimony:

> In support of its claim arising from the JLG Incident, ALSTOM asserted that the soil conditions were the cause of the incident. Regardless of the actual cause of the incident, the remaining construction work on the Iatan project required the use of a lot of heavy equipment. So the mere occurrence of the JLG incident on the Iatan Site created concern of the safe operation of similar equipment and the stability of the surface of the Site among the operators of large equipment. In support of its commitment to project safety, to improve the contractors' confidence regarding the safe operation of equipment on the Iatan site, and to minimize disruption to the construction, the Iatan project management team felt it was important to voluntarily and proactively commence a multi-phase construction resurfacing project to improve the quality and stability of the soil surface ("Construction Resurfacing Project"). ALSTOM submitted a claim for

> acceleration costs based on the alleged impacts and delays caused by KCP&L's execution of the Construction Resurfacing Project.

See Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 52, ln. 4-16.

169. Staff has failed to raise a serious doubt as to the prudence of these expenditures because it has not performed a prudence review of KCP&L's decision to pay these costs. Staff issued its Unit 1 Report in August 2010 with respect to its Unit 1 Prudence Review. *See* Staff's *Construction Audit and Prudence Review, Iatan 1 Environmental Upgrades (AQCS), For Costs Reported as of April 30, 2010* ("Staff's Unit 1 Report"). In Staff's Unit 1 Report, the only position Staff takes with respect to theses costs are that:

> As noted above, Staff finds that KCPL incorrectly charged costs of the Construction Resurfacing Project Alstom Settlement in the amount of $1,155,000 to the Iatan 1 construction work order. If KCPL believed these costs were reasonable and prudent, it should have charged these costs to the Iatan 2 construction work order. Staff will address the reasonableness and prudency of these costs in its Iatan 2 construction audit.

See Staff's Unit 1 Report at p. 32, ln. 19-23. However, in Staff's November 2010 Report, Staff simply states that "The costs of this settlement were challenged by the KCC Staff in its Iatan 1 prudence review. The staff is of the understanding that KCPL has agreed not [to] challenge the KCC Staff's adjustment to remove the costs of this settlement from the Iatan Project." *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 47, ln. 19-22.

170. The KCC Staff audit is not before this Commission and is therefore non-credible hearsay. Staff does not even provide in its November 2010 Report the basis of the KCC's recommended disallowance. Staff does not purport to have reached any independent determination about the prudence of the items listed in KCC's audit nor does Staff offer any evidence other than the audit KCC performed to support its recommendations. The fact that KCP&L decided not to challenge those adjustments in its Kansas case does not create a serious doubt as to the imprudence of those expenditures, especially in light of the fact that KCP&L has

not admitted that those expenditures were imprudent. In fact, KCP&L witness Brent Davis provides the circumstances under which KCP&L decided to settle with ALSTOM for these costs, and why these costs were prudent, even though Staff has not adequately challenged the presumption of prudence as to these costs. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 51, ln. 7 to p. 55, ln. 11. As a result, the Commission should deny Staff's recommended disallowance for these costs.

7. May 23, 2008 Crane Accident (Staff Proposed Disallowance: **[redacted]**)

171. The circumstances surrounding the crane accident are described in detail in KCP&L witness Mr. Downey's Rebuttal Testimony. *See* Hearing Exhibit KCP&L-22 at p. 14, ln. 3 to p. 24, ln. 8. In summary, on May 23, 2008, one of the largest mobile cranes in the world, a Manitowoc 18000 crane, collapsed while performing an unloaded test lift on the Iatan project (the "Crane Incident"). As a result of the collapse, one person was killed and others were injured. *See id.* at p. 14, ln. 20-22. KCP&L's EPC Contractor, ALSTOM, was responsible for the operation of the crane at the time of the incident. *See id.* at ln. 23.

172. In Staff's November 2010 Report, Staff's only reasoning for this disallowance is that based on a meeting that Staff had with KCP&L, **[redacted]** *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 41, ln. 15-19. Staff admits that it has not done a detailed review of project costs to determine if the charges are accurate and complete, even though many of these charges were incurred by KCP&L over two years ago. *See id.* at ln. 19-22.

173. Representatives from KCP&L including Curtis Blanc, Carl Churchman and Brent Davis informed Staff of the incident the day it happened. Representatives from Staff toured the

site within a few days of the accident to see the damage. Additionally, KCP&L informed the Staff of its activities in its Quarterly Reports and at each of its Quarterly meetings. For example, in KCP&L's 2nd Quarterly Report for 2008, KCP&L states:

> In order to assess the impact of the accident on the work, a scheduling team, made up of representatives from ALSTOM, Kiewit, the Start-up and Commissioning Team, and the Project Controls Team, conducted meetings to determine the schedule impact to the Iatan Unit 1 2008 fall outage. This team completed a comprehensive activity-by-activity review of the remaining pre-outage and outage work to determine what, if any, impact the incident would have on the outage start date, duration and labor requirements. Upon completion, it was the scheduling team's determination that all construction and outage milestone dates could be maintained. There were two areas of concern identified relative to the Iatan Unit 1 SCR construction: the replacement of the crane and fixing damage to a piece of ductwork for the SCR that was on a fabrication table in the area of the collapse. These concerns have now been mitigated.

See Hearing Exhibit KCP&L-22, Schedule WHD2010-4 at p. 25 and Downey Rebuttal Testimony at p. 22, ln. 11-30.

174. ** [redacted] ** However, although KCP&L has incurred those costs through no fault of its own, and in fact worked hard in the aftermath of the accident to minimize the impacts to the project and other contractors, there is no guarantee that KCP&L will be able to recover all of the costs from ALSTOM. In fact, KCP&L has attempted to recoup these costs from ALSTOM, but so far, has been unsuccessful. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 14, ln. 12-17.

175. As of October 31, 2010, KCP&L incurred approximately ** [redacted] ** of additional costs arising from the Crane Incident. The costs incurred by KCPL due to the Crane Incident were prudently incurred. As testified by KCP&L witness Mr. Downey:

KCPL's mitigation of the impacts of the Crane Incident was one of our management's major successes on the Iatan Project and an example of our management's ability to effectively and actively manage the contractors. Our management team immediately took action and did everything in its power to minimize the potential impact of this very unfortunate event, including preventing claims that could have easily have been made by the contractors. ** [redacted] ** [Citations omitted]. Without such data, KCP&L might not have been able to defend against such a claim, the schedule may not have been recovered, or both. ** [redacted] ** KCP&L agrees that to the extent it does recoup some of the costs it incurred related to the Crane Incident from ALSTOM, KCP&L will credit that money back to the cost of the plant.

See Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 23, ln. 6 to p. 24, ln. 8. Despite the fact that KCP&L and ALSTOM have as yet been unable to determine the costs that each party will bear as a result of the Crane Incident, the Commission can make a determination with respect to prudence on this issue, as KCP&L has proven that it has done everything within its control to effectively manage the contractor to mitigate these costs as well as recoup the costs to the extent possible from the responsible contractor. As a result, the Commission should deny Staff's recommended disallowance for these costs subject to the credit described above.

8. Cushman Project Management Rate Adjustment (Proposed Staff Disallowance: $101,776 Unit 1, $361,517 Unit 2).

176. Staff's proposed disallowance for a rate adjustment relating to Mr. Cushman's fees was based solely on Mr. Hyneman's assessment that Mr. Cushman's fees were unreasonable. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 98, ln. 4-20. In order to adjust Mr. Cushman's rates, Mr. Hyneman applied rates paid by KCP&L to LogOn & Associates based on his determining that both entities provide similar construction project management services. *See id.* However, Mr. Hyneman provides no basis for his conclusion that the services provided by Mr. Cushman, a consultant hired to perform a specific and special project, compare to those provided by LogOn, a company that primarily provided day-to-day staff augmentation services for the project (similar to a temporary staffing service). Cushman was hired to develop processes and procedures for the Iatan Project including the PEP. Mr. Cushman is highly respected in the industry and had a proven track record with KCP&L from Hawthorn. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 66, ln. 14-19. KCP&L evaluated the costs for Cushman's specialized services and determined that the costs were reasonable. *See id.* Mr. Hyneman does not have the expertise necessary to make a judgment as to whether Mr. Cushman's fees were reasonable, and as a result, he has failed to create a serious doubt as to the prudence of this expenditure. Furthermore, Staff has not indicated that either KCP&L's decision to hire Mr. Cushman, nor KCP&L's management of his services were imprudent. As a result, the Commission should deny Staff's recommended disallowance for these costs.

9. Pullman Adjustments—Performance Bond and Second Shift (Staff Proposed Adjustment **[redacted])**

177. Although Staff includes in Schedule 1-1 of its November 2010 Report two proposed disallowances related to Pullman, the Iatan Project's Chimney contractor, in the amount of **[redacted]** for Unit 1 and **[redacted]** for Unit 2, there is no explanation

anywhere in Staff's November 2010 Report as to Staff's evaluation of these costs or why they have been deemed to be imprudent. Because Staff provides no evidence in support of these recommendations, KCP&L has no way to determine Staff's reasoning for this recommendation. Therefore, Staff has deprived KCP&L of an opportunity to defend itself as to the prudence of these expenditures. As a result, Staff has not created a "serious doubt" as to these expenditures and they should be deemed to be prudent by the Commission. Accordingly, the Commission should deny Staff's recommended disallowance for these costs.

10. Adjustment from KCC Staff Audits (R&Os 139 and 330—Staff Proposed Adjustment $438,200 for Iatan 1 and $1,509,915 for Iatan 2)

178. Staff proposes adjustments in the amount of almost $2 million based on a KCC Staff audit. The KCC Staff audit is not before this Commission and is non-credible hearsay. Staff does not purport to have reached any independent determination about the prudence of the items listed in KCC's audit nor does staff offer any evidence other than the KCC audit to support Staff's recommendations. The fact that KCP&L decided not to challenge those adjustments in its Kansas case does not create a serious doubt as to the imprudence of those expenditures, especially in light of the fact that KCP&L has not admitted that those expenditures were imprudent. In fact, KCP&L witness Brent Davis has explained in his Rebuttal Testimony as to why those costs were prudent spends for the Iatan Project:

> R&O #330 in the amount of $82,180 was the cost associated with accelerating the vendor's supply of steel for the Ash Piping rack by 3-6 weeks. This steel was needed but the design documents were prepared after the main mill run was issued, so there were charges to insure that the steel arrived in time for installation. Kiewit's erection sequence changed the original sequence for these mill orders. This steel needed to be expedited to take advantage of the efficiency that Kiewit needed, and to reduce coordination problems on site. I believe that this nominal cost was a benefit to the Project.
>
> R&O #139 was for Kissick to add pilings to what we called the North Tank Farm. There are a series of tanks and other structures on the north side of Iatan Unit 1

> that were installed for the Iatan Project for the water treatment, wastewater and chemical systems that serve both units. The original design concept for these tanks was to allow the foundations to settle through weight and gravity, and not put structural piling below them. The settling process would take approximately 6 months. In April 2007, Kiewit's proposal for the Balance of Plant work included a number of ways to spread out the work on site over time so that the potential impacts of labor availability and poor productivity did not affect the schedule. Kiewit's plan was based on reducing the peak manpower as much as was practical. Kiewit and our team reviewed the work on site and resequenced the tank farm so that the work would be completed in 2008. This meant that the six months of settling time no longer worked with the schedule, so we asked Burns & McDonnell to design and Kissick to install piling for the tanks. It was the best option at the time we had to smooth out some of the work on site, and it was fortunate that we did the tank farm work earlier than planned.

See Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 71 ln. 20 to p. 72 ln. 19.

11. Affiliate Transaction (Proposed Staff Adjustment: $296,021 Unit 2)

179. Staff has proposed a disallowance for costs incurred by KCP&L's affiliate, Great Plains Power ("GPP") for work performed that was ultimately used as a part of the development of the Iatan Unit 2 project. As cited by Staff in its November 2010 Report, KCP&L identified the work performed as pertaining to "environmental permitting and engineering which defined the project scope and plant design." *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 51, ln. 10-12. Staff simply states that it "was not convinced that the costs incurred by GPP in its nonregulated activities were necessary for the construction of Iatan 2." However, Staff's November 2010 Report does not identify the reasons for this belief, nor does it provide any sort of prudence analysis of the costs incurred. As a result, Staff has not raised a serious doubt as to the prudence of these costs that can overcome the presumption of prudence afforded to KCP&L and the Commission should deny Staff's recommended disallowance for these costs.

12. Welding Services Incorporated ("WSI") Change Order Adjustment (Proposed Staff Adjustment: $12,714,596 Unit 2)

180. Staff and one of KCP&L's experts, Dr. Nielsen have proposed a disallowance for the additional costs associated with KCP&L's use of a specialty welding contractor, WSI, during the course of the Iatan Unit 2 Project. KCP&L witness Brent Davis discusses in his Rebuttal Testimony KCP&L's decision to direct ALSTOM to hire WSI at p. 66, ln. 21 to p. 68, ln. 22. *See* Hearing Exhibit KCP&L-19. In general, Mr. Davis testifies that KCP&L decided to direct ALSTOM to hire WSI in order to improve ALSTOM's schedule performance and to increase the quality of the welds performed. *See id.* at p. 68, ln. 1-22. It is important to note that KCP&L did not pay "double" for these costs, but instead only paid the difference between the cost of directing ALSTOM to hire the more expensive WSI versus utilizing its own craft workers. *See* Hearing Exhibit KCP&L-4 at Schedule FA2010-08. Under ALSTOM's Contract, directing ALSTOM to hire a specialty contractor at a higher price constitutes an "Owner Initiated Change" under Subsection 13.1 of ALSTOM's Contract. *See* Hearing Exhibit KCP&L-2601 at Schedule WPD-31. As a result, ALSTOM was entitled to additional compensation under its contract.

181. It is important to note that Staff does not make its own independent prudence evaluation of these costs, but simply relies on the recommendation of KCP&L's expert, Dr. Nielsen. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 101, ln. 2-11. Dr. Nielsen is the only person offering testimony with the requisite expertise and having performed a proper prudence analysis under Missouri Law. Dr. Nielsen supported KCP&L's prudent decision-making with the exception of two select items: (1) the agreement KCP&L had with ALSTOM to pay the premium portion of the specialty welding crews from its subcontractor WSI and (2) costs associated with the temporary auxiliary boiler. Staff has adopted these findings and also recommended these items for disallowance. These two items total $18,060,645.40. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 240, ln. 1-9.

182. In determining that the WSI costs were imprudent, Dr. Nielsen analyzed the status of ALSTOM's work on the Project including welding of the boiler, the construction schedule at the time, ALSTOM's contract terms, previous settlement agreements with ALSTOM, and the correspondence between KCP&L and ALSTOM regarding the status of the welding of boiler pressure parts. Dr. Nielsen concluded that because this issue was resolved outside of the normal dispute/settlement process utilized by KCP&L, KCP&L should not have provided additional compensation to ALSTOM. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 232, ln. 3 to p. 235, ln. 8. Although KCP&L agrees that Dr. Nielsen has conducted a proper prudence analysis, it disagrees with his conclusion. KCP&L did not believe that it had any time to lose with respect to instituting this change, and that by allowing ALSTOM to fall further behind could mean additional costs in excess of what it would pay WSI for KCP&L in the form of delay costs by other contractors. Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p 68, ll. 18-20. Additionally, KCP&L was ensured of higher quality welds. *See id.* at p. 68, ln. 10-17. As a result, the Commission should deny Staff's recommended disallowance for these costs.

13. Temporary Aux Boiler (Proposed Staff Adjustment: $5,346,049 - Unit 2)

183. Staff also makes a second recommended disallowance based solely on Dr. Nielsen's recommendation related to the cost of the temporary auxiliary boiler. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 231, ln. 8-12. In order to make his recommendation, Dr. Nielsen analyzed the project records including the evolution of the Project design and related correspondence regarding the need for auxiliary steam. Based on these records, Dr. Nielsen determined that KCP&L's decision to delete a permanent auxiliary boiler from the Project design in 2007 and later reincorporate this permanent equipment (and a temporary auxiliary boiler) was imprudent. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal

Testimony at p. 235, ln. 14 to p. 238, ln. 4. Dr. Nielsen then evaluated the associated costs to identify any additional costs KCP&L incurred and recommended that a total of $ 5,346,049 (KCP&L Missouri jurisdictional share $1,564,781 and GMO share $962,289 million) be disallowed. *See id.* at p. 239, ln. 2.

184. The reason for the difference in the amount recommended by Staff and the amount recommended by Dr. Nielsen is because Staff used the amount recommended by Dr. Nielsen in his Kansas Testimony (Docket No. 10-KCPE-415-RTS), which was filed in July 2010. Because KCP&L had not yet incurred all of the costs associated with the Temporary Auxiliary Boiler, Dr. Nielsen used KCP&L's estimated cost. However, since that time, KCP&L had expended more actual costs as well as had an opportunity to refine its final cost data. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 238, ln. 12-13. The amount recommended by Dr. Nielsen therefore significantly decreased between July and December 2010.

185. KCP&L also disagrees with Dr. Nielsen and Staff's recommendation to disallow costs for the temporary aux boiler. KCP&L witness Brent Davis provides KCP&L's rationale for the prudent expenditure of the temporary auxiliary boiler costs. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 68, ln. 23 to p. 71, ln. 14. Dr. Nielsen's proposed disallowance for the temporary auxiliary boiler costs is based on the fact that KCP&L could not provide Pegasus with documentation that established its decision for removing the aux boiler from the design of the Iatan Project. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 238, ln. 17-19. However, Brent Davis, in his pre-filed testimony, provides the circumstances which existed at the time KCP&L made the decision regarding the auxiliary

boiler. Based on his testimony, the Commission could find that KCP&L's decision was prudent based upon the circumstances at the time. Mr. Davis testified as follows:

Q: To provide the Commission with some context, please explain what an auxiliary boiler does and why was it needed to support the Iatan Project.

A: An auxiliary boiler is a piece of equipment that produces steam when the main boiler is not producing enough for the unit's needs. The steam necessary to support the unit during the start-up process is more than normal operating needs. There are numerous pieces of equipment throughout the plant that use auxiliary steam including the air heater coils and air heater sootblowers on the boiler and steam seals and turbine pre-warming systems on the turbine. Therefore, it was always contemplated that a supplemental source of auxiliary steam would be needed during the start-up process. During the second quarter of 2009, KCP&L reviewed equipment information and the requirements of both quality and quantity of steam that would be required during the start-up of Iatan Unit 2. Based on the supercritical components of Iatan Unit 2 and **[redacted]** the field engineering staff expressed concern about the Iatan Unit 1 auxiliary boiler's ability to supply a sufficient volume and quality of steam to support Iatan Unit 2.

After evaluation of the available options, KCP&L decided to construct three permanent electrode auxiliary boilers. There was insufficient time to design, fabricate and install these permanent auxiliary boilers in time to support the scheduled start-up of Iatan Unit 2. As a result, in parallel to the design and procurement of the permanent auxiliary boilers, KCP&L rented and installed temporary auxiliary boilers to meet the Unit's start-up needs. The permanent auxiliary boilers include one 60 kpph electrode boiler and two 30 kpph electrode boilers. KCP&L also installed a separator between the Unit 1 and Unit 2 piping to ensure that the steam coming from Iatan Unit 1 meets the quality requirements for Unit 2. The contracts for the temporary auxiliary boilers and the deaerator were awarded to Nationwide Boiler, Inc. on October 6, 2009 and a notice to proceed was issued for the permanent auxiliary boiler on June 30, 2010. The installation of the permanent auxiliary boiler and related equipment is schedule to begin during the fourth quarter of 2010.

Q: Was there any benefit to using a temporary auxiliary boiler for the start-up process and waiting to install the permanent auxiliary boiler?

A: Yes. The auxiliary steam requirements can be highly variable due to start-up conditions and the ambient temperatures experienced during a given start-up. Having the experience of the initial start-up using the temporary auxiliary boilers allowed us to better identify the overall auxiliary steam needs for the Plant and properly size the permanent auxiliary boiler system. Using the temporary auxiliary boilers during the startup process allowed us to gain this experience and knowledge. Postponing the permanent auxiliary boiler installation also allowed

> us to minimize congestion and access issues to other contractors. By waiting, we were able to utilize an optimal location for the permanent auxiliary boilers that would have been unavailable earlier in the Project.

See Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 69, ln. 21 to p. 71 ln. 14.

186. As a result, although Dr. Nielsen has raised a serious doubt as to both the WSI and the temporary auxiliary boiler expenditures, KCP&L has adequately addressed those doubts in its pre-filed and hearing testimony and the Commission should deny Staff's recommended disallowance for these costs.

14. Employee Mileage Charge Adjustment ($59,136 Unit 1)

187. Staff's adjustment with respect to Employee Mileage Charges is comprised of two parts. First, Staff proposes to disallow $51,113 of mileage reimbursements because the Iatan project site was designated as the recipient employees' primary work location. The remainder of Staff's proposed disallowance ($8,023) is derived by arbitrarily disallowing 10% of all other employees' mileage reimbursements, i.e., those employees who did not have the Iatan project site designated as their primary work location. However, KCP&L's decision to pay its employees for mileage to work on the Iatan Project was both appropriate and prudent. Second, Staff's deduction of 10% is arbitrary and not based upon competent evidence.

188. As testified by KCP&L witness Curtis Blanc, employees assigned to the Iatan Project were only going to be travelling to Iatan for some portion of the project. Therefore, "even though the Iatan project site was designated as the employees' primary work location, the employees were assigned to Iatan on a temporary basis during the construction and start up of the project." *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 39, ln. 4-6. It is prudent under these circumstances to agree to reimburse mileage costs for these temporary assignments rather than relocating the employees for a five-year period. *Id.* at ln. 7-8. To require employees to work at the Iatan project site on a temporary, five-year project without

compensation for mileage costs would not have been equitable and likely would have been viewed as a deterrent to working on the Iatan Project. *Id.* at ln. 8-11.

189. Staff's rationale for disallowing 10% of all other employees' mileage reimbursements is based upon Staff's perceived potential for errors or miscoding of mileage reimbursements. Mr. Blanc testified that KCP&L has a process in place to review mileage reimbursements in order to catch these errors. *Id.* at ln. 16-20. Without any evidence that Staff routinely found errors on every employee mileage charge that equaled 10%, this disallowance is wholly arbitrary. As a result, the Commission should deny Staff's recommended disallowance for these costs.

15. Inappropriate Charges ($25,000 Unit 1, $75,000 Unit 2)

190. With respect to the inappropriate charges, Staff has attached Schedules 4 and 5. These Schedules purport to identify the inappropriate charges identified by Staff during its Audit. Staff's amount for the proposed disallowances are only "estimates" and the attached documents identify only $18,351 of items charged to Unit 2 that Staff deemed as inappropriate. As stated by Mr. Blanc:

> Staff arbitrarily chose $25,000 and $75,000 for Iatan 1 and Iatan 2, respectively, because that amount "should be adequate in the Staff's opinion ... ." That is not the sound basis for a disallowance and disregards the requirement for Staff to identify an imprudent act or decision, then quantify its impact on the cost of the Iatan projects. It is not apparent that any more "inappropriate" charges exist than those Staff has identified and the Company has corrected. Staff's proposal to disallow potential "inappropriate" charges that might exist is arbitrary, unsupported and should be rejected.

191. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 40, ln. 9-15. Staff has no basis for its estimates, which should be disregarded by the Commission. As a result, the Commission should deny Staff's recommended disallowance for these costs.

16. KCP&L Direct Costs (Property Tax, AFUDC, KCP&L Only)

192. Several of Staff's AFUDC disallowances will require adjustment depending upon the commission's final decision on the related direct project cost disallowances and proposed project cost transfers between Iatan 1, Iatan 2 and Iatan Common project costs. For the other AFUDC disallowances discussed below, KCP&L believes that Staff's adjustments should be rejected by the Commission.

(a) Additional AFUDC due to Iatan 1 Turbine Start-Up Failure

193. Although Staff has not proposed any disallowance associated with the turbine trip, it is attempting to penalize KCP&L for the turbine failure by not allowing the AFUDC costs incurred on the Iatan AQCS project costs during the outage associated with the work. AFUDC costs are a component of the construction project's total costs and should not be disallowed when costs associated with prudent work required to return Unit 1 to service have not been proposed to be disallowed. *See* Ives True-Up Rebuttal at p. 11.

(b) Advanced Coal Tax Credit Availability of Funds

194. Staff's proposed adjustment is based on its mistaken notion that ratepayers are harmed by KCP&L carrying over to future years some of the Section 48A federal advanced coal investment tax credits generated in 2008 and 2009. As explained by KCP&L's witness Ives, KCP&L did not use the advanced coal tax credit in those years due to the utilization of net operating losses that were available after the acquisition of Aquila. *See* Ives True-Up Rebuttal at p. 13. KCP&L's financing costs did not increase as a result of GPE not utilizing the credits in 2008 and 2009 because of the small amount of total tax liability on GPE's consolidated tax return during those years. *Id.* Because only a small amount of cash was needed to fund income tax liabilities, the cash available to fund the Iatan construction projects was almost exactly the same whether the advanced coal tax credits were utilized in 2008 and 2009 or carried over to

future tax years. *Id.* At 13-14. Staff's adjustment should be rejected because it attempts to impute a cost savings that does not exist and ratepayers will continue to receive the benefits of the advanced coal investment for credits over time.

(e) MRA's Consultant's Proposed $17 Million Unit 1 and $231 Million Iatan Unit 2 Disallowances should be Rejected

1. The KCC rejected Mr. Drabinski's proposed disallowances and analysis.

195. MRA has retained the services of Walter Drabinski to provide his opinion and propose disallowances relating to the construction of the Iatan Project. Mr. Drabinski was originally hired by the Staff of the Kansas Corporation Commission ("KCC") for this analysis. Although the KCC rejected both Mr. Drabinski's opinion and his proposed disallowances, he has essentially presented the same opinion and analysis to this Commission for its consideration. Like the KCC, the Commission should disregard Mr. Drabinski's proposed disallowances as based upon hindsight. In summary, the KCC concluded:

> The evidence concerning the amount and level of costs that should be excluded from the rate base was highly contested by the three parties who prefiled testimony. First, KCPL built a strong and credible case in defense that its actions were not imprudent; its own expert, however, did testify that with respect to Iatan 2, KCPL should accept a $20.4 million . . . imprudence disallowance due to the engagement of Welding Service, Inc., and the removal/readdition of an auxiliary boiler and described in Dr. Nielsen's testimony.
>
> Second, Staff argued for a $231 million . . . disallowance. In our view, this claim hinges on a hindsight analysis, which is clearly prohibited. Staff's case was also fundamentally flawed because it starts with the premise that the project was 49% over the "original cost estimate" but never equates that term to the term "definitive cost estimate" as is done in the regulatory scheme.
>
> . . . Considering the record as a whole, the Commission finds that KCPL's presentation of evidence on the statutory factors weighed greater in our decision than did Staff's . . . The KCPL managers' own testimony about their own actions and what they directly observed and experienced during the construction and ongoing decision making process was credible and more convincing that Staff and CURB witnesses. On lengthy cross-examination, where we directly observed the

> KCPL witnesses testify, nothing occurred to undermine the truthfulness or accuracy of their direct or rebuttal testimony.

See Hearing Exhibit KCP&L-44 at Schedule DFM2010-28 at p. 15-16.

196. Mr. Drabinski appears to believe that the reason the KCC rejected his analysis was that, "Kansas doesn't really have a prudence standard but rather 12 factors that need to be fully addressed where Missouri has, in fact, a prudence standard." *See* Hearing Tr. p. 1564, ln. 17-20. However, Kansas case law has interpreted "prudence" and the analysis for the application of the 12 factors in a manner that is similar to the application of the prudence standard in Missouri. In Kansas, the Kansas Supreme Court has determined that the "commonly used" definition of prudence can be found in Black's Law Dictionary, which defines "prudence" as "carefulness, precaution, attentiveness and good judgment. *See Kansas Gas & Electric Co. v. Kansas Corporation Comm'n*, 720 P.2d 1063, 1075 (1986), *probable jurisd. noted by* 479 U.S. 1082 (1987), *vacated in part by* 481 U.S. 1044 (1987), *appeal dism. by* 483 U.S. 1036 (1987). Furthermore, Kansas also prohibits the use of a hindsight analysis in determining prudence. Instead, KCP&L's decisions regarding the Iatan Project should be based upon the facts and circumstances known at the time. *See* KCC Order, DFM2010-28 at p. 15. Dr. Nielsen disagrees with Mr. Drabinski that there is any real difference between the Kansas and Missouri prudence standards. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at pp. 31-34. Mr. Drabinski agrees that Missouri's prudence standard also requires that decisions should be judged based on the circumstances at the time. *See* Hearing Tr. p. 1565.

197. Ultimately, like so many other aspects of Mr. Drabinski's analysis, characterizing the differences between the prudence standards in Kansas and Missouri amounts to nothing more than a red herring because Mr. Drabinski did not address, much less correct, the flaws in his analysis that were summarily rejected by the KCC. In his prefiled Supplemental Rebuttal

Testimony, Mr. Meyer provides a concise recitation of the problems recognized by the KCC in Mr. Drabinski's analysis that were repeated here:

> Mr. Drabinski's approach to a prudence audit in this case is nearly identical in every substantive manner to the methodology he utilized in the 10-KCPE-415-RTS case regarding the prudence of Iatan Unit 2 (the "KCC 415 Docket") which was recently decided before the Kansas Corporation Commission ("KCC"). In fact, although Mr. Drabinski's testimony in this case contains a few revisions from his pre-filed testimony in the KCC 415 Docket, he has made no real, changes to the methodology or substance of his recommended disallowance to the KCC, who flatly rejected his analysis and Mr. Drabinski's associated prudence recommendation. I have attached the prudence section of the KCC Order issued on November 22, 2010 ("KCC Order") for the Commissions convenience at DFM2010-28. In its Order, the KCC declined "to place much weight on Drabinski's analysis". *See* DFM2010-28, KCC Order at p. 25. Specifically, the KCC rejected Mr. Drabinski's "holistic" approach, as well as determining that his methodology for finding imprudence was based entirely on hindsight, such that his conclusion of "imprudence [was] a consequence of the results attained rather than evaluating decisions and the decision making process, connecting the allegations, and then quantifying the impact." *See* KCC Order, p. 27.

See Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony at p. 2, ln. 15 to p. 3, ln. 10.

198. Dr. Nielsen agreed that Mr. Drabinski did not address the substantial flaws in his testimony in the instant case. Dr. Nielsen utilized the same basis for his prudence review in both dockets, and equates the Kansas and Missouri standards. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony, p. 30, ln. 22 to p. 34, ln. 11.

2. MRA has failed to prove imprudent actions on the part of KCP&L and the Commission should reject Mr. Drabinski's proposed Iatan Unit 2 disallowance

(a) Summary of MRA's Recommendation

199. MRA recommends a prudence disallowance of $230,955,466 ($67,600,318 KCP&L Missouri Jurisdictional share and $41,571,983 GMO share) based solely on Mr. Drabinski's recommended prudence disallowance associated with certain Iatan Unit 2 and

Common plant in-service costs. MRA's recommended prudence disallowance is not supported by facts or competent analysis, and as a result, should be rejected by this Commission.

200. Mr. Drabinski's Direct Testimony includes four separate methodologies and four separate potential disallowance calculations though he agreed at the hearing that the only actual recommendation that he is advancing to the Commission is his so called "Review of Initial Purchase Orders and Change Orders" which is found on p. 204, ln. 8 to p. 214, ln. 1 of his Direct Testimony. *See* Hearing Exhibit KCP&L-2601, Hearing Tr. p. 1597, ln. 10-15. It is this analysis that Mr. Drabinski provides all of his calculations and a summary of his reasoning, to the extent such is provided, for his recommended $231 million disallowance. As a result, the Commission should disregard Mr. Drabinski's other three analyses as they are irrelevant to his proposed disallowance.

201. As will be discussed in detail in the foregoing, Mr. Drabinski makes only a cursory attempt to tie a handful of the proceeding two-hundred and two pages of his Direct Testimony to this final section of his actual recommendation to the Commission. On one hand, Mr. Drabinski claims that his recommended disallowance is tied to specific Purchase Orders and Change Orders. *See* Hearing Tr. p. 1601, ln. 7-11 However, he described his method of choosing the change orders that make up his recommended disallowance as follows:

> How you come up with the allocation of imprudent costs is not based on a specific purchase order, but based on the overall testimony that shows that imprudent mismanagement took place, costs rose beyond expectations and reasonable levels and, therefore, certain areas warrant adjustment.

See Hearing Tr. p. 1638, ln. 23-25 to p. 1639, ln. 1-3

202. In the following sections, KCP&L addresses the fatal flaws of Mr. Drabinski's application of this methodology. In particular, Mr. Drabinski's proposed disallowances are: (1) not tied to even the general allegations of imprudence that exist in other, irrelevant portions of

his testimony; (2) not substantiated with credible evidence, (3) based on hindsight and Mr. Drabinski's substitution of his gut feel over facts; (4) riddled with errors, including double-counting of change orders and misunderstanding of the plain information that was available to him; (5) lacking in an audit trail that indicates why (to the limited extent he did) he selected certain change orders and purchase orders for disallowance; and (6) subjected to arbitrary percentage cuts, such as randomly choosing 50% of a cost, without any apparent or documented basis. Therefore, the Commission is left with a recommendation for disallowance that by its nature fails to meet the applicable prudence standard.

203. In his Rebuttal Testimony, Dr. Nielsen discusses all the ways in which Mr. Drabinski's analysis is "inappropriate, improper and flawed":

> 1) Drabinski applied an erroneous standard for prudence reviews.
>
> 2) Drabinski finds imprudence as a consequence of the results attained rather than evaluating decisions and the decision making process, causally connecting the allegations and then properly quantifying the impact.
>
> 3) Drabinski improperly asserts that Drabinski's opinion is preferable to prudence opinions which may be held by the MPSC.
>
> 4) Drabinski improperly asserts that Drabinski's opinion is preferable to KCP&L's management decisions and improperly employs hindsight in doing so rather than evaluating management decisions at the time.
>
> 5) Drabinski did not perform a prudence audit, but rather, engaged in what is essentially an inappropriate mixing of construction claims approaches and construction/financial audit approaches.
>
> 6) Drabinski failed to recognize the Iatan Project as a mega-project and thus, failed to evaluate the Iatan Project within the proper context of that definition.
>
> 7) Drabinski used selected "sound bites" drawn from internal audits and consultant reports performed by or at the request of KCP&L to support Drabinski's assertion of imprudence, ignoring information from those audits which runs contrary to Drabinski's position and not presenting these selections in context, including the proper time context.

8) Drabinski inappropriately uses KCP&L's internal audits to criticize KCP&L's decisions ignoring the fact that the process of conducting on-going internal audits during a complex construction project is considered part of the prudent management decision making process.

9) Drabinski's opinion relies upon an incorrect understanding of facts, and often directly conflicts with documented evidence regarding events on the Iatan Project, and conditions and circumstances that were known and/or reasonably known by KCP&L management.

10) Drabinski submits conclusions of imprudence without providing supporting explanation or documentation other than the selected "sound bites".

11) Drabinski fails to provide a connection between Drabinski's allegations of imprudence and any actual costs incurred as a direct result of the alleged imprudence.

12) Drabinski's analyses and conclusions display a lack of experience and understanding of construction industry practices, procedures and standards on a project like the Iatan Project. For example, Drabinski's analyses and conclusions display a misunderstanding of the cost estimating process and the proper use of various levels of cost estimates created during the planning and execution phases of a mega-project like the Iatan Project.

13) Drabinski substitutes his judgment rather than analyzing whether KCP&L's decision-making processes and procedures, and KCP&L's decisions fell within a zone of reasonableness, and thus would be prudent.

14) Drabinski uses impermissible hindsight to determine prudence.

15) Drabinski's analyses and conclusions filed in this MPSC case are inconsistent with testimony filed by Drabinski in the Kansas Commission case in July 2010. For example, in the Kansas Commission case Mr. Drabinski testified that the project peer review differential it calculated supported a disallowance of $530 million while in Drabinski's filed testimony in this MPSC case the project peer review differential he calculated supported a disallowance of $316 million, a difference of $214 million. The Kansas Commission in its November 22, 2010 Order (Docket No. 10-KCPE-415-RTS) also found that Drabinski's analysis was flawed for similar reasons noted above and stated in that order:

"Some decisions alleged as "inappropriate or poor" are not linked to the presentation of various "management decisions" embedded in Drabinski's report. Therefore, we decline to place much weight on Drabinski's analysis...we previously found...that Mr. Drabinski's testimony was flawed...Drabinski's 'holistic' analysis is severely undermined when his starting point for the cost overruns is corrected from a claim of being 49% over budget to about 18%, which is well within reasonableness for definitive cost estimates. Moreover, much of Mr. Drabinski's analysis builds on his perception that there was an imprudent

decision to contract using a multi-prime rather than an EPC approach. As established elsewhere, we found that KCPL did not have that option. Therefore, the Commission concludes that the 'holistic' approach used by Staff's expert, which resulted in many attempts to "assess reasonable percentage disallowances," is prone to being speculative and arbitrary. Not only is the method far afield from a reasoned, auditable methodology, we agree with KCPL that it runs afoul of standards articulated by our Courts for expert testimony." [Kansas Commission Order pages 25, 30, 18 and 32]

See Hearing Exhibit, KCP&L-46, Nielsen Rebuttal Testimony at pp. 27-30.

204. With the exception of the final ten pages and scant sections within his Direct Testimony, the remainder of Mr. Drabinski's Direct Testimony and Surrebuttal Testimony can be completely ignored. Mr. Drabinski's abandoning of three of the four of his analyses means that he has presented this Commission with whole sections of analysis that are completely irrelevant. Mr. Drabinski claims that he had to perform certain now abandoned analyses because he was required to do so by the Kansas Statute, which is true, though the KCC in its order completely rejected these other analyses. However, Mr. Drabinski had adequate time to revise his testimony to eliminate irrelevant material and correct known errors that were clearly apparent months before his testimony was filed in this case. Mr. Drabinski chose not to do so, and the Commission is left with testimony related to a significant number of issues that Mr. Drabinski raised that have no import whatsoever in this rate case. Mr. Drabinski failed to provide the Commission with guidance regarding which of these arguments he now admits are completely irrelevant.

(b) Drabinski's Opinions are not based on Substantial Competent Evidence

205. Mr. Drabinski's proposed disallowances suffer from many of the same shortcomings as Staff's. Primarily, Mr. Drabinski's analysis is not based on the underlying data in the record or on a proper expert analysis. As discussed herein, the significant flaws in Mr.

Drabinski's analysis are summarized in Dr. Nielsen's Rebuttal Testimony, Mr. Roberts Supplemental Rebuttal Testimony and Mr. Meyer's Supplemental Rebuttal Testimony.

206. As discussed above, Missouri Law requires an expert's opinion to be based upon reliable facts or data of the type reasonably relied upon in the relevant filed. *See* R.S. Mo. § 490.065.3 and *State Board of Registration for Healing Arts v. McDonagh*, 123 S.W.3d 146 (Mo. banc 2003). Based on this legal standard, Mr. Drabinski's analysis and conclusions should be afforded very little weight, if any, as they are clearly based only upon his speculation and general impressions of the Project. Furthermore, he fails to identify the applicable industry standards, or to identify the source of the industry standards that he believes to be applicable. Mr. Drabinski says he "considered" various published sources because he had read them at some point in his career, he never cites to a specific article, provision or authoritative source for the basis of his statements that a practice did not meet industry standards. Mr. Drabinski's use of "industry standard" is vague and is used to justify a position without explaining why or how that statement equates to a true "industry standard." Mr. Drabinski also fails to analyze and often simply ignores important facts that he had available to him.

207. The most egregious flaw in Mr. Drabinski's methodology is his taking statements made by the project team, Schiff Hardin or KCP&L's auditors out of context in order to establish imprudence. Thus, Mr. Drabinski has utilized KCP&L's transparent reporting and simply takes any negative statement as evidence of KCP&L's imprudence. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at p. 54, ln. 5 to p. 55, ln. 6; KCP&L-25, Giles Rebuttal Testimony at p. 42, ln. 23 to p. 43, ln. 4; KCP&L-19, Davis Rebuttal Testimony at p. 90, ln. 3-12. However, what Mr. Drabinski fails to recognize is that both the auditors and Schiff Hardin were tasked with providing visibility of Project risks to KCP&L's senior management, so that

such issues which could *potentially* have a negative impact on the Project could be dealt with and resolved in a timely manner. *See* Hearing Exhibits: KCP&L-46, Nielsen Rebuttal Testimony at p. 149, ln. 20 to p. 150, ln. 6; KCP&L-21, Downey Direct Testimony at p. 2, ln. 21 to p. 8, ln. 19; KCP&L-22, Downey Rebuttal Testimony at p. 9, ln. 14 to p. 11, ln. 22; KCP&L-25, Giles Rebuttal Testimony at p. 17, ln. 4 to p. 18, ln. 3. Additionally, those audit findings and reports simply identify "risks" to the Project. *See* Hearing Exhibits: KCP&L-51, Roberts Rebuttal Testimony at p. 9, ln. 11-18; KCP&L-19, Davis Rebuttal Testimony at p. 16, ln. 19-23, p. 90, ln. 16 to p. 91, ln. 2. They do not identify KCP&L's actions that caused an increase to the overall cost of the Project.

208. Time and again, Mr. Drabinski only looks at the warnings of risks that were given in the audits and not the response from KCP&L nor does he find any causal link between an additional, avoidable cost and a specific KCP&L "imprudent" action. What Schiff, Internal Audit, Ernst & Young, Strategic Talent Solutions ("STS") and members of the Project Team did throughout this Project was provide management with data that identified the problems and potential mitigation options so that the Project could be prudently managed.

209. Mr. Drabinski disputes that his analysis is based on hindsight. In his pre-filed Surrebuttal testimony, Mr. Drabinski stated:

> Vantage was retained in mid-2008 to begin monitoring the Iatan Project. Therefore, from mid 2008 we would argue that all of our observations and conclusions are contemporaneous in nature. We reviewed decisions in the context of the circumstances confronted by the decision maker at the time the decisions were made and judged the decision not on its outcome, but on its merits at the time the decision was made. Any direct observations Vantage made or reports we reviewed were in a real time context. We suggest that using hindsight in a prudence review, takes data from the past and interprets it in a manner inconsistent with interpretations of that time. In other words, did I use data from periods prior to mid-2008

> and interpret it differently from the interpretations of that period. I believe the answer is unequivocally no.

Drabinski Surrebuttal Testimony, p. 4, ll. 1-12.

210. In his Surrebuttal Testimony, Mr. Drabinski includes a chart of references to documents that he claims form the basis for his opinions. However, this chart, which is merely a re-printing of material that Mr. Drabinski provided in a series of schedules contained in his Direct Testimony, is no more than a series of snippets that Mr. Drabinski chose without context in attempt to portray the Iatan Project as out-of-control. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony, pp. 88-99; also *see* Hearing Exhibit KCP&L-52, Roberts Supplemental Rebuttal Testimony, pp. 61; 73-74. Mr. Drabinski makes no attempt in his pre-filed testimony or in any other materials he provides to do as he claims—there is no "real time context" of the decision-making, only, as Mr. Davis testifies, "Documents like meeting minutes or monthly reports show day-to-day issues that, when taken out of context, can sound much worse than they actually are. Mr. Drabinski repeatedly concludes that a snippet of information can be used to show a major issue, and more often than not, that is not the case." Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony, p. 96, ln. 22 to p. 97, ln. 2. Mr. Drabinski's protestations regarding his use of hindsight are hollow because he never cured the problems that KCC recognized with his analysis of the Project's record.

3. Mr. Drabinski's Opinions are Laced with Red Herrings

211. As noted above, there are significant portions of Mr. Drabinski's testimony that are not only flawed from a factual and analytical standpoint, but at the core his arguments are red herrings because they do not factor in any way in Mr. Drabinski's actual recommendation for disallowance of $231 million. There are multiple examples Mr. Drabinski raises in his Direct Testimony that he admits are red herrings, including:

- Mr. Drabinski's entire "Plant Comparison" analysis, "Comparison to Trimble County 2" and "Analysis of Budgets and Reforecasts", which he abandoned in exclusive favor of his single recommended $231 million disallowance. *See* Hearing Tr. p. 1597, ln. 10-15.

- Any measured cost "increase" from any project estimate prior to the December 2006 Control Budget Estimate, including Mr. Drabinski's claim that a preliminary estimate prepared in January 2006 has some significance. *See* Hearing Tr. p. 1593, ln. 24-25 to p. 1594, ln. 1-5.

- Mr. Drabinski's repeated allegation that KCP&L mismanaged the Project "early on," which he defines as the year 2006 to early 2007. This unsupported opinion based in hindsight conflicts with Mr. Drabinski's testimony that KCP&L pursued the critical path work through 2006 with great success. *See* Hearing Tr. p. 1648, ln. 8 to p. 1653, ln. 1.

- Mr. Drabinski's allegation that Burns & McDonnell was "late" in producing critical drawings is completely contradicted by the fact that Burns & McDonnell completed the foundation drawings on time for critical turnovers to ALSTOM and Kiewit. *See* Hearing Tr. p.1650, ln. 12-21.

- Mr. Drabinski's hindsight-based allegation that KCP&L's decision related to the Iatan Project's contracting methodology, i.e. to perform the Iatan Project on a multiple prime and not an EPC basis, increased the Project's cost (i.e. EPC vs. Multi-Prime) or was in and of itself imprudent; *See* Hearing Tr. p. 1593, ln. 17-22. Drabinski testifies, "I never stated that the decision to use a Multi-Prime rather that an EPC approach was, in itself, imprudent." *See* Drabinski Surrebuttal Testimony, p. 24, ln. 8-10.

212. There are also several allegations made by Mr. Drabinski for which he has no factual basis, and even if they were supported factually have nothing to do with his recommended disallowance. Examples of these red herrings include the following:

- **[redacted]**

- KCP&L made an untimely decision to hire Kiewit as the primary Balance of Plant ("BOP") contractor at a premium price; as explained further below, Mr. Drabinski does not know how to quantify this alleged premium. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony at p. 47, ln. 10 to p. 53, ln. 2.

- The "turbine building bust" and "the cost of the unintended consequences of the decision to add a de-aerator to the project. Evidence shows that the cost of the enlarged turbine building was at least $106 million and perhaps over $200 million. This was part of the reason for the large increase in balance of plant costs." *See* Hearing Exhibit KCP&L-

2601, Drabinski Direct Testimony at p. 33, ln. 14-18. KCP&L witness Mr. Meyer explains that while the Balance of Plant work increased due to design maturation, these were not in any way imprudent cost increases, as Mr. Drabinski obliquely asserts without examination of the facts. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony at p. 48, ln. 14 to p. 49, ln. 9.

- The cost of the Balance of Plant work increased from "$350 million to a billion dollars on this Project." *See* Hearing Tr. p. 1615, ln. 4-5. Mr. Drabinski's statement is completely unfounded and not supported by any facts. He apparently is attempting to measure the "growth" of the Balance of Plant by comparing early, irrelevant project estimates to the Project's final cost, and did so selectively. Fortunately, because Mr. Drabinski abandoned his meaningless comparison of estimates, the Commission will not have ferret out the manner in which Mr. Drabinski twisted these facts.

- KCP&L could not manage a multi-prime project, a fact disputed by numerous KCP&L witnesses. *See* Hearing Exhibit KCP&L-6, Bell Rebuttal Testimony at pp. 14-15; Hearing Exhibit KCP&L-19; Davis Rebuttal Testimony at pp. 20-26 and pp. 104-107; Hearing Exhibit KCP&L-21, Downey Direct Testimony at p. 27; Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at pp. 74-80; Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at pp. 94-97; Hearing Exhibit 52, Roberts Supplemental Rebuttal Testimony at pp. 33-44.

- The development and implementation of the PEP and other project tools such as SKIRE were untimely and increased Project costs; a fact disputed by numerous KCP&L witnesses and which Mr. Drabinski never ties to any disallowance. *See* Hearing Exhibit KCP&L-52, Roberts Supplemental Rebuttal Testimony at p. 58; Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 84, ln. 22 to p. 86, ln. 9. The contracts used for the major contractors were inadequate in that these contracts did not adequately shift risk to the contractors and did not contain a formulaic basis for calculating loss of efficiency change orders. Mr. Drabinski never cites a single sentence in any contract that was employed on the Iatan Project, yet he concludes that KCP&L employed "poorly written contracts" because "every time a problem arose, rather than being able to use the contract to resolve it, they went to a settlement." *See* Hearing Tr. p. 1645, ln. 11-14.

- KCP&L failed to timely implement expert advice, which Mr. Roberts and Mr. Downey thoroughly dispute; *See* Hearing Exhibit 52, Roberts Supplemental Rebuttal Testimony at p. 9, ll. 5-13 and p. 32 ln. 14 to p. 33, ln. 21, and Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony pp. 84-85; and

- KCP&L's planned construction schedule was compressed and was made worse by KCP&L's failure to timely hire Burns & McDonnell as the Owner's Engineer. *See* Hearing Exhibit 52, Roberts Supplemental Rebuttal Testimony at p. 45-47 (explaining that the Iatan Project Schedule was not compressed and even if it was, Mr. Drabinski does not provide any additional costs incurred that can be tied to this allegation). None of Mr. Drabinski's proposed disallowances in his $231 million recommendation appear to be causally connected to this allegation.

213. These red herrings have no bearing on Mr. Drabinski's recommended $231 million disallowance and as a result, should be disregarded by the Commission. In fact, these red herrings undermine the entire basis of Mr. Drabinski's opinions, because there is no way for the Commission to parse these irrelevant arguments from those arguments that may, in Mr. Drabinski's view at least, support his recommended disallowance.

4. Drabinski Fails to Establish a Nexus between Alleged Imprudence by KCP&L and the Recommended Disallowances

214. Mr. Drabinski's proposed $231 million disallowance analysis is flawed, lacks substance, and does not establish a nexus between additional costs and the allegedly imprudent actions of KCP&L.

215. As stated above, Mr. Drabinski proposes a disallowance of $231 million due to alleged imprudence by KCP&L. However, Mr. Drabinski has not offered competent evidence of KCP&L's alleged imprudent acts and does not attempt to establish how KCP&L's alleged imprudent actions were the cause of his proposed disallowance amounts. With respect to his $231 million proposed disallowance, Mr. Drabinski has failed to provide any form of audit trail, work papers, calculations, or rationale for his calculations. *See* Hearing Tr. p. 1594, ln. 13 to p. 1595, ln. 18.

216. Instead, many of his disallowance amounts are just simply straight-line percentages or disallowances of any costs over an original contract amount. Except for a few Kissick change orders and the 43 change orders identified in the "misc. PO" category, some of which Mr. Drabinski admits have been double- counted, Mr. Drabinski never identified any specific purchase orders or change orders supporting his other recommended disallowance amounts, nor did he provide any analysis linking KCP&L's decisions or actions to the Project's increased costs or imprudence under the standards described above.

217. Dr. Nielsen addresses Mr. Drabinski's failure to create a nexus between KCP&L's alleged imprudent actions and his proposed disallowances in his Rebuttal Testimony. Specifically, Dr. Nielsen testifies:

> Pegasus-Global's examination of Mr. Drabinski's "Review of Purchase Orders and Change Orders" determined that Mr. Drabinski again provided no nexus of causation between any unreasonable or imprudent decision or action by KCP&L and specific cost disallowance. Mr. Drabinski simply notes that its "analysis was in-depth and extremely data intensive" [Drabinski Direct Testimony at p. 204, ln. 11] and that based on that analysis it "determined if all or part of the cost should not be permitted into the rate base" [Drabinski Direct Testimony at p. 204, ln. 19 through p. 205, ln. 1]. Nowhere in Mr. Drabinski's testimony was there a single statement which linked a specific Purchase Order or Change Order, or a part of a specific Purchase Order or Change Order, to any decision made or action taken by KCP&L during the execution of the Iatan Unit 2 project.

See Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony, p. 227, ln. 9-18.

218. Under Missouri Law, MRA has the burden not only to establish KCP&L's imprudent actions, but also to show that those imprudent actions caused KCP&L to spend additional amounts on the Iatan Unit 2 Project that were otherwise avoidable.

219. The following chart is from Mr. Drabinski's testimony, and indicates Mr. Drabinski's breakdown into each line item of his $231 million disallowance:

Contractor	Unit 2	Imprudent Amount	Discussion Location
Total For ALSTOM		$37,221,000	Direct testimony p. 209, ll. 1-5
Total for Kiewit		$112,000,000	Direct testimony p. 209, ll. 7-14
Total for Kissick		$2,790,294	See spreadsheet for Kissick analysis. Items identified as Imp in last column are those disallowed, p. 209, ln. 18 to p. 210, ln. 1
Total for B&McD		$5,819,845	Direct testimony p. 210, ll. 4-7
Total Aerotek & Nextsource		$16,552,754	50% of total as taken from list of items in spreadsheet titled Aerotek Analysis, p. 210, ll. 10-13
Total for Toshiba		$0	
AQUILA, INC.		$0	
AFCO STEEL		$0	
LIST & CLARK CONSTRUCTION CO.		$0	
POWELL ELECTRICAL SYSTEMS INC.		$0	
PULLMAN POWER, LLC		$0	
R.F. FISHER ELECTRIC CO., INC.		$0	
Professional Support		$11,632,743	50% of total as taken from list of items in spreadsheet titled Professional Support, p. 210, ln. 15 to p. 211, ln.

Contractor	Unit 2	Imprudent Amount	Discussion Location
			1
Other Miscellaneous POs from Data		$0	
Other POs, Indirects, Uncommitted		$44,968,830	Direct Testimony p. 212
Project Total	$1,988,000,000	$230,955,466	

220. As an initial matter, the Kiewit and ALSTOM amounts need to be corrected so that they reflect only the actual sums applicable to Unit 2. For instance, Mr. Drabinski erred in stating that the actual cost of the Kiewit Unit 2 Contract Amendment is $112 million, when in fact its value is $79.6 million. This contract amendment is the entire basis of Mr. Drabinski's recommended disallowance. Therefore, correcting this mistake means that $79.6 million is the real starting point of Mr. Drabinski's recommended disallowance, not $112 million. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal at p. 47-50.

221. Mr. Drabinski also erroneously included in his ALSTOM disallowance amount approximately $6 million in Iatan Unit 1 change orders that are already included in his Unit 1 analysis and should have been excluded. As a result, Mr. Drabinski's recommended starting disallowance of $37.96 million should have been $31,782,667. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal at p. 39 ln. 18 to p. 40 ln. 4.

222. Only correcting for these simple errors in the ALSTOM and Kiewit amounts, Mr. Drabinski's actual total recommended disallowance should be corrected to $192.4 million. This adjustment is required before consideration of any argument about whether Drabinski has done a proper prudence analysis in determining his recommended disallowance.

223. Additionally, Mr. Drabinski has admitted that he has or it is possible that he has double counted certain change orders. In particular, there is at least $12 million of Mr. Drabinski's $44 million "other POs indirects and uncommitted" category that he counted as a part of the ALSTOM disallowance. There are other change orders in this category including

change orders for Kissick, ALSTOM, Kiewit and others that are likely double-counted as well. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal at p. 56-58.

5. Mr. Drabinski's Proposed Disallowance Amount for the ALSTOM Contract.

224. Mr. Drabinski states that the entirety of his analysis, conclusions and support for the $37,221,000 disallowance related to ALSTOM is contained in his Direct Testimony, pp. 141-148. *See* Hearing Exhibit KCP&L-2601. Unlike his proposed disallowances for other contractors, Mr. Drabinski proposed a disallowance for ALSTOM that is based on a specific list of change orders associated with the ALSTOM contract. However, Mr. Drabinski performs no analysis of these change orders. He simply states that the ALSTOM contract was a fixed price EPC contract and therefore should not have sustained any change orders. The only adjustments that Mr. Drabinski allows to the initial contract price are for the Iatan Unit 1 settlement and change orders executed for sales taxes. *See* Hearing Tr. p.1603, ln. 6 to p. 1610, ln. 13. This approach is unrealistic and without merit because it assumes that a fixed-price EPC contract should never have any change orders, a fact that even Mr. Drabinski admits is untrue and not grounded in fact or actual construction practice. *See* Hearing Tr. p. 1608, ln. 13-17. By arguing that there should be no change orders, Mr. Drabinski is holding KCP&L to an unreasonable and impossible standard. *See* Hearing Exhibit KCP&L-52, Roberts Supplemental Rebuttal Testimony at p. 91, ln. 10 to p. 92, ln. 2. As noted in Mr. Roberts' Supplemental Rebuttal Testimony, it is unreasonable to assume that a contractor will not issue changes on a fixed-price contract or that any change order to such a contract is per se imprudent. *See* Hearing Exhibit KCP&L-52, Roberts Supplemental Rebuttal Testimony at p. 91, ln. 10 to p. 92, ln. 21.

225. An analysis of Mr. Drabinski's proposed ALSTOM disallowance amount indicates that Mr. Drabinski has improperly included $6 million in change orders that have

already been dispositioned in the 0089 Docket. These costs are discussed in Mr. Meyer's Supplemental Rebuttal Testimony on p. 39, ln. 20 to p. 40, ln. 1 and include the following:

Approved Change Order	**Drabinski Recommended Disallowance**	**Costs Applicable to this Rate Case**	**Comments**
ALSTOM Settlement agreement to address disputed scope changes.	$2.7M+ $1.3M for overtime	$0	This amount was part of the settlement amount. Please see Purchase Order Nos. 0000203712 ($4 Million) and 0000205589 ($18 Million).
ALSTOM Settlement Agreement JLG 1200 incident.	$3.9M	$2,576,667	ALSTOM Settlement Agreement. $1,288,333 of this cost was included in the Unit 1 rate case. *See* Drabinski Direct Testimony in the 246 Docket on p. 29.
ALSTOM Settlement Agreement for costs associated with the delayed start-up of Unit 1 due to turbine problems.	$150K	$0	ALSTOM Unit 1 Settlement Agreement. – This is a Unit 1 Cost.

226. In particular, the first item in the above chart was a part of the [redacted]** ALSTOM Unit 1 Settlement Agreement that Mr. Drabinski agrees was a part of the Unit 1 rate case and has excluded it in its entirety from his calculations. *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 147, ln. 1-6. Removing the costs that Mr. Drabinski erroneously includes in the Iatan Unit 2 amount reduces Mr. Drabinski's recommended disallowance from $37.221 million to $31.898 million.

227. Mr. Meyer argues that it was also not appropriate for Mr. Drabinski to include in his recommended disallowance amounts paid to ALSTOM for scope additions. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony at p. 43, ln. 4 to p. 44, ln. 18. Such changes orders would include the following:

	Approved Change Orders	**Drabinski Recommended Disallowance**	**Comments**
	ALSTOM Change Order AP043X160721036 for coal conveyor steel support tower.	$1.6 M	Design Change by Owner. Could not be anticipated at the time of contracting. ALSTOM awarded this scope of work because ALSTOM was working the immediate area on the boiler steel and was in the best position to perform this work.
	ALSTOM Change Order AP03288X000016072103289 Boiler chemical cleaning waste disposal.	$1.3 M	Change to ALSTOM's scope of work.
	TOTAL Scope Changes	$2.9 M	

228. The change orders set forth above are additions to ALSTOM's scope of work. The actual change orders are attached to Mr. Meyer's Supplemental Rebuttal Testimony as Schedule DFM2010-32 and Schedule DFM2010-33. *See* Hearing Exhibit KCP&L-45. These changes were both reasonable and prudent as discussed by Mr. Meyer in his Rebuttal Testimony on p. 43, ln. 12 to p. 44, ln. 18. *See* Hearing Exhibit KCP&L-45. These are not items of work that would have or should have been contemplated at the time of contracting. As an example, one of the change orders is for the coal conveyor steel support tower, upon which the coal conveyor for the material handling system sits. No part of the material handling system was ever contemplated to be a part of ALSTOM's original scope of work. Instead, all of the material

handling work was to be done by a company called Automated Systems Inc ("ASI"). However, KCP&L awarded this scope of work to ALSTOM due to the fact that ALSTOM was already working in the area and had an available crane that could be used for erecting this tower. *Id.* at p. 43, ln. 12 to p. 44, ln. 5. By awarding the work to ALSTOM, KCP&L eliminated a potential claim by ALSTOM that it would be impacted in that area by another contractor who would have needed its own large erection crane. *Id.* at p. 43, ln. 12 to p. 44, ln. 5. Changes of this type reduce the Project's overall cost by efficiently facilitating coordination of the construction work and establish prudent management on the part of KCP&L. Mr. Drabinski did not know if this work was included in ALSTOM's bid price. *See* Hearing Tr. p. 1609, ln. 16-22. Mr. Drabinski's scant change order analysis fails to adequately explain why he does not believe this to be a prudent KCP&L expenditure which was not an additional cost to the Project. KCP&L simply decided to shift the cost to a different contractor than was originally intended. This underscores why it is important to look at each item of cost to determine the cause of such increase and confirm if there was actually an impact on the overall Project's cost—not just on a single contractor.

229. Further, Mr. Drabinski argues that the incentive payments negotiated with ALSTOM as a part of the Unit 2 Settlement Agreement should be disallowed due to the fact that the dates in the original agreement were not met. *See* Hearing Exhibit KC&L-2601, Drabinski Direct Testimony at p. 144, ln. 2 to p. 145, ln 4. Testimony by Mr. Downey and Mr. Roberts explain that the decision to incent ALSTOM was to get the Project moving in the right direction to meet an achievable schedule goal, and that the cost to incent ALSTOM was considerably less than paying Kiewit significant costs for acceleration related to a schedule that was unlikely to be met anyway. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at p. 44, ln. 11 to

p. 45, ln. 2, p. 68, ln. 22 to p. 73, ln. 17; KCP&L-52, Roberts Supplemental Rebuttal Testimony at p. 13, ln. 10 to p. 18, ln. 12.

230. Similar to Staff's position, Mr. Drabinski criticizes KCP&L due to the fact KCP&L renegotiated certain parts of the ALSTOM and Kiewit Contracts. However, as KCP&L has demonstrated, each of the ALSTOM Settlements and Kiewit Contract Amendments are evidence of KCP&L's prudent management of the Project. Using the management tools available to it, such as the schedule, KCP&L saw that both Kiewit and ALSTOM were falling behind schedule. KCP&L then met with the contractors on a weekly and when necessary, daily basis in order to resolve any coordination issues and discuss ways in which the contractors' productivity could be improved and the schedule dates met. When the contractors' performance did not improve to a satisfactory level, KCP&L organized and participated in several facilitation sessions with a nationally-renowned mediator in order to help find solutions and remediation plans to help get the project back on track. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at p. 69, ln. 19 to p. 70, ln. 12; KCP&L-52, Roberts Supplemental Rebuttal Testimony at p. 69, ln. 10-18.

231. Regarding the ALSTOM contract, Mr. Drabinski argues that control and oversight of the ALSTOM contract was inadequate, and that the poor productivity of ALSTOM caused significant schedule delays. *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 48, ln. 9-10. This is incorrect. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 69, ln. 17 to p. 70, ln. 12. Mr. Drabinski also testified that the entire amount of the Kiewit Contract Amendment, which as discussed he pegged at the wrong amount, should be disallowed. *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 155, ln. 22 to p. 71, ln. 7. These assertions are without basis. The Project was planned and engineered pursuant to industry

standards and KCP&L's construction management team did in fact manage Kiewit's and ALSTOM's work. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 68, ln. 22 to p. 71, ln. 7.

232. Even though contractors were responsible for meeting the schedule, KCP&L became involved so that it could mitigate any more lost time on the schedule or contractor claims. KCP&L recognized that active management of the contractors was the best possible success path. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at *id.* Furthermore, KCP&L recognized that blind enforcement of the contracts does not constitute prudent behavior. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 70, ln. 14 to p. 71, ln. 7. Waiting for the contractors to fail so that KCP&L could avail itself of its contractual remedies would be similar to waiting for the train to derail before taking action. KCP&L determined that the cost of mitigating the schedule was preferable to sitting on its contractual rights and waiting for a contractors' failure to meet both the schedule and budget. It would more aptly be considered imprudent to manage a project the size and scope of Iatan Unit 2 with such an inflexible and unrealistic approach.

233. Mr. Drabinski also takes issue with KCP&L not forcing ALSTOM and Kiewit to complete the Project by the initially-projected in-service date of June 1, 2010. However, KCP&L did not take this route because doing so would have been too costly, too risky, and potentially imprudent.

234. KCP&L did not order ALSTOM or Kiewit to accelerate their work because even if KCP&L had ordered ALSTOM and Kiewit to accelerate their work, it did not appear to be physically possible to meet the original June 1, 2010 target date given the status of the Project at that time. KCP&L determined that a better approach was to work with these companies to

determine the best and most predictable possible completion date for the lowest overall cost. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 70, ln. 14 to p. 71, ln. 7. The result of KCP&L's discussions with ALSTOM and Kiewit in mid-2009 was to move the Project's original target in-service date from June 1, 2010 to August 1, 2010, which decompressed the Project's schedule enough to reduce both ALSTOM's and Kiewit's costs or obviate the costs of acceleration. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at *id*; KCP&L-51, Roberts Rebuttal Testimony at p. 13, ln. 10 to p. 15, ln. 11.

235. KCP&L then simultaneously negotiated changes with each contractor, resulting in the two agreements. *See* KCP&L-22, Downey Rebuttal Testimony at p. 71, ln. 23 to p. 72, ln. 3, Schedules WHD2010-7, and WHD2010-14. The benefits of the final terms of each of these confidential contracts are described in the testimony by Mr. Downey and Mr. Roberts. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at p. 44, ln. 11 to p. 45, ln. 2, p. 72, ln. 7-18, KCP&L-51, Roberts Rebuttal Testimony at p. 16, ln. 19 to p. 18, ln. 9, p. 97, ln. 10 to p. 100, ln. 16.

236. However, Mr. Drabinski's recommendation ignored the circumstances and the prudent decision-making by KCP&L that resulted in these agreements with ALSTOM and Kiewit. Had KCP&L chosen to do nothing and sit on its contractual rights, such inaction would have negatively impacted the cost and schedule of the Project, demonstrating that the settlements KCP&L reached with ALSTOM and Kiewit were reasonable or prudent in light of industry standards, conditions, and circumstances that were known or reasonably should have been known at the time the decisions were made.

6. Mr. Drabinski's Proposed Disallowance Amount for Kiewit.

237. Mr. Drabinski's recommended disallowances related to the Kiewit contract had nothing to do with the work that Kiewit did or the method that KCP&L selected for performing the work. Mr. Drabinski testifies, "KCP&L's decision to shift from a Multi-Prime strategy to a fixed price contract with time and material adders based on Unit Prices, was the most effective and least cost approach to support the BOP work." *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 155, ln. 11-15. Mr. Drabinski also has "no problem with the quality of Kiewit's work." *See* Hearing Tr. p. 1613. Nonetheless, he seeks a $112 million disallowance from Kiewit on the basis that, "the cost control and management of this contract was inadequate." *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 155, ln. 11-15. However, Mr. Drabinski's testimony on this issue reveals that he didn't have even a basic understanding of the Kiewit contract and why it increased over the original contract price of $398 million for both units.

238. Mr. Drabinski's testimony includes the completely unproven allegation that, ** [redacted] ** *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 159, ln. 6-10. The connotation of this testimony is that the increases to Kiewit's contract price were imprudent and possibly the result of some orchestrated ruse. Mr. Drabinski first proffered this allegation in his Kansas Direct Testimony, and despite vehement rejection of this claim by KCP&L witnesses Mr. Downey, Mr. Davis and Mr. Meyer, Mr. Drabinski ignored the facts presented by witnesses who participated in the formation of Kiewit contract and repeated this spurious allegation in his Missouri testimony.

Importantly, Mr. Drabinski never confirmed the facts before making these allegations. In the hearing, Mr. Drabinski was shown two documents: Kiewit's initial estimate of ** [redacted] ** dated April 16, 2007, and a letter from Kiewit dated May 17, 2007 in which Kiewit acknowledged reducing its price by ** [redacted] ** because KCP&L had already purchased these items. *See* Hearing Tr. pp. 1621–1628, Hearing Exhibits: KCP&L-75; and KCP&L-76. A simple reading of these exhibits shows that Mr. Davis and Mr. Downey accurately portrayed how Kiewit's price was adjusted. *See* Hearing Exhibits: KCP&L-18, Davis Direct Testimony at p. 34, ln. 2 to p. 35, ln. 17; KCP&L-22, Downey Rebuttal Testimony at p. 62, ln. 17 to p. 63, ln. 16. These allegations prove to be just another of Mr. Drabinski's red herrings. Mr. Drabinski, however, remains undeterred, sticking with this unproven allegation to the end. However, this completely baseless testimony underscores the manner in which Mr. Drabinski ignores facts in place of his personal opinions.

239. Mr. Drabinski also completely ignores the true reasons that the Kiewit contract increased. KCP&L witness Mr. Meyer performed an extensive review of the reasons for Kiewit's contract to increase. *See* Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 34, ln. 22 to p. 39, ln. 14. The most important fact that Mr. Drabinski fails to acknowledge is that the Kiewit contract was signed on the basis of an estimate that Kiewit prepared when the Balance of Plant work was 20-25% complete, and that the major cost overruns from Kiewit's original contract value occurred as a consequence of the completion of the Balance of Plant design. *Id.*

240. Mr. Drabinski states that the entirety of his analysis, conclusions and support for the disallowance related to Kiewit is contained in his Direct Testimony on pp. 155-159. In total, Mr. Drabinski recommends a disallowance of $112,000,000. Simply put, Mr. Drabinski does not

explain his methodology regarding this recommendation whatsoever. Mr. Drabinski testifies, "Vantage is of the opinion that the $20M of the $43M first group of change orders, the $39M, and $29M and $24 Million of the last $44M change to the contract, totaling $112 million should not be included in rate base." *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 209. Mr. Drabinski testifies, "These were avoidable had the project been planned and engineered according to proposed standards and had KCP&L's Construction Management team appropriately managed Kiewit." *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 159, ln. 13-15. Mr. Drabinski does not articulate any basis for these recommended disallowances, nor does he provide a single reason why he chose those seemingly random amounts for disallowances that do not correspond to amounts in the Contract Amendment. In this section of his Direct Testimony, Mr. Drabinski throws out several more red herrings – the unit prices used to calculate some of Kiewit's change orders, the aforementioned turbine generator building bust, the "100-plus pages" of testimony he claims set forth how KCP&L couldn't assemble a project team – but never attempts to tie these unfounded allegations to these randomly chosen amounts. In other words, Mr. Drabinski has not only failed to establish that KCP&L acted imprudently, but he has also failed to provide a causal connection between the alleged imprudent act and specific, additional costs that could have been avoided but for KCP&L's alleged imprudence.

241. In fact, the amounts Mr. Drabinski cites do not accurately reflect the costs of the Kiewit Unit 2 Contract Amendment, the additional cost of which was $79 million, not $112 million. The primary difference in the actual cost and Mr. Drabinski's amount is related to Mr. Drabinski's inclusion of $29 million dollars of "costs assigned to the boiler Target Scope of work covered under a different contract." These are not actually additional costs incurred by

KCP&L as alleged by Mr. Drabinski. *See* Hearing Exhibits: KCP&L-2601, Drabinski Direct Testimony at p. 158, ln. 11; KCP&L- 45, Meyer Supplemental Rebuttal Testimony at p. 49, ln. 19 to p. 50, ln. 17. The $43 million Target Price includes approximately $29 million from the original contract amount. The $29 million was moved from Kiewit's original contract purchase order and put into the purchase order for the Target Price. This was a pure accounting exercise, not an additional cost to the Project. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony at p. 49, ln. 19 to p. 50, ln. 17.

242. As earlier noted, the Kiewit Unit 2 Contract Amendment's value was only an additional $79 million, not $112 million. Mr. Meyer discusses in detail in his rebuttal testimony the fact that the increase in the Kiewit Contract amount was both reasonable and justifiable. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal at p. 50, ln. 20 to p. 53, ln. 2. As an example, over $18 million of the total cost of the Contract Amendment is an award to Kiewit of the insulation and heat trace scope of work. This work was always included in the Project's Control Budget Estimate, but it was unknown at the time KCP&L and Kiewit entered into the Kiewit Contract that Kiewit would perform this scope of work. However, as the Iatan Project progressed, KCP&L determined that Kiewit was in the best position to perform and manage this work. As a result, KCP&L negotiated this scope of work into the Unit 2 contract Amendment when it had the best leverage with Kiewit to negotiate a favorable price. KCP&L's decision to award the work to Kiewit did not increase the overall cost of the project. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony at p. 36, ln. 13 to p. 37, ln. 4. It is important to note that Mr. Drabinski does not refute Mr. Meyer's testimony. In fact, in his response to Data Request No. 4, Mr. Drabinski states the following: "Vantage does not believe insulation and heat tracing should not have been installed. Our analysis and recommendation

suggests that some portion of the Kiewit contract could have been managed in a manner that would have resulted in a lower cost. What Vantage proposes is that $112 million of the much larger cost increase be disallowed. Since KCP&L rolled a number of changes into three amendments, we are unable to develop a more granular assessment."

243. Mr. Drabinski claims that he was unable to develop a more granular assessment of the Unit 2 Contract Amendment; a claim which defies logic. Mr. Drabinski's Schedule WPD 36 identifies all of the change orders associated with the Unit 2 Contract Amendment. Mr. Drabinski's own analysis shows $35M in change orders related to the Amendment (WPD Schedule 36, *see* Change Order Nos. KW03926X000019035603926, 3927, 3929, 3930, 3931, 3932, 3933, 3934, 3935, 3936, and 3937). There are approximately three boxes of information available to substantiate these change orders. The remaining $43 million associated with the Contract Amendment can be found in Purchase Order 247483. If after reviewing the documents supporting these changes, Mr. Drabinski remained unsure as to which change orders or purchase orders related to the Unit Contract 2 Amendment, he could have issued a data request or made a request directly to the KCP&L project team.

244. Mr. Drabinski met with Schiff to discuss the breakdown of the Kiewit Contract Amendment in detail. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony, pp. 53 ln. 23-25. In that meeting, Mr. Drabinski was given the same information that was provided by Mr. Meyer in his Rebuttal Testimony, and there is no reason Mr. Drabinski could not have done a more granular analysis.

7. MRA's Proposed Disallowance Amount for Kissick.

245. Mr. Drabinski states that the entirety of his analysis, conclusions and support for the $2,790,294 disallowance related to Kissick is contained on p. 209 of his Direct Testimony. However, nowhere in his testimony does Mr. Drabinski explain the reasoning for his

disallowance amount for Kissick. When asked at hearing to support this analysis, Mr. Drabinski admitted that he didn't have a "definitive description" from when he and his team round-tabled the Iatan Project's change orders. *See* Hearing Tr. p. 1634, ln. 9-16 He also admits that there is no audit trail of this meeting, and states, "in retrospect, we could have probably written two or three pages for every one of them." *See* Hearing Tr. p. 1635, ln. 1-2. Mr. Drabinski expects the Commission to overlook the fact that he and his team failed to follow the most basic of protocols for any kind of audit – failing to provide any documentation or audit trail - and disallow nearly $2.8 million of prudently spent dollars on the Iatan Project. Mr. Drabinski's analysis fails because he does not explain how KCP&L's imprudent actions caused the Iatan Unit 2 Project to incur those costs or how the additional costs could have been avoided.

8. MRA's Proposed Disallowance Amount for Burns & McDonnell.

246. Mr. Drabinski states that the entirety of his analysis, conclusions and support for the $5,819,845 disallowance related to Burns & McDonnell is contained in his Direct Testimony on pp. 153-155, 208, 210. *See* Hearing Exhibit KCP&L-2601. Mr. Drabinski recommends that every dollar above the original cost estimate for engineering services of **[redacted]** should be disallowed. In his pre-filed testimony, Mr. Drabinski states that his recommended disallowance is for **[redacted]** *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 155, ln. 4-5. Mr. Drabinski admits he did not look at Burns & McDonnell's purchase orders or invoices to determine what was prudent or not – he merely disallowed every dollar without regard to a reason. *See* Hearing Tr. p. 1602, ln. 2-9.

247. Several KCP&L witnesses, including Mr. Davis and Mr. Roberts have testified regarding KCP&L's prudent management of Burns & McDonnell. *See* Hearing Exhibits: KCP&L-51, Roberts Rebuttal Testimony at p. 59, ln. 13 to p. 64, ln. 12; KCP&L-19, Davis Rebuttal Testimony at p. 89, ln. 10 to p. 95, ln 16. On Unit 2, there has been no evidence presented by any party that KCP&L has had to pay additional money to contractors for Burns & McDonnell's late performance. Furthermore, Mr. Drabinski has not identified a single change order caused by Burns & McDonnell's alleged substandard performance, and he ignores the fact that the reason Burns & McDonnell's base contract estimate increased was because it performed work outside the scope of its original contract.

248. Also regarding Burns & McDonnell, Mr. Drabinski throws another red herring when he alleges, without support, that Burns & McDonnell had a conflict of interest in advising KCP&L on using the multi-prime contracting methodology for the Iatan Project, an allegation for which Mr. Drabinski readily admits he is "not sure that there's evidence." Hearing Tr. P. 1611, ln. 3 Mr. Drabinski's allegation stems from his assertion that Burns & McDonnell stood to make more money if KCP&L opted for the multi-prime approach rather than the EPC approach. First, this is a red herring because Mr. Drabinski does not allege that the multi-prime approach chosen by KCP&L was imprudent. Second, it is absurd to impute unethical conduct to a professional organization on this basis. As Mr. Drabinski had to acknowledge at hearing, if his standard for a conflict were in any way valid, he himself would also be conflicted in his role in this case because he stands to make more money if prudence is a disputed issue. *See* Hearing Tr. pp. 1611-12. No such allegation has been made against Mr. Drabinski and it was unnecessary and unfortunate that Mr. Drabinski chose to make such an allegation against a well-respected, internationally-known engineering firm such as Burns & McDonnell.

9. MRA's Proposed Disallowance Amount for Aerotek & Nextsource.

249. Mr. Drabinski states that the entirety of his analysis, conclusions and support for the $16,522,754 disallowance related to Aerotek & Nextsource is contained in Schedule WPD-36 to his Direct Testimony. Aerotek and Nextsource are staffing services that provided many of the project management personnel for the Iatan Unit 2 project. In arriving at his opinion, Mr. Drabinski ignores the testimony of Brent Davis that KCP&L's staffing levels were appropriate throughout the Iatan Project and were based on the overall ramp-up and ramp-down needed to support and manage the work. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 21, ln. 3 to p. 32, ln. 8.

250. Starting with the KCC Docket, KCP&L attempted to obtain from Mr. Drabinski some explanation for these disallowance amounts though this proved to be futile. Mr. Drabinski's recommended disallowance is simply 50% of the total spend, without any explanation as to how he chose such a percentage other than, "this is a case where we just looked at the totals, we looked when they occurred and tried to decide how you'd go about making an adjustment there and decided 50 percent was a reasonable adjustment." *See* Hearing Tr. p. 1638, ln. 7-10. Mr. Drabinski also based this percentage on the amount that the original estimate was exceeded. *See* Hearing Tr. pp. 1639 – 40.

251. It is unclear how Mr. Drabinski can argue in the first instance that KCP&L did not have enough project management personnel, and then argue that 50% of the costs it ultimately spent on staffing services should be disallowed. In fact, KCP&L attempted to clarify Mr. Drabinski's position with Data Request No. 26, in which KCP&L requested that Mr. Drabinski identify whether the project management team needed to be larger than it was, and if so, had he factored into his recommended disallowance some offset amount. Mr. Drabinski's response was,

"Vantage has not objected to the CM personnel associated with actual construction and project management." *See* Evidentiary Hearing, Exhibit 74-76 (KCC MRA Response to KCP&L Data Request No. 26). This is a puzzling response, given that Mr. Drabinski recommends that the Commission disallow half this cost. More importantly, Mr. Drabinski's response shows just how arbitrary and unsupported his proposed disallowance is.

10. MRA's Proposed Disallowance Amount for Professional Support.

252. Mr. Drabinski states that the entirety of his analysis, conclusions and support for the $11,632,743 disallowance related to Professional Support is contained in one short paragraph and a spreadsheet (chart – p. 209, ln. 18). *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 210, ln. 15-18. The majority of these costs listed in Mr. Drabinski's spreadsheet are fees paid to Schiff and KCP&L's external auditors for their work performed during the project. Mr. Drabinski testified that the audits that were performed were some of the tools used to manage the project, correct deviations and "get the project back on track." *See* Hearing Tr. p. 1574, ln. 1-3. He also agreed that Schiff Hardin was a qualified consulting company who provided KCP&L with good advice and had expertise with utility construction projects. *See* Hearing Tr. p. 1644, ln. 13-20.

253. Mr. Drabinski's objection to these services is that he believes that 50% of the total fees spent on Schiff and its auditors were to draft after-the-fact documentation to protect itself in the rate case. Mr. Drabinski testifies, "Once KCP&L realized, in early 2006, that the project was in trouble and many imprudent costs were likely to be incurred, it began expanding expenditures for professional support as detailed in the table below. Vantage believes a 50% reduction is very reasonable." *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 210, ln. 15-18. In the Evidentiary Hearing, Mr. Drabinski supported his number as "reasonable" by noting that the final amount paid for

professional support increased, and stating, "I know that much of the work done by Schiff Hardin, much of the work that Ernst & Young was required to do resulted from imprudent management of KCP&L." *See* Hearing Tr. p. 1643, ln. 21-25. Mr. Drabinski also testified, "these consultants, lawyers, auditors were hired to help recover and make up for management's mistakes." *See* Hearing Tr. p. 1644, ln. 1-6. However, as with many of seemingly his random percentage cuts to cost categories, because Mr. Drabinski's actual calculation of this category cannot be verified, so it is not known whether he deducted 50% from only Schiff Hardin or 50% from both Schiff Hardin's and Ernst & Young's fees.

254. Mr. Drabinski does not cite a single fact in support of his opinion that Schiff Hardin and Ernst & Young were covering over management's alleged imprudence. As noted earlier, Mr. Drabinski mistook the warnings that Schiff Hardin and Ernst & Young issued early in the Project as fully realized, imprudent events. Now, with this allegation, he is alleging that Schiff Hardin and Ernst & Young at some undefined moment went from being the Iatan Project's primary antagonists to its apologists, or worse. When he testified before the KCC, Mr. Drabinski admitted that he did not review Schiff's invoices or request any additional data to determine if this was an accurate assumption, nor did Mr. Drabinski identify individual tasks performed by Schiff Hardin as caused by KCP&L's alleged imprudent management of the Project. Instead, he simply makes blanket statements that the additional costs resulted from imprudent management of KCP&L without any analysis or explanation. *See* Hearing Tr. pp. 1643-44. Mr. Drabinski told the KCC that he simply guessed at what he believed KCP&L should have spent. "What I've done is given a conservative number and said let's take what they probably would have spent if this had been a prudently managed project. And in my judgment 50 percent was a reasonable number there." *Id.* at p. 44, ln. 7-12.

255. Mr. Drabinski never substantiates his wild claims regarding the Professional Services rendered by Schiff Hardin or Ernst & Young, and has no basis for his arbitrary 50%

recommended disallowance. Mr. Drabinski argues that KCP&L did not have enough management oversight though still seeks an arbitrary disallowance of 50% for such oversight. This is nonsensical and unsupported.

11. MRA's Proposed Disallowance Amount for Other POs, Indirects, and Uncommitted.

256. Mr. Drabinski's $44.968 million recommended disallowance for "Other Ops, Indirects, and Uncommitted" fails from many of the same errors as with his other recommended disallowances. Again, Mr. Drabinski does not provide a single reason as to why the change orders listed on p. 212 of his Direct Testimony should be disallowed or what specific imprudent actions by KCP&L caused those increases in cost. All Mr. Drabinski states in support of this $44.9 million disallowance is that this was developed "by reviewing hundreds of purchase orders for evidence that they included unreasonable costs." *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 211, ln. 3-5. As with his and his team's analysis of the Kissick change orders discussed above, there is no audit trail, no notes and no back-up documentation that evidences why Mr. Drabinski chose this list of purchase orders and change orders.

257. Secondly, a significant portion of those change orders have been double- counted. When Mr. Drabinski testified with respect to these allegations in the Kansas Rate Case Hearing, he had not provided a detailed list of the items included in the $44 million total but represented that his recommended disallowances were not part of other disallowance categories. *See* generally, the transcript excerpts provided at Schedule DFM2010-35 at Hearing Tr. Vol. 7, p. 1592, ln. 21 to p. 1593, ln. 8 and p. 1593, ln. 5-8 ("My sorting was done such that no Alstom, Kissick or Kiewit purchase ordering change orders would have been included in that."). However, even a cursory review of what MRA provided in this case shows that this statement is untrue.

258. The change orders that begin with an "AP" are related to ALSTOM's scope of work. Indeed, the first two change orders (in the amount of almost **[redacted]** of the total **[redacted]) were specifically identified and included by Mr. Drabinski in his ALSTOM disallowance amounts – this is a double-up. *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at pp. 145-47 (chart entries, items nos. 8, 6 & 10) and *cf.* to Drabinski Direct Testimony on p. 212. Mr. Drabinski admitted that the first item on this list was double-counted and needed to be deducted from either this category or from the ALSTOM disallowances. *See* Hearing Tr. p. 1605, ln. 4-7. It is clear from a comparison of the chart Mr. Drabinski provides on p. 212 of his Direct Testimony and that on pp. 146-7 (his summary of the ALSTOM change orders) that this was just one of many errors Mr. Drabinski made just from pure inattentiveness in this cost category. The change orders that start with a "KW" are related to Kiewit, and are also included in Mr. Drabinski's analysis of Kiewit costs. Finally, the change orders that start with a "KI" are Kissick change orders. In all, this chart shows **[redacted]** that would have been included in Mr. Drabinski's analysis for those contractors. Furthermore, even for those purchase orders and change orders that were not double-counted, Mr. Drabinski fails to establish any basis whatsoever why these constitute avoidable costs due to KCP&L's imprudence. In most instances Mr. Drabinski does not even identify the name of the contractor that the change order is related to, much less identify the circumstances that gave rise to the change order. Mr. Drabinski provides no credible evidence to the Commission why these costs should be disallowed. As a result, Mr. Drabinski has failed to create a serious and credible doubt that these costs were caused by KCP&L's imprudence.

259. The detailed analysis provided above shows that Mr. Drabinski's proposed $231 million disallowance amount is not supported by any competent evidence. Instead, Mr.

Drabinski bases these proposed disallowances primarily upon his own gut feel with no data or support for his conclusions. Additionally, Mr. Drabinski never attempts to establish how KCP&L's imprudent actions caused the increase in costs he recommends disallowing. In fact, what the analysis described above establishes is that Mr. Drabinski's imprecise methodology resulted in his recommended disallowance of amounts for which KCP&L planned and budgeted but though were assigned at a later time via a change order. An example cited earlier of this is Kiewit's insulation and heat trace work which KCP&L assigned to Kiewit that did not increase the cost of the Project. This is not the type of analysis or evidence upon which the Commission can rely to support an imprudence disallowance.

260. Dr. Nielsen provides the following conclusion regarding the sum and substance of Mr. Drabinski's hindsight-driven analysis:

> Every one of the bases listed by Mr. Drabinski could have been caused by any number of issues, events, or conditions which impact a mega-project over the life of its execution. For example; re-sequencing of work from an original plan which may have been developed two years earlier may have been necessary due to a storm at sea which delayed the delivery of a certain valve needed to complete a critical piping system. KCP&L cannot be found to have been imprudent for not having taken that storm into account two years earlier during the development of the project schedule and sequence. KCP&L's move to re-sequence the work may have been a reasonable and prudent response to that storm delay. Management of a mega-project executed over an extended period of time must constantly react to unexpected issues, events and changes in project conditions, that does not mean that the facts and circumstances upon which the original plans were developed were flawed or unreasonable; it simply means that no one is capable of foreseeing every possible issue, event or change from a point that may be years in advance of that issue, event or change.

See Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 228, ln. 6-19.

12. MRA's proposed disallowance for Iatan Unit 1

261. Mr. Drabinski has proposed a $13,938,795 disallowance for Iatan 1 (or $5,220,079 KCP&L Missouri Jurisdictional share and $2,508,983 GMO share) based upon an analysis he performed for the Kansas Commission almost two years ago. KCP&L and the

Kansas Staff were able to come to a negotiated resolution in Docket No. 09-KCPE-246-RTS ("246 Stipulation).

262. MRA's recommended disallowance is based upon Mr. Drabinski's identification of five separate R&O packages related to the Iatan Unit 1 AQCS and Common plant projects that he believes reflect KCP&L's management's imprudence. *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony, Exhibit WPD-8. These same items were part of Staff's Iatan 1 recommended disallowances, and KCP&L will not repeat its defenses to MRA's allegations to the extent they have already been articulated herein. KCP&L contends that its actions related to these items were prudent and reasonable and MRA has failed to show otherwise.

263. **R&O Packages 367A-C – ALSTOM Delay Claim**. KCP&L has given ample testimony and evidence regarding its prudent decision to enter into the ALSTOM Unit 1 Agreement as outlined in the response to Staff. Mr. Drabinski's recommendation is to simply disallow 50% of the total cost of the Unit 1 Settlement. *See* Hearing Exhibit 2601, Exhibit WPD-8.

264. As with his Iatan 2 analysis, Mr. Drabinski gives no solid basis for his claims regarding the impact of alleged engineering, oversight or productivity on Iatan 1. Moreover, Mr. Drabinski made no attempt to discern how any such activities related to or caused the ALSTOM settlement amount. His recommended disallowance of 50% of the settlement amount has no foundation whatsoever and is completely arbitrary. Although Mr. Drabinski states that "After reviewing the specific change order summaries, Vantage concluded that 50% of the claims for additional hours should be treated as avoidable", he provides no basis for the determination of the percentage disallowance nor does he link it in any way to imprudence. *Id.*

265. **R&O Packages 139 and 330 –** KCP&L has also provided testimony with respect to R&O items 139 and R&O 330. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 71 ln. 20 to p. 72 ln. 19. KCP&L has provided evidence that these items are prudent cost expenditures.

266. **R&O Package 125** – Location of SCR Air Compressor. This R&O package dealt with costs associated with a decision to relocate the Iatan Unit 1 SCR air compressors for efficiency reasons. The relocation decision did not result in any construction rework. Mr. Drabinski first recommended a disallowance of $751,422 (Total project) for this R&O package but later reduced the disallowance to $226,953 (Total project). Mr. Drabinski states:

> This claim is a result of ALSTOM contesting location and costs associated with air compressors for cooling Unit I SCR. It appears the real problem is that B&McD did not get drawings to ALSTOM early enough for them to incorporate in plans. Should not be paid. Appears to be due to poor planning and production by B&McD. Direct result of late start with engineering.

Hearing Exhibit 2601, Exhibit WPD-8 (Drabinski 246 Direct Testimony, Exhibit WPD-1, p. 59.)

267. Mr. Drabinski incorrectly attributes the costs associated with the location of the Iatan Unit 1 SCR air compressor to poor planning and late engineering by Burns & McDonnell. As discussed in Mr. Brent Davis's testimony in the 246 Docket, this was not the case. In fact, the original drawings for the compressors were accurate. As the Iatan 1 AQCS design matured, KCP&L made a decision to relocate the air compressors so that they would all be housed in a common facility for operational and maintenance efficiency. *See* Kansas Docket No. 09-KCPE-246-RTS, Davis Direct Testimony Schedule BCD2010-2; Davis Rebuttal Testimony at p.12, ln. 12, to p. 14, ln. 4. This represents a prudent and reasonable decision and these valid costs should be allowed and recoverable in this case. Furthermore, Mr. Drabinski does not provide any analysis or documentation that establishes how he reached this conclusion.

4. Conclusion

268. KCP&L has shown that it has met all of the conditions in the Stipulation. KCP&L's prudent management included establishing a robust cost controls system and a process of management oversight that allowed all interested parties to transparently see how KCP&L made its decisions during the course of this very complex project. KCP&L has reported every significant event to Staff and the other parties and engaged in five-year long dialogue regarding the challenges that KCP&L encountered and mitigated. The result of the Iatan Project's prudent management is that the plant will provide the ratepayers with reliable, low cost power for decades. *See* Hearing Tr. p. 3862 (testimony of Staff witness Lena Mantle stating: "Iatan 2 is a very valuable resource . . . [i]it will provide inexpensive energy for at least half a century, most likely 50 years").

269. Staff has failed to "raise a serious doubt" regarding the prudence of any expenditure on the Iatan Project. Staff's most prominent claim – that KCP&L did not comply with the Stipulation in regard to the Iatan Project's Cost Control System - is completely without basis. KCP&L has proven that its Cost Control System meets the Stipulation's requirement to "identify and explain" cost overruns over the project's Definitive Estimate/Control Budget Estimate, and has also shown that those overruns were not caused by imprudence. Staff chose to perform this prudence analysis without utilizing the expertise of its own engineering staff members or an independent consultant. Not only does Staff lack the qualifications to provide an opinion based upon the applicable industry standards, in many instances, Staff's proposed disallowances are not based upon a finding of imprudence, as required by Missouri law.

270. MRA has also failed to raise a serious doubt as to any of KCP&L's expenditures. MRA's recommended disallowance depends entirely on Mr. Drabinski's flawed analysis that cannot be factually supported. Though he performed four different analyses, MRA is only

advancing Mr. Drabinski's $231 million disallowance as its recommendation to the Commission. Mr. Drabinski fails to provide the Commission with the necessary facts and analysis from which it could conclude that KCP&L acted imprudently. Mr. Drabinski has not assessed the costs associated with this alleged imprudence with any degree of specificity, nor does he provide any sort of audit trail that could allow the Commission to determine the basis of his opinions.

271. Dr. Nielsen, a well known and noted construction prudence expert, performed an independent analysis that disagrees with Mr. Drabinski on KCP&L's prudent management and with Staff's auditing approach in its entirety. The only exceptions that Dr. Nielsen identified were two issues where he believes KCP&L acted imprudently; (a) KCP&L's paying the premium portion of ALSTOM's welding crew's costs ($12.7 million, whole plant) and; (b) costs for the temporary auxiliary boiler ($5.3 million, whole plant). These two issues total approximately $18 million (KCP&L Missouri jurisdictional share $5,286,324 million and GMO share $3,250,916). As previously stated, KCP&L disagrees with Dr. Nielsen's conclusions. However, KCP&L acknowledges that Dr. Nielsen's methodology in reaching his conclusions has raised a serious doubt, which KCP&L has sufficiently rebutted through the testimony of its witness Brent Davis.

B. Write-Down Effect

272. As the Commission considers the various disallowances proposed by Staff, MRA and other parties to this proceeding, the Commission also needs to consider the impact the adoption of these disallowances, particularly prudence disallowances, would have on KCP&L and GMO. As discussed in this section, all dollars disallowed by the Commission associated with prudence disallowances of Iatan 1 and 2, as well as with any of the Staff's proposed adjustments related to the Merger Transition Costs, Hawthorn 5 Settlement, Rate Case Expenses, and Iatan Regulatory Assets, will mean that the Companies will have to write off the

amounts of the disallowances from their books. Consistent with accounting guidance, costs disallowed by regulatory agencies of a recently constructed plant are required to be written down from the plant accounts and recorded as a current period loss in the Companies' financial statements. Such a write-down is required to be made when disallowances of recently constructed plant are probably and reasonably estimable. *See* Hearing Exhibit KCP&L-113, pp. 2-3 and GMO-56, Ives True-Up Rebuttal at pp. 2-3. Likewise, accounting guidance requires write off of regulatory assets that are not probable of recovery. *See id.* at p. 14.

273. Unlike other rate case adjustments which may only be in effect until the next rate case, a prudence disallowance of expenditures for a recently constructed plant will mean that, under Statement of Financial Accounting Standards ("SFAS") No. 90, the Companies will permanently lose their ability to earn a return on or otherwise recover those disallowed expenditures incurred in building that plant. It becomes a permanent write-off of actual dollars spent to build the plant, and that is one of the reasons that these prudence issues in this case are so important to the Companies and their investors who will be called upon in the future to put up additional funds for future projects that will need to be constructed to serve customers. While the Revenue Requirement impact of a prudence disallowance related to rate base is only about 15% of the disallowance, these are very serious adjustments because of the requirement to write-off the full amount of the disallowance from the Companies' books.

274. Mr. Curtis Blanc explained the concern related to the write-downs related to prudence disallowances as follows:

> Staff's simplistic approach also irresponsibly jeopardizes KCP&L's financial integrity. Under accounting rules KCP&L would have to immediately write off its books any portion of Iatan 2 costs that this Commission concludes cannot be included in the Company's Missouri rates. To so cavalierly put a utility in the position of having to write off such significant sums is irresponsible, particularly

when that recommendation comes from the Staff, who is supposed to balance the interest of KCP&L and its customers.

Hearing Exhibit KCP&L-8, Blanc Rebuttal at p. 6.

275. Mr. Darrin Ives quantified the write-down impact of the Staff's final proposed disallowances of Iatan construction costs based on actual costs through October 31, 2010, as reflected in Staff witness Mr. Hyneman's direct true-up testimony in this case as follows:

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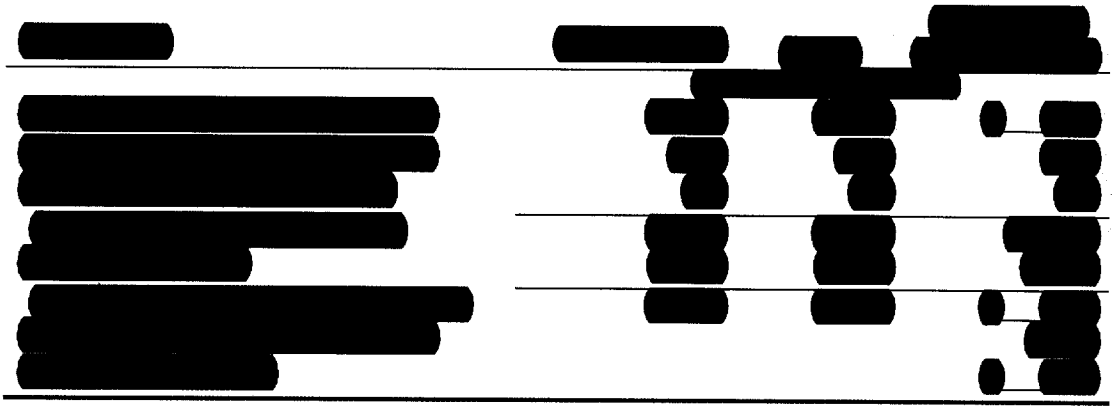

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Hearing Exhibit. KCP&L-113, p. 3 and GMO-56, Ives True-Up Rebuttal at pp. 2-3.

276. Adoption by the Commission of the Staff's or MRA's proposed disallowances would have a material financial impact to the Companies' results of operation (Net Income) and its financial position (Retained Earnings) in the period any such decision would be final. Such an impact on the Companies' results of operation and financial position jeopardizes the Companies' financial integrity. The Companies' business and financial risk profiles could be weakened which could negatively affect Great Plains Energy's ("GPE") corporate credit rating and, by extension, the senior unsecured debt ratings of KCP&L and GMO. *See* Hearing Exhibit. KCP&L-113, Ives True-Up Rebuttal at p. 3 and GMO-56, Ives True-Up Rebuttal at p. 3-4.

277. If the Commission were to adopt Staff's proposed disallowances for Iatan 1 and Iatan 2 discussed in Staff True-Up Direct Testimony, ** [redacted] ** million and ** [redacted] ** million for KCP&L and GMO, respectively, would be written down from plant-in-service recorded in FERC account 101 and the pre-tax loss would be reflected in FERC account 426.5. Taxes would be recorded on the loss and the estimated impact to the Companies' income statement and balance sheet (retained earnings) would be ** [redacted] ** million and ** [redacted] ** for KCP&L and GMO, respectively. The estimated earnings per share impact to GPE, based upon December 31, 2010, weighted average outstanding shares would be a loss of ** [redacted] ** per share. *See id.* at p. 3 (KCPL) and pp. 5-6 (GMO).

278. As explained during the True-up proceeding, the Companies' expect write-down impacts if the Commission adopts the Staff's proposed disallowances related to Merger Transition costs, Hawthorn 5 Settlement, Crossroads, Jeffrey Energy Center, Rate case expenses, and Iatan 1 and 2 Regulatory Assets.

C. Iatan Regulatory Assets

1. Iatan 1 AQCS and Iatan Common Regulatory Assets

279. The Non-Unanimous Stipulation and Agreement in the 2009 KCP&L and GMO Rate Cases, Case No. ER-2009-0089 and 0090 ("Stipulation"), approved by the Commission on June 10, 2009, included a provision that allowed KCP&L and GMO to record in a regulatory asset carrying costs related to Iatan 1 Air Quality Control System ("AQCS") and Iatan Common plant additions that were not included in rate base in the 2009 Case, through the effective date of new rates in the 2010 rate case (current case). Additionally, the regulatory asset provision in the Stipulation allowed KCP&L and GMO to defer to these regulatory asset depreciation charges on these plant additions, also through the effective date of new rates in this case. The Stipulation included the following provision:

(a) The Non-Utility Signatories agree that the Company can record as a regulatory asset the depreciation and carrying costs associated with the Iatan 1 AQCS plant and identified Iatan common facilities costs appropriately recorded to Electric Plant in Service that are not included in rate base in the current rate case. Depreciation and carrying costs will continue to be deferred to the regulatory asset until the date new rates become effective resulting from the Company's next general rate case. Amortization of the accumulated deferred costs will begin at that time based on the depreciable life of the Iatan 1 AQCS plant.

See Non-Unanimous Stipulation And Agreement, Case No. ER-2009-0089 and 0090, p. 5, Hearing Exhibit KCP&L-64 (NP), Weisensee Rebuttal at p. 4-5; Hearing Exhibit GMO-43, Weisensee Rebuttal Testimony at p. 2.

280. The combined effect of these two provisions is essentially to treat plant additions not included in the 2009 Rate Case similar to construction work-in-progress, until new rates are established in this rate case. *See* Hearing Exhibit KCP&L-65, Weisensee Surrebuttal at p. 13; Hearing Exhibit GMO-43, Weisensee Rebuttal Testimony at p. 5. Although a majority of KCP&L's investment in the Iatan 1 AQCS equipment was included in rates as part of the Companies' most recent rate cases, ER-2009-0089 and 0090, a portion remains to be included in rates as a part of this case. *See* Hearing Exhibit KCP&L-6 (NP), Blanc Direct Testimony at p. 4. This portion of the Iatan 1 costs is the basis of the Iatan 1 regulatory asset issue in this case. A similar, but more narrow, issue exists relating to the regulatory asset on Iatan Common plant added after April 2009. This will be discussed in a separate section below.

281. This issue involves the question of whether KCP&L and GMO should be permitted to recover the carrying costs contained in the Iatan 1 regulatory asset, as contemplated by the Stipulation. The Companies have included these carrying costs in their regulatory assets.

282. If the Commission adopts the Companies' position on the Iatan 1 prudence disallowances, then Staff and the Companies agree that KCP&L and GMO should recover the amount included in their regulatory assets. Staff and the Companies agree that this treatment would be consistent with the 2009 Stipulation. *See* Hearing Exhibit KCP&L-230, p. 23, Majors Rebuttal, Hearing Tr. pp. 3243-44.

283. However, Staff is taking the position that the costs in the regulatory asset should not be recovered since Staff has proposed to disallow all the Iatan I costs above its Control Budget Estimate. (Hearing Tr. pp. 3241-42)(*See also* Iatan Prudence Section of Brief) In his Rebuttal Testimony at page 22, Staff witness Keith Majors stated:

> Staff included neither the Iatan 1 regulatory asset nor an amortization of it in Staff's determination of KCPL's revenue requirement in its direct filing because Staff's proposed disallowances of costs of both the Iatan Unit 1 Air Quality Control System (AQCS) Project and the Iatan Common Plant essentially remove the need for construction accounting on the plant expenditures not included in rates in the prior case, Case No. ER-2009-0089. (Hearing Exhibit KCP&L-230(NP) p. 22, Majors Rebuttal)

For the reasons stated herein, Staff's position on the Iatan 1 regulatory asset should be rejected.

284. If Staff prevails on the "unexplained cost overrun" issue, then all of the expenditures made by KCP&L after April 30, 2009 would be disallowed. *See* Hearing Tr. p. 3242. Therefore, Staff believes it would be inappropriate to allow carrying cost similar to AFUDC on any of those costs because it believes all of these costs spent since April 30 should be disallowed. Hearing Tr. pp. 3242-43. As explained herein in the Prudence Section of this Brief, KCP&L and GMO adamantly disagree with Staff on the Iatan 1 prudence disallowances.

285. The Companies agree, however, that they should not be allowed recovery of carrying costs on expenditures, if any, that the Commission finds to be imprudent. But is

the Companies are concerned that the Staff's approach to the Iatan 1 regulatory asset issue would effectively disallow carrying costs twice if the Commission found that some portion of the Iatan 1 costs expended after April 30, 2009 were somehow imprudent.

286. The reason for this concern is straightforward. The Companies have not included any carrying costs in plant-in-service accounts for Iatan 1 expenditures after April 30, 2009. Instead, the Companies have included the carrying costs in their regulatory assets. *See* Hearing Exhibit KCP&L-63 (NP), Weisensee Direct at p. 10; Hearing Exhibit GMO-42, Weisensee Direct at p. 9.

287. Staff is arguing that the Commission should not allow the recovery of the Iatan 1 regulatory assets which include those AFUDC-like carrying costs since it does not believe the Commission should find those costs to be prudent. *See* Hearing Tr. pp. 3245-56. So, if the Staff position on the Iatan 1 regulatory assets would prevail, then the Companies would be denied recovery of the carrying costs in their regulatory assets. *See* Hearing Tr. pp. 3245-46.

288. At the same time, on the Iatan 1 prudence issues, the Staff's proposed prudence disallowances have included in them an additional AFUDC adjustment to reflect the carrying costs associated with each adjustment. Hearing Tr. p. 3245. If Staff prevails on their proposed prudence disallowances, the disallowances would increase by an amount to reflect the carrying costs—the same type of carrying costs included in KCP&L's and GMO's regulatory assets.

289. It would be a double dip for the Commission to exclude both KCP&L's and GMO's regulatory asset costs which include carrying costs, and also adopt the Staff's Iatan

1 disallowances which include an additional component for imputed AFUDC-like carrying costs.

290. In summary, the Companies request that the Commission decline to make this error. All Iatan 1 AQCS and Iatan Common costs should be included in rate base prior to any decision as to possible prudence disallowance. The Commission should not exclude the carrying costs in the Iatan 1 regulatory assets and again disallow carrying costs associated with prudence adjustments recommended by the Staff.

291. Second, the Companies have also placed the depreciation expense on the post-April 30 expenditures into their regulatory assets. As a part of the accounting entry, it has reflected the associated Accumulated Depreciation Reserve in rate base. In other words, the Accumulated Depreciation Reserve was not deferred, and was instead included as a rate base offset in the normal manner.

292. Although Staff adjusted the Plant-in-Service accounts, it did not make the associated adjustment for the reserve for depreciation for those disallowances. If the Commission adopts a prudence disallowance for Iatan 1, then Staff agrees that the accumulated reserve for depreciation related to those plant disallowances should be adjusted to remove the related reserve for depreciation. *See* Hearing Tr. p. 3246.

293. During the True-Up hearings, Staff witness Majors did confirm that the Iatan 1 and Iatan Common regulatory asset balances, as determined by the Commission in this case, should be amortized over 26 years for KCP&L and 27 years for GMO. *See* Hearing Tr. pp. 4764-4765. KCP&L and GMO accept this approach to this amortization.

294. In summary, the Iatan 1 regulatory asset should be included in rate base in this case, as should capitalized Iatan 1 costs. Any Commission-authorized disallowance should

relate to prudency issues and should be reflected as a reduction in total Iatan 1 costs, including associated carrying costs/AFUDC.

295. Finally, Iatan 1 AQCS and Iatan Common costs deferred between December 31, 2010 and the effective date of new rates in this case, pursuant to the terms of the Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329, will be included in the next rate case.

2. Iatan Common Regulatory Asset

296. Although Staff included a regulatory asset for deferred depreciation and carrying costs on Iatan Common plant expenditures incurred subsequent to the April 2009 cut off date used in the 0089 and 0090 cases, it reduced the amount of carrying costs claimed by the Companies by first reducing the expenditures by the amount of its proposed disallowances. For the reasons stated above, this inappropriately duplicates the disallowance of carrying costs and should not be accepted by the Commission.

3. Iatan 2 Regulatory Assets

297. KCP&L and GMO have also included in this case deferral of costs under the construction accounting concept , including carrying costs, related to the time period after Iatan 2 was found to be in-service (i.e. August 26, 2010) and the December 31, 2010 True Up date. Costs deferred between December 31, 2010 and the effective date of new rates in this case, pursuant to the terms of the Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329, will be included in the next rate case.

298. The Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329 (pages 43-44) authorized Iatan 2 construction accounting after Iatan 2 met its in-service criteria, and the resulting Iatan 2 regulatory asset. KCP&L believes this regulatory asset should accordingly be included in rate base in this case, with the annualized amortization

expense included in cost of service. The Regulatory Plan Stipulation And Agreement specifically stated:

> Construction Accounting. The Signatory Parties agree that KCPL should be allowed to treat the Iatan 2 project under "Construction Accounting" to the effective date of new rates in the 2009 Rate Case. Construction Accounting will be the same treatment for expenditures and credits consistent with the treatment for Iatan 2 prior to Iatan 2's commercial in service operation date. Construction Accounting will include treatment for test power and its valuation consistent with the treatment of such power prior to Iatan 2's commercial in service operation date with the exception that such power valuation will include off-system sales. The AFUDC rate that will be used during this period will be consistent with the AFUDC rate calculation in Paragraph III.B.1.g. The amortization of the amounts deferred under this Construction Accounting method will be determined by the Commission in the 2009 Rate Case. The non-KCPL Signatory Parties reserve the right to challenge amounts deferred under this Paragraph in the event that they contend that the Iatan 2 commercial in service operation date was delayed due to imprudence relating to its construction.

299. In File No. EU-2011-0034, the Commission granted GMO an accounting authority order that allowed GMO to utilize construction accounting from the in-service date of Iatan 2 until the effective date of the rates in this rate case (ER-2010-0356).

300. The Commission should not disallow from the Companies' Regulatory Assets the carrying costs related to Staff's proposed disallowances that have been included as a part of its "Construction Accounting" for Iatan 2, and then also accept Staff's proposed prudence disallowances on Iatan 2 that include an additional component for AFUDC. *See* Hearing Tr. 3252. The Commission would effectively be disallowing the carrying costs associated with Iatan 2 twice if the Commission accepted the approach recommended by Staff on the Iatan 2 regulatory assets, and also the prudence disallowances recommended by Staff related to the Iatan 2 plant itself.

301. During the True-Up hearings, Staff witness Majors agreed that the Iatan 2 regulatory asset balances, as determined by the Commission in this case, should be

amortized over 47.7 years for both KCP&L and GMO. *See* Hearing Tr. pp. 4765. KCP&L and GMO accept this approach to this amortization.

D. Cost of Capital

1. Return on Common Equity: What Return on Common Equity Should be Used for Determining KCP&L's and GMO's Rate of Return?

302. During the past five years, the Commission has allowed KCP&L the opportunity to earn a reasonable rate of return in the midst of the largest construction program in its history, as well as the worst economy since the Great Depression. GMO has similarly been able to weather the storm, in part based upon its acquisition by KCP&L's parent company Great Plains Energy Inc. ("GPE").

303. The question facing this Commission is whether it will continue to permit the Companies to earn a reasonable rate of return, or accept the recommendations of Staff and the Industrials that are well below the national ROE average of 10.32%. How the Commission responds to these questions will not only determine whether the Companies will continue to attract investors, but also whether it will be able to maintain a sound financial base that will benefit customers over the long term.

304. The following table summarizes the positions of the three experts in this case: David Murray for Staff, Michael Gorman for the Industrials, and Dr. Samuel Hadaway for the Companies:

COST OF EQUITY ESTIMATES

Method	Murray+	Gorman	Hadaway++
Discounted Cash Flow	---	9.82%	10.50%
a. Constant Growth	8.7% – 9.7%	10.33%	10.2% –

(Analysts' Rates)			10.4%
b. Long-Term Growth (GDP/Sustainable)	---	9.33%	10.7% – 10.8%
c. Multi-Stage Growth	8.7% – 9.4%	9.8%	10.5%
Capital Asset Pricing Model (CAPM)	6.69% – 7.72%	9.20%*	---
Risk Premium	---	9.58%**	10.05% – 10.24%
Recommendation	**9.0% (mid-pt. of 8.5% – 9.5%)**	**9.65%*** **	**10.75% (mid-pt. 10.5% + .25)**

+ Staff Reports (Nov. 2010)

++ *See* Hearing Exhibits KCP&L-28 and KCP&L-29, Hadaway Rebuttals (Dec. 8 and 15, 2010).

* Range of 8.12% - 9.17%; relies on high-end, rounded up from 9.17%. *See* Hearing Exhibit GMO-1403, Gorman GMO Direct Testimony at p. 39.

** Average of Treasury bond mid-point of 9.74% (range of 8.90% - 10.58%) and Utility bond mid-point of 9.41% (range of 8.63% - 10.19%). *See* Hearing Exhibit KCP&L-1403, Gorman GMO Direct Testimony at pp. 33-34.

*** Recommendation in KCP&L Direct was 9.65%, but was lowered in GMO Direct to 9.5%. Restored to 9.65% at Hearing (Jan. 28, 2011) at Hearing Tr. pp. 2852-53.

* * *

305. It was established at the hearing that according to information compiled by Regulatory Research Associates, a source regularly relied upon by the Commission, vertically integrated utilities like KCP&L and GMO were awarded ROEs of 10.32% on average for the

third and fourth quarters of 2010. *See* Hearing Tr. pp. 3000-04. Assuming that a zone of reasonableness extends from 10.32% for 50 points in either direction, the zone would be 9.82% to 10.82%. Of the three experts, only Dr. Hadaway's recommendation falls completely within this range.

306. Dr. Hadaway's estimates of the cost of equity in his Discounted Cash Flow ("DCF") analysis were 10.2% to 10.8%. His mid-point was 10.5%. Adding the 25 basis points that the Companies have requested based upon its record of reliability and customer service, Dr. Hadaway's recommendation of 10.75% is toward the upper range of the zone of reasonableness.

307. Mr. Gorman on behalf of the Industrials came to the hearing recommending 9.5%, which he increased to 9.65%. He testified: "[s]ince I filed the GMO testimony, the capital market costs have since gone back up, so I would recommend that a 9.65% return on equity be awarded for both KCP&L and KCP&L/GMO." *See* Hearing Tr. pp. 2852-53. Mr. Gorman confirmed on cross-examination that Treasury yields for both the 5-year note and 30-year bond "hit a bottom" when he first filed his testimony in the October-November 2010 period, and that "they have come up since that time." *See* Hearing Tr. pp. 2854-56; Hearing Exhibit KCP&L-100. Exhibit 100 illustrates these trends in the bond market, demonstrating why Mr. Gorman raised his ROE recommendation. Although his recommendation is outside the 100 basis point zone of reasonableness (9.82% - 10.82%), it is at least within striking distance.

308. In contrast to Dr. Hadaway and Mr. Gorman, Staff witness David Murray, with a recommendation of 9.0% is well beyond the zone of reasonableness. Indeed, the top figure in his range of 8.5% - 9.5% is 15 points below Mr. Gorman's recommendation and 82 points below the average ROE of 10.32% awarded to vertically integrated utilities for the last two quarters of 2010.

309. The reasons for the Industrials' recommendation being below the zone of reasonableness, and Staff's being significantly below that zone are as follows:

310. **(1) Proxy Groups** Whereas Mr. Gorman accepted the proxy group of 31 comparable companies proposed by Dr. Hadaway, Mr. Murray used 10 companies. *See* Hearing Exhibit KCP&L-27, Hadaway Direct Testimony, Sch. 2010-1; Staff Report, Murray Sch. 8. With the exception of Alliant Energy, Mr. Murray had no companies in his proxy group that did business in Missouri or its surrounding states. Most of the utilities in his proxy group do business in the South (Progress Energy, Southern Company and Cleco Corp.) or the West (PG&E Corp., Pinnacle West Capital [Arizona Public Service Company], and IDACORP, Inc. [Idaho Power]). Although he did use American Electric Power and Xcel Energy, which have regulated operations in the Midwest, they also have significant operations in Colorado, Texas and the East. He also included one relatively small utility in Ohio, DPL Inc.

311. The use of such a small comparable group of public utilities is inconsistent with the Supreme Court's decision in *Bluefield* and the cases that follow it. *See Bluefield Waterworks & Improv. Co. v. Public Serv. Comm'n.*, 262 U.S. 679, 692 (1923).

312. **(2) Growth Rates** The most significant factor differentiating Dr. Hadaway from the other two cost of capital witnesses is their use of unreasonably low growth rates.

313. Mr. Murray's initial analysis of growth rates, based upon data from Value Line and Reuters, yielded a growth rate of 5.97%. *See* Hearing Tr. pp. 2992-93. Without citation to any particular authority (Hearing Tr. 2998), Mr. Murray, after internal discussions with unnamed Staff members, lowered what he personally believed was a "non-sustainable" growth rate of 5.97%, and arbitrarily chose a range of 4.0% - 5.0% "based upon Staff's expertise and understanding of current market conditions." *See* Staff Report (KCP&L) at p. 29.

314. Clearly, such a subjective formulation of growth rates, rejecting data relied upon by the other two cost of capital witnesses, must be rejected as without proper foundation and not based upon sources reasonably relied upon by expert witnesses. As Dr. Hadaway pointed out, if Mr. Murray's growth rates based upon the Value Line and Reuters' data had been used, an average ROE of 10.66% would be the result. *See* Hearing Tr. pp. 2994-95; Hearing Exhibit KCP&L-27, Hadaway Rebuttal Testimony at p. 12.

315. While Mr. Gorman's growth rate for his DCF Constant Growth model of 5.41% is comparable to Dr. Hadaway's 5.69%, the growth rates he uses for his Long-Term and Multi-Stage DCF models are too low. Mr. Gorman uses short-term GDP (gross domestic product) growth rate forecasts that are dominated by recent low inflation rates and the lack of growth in the economy. *See* Hearing Exhibit KCP&L-28, Hadaway Rebuttal Testimony at pp. 16-19. On cross-examination, Mr. Gorman admitted that the January 26, 2011 Congressional Budget Office outlook report had raised its projected growth rate for 2013-2016 to 5.1%. *See* Hearing Tr. p. 2860.

316. The nominal 4.75% growth rate used by Mr. Gorman is lower than any nominal GDP growth in any 10-year period reported by the Federal Reserve Bank of St. Louis. *See* Hadaway Sch. 2010-4. If Mr. Gorman had used the 6.0% GDP growth forecast recommended by Dr. Hadaway, the Gorman average ROE would have been 10.79%, with a median point of 10.81%. *See* Hearing Exhibit KCP&L-28, Hadaway Rebuttal Testimony at p. 19.

317. Although several parties criticized Dr. Hadaway's 6.0% growth rate as "self-created," he explained that recent depressed economic productivity and low inflation rates must be considered over time for the DCF model to work accurately. Indeed, Dr. Hadaway noted that inflation in China today is 5% and that companies like McDonald's are already announcing price

increases, indicating that inflation rates will not stay at their recently depressed level. *See* Hearing Tr. pp. 2492-94.

318. The following table summarizes the three cost of capital witnesses' testimony on growth rates:

GROWTH RATES

DCF Approach	Hadaway	Gorman	Murray
Constant Growth	5.69%	5.41%[2]	4.0% - 5.0%
Long-Term Growth	6.00%[1]	4.59%/4.61%[3]	---
Multi-Stage Growth	6.00%	4.75%[4]	3.0% - 4.0%

[1] Historical long-term average GDP growth rate is 6.9% (St. Louis Federal Reserve Bank). *See* Hearing Exhibit KCP&L-27, Hadaway Direct Testimony at p. 41.

[2] Median. Average = 5.68% (KCP&L), 5.63% (GMO). *See* Hearing Exhibit KCP&L-1203, Gorman Direct Testimony at p. 20 and Hearing Exhibit GMO-1403, Gorman Direct Testimony at p. 21.

[3] Median. Average = 4.92% (KCP&L), 4.89% (GMO). *See* Hearing Exhibit KCP&L-1203, Gorman Direct Testimony at p. 24 and Hearing Exhibit GMO-1403, Gorman Direct Testimony at p. 25.

[4] Average of Blue Chip Economic Indicators: 4.7% (Yr. 1-5) and 4.8% (Yr. 6-10). *See* Hearing Exhibit KCP&L-1203, Gorman Direct Testimony at p. 25 and Hearing Exhibit GMO-1403, Gorman Direct Testimony at p. 27.

Analysts' Growth Rates Sources, as used by Cost of Capital Witnesses:

Hadaway: Value Line, Zacks, Thomson. *See* Hearing Exhibit KCP&L-27, Hadaway Direct Testimony, Schedule SCH 2010-5 at p. 2.

Gorman: Zacks, SNL, Reuters. *See* Hearing Exhibit KCP&L-1203, Gorman Direct Testimony, Sched. MPG-3.

Murray: "Non-sustainable" growth rate of 5.97% from Value Line and Reuters rejected in favor of 4.0% - 5.0% "based upon Staff's expertise and understanding of current market conditions." *See* Hearing Exhibit KCP&L-210, Staff Report at 29; Hearing Tr. 2992-98 (Jan. 28, 2011).

* * *

319. **(3) Equity Risk Premiums and Interest Rates** Finally, Dr. Hadaway effectively rebutted Mr. Gorman's suggestion that the risk premiums noted by Dr. Hadaway were unreasonably high. Dr. Hadaway's Surrebuttal Testimony illustrated how risk premium estimates are artificially affected by current government monetary policy and understate the cost of equity. For these reasons, Dr. Hadaway adjusted the average risk premium to account for changes in nominal interest rates. *See* Hearing Exhibit GMO-17, Hadaway Surrebuttal Testimony at pp. 8-11.

320. Dr. Hadaway demonstrated in Table 1 of his Surrebuttal Testimony[8] in both cases that the volatility of Baa Utility Bond interest rates since 2008 has been much higher than existed during even the high interest years in the 1980s. More significantly, in the past few years when interest rates have been low, risk premiums have been notably larger and must be accounted for when the Commission weighs the risks facing KCP&L and GMO.

321. On cross-examination, Mr. Gorman could not dispute any of Dr. Hadaway's figures in Table 1. *See* Hearing Tr. pp. 2869-71. He also conceded that while he criticized Dr. Hadaway's use of projected interest rates, he himself has used estimates of both current and projected interest rates in his risk premium calculations. Hearing Tr. 2870-71. *See* Hearing Exhibits: KCP&L-1203, Gorman Direct Testimony at p. 31; KCP&L-29, Hadaway Surrebuttal Testimony at p. 9.

322. Of the three experts, Dr. Hadaway's credentials and experience are superior. His analysis of financial and economic data is comprehensive and sound. The adjustments that he has made are based on reality, not on personal opinion or preconceived notions. His DCF range

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[8] Hearing Exhibit KCP&L-29, KCP&L Hadaway Surrebuttal Testimony at p. 11; Hearing Exhibit GMO-17, GMO Hadaway Surrebuttal Testimony at p. 10.

of 10.2% to 10.8% is the most reasonable, particularly given that vertically-integrated utilities have averaged ROEs of 10.32% during the past two quarters. Dr. Hadaway's recommended mid-point of 10.5% is the only mid-point that falls within the zone of reasonableness of 9.82% to 10.82%.

323. The Companies request an additional 25 basis points be added to the mid-point, given their undisputed excellent performance in the areas of reliability and customer service. As noted by KCP&L witness Mr. Blanc, both objective statistics and customer surveys conducted by outside sources justify a 25 basis point adder. *See* Hearing Exhibit KCP&L-7, Blanc Direct Testimony at p. 10; Hearing Exhibit KCP&L-9, Blanc Surrebuttal Testimony at pp. 4-5; Hearing Tr. pp. 2933-36. Although Staff has opposed this request, both Staff witnesses Lisa Kremer and Gregory Brossier admitted that KCP&L's customer service rankings were higher than the two other electric utilities doing business in Missouri, and that its service was very reliable. *See* Hearing Tr. pp. 2957-60 (Kremer); Hearing Tr. pp. 2964-65 (Brossier). While Ms. Kremer noted the increase in KCP&L customer complaints, she failed to note that the vast majority of these increases related to customers' difficulty in paying their bills during the past 12 months because of economic conditions, and not because of poor service provided by KCP&L. *See* Hearing Exhibit KCP&L-3, J. Alberts Surrebuttal Testimony at pp. 3-11.

2. Capital Structure

(a) What Capital Structure Should be Used for Determining KCP&L's and GMO's Rate of Return?

324. The Companies recommend the following capital structure for both KCP&L and GMO, based upon the actual capital structure of GPE as of December 31, 2010:

KCP&L and GMO Proposed Capital Structure

Debt	48.58%

Equity-Linked Convertible Debt	4.52%
Preferred Stock	0.61%
Common Equity	46.29%
Total	100.00%

See Hearing Exhibit KCP&L-27, Hadaway Direct Testimony at p. 7; Hearing Exhibit GMO-15, Hadaway Direct Testimony at p. 6; Cline KCP&L True-Up Direct Testimony at pp. 1-2; Cline GMO True-Up Direct Testimony at pp. 1-2.

325. The Companies understand that Staff has agreed to the capital structure proposed in the direct testimony of the Companies, subject to true-up. There is a disagreement between GMO and Staff regarding GMO's cost of debt, which is addressed in the post-hearing brief that addresses only GMO issues.

(b) Equity Units: Should the Equity Units be Included in KCP&L's Capital Structure and at What Rate?

326. The equity-linked convertible debt known as Equity Units should be part of the Companies' capital structure and should be included at their cost of 13.59%. As discussed by Michael Cline, who is the Treasurer of both GPE and KCP&L, GPE raised gross proceeds of $450 million in May 2009 through a simultaneous issuance of 11.5 million shares of common stock ($14/share resulting in gross proceeds of $161 million) and 5.75 million Equity Units ($50/unit resulting in gross proceeds of $287.5 million). Mr. Cline testified that it was cheaper for GPE to raise capital through the equity units because a portion of the quarterly distribution is tax deductible. *See* Hearing Tr. p. 2902. As a result, the Equity Units were a lower cost alternative to issuing common stock and would ultimately cost ratepayers less. *Id.*

327. The only basis for Staff's argument that the cost of the Equity Units should be 11.14% (or 245 basis points below the actual cost to GPE) is that a much larger utility, FPL

Group (the parent of Florida Power & Light Co.) issued its Equity Units at a lower cost. Mr. Murray testified that Staff's adjustment of 245 basis points was not based on any other equity offering that any other company made in 2009. *See* Hearing Tr. p. 2975.

328. Unlike Mr. Cline and the authors of Schedules MWC 2010-4 through 2010-6 (Goldman Sachs & Co. and J.P. Morgan), Mr. Murray has never been employed by a firm that served as manager of an offering of equity units, nor has he ever worked for a company that issued such equity units. He agreed with the Goldman Sachs analysis that GPE's offering price was the third best pricing of any offering of equity units in 2009. *See* Hearing Tr. pp. 2980-81; Schedule MWC 2010-6 at 3.[9] J.P. Morgan also explained that the FPL equity units represented only 1.5% of its equity market capitalization, in comparison with the GPE's offering which was 16.6% of its equity market capitalization. *Id.* Additionally, Mr. Cline noted that J.P. Morgan stated that FPL's equity units offering was more senior in the capital structure of the company, in comparison with GPE, where its Equity Units were further subordinated to other debt. *Id.* Finally, FPL had previously issued $506 million of Equity Units in 2002 and had a track record that investors could rely on, whereas GPE had never before issued Equity Units. *See* Schedule MWC 2010-5, pp. 1, 4; Schedule MWC 2010-6 at p. 1.

329. Mr. Murray did accept Mr. Cline's testimony, consistent with the Goldman Sachs reports (Cline Schedule MWC 2010-4 and 2010-5), which stated that investors in Equity Units "demand higher yield than common stock" and that "security [is] more expensive than equity in [a] downside scenario." Hearing Tr. p. 2977.

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[9] GPE's offering was priced at a 6.08% spread over its common dividend yield, representing the third best pricing of any transaction in 2009 (behind FPL at 4.98% and Johnson Controls at 5.69%).

330. Although Staff noted that Schedule MWC 2010-5 was prepared after Staff had filed its initial case, Mr. Cline testified that the report was entirely consistent with the earlier Goldman Sachs report (MWC-2010-4) that was prepared on March 17, 2009. *See* Hearing Tr. pp. 2900-01. Although Staff suggested that the cost of the Equity Units was greater because of the negative impact of GMO on GPE's credit ratings, Mr. Cline, while rejecting Staff's premise, did not elaborate given his further explanation that GPE's dividend yield, not its credit rating, was the primary factor in the pricing of these Equity Units.. *See* Tr. pp. 2903; Hearing Exhibit KCP&L-12, Cline Rebuttal at 8-10.

331. Overall, the cost of the Equity Units was reasonable and was incurred in the best interests of the ratepayers, as Mr. Cline confirmed. *See* Hearing Tr. pp 2902-03. Given that GPE acted in the best interests of both KCP&L and GMO at a time when the country was in the midst of a severe economic recession, and the pricing terms were as favorable as could be obtained, there is no sound reason for accepting Staff's 245 basis point adjustment in the cost of the Equity Units.

E. Off-System Sales Margins

1. Should KCP&L's Rates Continue to be Set at the 25th Percentile of Non-Firm Off-System Sales Margin, as Proposed by KCP&L and Previously Accepted by the Commission?

332. The Commission should continue to set rates for such margins at the 25th percentile level, given the risks continuing to be posed by the volatile natural gas market and the wholesale power markets in general. Any margins earned by KCP&L in excess of the 25th percentile level are flowed back to ratepayers with interest, as ordered by the Commission in KCP&L's 2007 rate case. *See* Report & Order, Case No. ER-2007-0291 at 39-40 (Dec. 6, 2007); Hearing Tr. pp. 3356-58, 3359-60 (HC).

333. The Industrials and, to an extent, Staff have suggested that KCP&L makes only half-hearted efforts to reach the 25th percentile for its off-system sales (OSS) margins, and either negligently or intentionally fails to hit a higher target. As was discussed in both open and closed sessions, that is not true. While the specific numbers are highly confidential, Mr. Blanc's testimony and several witnesses' responses to Commissioner Davis's questions clearly demonstrated that KCP&L was not managing to the 25th percentile. *See* Hearing Tr. pp. 3362-3410. Both Mr. Blanc and NorthBridge Group's Michael Schnitzer, as well as Staff witness V. William Harris noted that while KCP&L is responsible for its unit availability, it cannot control wholesale electricity prices, natural gas prices that drive such electricity prices, transmission constraints or the weather. *See* Hearing Tr. pp. 3408-09 (Blanc); 3303-04, 3338-39 (Schnitzer); Harris True-up Rebuttal Testimony at p. 5. *See also* W.E. Blunk Direct Testimony at pp. 3-5, 26, 32-33.[10]

334. No party has questioned the probabilistic analysis conducted by Mr. Schnitzer. Since filing his Direct Testimony on June 4, 2010, Mr. Schnitzer has updated his study and provided in his February 22, 2011 True-Up Direct Testimony both the median and the 25th percentile values related to his prospective calculation of OSS margin for KCP&L for the period May 1, 2011 to April 30, 2012. This analysis includes the expected output of Iatan 2. While the addition of that unit should increase margin, Mr. Schnitzer explained that the potential volatility in off-system sales "actually increases with an increase in available capacity for sale, other things being equal." *See* Schnitzer True-Up Direct Testimony at p. 3. "Relative to the 2009 rate case,

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[10] *See* Joint Report on Natural Gas Market Conditions, Case No. GW-2006-0110 (Feb. 24, 2006), which stated at p. 25: "Two major hurricanes in late August and September, 2005 in the Gulf region further exacerbated this supply situation. As a result of Katrina and Rita, approximately 13% of total U.S. natural gas production was shut-in, resulting in a significant increase in already high natural gas price."

there is more to sell, but that doesn't decrease the risk to the Company of not being able to reach the 25th percentile." *Id.* at p. 4.

335. Additionally, Mr. Schnitzer confirmed that energy prices in SPP-North continue to be volatile. The 2008 financial crisis triggered an increase in energy price volatility, with a sharp decline in prices from the fall of 2008 through 2009. Forward prices in the power markets began to recover in 2010, although prices declined later in the year. *Id.* at pp. 4-5. This evidence, along with the post-hearing exhibits admitted into evidence as a result of questions to Mr. Schnitzer from Commissioner Davis and counsel for the Industrials all confirm that KCP&L's off-system sales and the resulting margins are entirely consistent with energy prices in the market place. *See* Hearing Exhibit 121(HC) ("subject to check" responses); Hearing Exhibit 122 (SPP-North Quarterly Spot Prices, 2003-2010); 123(HC) (33rd Percentile as of Direct and True-up Direct). Any suggestion that KCP&L was either careless or not using its best efforts to make off-system sales is not supported by credible evidence.

336. The question before the Commission is, therefore, whether to depart from the 25th percentile policy that has been in effect since the 2006 Rate Case. Other parties suggest that KCP&L needs more incentive to make greater off-system sales, all of which benefit ratepayers. Given the record—particularly, the highly confidential numbers contained in Mr. Blanc's hearing testimony at pages 3362-64, 3384-90, and 3404-10—it is clear that KCP&L has produced substantial benefits for ratepayers, without earning any benefit for itself.

337. Setting off-system sales margins at the 25th percentile permitted the KCP&L to ask for $32 million less in its rate increase than it otherwise would. *See* Hearing Tr. pp. 3404-07. Although the Industrials ask that this "credit" be even greater, given that customers receive

100% of the benefit plus interest and bear none of the risk, there is no good reason to depart from the 25th percentile.

338. Mr. Schnitzer explained the choice facing the Commission:

> "And I think the policy considerations are that when you're going to use an asymmetric type of formulation, which we have had recently -- which is the shareholders bear the down side but they don't get to keep the upside -- that when you're going to be in that kind of asymmetric situation, that argues to calibrate, you know, at the lower end of the scale -- the 25th percentile being the Commission's choice.
>
> If one is going as a matter of policy to something more symmetric, where the shareholder loses on one side and gains on the other, then you could make other choices." [Hearing Tr. p. 3342 (emphasis added).][11]

339. The evidence supports a decision to set non-firm off-system sales margin at the 25th percentile level, and to continue the policies established in KCP&L's last two rate cases decided by the Commission in Case Nos. ER-2006-0314 and ER-2007-0291. Unlike all other Missouri electric utilities which have a fuel adjustment clause, KCP&L faces risks that merit the use of the 25th OSS percentile in this proceeding. OSS is a significant contributor to the Company's earnings and this earnings situation is uncertain due to the significant increase in MW hours associated with Iatan 2 becoming available. Moreover, there is significant demand and price volatility for OSS.

2. Should the Commission Include the Adjustments to the 25th Percentile Projection Recommended by KCP&L as Components to the Off-System Sales Margin Calculation?

340. KCP&L has proposed through its witness Burton Crawford three adjustments related to (1) Purchases for Resale, (2) Southwest Power Pool (SPP) Line Loss Charges, and (3)

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[11] Staff witness Harris agreed that his margin percentages located on page 5 of his Rebuttal Testimony (HC) did not reflect KCP&L's OSS margins on the probability scale of Mr. Schnitzer, but were rather a simple comparison of KCP&L's OSS sales with the margin earned on those sales. *See* Tr. 3417-18.

SPP Revenue Neutrality Uplift charges. Each of these adjustments should be made to KCP&L's OSS margin calculation.

341. **(1) Purchases for Resale.** As a result of participating in the wholesale energy market, in particular the SPP Energy Imbalance Service (EIS) market, KCP&L earns revenue and incurs expense as a result of the wholesale transactions described by Mr. Crawford to ensure that adequate energy is available in real-time to reliably meet all of its energy obligations. *See* Hearing Exhibit KCP&L-15, Crawford Direct Testimony at pp. 10-11. The actual test year amounts are shown in Schedule BLC 2010-5 (HC).

342. Staff does not oppose this adjustment. *See* Hearing Exhibit KCP&L-210, Staff Report at p. 69; Hearing Tr. p. 3419 (Harris). The only opposition to this adjustment was offered by the Industrials, whose witness Mr. Meyer accepted Mr. Crawford's Post Analysis calculation, which determined the actual benefits from these off-system sales. *See* Hearing Exhibit KCP&L-16, Crawford Rebuttal Testimony at p. 5. Mr. Meyer stated: "I do not have any information to disagree with Mr. Crawford's statement regarding the Post Analysis Program." *See* Hearing Exhibit KCP&L-1202, Meyer Surrebuttal Testimony at p. 6. Mr. Meyer simply wants an additional analysis or study done as he was unable to determine to cause of these losses. *See* Hearing Exhibit KCP&L-1201, Meyer Direct Testimony at p. 9. This is not a sufficient reason to oppose KCP&L's adjustment, which has been agreed to by Staff.

343. **(2) SPP Line Losses**. Mr. Crawford also proposed an adjustment for charges that SPP levies on wholesale energy transactions that exit the SPP EIS market. This charge relates to transmission system energy losses, and results in both payments that KCP&L makes on a portion of its off-system sales, as well as revenue that it receives on a share of the loss charges collected by SPP. The adjustment proposed by KCP&L reflects the net loss revenue of

$264,889. *See* Hearing Exhibit KCP&L-15, Crawford Direct Testimony at pp. 14-15 and Sched. BLC 2010-6.

344. Staff agrees with KCP&L that an adjustment should be made to reflect the revenues associated with SPP compensating payments from other SPP members. *See* Hearing Exhibit KCP&L-210, Staff Report at 69. However, it opposes an unspecified portion of the line loss charges related to sales not in the database analyzed by Mr. Schnitzer and the NorthBridge Group. Although the Industrials oppose SPP line losses as an adjustment to OSS margin, they do not oppose Mr. Crawford's request that such costs, at the very least, be included and recovered in KCP&L's revenue requirement, which is the identical position of Staff. *See* Hearing Tr. p. 3421 (Harris); 3426 (Meyer).

345. **(3) Revenue Neutrality Uplift (RNU) Charges**. RNU charges consist of revenue and expenses related to SPP's EIS market. As total revenues collected by SPP do not always match the total required disbursements, imbalances in revenue and expense are shared by market participants as either a charge (if SPP is short of funds) or a credit (if SPP has over-collected). The actual RNU charges incurred by KCP&L for test year 2009 are $685,578. *See* Hearing Exhibit KCP&L-15, Crawford Direct Testimony at pp. 15-16 and Sched. BLC 2010-8.

346. Staff does not oppose this adjustment, as proposed by Mr. Crawford. *See* Hearing Exhibit KCP&L-210, Staff Report at p. 69; Hearing Tr. p. 3419 (Harris).

347. Although the Industrials oppose RNU charges as an adjustment to OSS margins, they agree that these costs are a component of KCP&L's cost of service and should be put into cost of service. *See* Hearing Exhibit KCP&L-1201, Meyer Direct Testimony at p. 13; Hearing Tr. pp. 3426-27 (Meyer).

F. Fuel & Purchased Power Expense

1. How Should Natural Gas Costs be Determined?

348. No party opposed the forecasting process proposed by KCP&L Witness W. Edward Blunk. Under this process, natural gas prices are based on the first of the month index price published in Platt's Inside FERC, as well as NYMEX closing prices related to Henry Hub natural gas futures contracts. Mr. Blunk stated in his Direct Testimony that the Companies expected to true-up 2010 natural gas prices for their cost of service to actual prices at the conclusion of the case. *See* Hearing Exhibit KCP&L-10, Blunk Direct Testimony at p.14; Hearing Exhibit GMO-7, Blunk Direct Testimony at p. 10.

349. In True-Up Direct Testimony, KCP&L Witness Burton L. Crawford confirmed that natural gas costs were updated to reflect the actual monthly purchase prices for January through December 2010. *See* Crawford KCP&L True-up Direct Testimony at p. 2; Crawford GMO True-Up Direct Testimony at p. 2. These costs are reflected in Schedule JPW 2010-9, attached to the True-Up Direct testimonies of John P. Weisensee.

350. At the hearing there was no cross-examination for Mr. Blunk. *See* Hearing Tr. p. 3198. Similarly, no party offered pre-filed true-up rebuttal testimony opposing the true-up direct testimony filed by Mr. Crawford in each of the cases.

2. How Should Wolf Creek Fuel Oil Expense be Determined? (KCP&L Issue Only)

351. Fuel oil is used at the Wolf Creek Nuclear Plant for multiple purposes, such as building heat and the start-up of operations. These costs are continuing expenses incurred in the normal course of station operations and should be included in this case.

352. Counsel for Staff agreed with counsel for KCP&L that there is no disagreement on this issue, which was confirmed by Staff witness V. William Harris. *See* Hearing Tr. pp. 3194, 3195, 3210-11.[12]

353. As Mr. Crawford noted in his KCP&L True-Up Direct Testimony at 2, oil prices were updated to December 2010 purchase prices. As KCP&L has accepted Staff's position, it believes that this matter is no longer at issue.

3. Should Missouri Joint Municipal Electric Utility Commission (MJMEUC) Margin be Included in Native Load as well as Off-System Sales Margin? (KCP&L Issue Only)

354. No. The testimony at the hearing made clear that all parties agree that the megawatts formerly associated with KCP&L's contract to sell power to MJMEUC should now be considered available for off-system sales.

355. Michael Schnitzer of the NorthBridge Group testified on behalf of KCP&L that his model assumed that there were no contractual obligations to MJMEUC and that all of the hours previously related to that contract were now available for sale in the off-system market. *See* Hearing Tr. pp. 3307-08. Given Mr. Schnitzer's testimony, as well as that of Mr. Crawford that the MJMEUC contract has expired and supply related to that contract is now available for off-system sales (Hearing Tr. pp. 3206-07), there does not appear to be any controversy with regard to the expired MJMEUC contract. *See* Hearing Tr. pp. 3211-12 (Harris).

4. How Should Spot Market Purchased Power Prices be Determined?

356. The Commission should adopt KCP&L's recommendation to use the MIDAS™ model to forecast spot market electricity prices, rather than Staff's more limited 1996 model which only uses historical market prices and loads. As Mr. Crawford explained in his KCP&L

[12] The transcript contains an error at 3193, where KCP&L counsel was quoted as saying: "How should both prefuel oil expense be determined?" Counsel actually stated: "How should Wolf Creek fuel oil expense be determined?"

Rebuttal Testimony at p. 6, Staff's procedure "does not consider the impact of other market price drivers, such as natural gas prices, environmental allowances or other factors of electric production."

357. At the hearing Mr. Crawford explained that while portions of the model proposed by KCP&L were "based on the historical experience" of KCP&L, the model is also "based on a production simulation for the Eastern Interconnect." *See* Hearing Tr. pp. 3203-04. MIDAS™ is a proprietary production cost model that includes "a tremendous amount of data," including information supplied by electric utilities in their FERC Form 1 filings, as well as data submitted to the U.S. Department of Energy's Energy Information Administration and to the Continuous Emissions Monitoring System (CEMS)[13] of the U.S. Environmental Protection Agency. *See* Hearing Tr. pp. 3205-06. Using this data, the MIDAS™ model is designed "to simulate the wholesale power markets to develop an hourly price of power for the wholesale market. That information then gets fed also into the model and another portion of the model to determine the normalized level of fuel and purchase power for the company." *See* Hearing Tr. p. 3205.

358. By contrast, Staff's model rejects the use of any forecasted data and relies exclusively on historical data, as confirmed by Staff Witness Erin Maloney. *See* Hearing Tr. p. 3215. Indeed, Staff only uses KCP&L and GMO data, and no data from any other utility to arrive at a recommendation of spot market prices. *See* Hearing Tr. p. 3217.

359. Mr. Crawford described in his Direct Testimony at 2-5 the extensive amount of data that is utilized by the MIDAS™ model, including assumptions about market supply, demand and transmission constraints. This data is used to forecast power prices through the Eastern Interconnect. Staff Witness Maloney recognized that the MIDAS™ model includes both

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[13] Erroneously transcribed as "SIMS" at Tr. 3205. *See* Hearing Exhibit KCP&L-15, Crawford Direct at 3.

historical and forecasted data, whereas Staff's model does not. *See* Hearing Tr. p. 3219. Indeed, Staff's model does not include any projected data at all. *See* Hearing Tr. p. 3220. Ms. Maloney conceded that she was not familiar with all of the inputs to the MIDAS™ model and that she had never worked the model herself. *See* Hearing Tr. pp. 3217-19.

360. The Commission must set the level of fuel expense and purchased power expense for the Companies in this case, and therefore should use the greatest amount of information available to set spot market prices. Given the multitude of variables that affect electricity prices (as described in Mr. Crawford's KCP&L Direct Testimony at 3), the Commission should accept KCP&L's recommendation to use the MIDAS™ model which considers a vast amount of information, both historical and projected. Staff wants only historical data from the Companies to be considered, apparently arguing that use of the traditional historical test year prevents the Commission from relying upon forecasted data.

361. To the contrary, the Commission is afforded considerable discretion in setting rates, and in this instance should utilize a nationally recognized tool like the MIDAS™ model to determine spot market prices. In the past when the Commission approved the use of methods to develop a "forecasted peak times load factor," its decision to use forecasted data was affirmed as lawful and reasonable in all respects. *State ex rel. Arkansas Power & Light Co. v. PSC*, 736 S.W.2d 457, 461 (Mo. App. W.D. 1987). The Commission should exercise its regulatory discretion to allow the setting of spot market rates using both historical and forecasted data, given the evidentiary support in the record. *See State ex rel. Missouri Gas Energy v. PSC*, 186 S.W.3d 376, 382 (Mo. App. W.D. 2005) (Courts will not substitute their judgment for Commission decisions within its area of expertise).

G. Transition Cost Recovery

362. Consideration of the proper treatment of the recovery of transition costs was discussed at length in the Commission's Report and Order in the joint application to merge the operations of Great Plains Energy, Inc. (i.e., KCP&L) and Aquila, Inc. ("Merger Order"). Case No. EM-2007-0374 (Jul. 1, 2008). In the Merger Order, the Commission specifically addressed three areas of costs sought to be recovered: merger transaction costs, merger transition costs and merger synergy savings.

363. Merger transaction costs represent the costs that were incurred in order to consummate the merger between Great Plains Energy and Aquila. Examples of these types of costs include the investment banker fees and legal fees associated with structuring the merger deal. *See, e.g.* Merger Order at 76. Merger transition costs represent those costs that were incurred in order to integrate Aquila's operations into Great Plains Energy's operations. Merger synergy savings represent the reductions in costs associated with combining the operations of Great Plains Energy and Aquila. *Id.* at 79. The Merger Order was exceedingly clear regarding the recovery treatment of these costs.

364. The Merger Order stated that the merging companies were not allowed recovery of merger transaction costs. The Commission opined "that it is not a detriment to the public interest to deny recovery of the transaction costs associated with the merger ...." *Id.* at 241. Similarly, in its ordering paragraphs, the Commission stated "Great Plains Energy, Incorporated will not be allowed to recover transaction costs associated with the transactions from ratepayers." *Id.* at 282(6)(a).

365. With regard to Merger Transition Costs, however, the Commission stated that it was "not a detriment to the public interest to ***allow*** recovery of transition costs of the merger."

Id. at 241 (emphasis added). The Commission stated that the company was allowed to defer and amortize the Merger Transition Costs over a five-year period.

> If the Commission determines that it will approve the merger when it performs its balancing test (in a later section in this Report and Order), the Commission will authorize KCPL and Aquila to defer transition costs to be amortized over five years.

Id. In an accompanying footnote, the Commission stated that recovery in future rate cases would be dependent on an evaluation as to the reasonableness and prudence of the transition costs. The Commission added that KCPL and Aquila would be expected to "demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service expenses in future rate cases." *Id.* at fn. 930. In order to track the synergy savings to determine whether they would exceed the amortized transition costs, the Commission ordered the company to implement a synergy savings tracking mechanism utilizing a base year of 2006. *Id.* at 282(6)(d).

366. After performing the balancing test noted above, the Commission did, in fact, approve the merger, and the company deferred the merger transition costs, both in reliance on and compliance of the Merger Order. *See* Hearing Exhibit KCP&L-266.

367. In the instant rate case, there has been no testimony provided by any party which challenges or even questions the reasonableness or prudence of the merger transition costs, which was the standard established by the Commission in order for the company to be allowed to recover the costs in rates. In fact, Staff acknowledged at hearing that the transition costs incurred by the company were not unreasonable or imprudent. *See* Hearing Tr. p. 3489.

368. Perhaps because it was unable to find that the merger transition costs were unreasonable or imprudent, Staff ignored the standard established by the Commission and instead imposed a different standard on the company. Staff's standard would not only require

the company to demonstrate that savings exist in excess of the transition costs before recovery in rates is permitted, but also demonstrate "that the company has not already benefited from those savings sufficiently to already recover the transition costs." *See* Hearing Exhibit KCP&L-210, Staff Report at 191. In other words, Staff proposes netting the transition costs against synergy savings retained by the company.. Specifically, Staff stated that it would be unreasonable to recover transition costs that have already been recovered through regulatory lag. *See* Hearing Tr. p. 3497. This approach is inconsistent with the Commission's Merger Order and should be rejected by the Commission.

369. In discussing the treatment of merger synergy savings, the Commission explicitly authorized recovery of merger synergy savings through regulatory lag. Merger Order at 238. Over the first five-year period, the total operational synergies projected to result from the merger were $305 million, and $755 million over the first 10-year period. *Id.* at 234. The Commission not only found these estimates to be "accurate, realistic and achievable," but also recognized that "the synergies actually realized from the merger have a very high probability of exceeding the [company's] estimates." *Id.* at 238. In other words, the Commission was well aware of the level of synergy savings the company expected to achieve and still explicitly found that there was "no net detriment to customers" by allowing the company to recover merger savings through regulatory lag. *Id.* at 120 and 238; *see also* Hearing Tr. 3473.

370. There is no way to reconcile Staff's netting approach with the Commission's findings in the Merger Order. Based on the information in the Merger Order regarding the company's expected retention of regulated synergies, the Commission never would have contemplated deferral and amortization of transition costs because the Companies would not get any recovery of transition costs under Staff's approach, and the Commission's position regarding

synergies was that they expected the Companies would achieve more than the $305 million estimate. There would be no reason to discuss deferral unless the Commission intended recovery without offsetting the synergies.

371. In allowing recovery, the Commission appropriately recognized the expected long-term benefits of the merger and the fact that shareholders carried the upfront risk of pursuing the transaction, paid the transaction costs and fronted the transition costs for the customers. Further, the Commission recognized that once the savings flowed through the test year cost of service, they are perpetual benefits for customers and provide no more upside to the company and shareholders.

372. Staff would have the Commission reject its decision in the merger case which was based on pages and pages of comprehensive discussion. Staff solely relies on the boilerplate language found at the end of every Commission order, which states that the "Commission reserves the right to consider any ratemaking treatment to afforded the transactions herein involved in a later proceeding." *See* Merger Order at 284.

373. The Companies, however, had an expectation from the Merger Order that so long as the transition costs were deemed reasonable and prudent, and the Companies could demonstrate that merger synergy savings exceed the level of amortized transition costs, the company would be permitted to recover the transition costs in rates. The Companies fully complied with the requirements established in the Merger Order.

- The Companies have accumulated all transition costs consistent with the Merger Order;

- The Companies developed and maintained a Synergy Tracking Model which demonstrates that the merger synergy savings exceed the amortization of merger transition costs;
- The Companies are requesting less transition cost recovery than anticipated in the Merger Order;
- The Companies are delivering more synergies to customers (and the company) over both the five and 10-year periods than contemplated in the merger case; and
- The Companies stopped the deferral as of December 31, 2010 in anticipation of recovery of the transition costs in these rate cases, which are the first set of cases where the full test year reflects the impact of synergy savings.

If the Staff's position is adopted the company will have to write off millions of dollars of these accumulated costs. Specifically, the projected true-up value of Missouri jurisdictional transition costs is $41.8 million. Hearing Exhibit KCP&L-37, Ives KCP&L Surrebuttal Testimony at p. 3.

374. Further, no party to this proceeding has either challenged the reasonableness and prudence of the claimed transition costs or challenged the calculated synergy savings. As a result, there is no evidence that would justify this Commission reaching a different conclusion than in the merger case, and the company should be permitted to recover the merger transition costs in rates over five years beginning with rates effective from this case.

H. Rate Case Expense

1. Introduction

375. The company seeks to recover $4.1 million in rate case expense incurred through the true-up of the KCP&L case and approximately $3 million collectively for GMO. In its filed case, Staff failed to include any of the current rate case expenses incurred in this case. As a starting point, Staff started with the cumulative rate case expense booked as of June 2010. Then

Staff removed the vast majority of that amount because it believed that these costs were related to the Iatan construction project and therefore should be capitalized. *See* Hearing Exhibit KCP&L-210, Staff Report at 147. Staff provided the Companies no supporting detail for the amount it removed and indicated it would review further during the true-up. At the time of hearing, Staff had not transferred this amount to the capital accounts. It now appears that Staff abandoned this transfer in its true-up.

376. In addition to the rate case expense booked as of June 2010, Staff also indicated it would review subsequently incurred rate case expenses in the true-up case. *Id.* So, effectively, this issue was tried in the true-up case, which KCP&L asserts is inappropriate and an abuse of the true-up process. It is KCP&L's position that substantive issues are to be heard in the main evidentiary hearing, and the true-up is to merely update costs to reflect the period ending December 31, 2010. The true-up is not intended to be the time to raise new issues or even relitigate issues heard previously at hearing. Specifically, at page 4 of its August 18, 2010 Order Approving Nonunanimous Stipulation and Agreement, Setting Procedural Schedule, and Clarifying Order Regarding Construction and Prudence Audit, the Commission stated: "The true-up hearings should cover the reconciliation of the numbers for Iatan projects and all traditional rate case true-up costs for the true-up period and compliance with in-service criteria for Iatan 2." To propose further adjustments or make additional disallowances is not a reconciliation. The Commission should therefore reject Staff's attempt to try the rate case expense issue in the true-up proceeding.

377. Staff claims it was required to make its case in the true-up portion of this proceeding because it did not receive adequate supporting documentation from the company on a timely basis. *See* Majors True-Up Direct Testimony at p. 2. Staff claims it didn't receive

complete invoices from two law firms - Stinson, Morrison and Hecker and Morgan, Lewis & Bockius - and Pegasus Global Holdings until November 29, 2010. *Id.* at 2. What Staff fails to indicate is that these invoices represent a small portion of the total invoices it received in earlier time periods.[14] Staff also fails to indicate that the invoices related to law firm bills required extensive review to protect attorney-client privileged information. *See* Hearing Tr. p. 3642.

378. Staff acknowledged that the company provided face sheets in its initial response to Staff's request for legal invoices, but criticized the lack of detail. *See* Majors True-Up Direct Testimony at pp. 2-3. However, Staff failed to acknowledge that it is common practice to provide face sheets in response to a request for legal invoices due to the confidential and proprietary information contained on the invoices themselves. In fact, according to company witness John Weisensee, face sheets were provided in prior cases and if additional detail was required, the company provided it. The same is true in this case. According to Mr. Weisensee, face sheets were timely provided in response to Staff's request for legal invoices. When additional detail was requested, the detail was also provided in a timely manner with appropriate redactions made. *See* Hearing Tr. pp. 3640-42.

379. While initially Staff disallowed all legal expenses from vendors Stinson, Morrison & Hecker, Schiff Hardin, Pegasus Global and Morgan, Lewis, & Bockius, upon review of the invoices provided, Staff proposes to remove all legal expenses of Morgan, Lewis & Bockius. In addition, Staff proposes an adjustment to rate case expenses charged by Schiff Hardin and an adjustment for services relating to witness preparation. Finally, Staff maintains its disallowance

[14] Staff has not claimed that it did not timely receive invoices related to SNR Denton, Fischer & Dority, Schiff Hardin, Cafer Law Office, Duane Morris, Polsinelli Shalton Flanigan & Suelthaus or Spencer Fane Britt & Browne, collectively which make up the vast majority of legal expenses incurred by the company.

of the NextSource consulting expenses of Chris Giles per its prefiled testimony as duplicative. *See* Majors True-Up Direct Testimony at pp. 3-4 and 8.

2. Specific Disallowances

(a) Morgan, Lewis & Bockius

380. With regard to Staff's proposed adjustment to remove all legal expenses of Morgan, Lewis & Bockius, Staff claims the attorneys' rates are "significantly higher than the highest paid attorney from a Missouri firm." *Id.* at 4. Staff further claims that two of the attorneys at this firm are not "known to be involved in the current KCPL and GMO rate cases." *Id.* Staff has applied a standard to attorney rates that is not supported by any statute, rule or other legal authority. It is unreasonable to apply Missouri law firm rates to the rates charged by attorneys practicing in other, possibly more expensive locations. In addition, Staff's "standard" fails to take into account particular areas of expertise—including accounting, engineering, economics, large scale construction projects, financial markets, to name a few--needed by attorneys to assist utilities in rate case preparation and hearing. The elimination of all costs associated with Morgan, Lewis & Bockius because Staff believes them to be excessive appears to be an extreme remedy. Although the company does not accede to Staff's position, it would seem more appropriate to disallow a portion of these costs Staff believes are excessive rather than wholesale elimination.

381. It is also inappropriate for Staff to disallow costs because Staff does not know an attorney or how that attorney provides service to the company. Although it is not clear what Staff means when it says "known to be involved" in the current cases, Staff's position would appear to suggest that any attorney hired by the company would be required, at a minimum, to enter an appearance. This ignores the widely varying practice of law. Not all attorneys litigate. If Staff believes the company has allocated costs inappropriately to the rate case proceeding

because certain attorneys are not known to them, then Staff should seek additional information from the company before rejecting the costs on a wholesale basis. Unless Staff can prove that the company misallocated these costs, the legal expenses of Morgan, Lewis & Bockius should not be eliminated.

(b) Schiff Hardin

382. With regard to the invoices related to Schiff Hardin, Staff proposes to disallow a portion of the expenses by, in effect, discounting the rate charged by Schiff Hardin attorneys to the hourly rate charged by Pegasus Global Holdings. *Id.* at 7. Staff claims this discount is reasonable because Staff "assumes" there was duplicative legal expenses charged to rate case expense. *Id.* Staff also claims it is appropriate to disallow excessive expenses. Staff is correct that both Schiff Hardin and Pegasus provided services to KCPL and GMO in the form of expert witnesses on the prudence of the Iatan construction project. However, Staff has made no showing that the witnesses provided duplicative services. The Schiff Hardin and Pegasus witnesses each provided testimony on separate, discrete issues related to the reasonableness of the expenditures related to the construction of Iatan. Even a cursory reading of the testimony filed by Kenneth Roberts, Daniel Meyer, Steve Jones and Dr. Kris Nielsen demonstrates the differences in the areas each was assigned to address. Clearly, there was no duplication of effort and Staff assumed incorrectly.

383. Further, it is nonsensical to suggest that because both Schiff Hardin and Pegasus provided witnesses, that both firms should provide those witnesses at identical rates. Contracting for outside services, whether legal, technical or other, is a matter of negotiation. Staff's adjustment fails to consider the myriad factors that are considered when hiring an outside consultant. Staff's adjustment also fails to consider that Kenneth Roberts, for example, provided

both legal services and expert witness services during the course of the Iatan construction project. It appears Staff failed to adjust for Mr. Roberts' provision of legal services.

(c) NextSource

384. Staff initially removed "all dollars KCPL has included in rate case expense related to Mr. Giles' services as an independent contractor." *See* Hearing Exhibit KCP&L-9, Blanc Surrebuttal at 6, quoting Majors Rebuttal at 21. As set out in the Surrebuttal Testimony of Mr. Blanc at page 6, Staff's rationale for removing Mr. Giles' expenses are flawed. First, Staff appears to argue that the company should be not be allowed to recover Mr. Giles' expenses as an independent contractor because it believes his salary was included in the rates that resulted from KCP&L's last rate case. Mr. Giles' salary was, in fact, included in the last rate case—because at that time Mr. Giles was a company employee. Mr. Giles' change in employment status does not justify disallowing inclusion of his expenses as an independent contractor in the current rate case.

385. Staff next argues that the company should not be allowed to recover Mr. Giles' expenses as an independent contractor because Mr. Giles has the same job duties as Mr. Blanc, and therefore customers should not pay two people to perform one job. *See* Hearing Exhibit KCP&L-230, Majors Rebuttal Testimony at p. 12. While it is correct that Mr. Blanc assumed the former duties of Mr. Giles, Staff has failed to demonstrate—and cannot demonstrate—that Mr. Giles performed the same duties as an independent contractor as he did while a company employee. In fact, Mr. Blanc specifically stated that Mr. Giles provided support to him "in the same manner as any contract employee or KCP&L employee in the Regulatory Affairs Department." *See* Hearing Exhibit KCP&L-9, Blanc Surrebuttal Testimony at p. 6.

386. In making this adjustment, Staff seems to believe that the expenses of Mr. Giles and Mr. Blanc are duplicative. However, as testified to by KCP&L witness John Weisensee,

only one full-time equivalent ("FTE") employee has ever been included in KCP&L's cost of service as the head of the Regulatory Affairs Department, because payroll is annualized. *See* Hearing Tr. p. 3644. Further, Mr. Giles never performed the same duties as Mr. Blanc once Mr. Giles left the company's employ. *Id.* at 3644. As further explained by Mr. Blanc, employees may move around to different jobs within the company, or work as an outside consultant and take a job in-house, or conversely leave the employ of the company and work for the company as an outside consultant. In all of these cases, the company has only sought recovery of one FTE per employee function plus the costs of outside consultants for purposes of rate case expense. According to Mr. Blanc, the company has not sought to recover overlapping or duplicative expenses. *Id.* at 3655-60.

387. In the true-up case, Staff did not appear to revise its opinion about disallowing the costs associated with Mr. Giles' consulting fees on behalf of NextSource; however, Staff did propose to reallocate the total adjustment between KCP&L and GMO using the payroll factors for labor expenses used in Staff's payroll annualization. *See* Majors True-Up Direct Testimony at p. 8.

388. Because the company has demonstrated that the expenses associated with Mr. Giles are not duplicative, the Commission should reject Staff's proposed disallowance.

(d) Communication Counsel of America ("CCA")

389. In its true-up case, Staff proposes removing the costs associated with CCA from rate case expense. Staff claims that the services provided by CCA related to witness development and coaching are typically performed by counsel. *Id.* at 8. That is the sum total of Staff's rationale for removing the costs. While it is true that counsel may prepare witnesses for hearing, there is certainly no requirement that only counsel is permitted to perform this function. Staff has failed to demonstrate that CCA's services were not reasonable and prudent—only that

other personnel typically handles this responsibility. Because Staff was unable to prove that CCA's costs were not reasonable and prudent, the Commission should reject Staff's disallowance.

3. Conclusion

390. The above-described Staff adjustments reduce rate case expense recoverable in this case to approximately $3.3 million for KCP&L and $2.6 million collectively for GMO. These amounts represent the true-up amounts recorded as of December 31, 2010, not final rate case expense.[15] Many of Staff's adjustments to reduce or eliminate the costs of certain vendors from the company's rate case expense were based on faulty assumptions about the work performed or concerns with the level of rates charged. It is clear that the company did not seek to recover duplicative services in rate case expense, therefore, Staff's adjustments based on that reason should be rejected by the Commission as unsupported by the evidence in this case. With regard to the rates charged by certain vendors, the company maintains that one size does not fit all. The consultants hired by the company are located in different regions of the U.S., and the rates charged so reflect. The company should not be penalized because it requires the services of experts, not all of whom are available in or around the Kansas City area. Of course, location is only one factor that makes up a consultant's rate. Experience and specialization are also important considerations. The more experienced and specialized the consultant, the higher the rate is likely to be. Again, the company should not be penalized for seeking out experience and qualified consultants. Staff's attempts to arbitrarily discount or disallow entirely the costs of certain consultants, described above, should be rejected by the Commission.

I. Hawthorn 5 Settlement

[15] The difference will be recovered in the next rate case, subject to Staff review. *See* Majors True-Up Rebuttal Testimony.

391. The Hawthorn 5 Settlement issue has two components. First, in 2007, KCP&L had an outage to replace the catalyst in the selective catalytic reduction system (SCR) at the Hawthorn 5 coal unit. The outage period was from February 24 - March 9, 2007. The company sought reimbursement from Babcock and Wilcox, the vendor who built the SCR, to recover the damages associated with the outage, the majority of which were replacement power costs during the outage. KCP&L's claim resulted in a settlement with Babcock and Wilcox in the amount of $2.8 million, which was received in 2007.

392. While 2007 was the test year in the company's last rate case, KCP&L did not seek recovery of the expenses incurred as a result of the outage in that case because fuel and purchased power costs are normalized in a rate case. In addition, the last rate case resulted in a global black box settlement. The outage-related fuel and purchased power costs would have been addressed as part of that settlement.

393. It is KCP&L's position that customers never paid the outage-related fuel and purchased power costs; therefore, customers should not be reimbursed for costs they did not pay.

394. Staff proposed an adjustment to reflect the $2.8 million settlement proceeds "as an increase to the depreciation reserve and a decrease in depreciation expense, as if the plant cost had been adjusted for the total settlement proceeds received." *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 48. Staff's adjustment is based on its belief that "[a]ll the increased costs to KCPL were and are currently being paid by KCPL customers in utility rates." *See* Hearing Exhibit KCP&L-210, Staff Report at 109.

395. KCP&L asserts that the settlement proceeds should not be flowed back to customers. First, the proceeds of this litigation are non-recurring revenue and are also outside the test year in this case. Unusual, non-recurring events (expenses or revenues) are excluded

from the test year because they do not reflect the ongoing cost of service of the company. Further, the cost of replacement power and additional ammonia expense that resulted from the catalyst outage was never paid by customers. Customers did not pay for replacement power or additional ammonia expense because KCP&L did not have a fuel adjustment clause at the time of the outage and also KCP&L normalizes fuel and purchased power expenses in its rate cases so test year anomalies are disregarded. Additionally, there were no incremental costs to the company and, in turn, to its customers related to work assigned to KCP&L personnel as a result of the outage. Finally, Staff's position constitutes retroactive ratemaking. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at pp. 49-50.

396. Second, in 2005, KCP&L had a transformer outage at the Hawthorn 5 coal unit. The company sought reimbursement from Siemens, the vendor who built the transformer, to recover the damages associated with the outage, almost entirely consisting of replacement power costs during the outage. KCP&L's claim resulted in a settlement with Siemens in the amount of $6.7 million, which was received in 2008.

397. While 2005 was the test year in the company's 2006 rate case, the company did not seek recovery of the expenses incurred as a result of the transformer outage in that case because fuel and purchased power costs are normalized in a rate case. The order in the 2006 rate case resulted in ordered rates that did not include these unusual and non-recurring costs.

398. It is KCP&L's position that customers never paid the outage-related fuel and purchased power costs; therefore, customers should not be reimbursed for costs they did not pay.

399. Staff proposed an adjustment to reflect the $6.7 million settlement proceeds "as an increase to the depreciation reserve and a decrease in depreciation expense, as if the plant cost had been adjusted for the total settlement proceeds received." *See* Hearing Exhibit KCP&L-8,

Blanc Rebuttal Testimony at p. 51. Staff's adjustment is based on its belief that "[a]ll the increased costs to KCPL of the operation of Hawthorne [sic] 5 resulting from the step-up transformer failure were paid by KCP&L customers in utility rates." *See* Hearing Exhibit KCP&L-210, Staff Report at 111.

400. KCP&L asserts that the settlement proceeds should not be given to customers. Customers were not charged for the costs of replacement power related to the Hawthorn 5 transformer failure. Replacement power represents approximately 97% of the settlement proceeds. At the time of the outage, KCP&L did not have a fuel adjustment clause which would have provided for the recovery of replacement power costs. Further, KCP&L normalizes fuel and purchased power costs in its rate cases so test year anomalies are disregarded. Finally, KCP&L received these proceeds in 2008, one year prior to the test period in this case. To include the settlement proceeds in this case constitutes retroactive ratemaking. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at pp. 51-52.

401. These issues are not novel to the Commission. In Case No. ER-2007-0291, KCP&L removed from its case the receipt of $16.9 million in subrogation proceeds that were recorded by the company in 2006 related to the Hawthorn 5 boiler explosion that occurred in 1999. In that case, the Commission agreed with the company's removal of the proceeds from test year consideration. The Commission found that the proceeds were unusual and non-recurring, and should therefore be excluded from the test period. The Commission also found that KCP&L's customers never paid the costs for which the settlement provided reimbursement. *Id.* at 50-51.

402. In both instances, the Commission should reject Staff's attempts to include unusual, non-recurring, out-of-period settlement proceeds to KCP&L's cost of service. To

include these settlement payments would constitute retroactive ratemaking. Additionally, it would violate the matching principle that if customers receive the benefit of the payments, then they should have paid the costs being reimbursed by the settlement. Customers did not pay the costs associated with the outages; therefore, to receive the benefit of reimbursement for costs they did not pay would unjustly enrich KCP&L's customers to KCP&L's detriment.

J. Fuel Switching

403. In an unprecedented request, Missouri Gas Energy ("MGE"), KCP&L's fuel source competitor, seeks to impose a tariff on KCP&L that would only serve to benefit MGE to the detriment of KCP&L. Under the guise of energy efficiency, and despite questionable calculation of standard cost effectiveness tests, MGE has proposed for KCP&L to implement a fuel-switching program whereby KCP&L would be required to offer financial incentives to its customers to convert certain end use appliances from electricity to natural gas. Hearing Exhibit KCP&L-2201, Reed Direct at p. 2. In reality, MGE seeks to incent greater use of natural gas-using appliances in order to increase its own revenues. Further, MGE's proposal would result in KCP&L failing to recover the fixed costs associated with the lost revenues of customers switching from electricity to natural gas. The Commission should not require KCP&L to implement a questionable demand side management program proposed by a competitor that would not only require KCP&L to lose revenue but to pay customers to use more natural gas. MGE's self-serving proposal should be rejected.

404. MGE bases its proposal in part on a report from the National Research Council ("NRC") in response to a request from the Department of Energy ("DOE"), Office of Energy Efficiency and Renewable Energy ("EERE") to review the DOE's appliance standard program. *Id.* at 5; Hearing Tr. at 3101-02. According to MGE, the DOE is considering whether to adopt an alternative method for measuring energy consumption known as the full fuel cycle approach.

Hearing Exhibit KCP&L-2201, Reed Direct at p. 5. It is important to note that the context of DOE's inquiry is whether to use the full fuel cycle approach[16] in measuring energy consumption for inclusion on the yellow Energy Guide labels found on home appliances, or whether to continue using the site-based approach.[17] *See* Hearing Exhibit KCP&L-2209, Review of Site & Full-Cycle Measurement.

405. Reliance on the DOE's report from the NRC in setting state energy efficiency policy, however, is misplaced. In appointing a committee to conduct a review of the DOE's appliance standards program, the NRC clearly stated the "committee will not address whether energy conservation standards are appropriate government policy or what levels may or may not be appropriate." Hearing Exhibit KCP&L-2209, Review of Site & Full-Cycle Measurement at p. 16. Rather, the committee's task was "to evaluate or critique the methodology used for setting energy conservation standards" on appliance and commercial equipment. *Id.* Further, the committee was not unanimous in its recommendation. In the Minority Opinion of Committee Member David H. Archer, he stated:

> [T]he report overemphasizes the concept that the full fuel cycle energy to the point that it diverts attention from the purpose of the DOE/EERE program: to assure that the available building appliances for all the various functions, energy sources, and building applications are efficient; not to compare the energy use of appliances using different energy sources on the basis of full fuel cycle energy consumption.

Id. at 38.

406. More significantly for the context of this rate case, Committee Member Ellen Berman indicated that switching from a site-based approach to appliance standards to the full

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[16] The full fuel cycle approach is a method of measuring energy consumption not just at the point of use in the home but also the upstream consumption, including production, generation and transmission and delivery of the appliance. Reed Direct at 5-6; Hearing Tr. p. 3104.

[17] The site-based approach is measuring consumption at the point of use. Hearing Tr. p. 3105.

fuel cycle approach is complex and won't benefit consumers, in part because consumers have no control over the upstream costs included in the full fuel cycle methodology. Specifically, Ms. Berman stated:

> As laudable as this intent is meant to be, this approach [the full fuel cycle approach] would not benefit consumers. Developing a full-fuel-cycle cost methodology is fraught with complexity and controversy. A simple conversion factor from site energy to full fuel cycle is not adequate. ... As explained in this report, "the appliance standards program is not meant to identify or establish favored energy sources or technologies for building appliances. That is a matter of government policy and/or free market" Notwithstanding this caveat, direct comparisons among fuels will inevitably favor one fuel over another in terms of the measures used in the analysis - one fuel will be more environmentally sound, one will be more affordable, another might be more reliable or secure, yet another might be more available, and another might be determined to be safer. These preferences are beyond the intention of the Program and are a matter of national energy policy. Of particular significance is the fact that the consumer has no control over upstream costs of producing energy or the physical characteristics of fuels. ... Were consumers to switch fuels based on incomplete analysis, costs of conversion could be very great and energy savings might not occur at all.

Id. at 39-40.

407. This Commission should not make a decision to require KCP&L to implement a questionable fuel switching program based on a complex and controversial methodology that wasn't even designed to compare the energy use of appliances using different energy sources.

408. As further support for the use of full fuel cycle approach to measuring energy efficiency, MGE cites to Energy Star Performance Rating Methodology for Incorporating Source Energy Use (December 2007). Hearing Exhibit KCP&L-2201, Reed Direct at p. 8, fn. 6. However, MGE's claim that its proposed program is based on energy efficiency is disingenuous given its program would not allow conversion to propane or other fuels with equivalent full fuel cycle values to natural gas. *See* Hearing Exhibit KCP&L-103 at 3. This report calculates the source-site ratio for various types of energy. Table 1 on page of 3 of the report shows that fuel oil (diesel, kerosene), propane and even wood have similar values to natural gas, yet MGE only

promotes a fuel switching program from electricity to natural gas. MGE's witness attempted to explain away the data that appears in its own cited document (Hearing Tr. p. 3111-13); however, the Energy Star Performance Methodology for Incorporating Source Energy Use clearly discusses the "potential for inefficiency in the conversion of primary fuels" and the "potential for loss when either primary or secondary fuels are transmitted/distributed to individual sites." *Id.* at 2.

409. In order to overcome these "potential inefficiencies," this report makes a comparison of source energy and site energy. This is the exact basis of MGE's argument -- that source energy (full fuel cycle) comparisons generally reflect energy costs and carbon emissions more accurately than site energy, therefore this Commission should promote programs that use fuels that compare more favorably to electricity. If MGE were truly concerned with promoting energy efficiency through the full fuel cycle, it would have supported a program that would allow for the conversion to any fuel source with an equivalent full fuel cycle value to natural gas.

410. MGE included its own tables which purport to show comparisons of electric and natural gas consumption under the full fuel cycle, whereby natural gas appears to be the more attractive fuel choice. Hearing Exhibit KCP&L-2201, Reed Direct at pp. 10-11. However, the data used by MGE is not specific to KCP&L, and MGE has not demonstrated that the general data it received from the American Gas Association ("AGA") is even applicable to KCP&L. *See* Hearing Exhibit KCP&L-26, Goble Rebuttal at p. 20. The footnotes which accompany MGE's tables state that the data is from a document entitled "A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances" prepared by the AGA. *Id.* A review of this document indicates that the AGA's information was developed by the Gas Technology Institute for Codes & Standards Research Consortium in a paper entitled "Source

Energy and Emission Factors for Building Energy Consumption" (August 2009). *Id.* KCP&L's witness, Gary Goble, discovered that the original source of the information relied upon by MGE includes the following statement:

> Average energy and emissions calculations may be appropriate for inventory purposes, but they do not necessarily provide good information when evaluating competing energy efficiency measures.

Id. at 20-21. The underlying data of MGE's analyses demonstrates that it is not reliable for the purposes intended by MGE, and filtering the data through the AGA does not affect its usefulness.

411. In Table 3 prepared by MGE (Hearing Exhibit KCP&L-2201, Reed Direct at p. 13), MGE attempts to demonstrate the estimated annual cost savings when using water heating and space heating gas and electric appliances. However, MGE's calculations contain errors which must be corrected in order to find the result reliable. Specifically, the prices used by MGE are not measured in the same units as the consumption. "Inexplicably, the consumption is measured in MMBtu, but the price is stated in terms of Dollars per hundred kWh." Hearing Exhibit KCP&L-26, Goble Rebuttal at p. 22. In addition to this specific error, KCP&L takes exception to "underlying conceptual errors" contained in MGE's calculations. *Id.* According to KCP&L witness Goble:

> In particular, the consumption used in [MGE's] calculations represents total energy, including all losses to the site. In the case of natural gas, this represents gas volumes at the well head. However, the price is not stated at the well head. MGE purchases natural gas and then bundles the cost of all losses into its retail price. Therefore, Mr. Reed's inclusion of losses in both the consumption amounts and the prices represents a serious double counting.

Id. at 22-23.

412. In correcting for these errors, KCP&L found that customers who switch from electricity to natural gas for their water heating needs alone will experience no savings. In fact,

their annual bill will increase by over $200 per year. *Id.* at 24. This is in direct contradiction to the $200 in annual savings estimated by MGE for switching from electricity to natural gas.

413. Another flaw in MGE's fuel switching program is that MGE did not provide the results of any Total Resource Cost ("TRC") test for its proposed water heating and space heating fuel substitution program. As MGE recognizes, this Commission has routinely employed the TRC test in its economic analysis of potential energy efficiency measures. Hearing Exhibit KCP&L-2201, Reed Direct at p. 39. For MGE's proposal to be considered a serious and viable energy efficiency measure, as it claims, the results of the benefit-cost tests would have to be evaluated. Not only did MGE not provide any TRC test results, it did not provide sufficient information for any other party to perform this test. Nonetheless, KCP&L's witness Goble attempted to estimate the required data in order to provide the Commission at least a rough analysis. Mr. Goble's analysis showed that "[t]he costs exceed the benefits in absolute as well as on a present worth basis. Even using very favorable assumptions, the Benefit-Cost ratio is only 0.5." Hearing Exhibit KCP&L-26, Goble Rebuttal at p. 26. Mr. Goble acknowledged that not all water heater fuel substitution programs are unacceptable. However, even with the suspect quality of data available for his analysis, Mr. Goble unequivocally concluded "that it would be imprudent to implement the hastily designed electric to gas water heater substitution program recommended by MGE's witness ... on the basis of economics." *Id.*

414. KCP&L's witness Goble also conducted a Ratepayer Impact Measure ("RIM") test and a Total Participant test. The results of the RIM test indicated again that the costs exceed the benefits in every year as well as on a present worth basis, suggesting that implementation of MGE's proposed water heater fuel substitution program will result in higher rates for KCP&L's customers. *Id.* at 26-27. Similarly, customers' costs would exceed the benefits in every year as

well as on a present worth basis under the Total Participant test. "Even using very favorable assumptions, the Benefit-Cost ratio is only 0.6." *Id.* at 27.

415. KCP&L did not confine its economic analysis to a water heater conversion program only. KCP&L also performed an analysis of MGE's proposed space heating electric to natural gas fuel substitution program. In general, the results of the TRC test for space heating were comparable to the results for water heating. *Id.* The results of the RIM and Total Participant tests revealed costs slightly in excess of the benefits. *Id.* Based on KCP&L's analysis, "neither the participant, the non-participants, nor society as a whole would benefit economically from the substitution of electricity by natural gas for both the water and space heaters," and the Commission should therefore not require its implementation. *Id.* at 27-28.

416. The Commission also should not require KCP&L to implement a fuel switching program that MGE itself is not willing to implement. MGE suggests that KCP&L should offer financial incentives to residential customers to encourage them to convert from electric water heating to natural gas water heating and/or from electric resistance heat to natural gas heat. Hearing Exhibit KCP&L-2201, Reed Direct at p. 19. MGE, however, is not willing to pay KCP&L's customers to make the appliance switch. It conveniently claims that it can't make such a proposal to revise its own programs in the context of KCP&L's rate case. Hearing Tr. p. 3089. MGE says that it bears part of the expense (per its existing programs), but its proposal in reality puts the financial burden on KCP&L. Additionally, MGE is not willing to contemplate the reverse of its program, meaning, providing an incentive to its customers to convert from natural gas appliances to electric if the conditions impacting the fuel relationships change to favor electric. Hearing Tr. p. 3108.

417. MGE states that fuel switching programs have been approved for other utilities, including Puget Sound Energy, CenterPoint, Avista Corporation and Philadelphia Electric Company. Hearing Exhibit KCP&L-2201, Reed Direct at p. 20. For these utilities cited, Puget Sound Energy and Avista Corporation are combination utilities, providing both electric and natural gas service. CenterPoint is an electric utility, but its parent owns natural gas assets. Hearing Tr. p. 3113-14. These utilities are not similarly situated to KCP&L and therefore are not appropriate examples. For a combination utility, or a utility whose parent has natural gas interests, there is little or no harm to providing an incentive for a customer to switch from one fuel source to another. The same company receives the revenue. In the case of KCP&L and MGE, there is a winner and loser.

418. MGE states that its proposed fuel switching program would help KCP&L reduce its peak load or defer future plans for new generation or transmission facilities and that "utility planning involves very long time horizons in order to meet future demand growth." Hearing Exhibit KCP&L-2201, Reed Direct at p. 34. In fact, MGE is aware that KCP&L does not need capacity until the 2020-25 timeframe. Hearing Tr. p. 3129. With no need for capacity additions in the next decade or longer, it appears that MGE's proposal is unnecessary at this time. In addition, MGE recognizes that KCP&L previously considered fuel switching in Missouri as part of its 2008 Integrated Resource Plan ("IRP"). Hearing Exhibit KCP&L-2201, Reed Direct at p. 35. At that time, KCP&L acknowledged that "the impact of greenhouse gas restrictions could encourage large scale fuel switching." *Id.* The 2008 IRP was developed during a time of uncertainty surrounding federal mandates regarding emissions. To date, there have been no federally-mandated greenhouse gas emissions standards or restrictions implemented. Nor does Missouri have any such restrictions. Hearing Tr. p. 3130.

419. With regard to program funding, MGE states that "KCP&L would fund the costs associated with the conversion and installation portion of the fuel switching rebate program through its current energy efficiency and conservation program, under which KCP&L defers the costs of the program for possible future recovery in a rate case." Hearing Exhibit KCP&L-2201, Reed Direct at p. 28-29. MGE made it clear that it supports rate recovery of monies spent by KCP&L. *See id.*; Hearing Tr. p. 3124. What is less clear is recovery of lost margins and fixed costs. While MGE supports lost margin and fixed cost recovery, it refuses to conceive of a scenario in which recovery of lost margins and fixed costs isn't available to KCP&L. Hearing Tr. p. 3125-27. MGE, of course, has a decoupling mechanism in place that allows it to recover its lost margins and fixed cots. *Id.* at 3139. However, to date, no electric utility in Missouri has been authorized to implement a decoupling or other type of lost margin recovery mechanism. MGE acknowledges that without a cost recovery mechanism, KCP&L would have to "eat the costs" of it proposed program. *Id.* at 3129. Until all issues surrounding cost recovery are resolved, it would be premature to implement a fuel switching program.

420. There are broad policy implications that the Commission must consider before implementing an electric to gas substitution program. Despite MGE's attempts to characterize its proposed program as merely an energy efficiency measure, its proposal actually represents a fundamental policy shift that could potentially interfere with market factors affecting the electric and natural gas distribution industries. *See* Hearing Exhibit KCP&L-26, Goble Rebuttal at pp. 4-20. Among other possible policy issues, the Commission must address the following when considering approving fuel switching programs generally and MGE's proposal specifically:

- The Commission's role in restructuring the power supply and end use appliance markets;

- Whether a fuel switching program should be implemented in the context of this rate case proceeding;
- Balancing social goals with economic efficiency goals;
- The true environmental impacts of electric to gas substitution;
- Whether the Commission should address environmental impacts prior to the conclusion of pending investigations at the national level;
- The recovery of lost margins and fixed costs resulting from electric to gas substitution;
- Whether MGE's proposal that KCP&L pay customers to switch from electric to natural gas appliances benefit non-participating customers;
- The impacts the proposed incentives for electric to gas substitution will have upon existing or future energy efficiency, energy conservation, demand side management and demand response activities of KCP&L;
- The accuracy of the data used to assess the costs and benefits of electric to gas substitution; and
- The need for input from other stakeholders in the state (*e.g*, other electric and natural gas utilities).

Id. at 4-5. None of these issues have been -- nor should be -- addressed in the context of this rate case. This inquiry is more appropriately suited for a general investigation docket.

421. MGE's proposal to require KCP&L to implement a fuel switching program is self-serving at worst and premature at best. Under the guise of promoting energy efficiency, the proposal is based on analyses not intended as a comparison of fuel sources, faulty analyses and incomplete analyses. MGE's proposal is based on the concept of the full fuel cycle, which means measuring energy consumption not just at the point of use in the home but also the

upstream consumption, including production, generation and transmission and delivery of the appliance. However, the full fuel cycle doesn't make the appliance more efficient; rather, it changes how the efficiency of the appliance is measured. In reality, customers have no ability to control the upstream costs related to the production of the appliance, only how the appliance is used in the home. The premise of MGE's proposal therefore is flawed and the only winner if its proposal is implemented is MGE. KCP&L is committed to promoting energy efficiency and demand side management programs, as is evidenced by KCP&L's previously approved portfolio of programs. However, it is inappropriate to approve a competing utility's proposed program without the same careful and rigorous scrutiny undertaken by the company when its other energy efficiency/DSM programs were implemented. In addition, there are broad policy implications that must be considered before implementing electric to gas substitution. This rate case is not the appropriate context in which to vet these issues. MGE's proposed fuel switching program should therefore be rejected.

K. Demand-Side Management

1. Introduction

422. From the Companies' perspective, the primary goal related to Demand Side Management ("DSM") programs in this case is to establish a bridge or a temporary framework for going forward on the Companies' DSM programs until the Commission completely implements its rules related to the Missouri Energy Efficiency Investment Act ("MEEIA").

423. As recognized in the Staff Cost of Service Report, (Hearing Exhibit KCP&L-2010 (NP), p. 127, COS Report), "The Company's overall spending levels for demand-side programs have met and exceeded the expectations established in the Regulatory Plan. As reported by the Company, through June 30, 2010 the budget for all Company demand-side programs is $24,001,009 and the actual total expenditures through this period are

$27,442,517, or 14% greater than budget." Clearly, the Companies have been aggressive participants in DSM programs in their respective service areas.

424. With the ending of the KCP&L Regulatory Plan in this case, however, there is no established framework approved for addressing KCP&L's future investments in DSM programs. KCP&L believes that it has complied with the requirements of the KCP&L Regulatory Plan, as well as the Integrated Resource Planning ("IRP") rule regarding DSM programs. In fact, KCP&L has been active with many of the parties, including the Staff, Public Counsel and MDNR, in addressing the KCP&L's IRP as well as the Customer Program Advisory Group ("CPAG"), in addressing and planning the status of its DSM programs.

425. At this time, the Companies are continuing their DSM programs contained in its tariffs. However, there needs to be a determination from the Commission regarding how the DSM programs will be treated following the conclusion of the KCP&L Regulatory Plan. Staff has suggested that the existing levels of DSM investments should be mandated by the Commission to continue into the indefinite future, and the existing cost recovery mechanism should be maintained. *See* Hearing Exhibit KCP&L-210 (NP) p. 126-30, COS Report; Hearing Exhibit KCP&L-239, Rogers Rebuttal at p. 2.

426. However, the current mechanism does not provide timely recovery or earnings opportunities, nor does it sufficiently encourage the implementation of energy efficiency programs by KCP&L. Therefore, the Staff's proposal should not be accepted by the Commission.

427. Under the existing cost recovery mechanism, KCP&L first funds the DSM programs, and the costs are placed into a regulatory asset for consideration for recovery in

the next rate case without a carrying cost. Assuming the DSM costs are determined to be recoverable, then those costs are amortized over a ten-year period without the inclusion in rate base.

428. Until the new MEIAA rules are finally implemented, it is important for the KCP&L to have a bridge that establishes the framework for the treatment of its DSM investments until the MEEIA rules can be implemented. For the purposes of this case, KCP&L has proposed that the cost recovery mechanism should be consistent with the recent *Order Approving First Stipulation And Agreement* in the AmerenUE rate case, Case No. ER-2010-0036 (March 24, 2010). *See* Hearing Tr. pp. 3531-32. This would change KCP&L's current amortization period for the DSM regulatory assets from ten (10) years to six (6) years as described below, and include the unamortized balance in rate base for actual expenditures booked to the DSM regulatory asset up through the period of December 31, 2010. Hearing Tr. pp. 3501-03.

2. Should DSM investments be included in rate base in this proceeding?

429. Yes. KCP&L has not taken any action in this rate case beyond what is currently in place and was established in the Regulatory Plan with regard to DSM investments. As explained above, the current regulatory accounting mechanism does not adequately address the policy goals set out in MEEIA. Specifically, the current mechanism does not provide timely recovery or earnings opportunities, nor does it sufficiently encourage the implementation of energy efficiency programs by the utility. *See* Hearing Exhibit KCP&L-54 (NP), Rush Direct at p. 22.

430. It is KCP&L's expectation that the MEIAA rule, if properly implemented, will address these goals and will more adequately address energy efficiency programs and cost

recovery. *See id.* at pp. 21-22. KCP&L continues to have concerns, however, that the current MEEIA rule does not adequately address the "lost revenue" issue.

431. Based upon a reading of the newly adopted MEEIA rule, KCP&L would not be entitled to recover "lost revenues" unless the revenues, in the aggregate, were declining. This is not an adequate incentive to aggressively pursue DSM programs. The Commission should modify its approach, assuming KCP&L's reading of the new MEEIA rule is accurate.

3. Should 50% of Connections program costs and certain other advertising costs be transferred from a recoverable expense to the DSM rate base balance?

432. This issue has been settled among the parties. *See Non-Unanimous Stipulation And Agreement As To Miscellaneous Issues* filed on February 2, 2010.

4. How should DSM amortization expense be determined in this case?

433. As discussed above, KCP&L's current amortization period for the DSM regulatory asset should be changed from 10 years to 6 years, and the unamortized balance should be included in rate base for actual expenditures booked to the DSM regulatory asset up through the period of December 31, 2010. Under KCP&L's proposal, the six year amortization period would be applied to DSM program expenditures referred to by Staff as being incurred in "Vintage 4", that is, those subsequent to September 30, 2008. Prior expenditures would continue to be amortized over the originally authorized ten-year period. Additionally, KCP&L would defer the costs of the DSM programs in Account 182 and, beginning with the December 31, 2010 True Up date in this case, calculate carrying costs monthly using the monthly value of the annual Allowance for Funds Used During Construction (AFUDC) rate. *See* Hearing Exhibit KCP&L- 55 (NP), pp. 5-6, Rush Rebuttal at p. 5-6.

434. MDNR also proposed that DSM program costs continue to be booked in the regulatory asset account and that the amortization period for the energy efficiency regulatory asset account be reduced from 10 years to 6 years. DNR recommended that shortening the amortization period be contingent upon KCPL's continuation and expansion of its DSM portfolio, as required by the Commission. *See* MDNR Position Statement; Hearing Exhibits KCP&L-601, 602 and 605, Bickford Direct, Rebuttal, and Surrebuttal.

5. Should the Companies be required to fund DSM programs at the current level?

435. No. The Commission should reject Staff's and MDNR's recommendations to direct the Companies to invest in DSM programs without any assurance that the full costs and lost revenues associated with these programs will be recognized in rates. Instead, the Commission should move forward to implement the cost recovery issue expeditiously, including the recovery of lost revenues associated with the specific DSM programs. *See* Hearing Exhibit KCP&L-55 (NP), Rush Rebuttal at p. 8. The Commission should not interpret the MEEIA statute and pending rule to allow recovery of lost revenues only when the Companies' revenues, in the aggregate, decline. *See KCP&L and GMO's Application for Rehearing and Application for Stay Order*, Case No. EX-2010-0368.

6. Should the Companies' be required to make a compliance filing with the Commission regarding MEEIA legislation as proposed by Staff?

436. No. The Companies believe that they are complying with the requirements of MEEIA as well as the IRP rule regarding DSM programs. The Companies are active with many parties, including the Staff in addressing the Companies' IRPs, as well as the Customer Program Advisory Group (CPAG) in addressing planning and the status of all DSM programs. Like other electric utilities, the Companies have experienced customer load growth changes due to

many factors including the downturn in the economy. The change in load has necessitated some changes to the plant, which has been presented to the parties involved in the Companies' IRP processes. At this time, the Companies are continuing their DSM programs contained in their tariffs with the hope that the Commission will implement rules that provide for adequate cost recovery of DSM expenditures. In fact, as discussed above, KCP&L has expended more funds on DSM in total than was set out in the Regulatory Plan. Hearing Exhibit KCP&L-56 (NP), Rush Surrebuttal at p. 4.

437. It is unnecessary for the Commission to require KCP&L and GMO to make a compliance filing with the Commission regarding MEEIA legislation as proposed by the Staff. *See id.* at p. 3.

7. Unrelated Accounting Issues Included in Staff's DSM Analysis.

438. Staff nets unrelated issues to be included with its adjustment for DSM program costs. *See* Hearing Exhibit KCP&L-210 (NP), COS Report at p. 131-37; Hearing Exhibit KCP&L-226 (NP), Hyneman Surrebuttal at p. 63. Staff includes negative costs against the unamortized balance of DSM program costs for purposes of computing an annual amortization and return. These negative costs are those that the Commission has previously ordered to be returned to ratepayers over ten years and include excess margins on off-system sales and net reparations from the litigation of Montrose coal freight rates before the Surface Transportation Board, but are unrelated to DSM Program costs.

439. As discussed in the Rebuttal Testimony of John P. Weisensee, KCP&L and GMO believe this netting to be inappropriate. Mr. Weisensee discusses at length the concerns raised by Staff's specific adjustments and its approach to lump together these unrelated adjustments. *See* Hearing Exhibit KCP&L-64 (NP), Weisensee Rebuttal at p. 6-18. DSM costs should be considered as a stand-alone cost for purposes of cost recovery.

L. Low-Income Weatherization Program Funding

440. In the Staff's Cost of Service Reports (Hearing Exhibit KCP&L-210 (NP), Staff's COS Report, p. 143 and Hearing Exhibit GMO-210 (NP), p. 156), the Staff recommended that KCP&L and GMO be required to continue to provide annual funding of $573,888 and $150,000, respectively. Staff also suggested that unspent weatherization funds should be placed into an account with EIERA. *See* Hearing Exhibit KCP&L-246 and Hearing Exhibit GMO-247, Warren Surrebuttal.

441. The Companies disagrees with both Staff proposals. This rate case is not the proper forum for a decision to continue the current funding levels for low income weatherization. From the Companies' perspective, such proposals should be first vetted with the Customer Program Advisory Group ("CPAG") which consists of various interested parties. Perhaps more importantly, a Commission determination of the recovery mechanism for such programs should be made before a decision on the level of weatherization funding is made. It would be unlawful for the Commission to mandate a specific funding level for low income weatherization without a mechanism in place for the Companies to recover these mandated-expenditures.

442. It would also be inappropriate to require the unspent funds be deposited into an EIERA account. The record reflects that KCP&L anticipates spending ninety-six percent (96%) of the budgeted funds for its existing weatherization program. *See* Hearing Exhibit KCP&L-246, Warren Surrebuttal at p. 4. It does not seem reasonable to require that the remaining unspent funds (4%) should be deposited into an EIERA account for use by a program that has recently been able to spend a much lower percentage of its funds for weatherization purposes. *See* Hearing Tr. p. 3608.

443. MDNR witness Adam Bickford also testified that MDNR had not been approached by any party regarding Staff's proposal in this case. He indicated that EIERA would

have to balance resources with other projects they are involved in, and consider whether there are significant design differences between the federal weatherization programs and KCP&L's program. *See* Hearing Exhibit KCP&L-605, Hearing Exhibit GMO-603, Bickford Surrebuttal at p. 3.

444. Additionally, Staff is recommending that the Companies modify their direct reimbursement payment method to the weatherization agencies from monthly to annual. This recommendation would also be harmful to the Companies' cash flow and place an undue burden on the Companies. *See* Hearing Exhibit KCP&L-55 at p. 3; Hearing Exhibit GMO-33, Rush Rebuttal at pp. 12-13.

445. Given these concerns, the Companies respectfully requests that the Commission reject the Staff's proposals regarding mandating the funding of low income weatherization programs in this case.

M. Pension and Other Post Employment Benefit (OPEB) Trackers

446. In his KCP&L Direct Testimony (pp. 22-23; 25), Mr. Blanc made four requests on behalf of KCP&L regarding pensions and OPEB costs:

> 1. That Section III(B)(1)(e) of the Regulatory Plan related to pensions continue in effect after the conclusion of the Regulatory Plan.
>
> 2. That it be allowed rate recovery for contributions made to the pension trust in excess of the Financial Accounting Standard No. 87 regulatory expense for the following reasons: (1) reduction in Pension Benefit Guarantee Corporation variable premiums; (ii) avoidance of pension benefit restrictions under the Pension Protection Act of 2006 ("PPA") that would cause an inability of the Company to pay pension benefits to recipients according to the normal provisions of the plan; and (iii) avoidance of at-risk status under the PPA that would result in acceleration of minimum contributions.

3. That the Commission accept the allocation method proposed by KCP&L witness Ken Vogl as an appropriate means to allocate consolidated Great Plains Energy FAS 87 regulatory pension costs between KCP&L and its other affiliates.

4. That the Commission grant authority to establish a tracking mechanism for OPEB costs similar to that used for pension costs.

447. In his GMO Direct Testimony (pp. 12; 14), Curtis D. Blanc made three related requests on behalf of GMO:

1. That the Commission authorize a pension ratemaking methodology for GMO similar to that authorized for KCP&L

2. That such proposed methodology be determined to satisfy the requirements of Case No. EM-2000-292, the UtiliCorp United / St. Joseph Light & Power Company ("SJL&P") merger case, that the SJL&P pension funded status be accounted for separately following the merger.

3. That the Commission grant authority to establish an OPEB tracking mechanism.

448. There was no opposition to any of these requested items by any of the parties to the case. The Companies are currently trying to finalize a separate Stipulation and Agreement in both the KCP&L and GMO cases regarding pension and OPEB costs. As part of this endeavor, Staff has raised opposition to portions of the requested items, particularly to the second item regarding recognition of pension contributions in response to PPA requirements. The Companies are continuing to work with Staff to resolve these issues. Should the parties be unable to come to a resolution, the Companies request that the Commission approve the requested items, given that there has been no opposition during the cases.

III. CONCLUSION

449. As a precursor to the negotiation and establishment of the Regulatory Plan, KCP&L and GMO embarked upon a long and robust planning exercise to produce a balanced portfolio of investments that would provide the greatest benefit and the greatest protection to their customers, their investors, and the communities they serve. This balanced portfolio included (1) the construction of a new coal-fired generating plant that will provide low cost and reliable energy to meet the Companies load growth; (2) environmental upgrades that will permit the Companies to reduce their emissions, even with the addition of the new coal plant; (3) the development of new renewable energy resources; (4) increasing investments in transmission and distribution infrastructure to ensure the adequate and reliable delivery of customer's energy needs; and (5) the development of energy efficiency, conservation and affordability programs.

450. The Regulatory Plan memorialized the goals of the Companies' balanced portfolios and shaped a transparent, long-term process requiring KCP&L, GMO Staff, and other parties to work collaboratively over a five-year period to strengthen the energy infrastructure needed to reliably serve Missouri consumers. In creating, executing, and fulfilling the Regulatory Plan, the Companies submit that neither the Commission nor any party anticipated flawlessness or perfection. However, the Companies assert that all interested parties had the right to expect balanced, reasoned, decision-making on the part of KCP&L in its execution of the Regulatory Plan and the Companies submit that the evidence presented in this Brief demonstrates that the KCP&L wholly surpassed these expectations.

451. The Companies have demonstrated that: (i) KCP&L's actions and decisions concerning the Iatan Project were both reasonable and prudent based on industry standards, conditions and circumstances as they were known, or reasonably should have been known, at the time when decisions were made; (ii) the Companies' requested Return on Equity is 10.75%

based upon a capital structure of 46.29% for Equity, 48.58% for Debt; 0.61% for Preferred Stock, and 4.52% for Equity-linked Convertible Debt is reasonable and consistent with other similarly situated vertically-integrated utilities; (iii) the Companies' requested revenue requirement is just and reasonable and should be adopted; and (iv) the Companies' proposed rate design is just and reasonable, and should be adopted.

452. Lawful, appropriate and reasonable ratemaking by the Commission necessarily involves a balancing of competing and often apparently conflicting interests. This balancing function may imply a distribution of risks and rewards between customers and shareholders. The Companies submit that the Commission can strike the appropriate balance between customer and shareholder interests by adopting the Companies proposed revenue requirements and issuing an order in accordance with KCP&L's recommended Findings of Fact and Conclusions of Law.

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 10th day of March, 2011, to all counsel of record.

/s/ James M. Fischer

James M. Fischer