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 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**

STAFF'S INITIAL BRIEF

Respectfully submitted,

Nathan Williams
Deputy Counsel
Missouri Bar No. 35512

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-8702 (Telephone)
(573) 751-9285 (Fax)
nathan.williams@psc.mo.gov

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COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its Initial Brief, states as follows:

INTRODUCTION

Kansas City Power & Light Company ("KCPL") and KCP&L Greater Missouri Operations Company ("GMO") are both wholly owned by Great Plains Energy, Inc. ("GPE"). Their service areas in Missouri are shown on Schedule 2 to the direct testimony of Cary G. Featherstone.[1] Collectively, KCPL and GMO operate and present themselves to the public under the brand and service mark "KCP&L." The workforce for GMO consists of KCPL employees; GMO has no employees of its own. Before it was acquired by GPE, GMO was named Aquila, Inc., and before that, Utilicorp United, Inc.[2]

KCPL serves approximately 509,000 customers, of which about 450,000 are residential customers, about 57,000 are commercial customers and the remaining about 2,000 are industrial,

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[1] Ex. KCP&L—215.

[2] Ex. KCP&L—210, Staff Cost of Service Report, p. 1; Ex. KCP&L—215, Direct Testimony of Cary G. Featherstone, pp. 3-4 & 12; Ex. GMO—210, Staff Cost of Service Report, p. 1; Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 3, 11.

municipal and other utility customers. To serve these customers, KCPL owns and operates 571 MW of nuclear generating capacity and, with Iatan 2, about 2,774 MW of coal capacity,[3] and with Spearville 2, 148 MW of wind capacity, 829 MW of natural gas-fired combustion turbine capacity, and 302 MW of oil-fired combustion turbine capacity. It also purchases power.[4]

GMO has approximately 312,000 customers, of which about 273,500 are residential customers, about 38,000 are commercial customers and the remaining about 500 customers are industrial, municipal and other utility customers. To serve these customers, GMO owns, with Iatan 2, 2,128 MW of generating capacity, of which 1,045 MW is coal capacity,[5] 1,019 MW is natural gas-fired combustion turbine capacity, and 64 MW is oil-fired combustion turbine capacity. Like KCPL, it also purchases power.[6]

These two rate cases started on June 4, 2010, when KCPL and GMO filed applications and proposed tariff changes to implement general electric rate increases. The cases are File Nos. ER-2010-0355 and ER-2010-0356, respectively. KCPL stated its application was designed to recover an additional $92.1 million per year in rate revenues, a 13.8% increase.[7] By its true-up direct case filed on February 22, 2011, KCPL stated its revenue deficiency is $55.8 million.[8] In its true-up direct case filed that same day, Staff recommended an annual increase in revenue requirement of $9.6 million.[9]

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[3] Iatan 2 ownership is 54.7% of 850 MW, equaling 465 MW.

[4] Ex. KCP&L—210, Staff Cost of Service Report, pp. 1-2; Ex. KCP&L—215, Featherstone Direct, p. 43.

[5] Iatan 2 ownership is 18% of 850 MW, equaling 153 MW.

[6] Ex. GMO –210, Staff Cost of Service Report, pp. 1-2; Ex. GMO—215, Featherstone Direct, p. 34.

[7] Ex. KCP&L—215, Direct Testimony of Cary G. Featherstone, pp. 10-11; Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 3-4.

[8] Ex. KCP&L—114, Rush True-up Direct, p. 1; Ex. KCP&L—117, Weisensee True-up Direct, p. 1.

[9] Ex. KCPL—304, Featherstone True-up Direct, p. 4.

GMO's service area is divided into two separate rate districts referred to as MPS and L&P. The MPS rate district includes parts of Kansas City, Lee's Summit, Sedalia, Warrensburg and surrounding areas. The L&P rate district is in and about St. Joseph, Missouri. GMO stated its application was designed to recover an additional $75.8 million per year in rate revenues from its customers in its MPS rate district, a 14.4% increase, and an additional $22.1 million per year in rate revenues from its customers in its L&P rate district a 13.9% increase.[10] By its true-up direct case filed on February 22, 2011, GMO stated its revenue deficiency for MPS is $65.2 million and its revenue deficiency for L&P is $23.2 million.[11] In its true-up direct case filed that same day, Staff recommended an annual increase in revenue requirement for MPS of $4.6 million and an increase of $16.6 million for L&P.[12]

A major difference in the revenue requirements of Staff and GMO for MPS and L&P is due to Staff including a full annual trued-up cost of fuel, purchased power and off-systems sales margins in the revenue requirement while GMO proposes to leave the cost of fuel, purchased power and off-system sales margin at the level agreed to in its last rate case (Case No. ER-2009-0090) and collect through its fuel adjustment clause ("FAC") the difference between the level agreed to in the last case and the true-up estimate of fuel, purchased power and off-system sales margin. Another significant difference is that Staff has allocated 100 MW of the capacity and costs of Iatan 2 to L&P and 53 MW to MPS, while GMO has allocated 112 MW of the capacity and costs of Iatan 2 to MPS and the remaining 41 MW to L&P.

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[10] Ex. GMO—210, Staff Cost of Service Report, p. 7; Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 3, 10; Ex. KCP&L—215, Direct Testimony of Cary G. Featherstone, Sch. 2.

[11] Ex. GMO —58, Rush true-up direct, p. 1.

[12] Ex. KCP&L—304, Featherstone true-up direct, p. 4.

INITIAL NOTE ON PRUDENCE

KCPL:

In rebuttal testimony KCPL's and GMO's expert witness Kris Nielsen admitted that KCPL incurred imprudent expenditures in the construction of Iatan 2.[13] The issue in KCPL's case, therefore, is not whether KCPL incurred imprudent expenditures — the Company's own witness testified that it did —rather, the issue is the quantification of the imprudent expenditures.

GMO:

In 2005, after relying on purchased power to serve the increasing needs of its retail customers since 1983, GMO / Aquila finally built 315 MW of combustion turbine generation at South Harper near Peculiar, Missouri. It installed three 105 MW combustion turbines it acquired from an affiliate that had owned and stored the combustion turbines for several years. GMO / Aquila imprudently only installed three 105 MW combustion turbines at South Harper, although it actually needed an additional 500 MW to serve its retail customers in the summer and its 2004 least cost resource plans were to install five 105 MW combustion turbines at a site like South Harper.[14] Not only was GMO / Aquila imprudent in only installing 315 MW of combustion turbine generation when it needed 500 MW, it was also imprudent in proceeding to install combustion turbines at South Harper when the Cass County Circuit Court had enjoined that construction as violating Cass County's zoning ordinance.[15]

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[13] Ex. KCP&L—46.

[14] Ex. GMO—215, Featherstone direct testimony, pp. 39-42; Ex. GMO—232, Mantle rebuttal testimony, p. 2; Ex. GMO—216, Featherstone rebuttal testimony, pp. 2-3; Ex. GMO—217, Featherstone surrebuttal testimony, pp. 3-6, 9-12, 16-42, 48-49; Ex. GMO—233, Mantle surrebuttal testimony, pp. 1-7.

[15] ***StopAquila.Org v. Aquila, Inc.*,** 180 S.W.3d 24 (Mo. App., W.D. 2005).

Ultimately, the imprudence of GMO / Aquila in the construction of South Harper led to three final appellate court decisions,[16] at least two cases before this Commission[17] and enactment of legislation with a one year sunset.[18] It was also part of the focus of a Staff management audit of GMO / Aquila.[19] That GMO / Aquila is still imprudent even after its management changed after its acquisition by GPE is shown by the failure of GMO / Aquila to pursue a share of the $125 million advanced coal tax credits for Iatan 2 that its affiliate, KCPL, obtained from the IRS. The Empire District Electric Company pursued a share of the $125 million advanced coal tax credits from KCPL based on its 12% ownership interest in Iatan 2, and was awarded in arbitration a share of the advanced coal tax credits based on that ownership share. These examples demonstrate that GMO / Aquila has been and continues to be imprudent in its affairs and, therefore, there is no initial presumption of prudence such as is normally afforded a utility. Thus, Staff asserts that GMO / Aquila has the initial burden to prove that its actions and expenditures are prudent and cannot rely on a presumption of prudence until challenged by some party with evidence that they are not.

Nathan Williams

I. IATAN 1, IATAN 2 AND IATAN COMMON PLANT ISSUES

1. Iatan 1, 2 and Common:

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[16] ***StopAquila.Org v. Aquila, Inc.***, 180 S.W.3d 24 (Mo. App., W.D. 2005); ***StopAquila.Org v. City of Peculiar***, 208 S.W.3d 895 (Mo. banc 2006); ***State ex rel. Cass County v. Public Service Commission***, 259 S.W.3d 544 (Mo. App., W.D. 2008).

[17] Case Nos. EA-2005-0248 and EA-2006-0309.

[18] Section 393.171, RSMo.

[19] Case No. EO-2006-0356.

a. Should the Iatan 1, Iatan 2, and Iatan Common Plant Rate Base Additions be included in rate base in this proceeding?

Yes, net of Staff's adjustments.

b. Should the Commission presume that the costs of the Iatan 1, Iatan 2, and Iatan Common Plant Rate Base Additions were prudently incurred until a serious doubt has been raised as to the prudence of the investment by a party to this proceeding?

Yes, except in the case of affiliate transactions and costs covered by section III.B.1.q. Cost Control Process for Construction Expenditures in the KCPL Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329.

c. Has a serious doubt regarding the prudence of the Iatan 1, Iatan 2, and Iatan Common Plant Rate Base Additions been raised by any party in this proceeding?

Yes, the Company has raised a serious doubt by its very own non-compliance with section III.B.1.q. Cost Control Process for Construction Expenditures in the KCPL Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329 and Staff has raised serious doubts by the evidence it has adduced through its Iatan Construction Audit And Prudence Review.

d. Should the Company's conduct 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? ("prudence standard").

Yes, with respect to imprudence. The Commission is not limited to prudence determinations and prudence disallowances.[20] The Staff's Iatan Common Plant adjustments, other than the Staff's true-up adjustment regarding which the Staff and KCPL/GMO have reached an agreement to address this issue in KCPL's/GMO's next rate cases are transfer adjustments, not disallowances.

e. Has KCPL demonstrated that it prudently managed this complex project and prudently managed matters within its control?

No.

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[20] State ex rel. Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222, 228-29 (Mo.App. W.D. 1980), appeal dismissed, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981); State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 645 S.W.2d 44, 55-56 (Mo.App. W.D. 1982).

f. In order for the Commission to disallow a utility's recovery of costs from Iatan 1, Iatan 2, or Iatan Common Plant, does the Commission need to find that a party has proven both that (1) the utility acted imprudently and (2) such imprudence resulted in an avoidable cost to the KCPL's customers.

No. The Commission is authorized to determine the value of utility plant and to determine rate elements, such as rate base, in consideration of all relevant factors. In addition to imprudent costs, the Commission may disallow costs related to unnecessary expenditures, overbuilding, and costs reflecting expenditures not of benefit to ratepayers. No showing of bad faith or an abuse of discretion is required. The term "prudence" does not appear in Chapter 386 or Chapter 393, but other terms such as "just and reasonable rates," "safe and adequate service," "public welfare," and "efficient facilities" do.[21]

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[21] KCPL has already had its Iatan 1, Iatan 2, and Iatan Common Plant case heard in August, 2010 and decided in November, 2010 by the Kansas Corporation Commission (KCC). The recent KCC Order is being be used by KCPL in this a Missouri proceeding to provide the Commission assurance that only the minimal adjustments proposed by one of KCPL's consultants is the full extent of the disallowance for KCPL actions relative to the lack of success of the Iatan construction project in meeting its own established goals regarding safety, quality, schedule, and cost. In Kansas there is a specific statutory provision regarding factors which the KCC is to consider in making the determination of prudence or lack thereof in determining the reasonable value of electric plant: K.S.A. 66-128g. A review of that statutory provision as compared to the lack of a similar Missouri statutory provision is instructive.

The Kansas statute on prudence, K.S.A. 66-128g, states, in entirety, as follows:

> (a) The factors which shall be considered by the commission in making the determination of **"prudence" or lack thereof** in determining the reasonable value of electric generating property, as contemplated by this act shall include without limitation the following:
>
> (1) A comparison of the existing rates of the utility with rates that would result if the entire cost of the facility were included in the rate base for that facility;
>
> (2) a comparison of the rates of any other utility in the state which has no ownership interest in the facility under consideration with the rates that would result if the entire cost of the facility were included in the rate base;
>
> (3) a comparison of the final cost of the facility under consideration to the final cost of other facilities constructed within a reasonable time before or after construction of the facility under consideration;
>
> (4) a comparison of the original cost estimates made by the owners of the facility under consideration with the final cost of such facility;
>
> (5) the ability of the owners of the facility under consideration to sell on the competitive wholesale or other market electrical power generated by such facility if the rates for such power were determined by inclusion of the entire cost of the facility in the rate base;
>
> (6) a comparison of any **overruns in the construction cost** of the facility under consideration with any cost overruns of any other electric generating facility

constructed within a reasonable time before or after construction of the facility under consideration;

(7) whether the utility having an ownership interest in the facility being considered has provided a method to ensure that the cost of any decommissioning, any waste disposal or any cost of clean up of any incident in construction or operation of such facility is to be paid by the utility;

(8) **inappropriate or poor management decisions in construction** or operation of the facility being considered;

(9) whether inclusion of all or any part of the cost of construction of the facility under consideration, and the resulting rates of the utility therefrom, would have an adverse economic impact upon the people of Kansas;

(10) whether the utility acted in the **general public interest** in management decisions in the acquisition, construction or operation of the facility;

(11) whether the utility accepted **risks** in the construction of the facility which were **inappropriate to the general public interest** to Kansas;

(12) any other fact, factor or relationship which may indicate **prudence or lack thereof** as that term is commonly used.

(b) The portion of the cost of a plant or facility which exceeds 200% of the "original cost estimate" thereof shall be presumed to have been incurred due to a **lack of prudence**. The commission may include any or all of the portion of cost in excess of 200% of the "original cost estimate" if the commission finds by a **preponderance of the evidence** that such costs were prudently incurred. As used in this act "original cost estimate" means:

(1) For property of an electric utility which has been constructed without obtaining an advance permit under K.S.A. 66-1,159 *et seq.,* and amendments thereto, the **"definitive estimate"**; and

(2) for property of an electric utility which has been constructed after obtaining an advance permit under K.S.A. 66-1,159 *et seq.,* and amendments thereto, the cost estimate made by the utility in the process of obtaining the advance permit.

Emphasis added; Laws 1984, ch. 247, § 8. A mere perusal of K.S.A. 66-128g, indicates that in Kansas before the KCC, the term and concept "prudence" is not literally limited to the single word "prudence" itself. Among the factors to be considered in making the determination of prudence or lack thereof, are "inappropriate or poor management decisions."

KCC November 22, 2010 Order: 1) Addressing Prudence; 2) Approving Application, In Part; & 3) Ruling On Pending Requests, pages 13-14, respecting "Issue III. What party bears the burden of proof – Staff to prove imprudency or KCPL to prove prudence – and is either party entitled any presumptions or permitted to shift the burden?" (KCC November 22, 2010 Order, p. 11.) states at pages 13 to 14:

As to Issue **III,** burden of proof, only Staff and CURB filed testimony challenging the prudence of KCPL's construction expenditures. Neither disputed an Order placing the burden of proving imprudence on them, and neither alleged that the presumption in 66-128g(b) applies. That presumption is triggered when costs exceed 200% of the "original cost estimate." In its post-

g. Is the December 2006 Control Budget Estimate the "Definitive Estimate?"

Yes. KCPL designated the December 2006 Control Budget Estimate (CBE) as the Definitive Estimate. The designation of a Definitive Estimate is required under KCPL's Regulatory Plan in Case No. EO-2005-0329.

h. Should KCP&L's prudent management of the Iatan 1 and Iatan 2 Projects be measured against the Control Budget Estimate?

KCPL's management of the Iatan 1 and Iatan 2 Projects should be measured against the Control Budget Estimate. See j. below.

i. Do the disallowances proposed by Staff in its construction audit and prudence review establish any imprudent expenditures by KCPL?

Yes.

j. Should the Commission disallow any cost overruns above the Control Budget Estimate for Iatan 1 and Iatan 2?

Yes. The standard is set by section III.B.1.q. Cost Control Process for Construction Expenditures in the KCPL Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329. Cost overruns over the definitive estimate must be identified and explained. Any Iatan cost overrun that is not identified and explained, i.e., for which there is no or inadequate documentation that identifies and explains the cost overrun fail to satisfy KCPL's burden of proof and should be disallowed from recovery for Missouri ratepayers.

k. Has Iatan met the in-service criteria?

Yes. Iatan 2 was fully operational and used for service as of August 26, 2010.[22] Iatan 1 AQCS was fully operational and used for service as of April 19, 2009.

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hearing brief, Staff claims in error that it only carries a seemingly lesser burden of persuasion and not the burden of proof. However, Kansas law provides no distinction between those two burdens; it also provides that the requisite level of proof to satisfy the burden of proof is a preponderance of the evidence. Therefore, the Commission concludes that Staff and CURB must prove, by the preponderance of the evidence, that KCPL, under K.S.A. 66-128g, imprudently incurred costs that should be excluded from the rate base. In other words, Staff's evidence of KCPL's imprudent actions must be of greater weight or more convincing than KCPL's evidence that it acted prudently, and Staff must show that its alleged facts of imprudent actions by KCPL are more probably true than not true. [Footnotes omitted.]

[22] ***Staff's Construction Audit and Prudence Review for Costs Reported as of June 30, 2010*** (Case Nos. ER-2010-0355 and ER-2010-0356, November 3, 2010) ("***Audit Report***") at 32, KCPL Ex. 205.

l. Should the Iatan 1, Iatan 2 and Iatan Common Plant regulatory assets be included in rate base in this case, as well as the annualized amortization expense?

Yes, net of Staff's adjustments.

INTRODUCTION

In this case, Staff presents its prudence review and construction audit of the costs intended for inclusion in rate base with respect to the construction of the Iatan 2 generating unit at Weston, Missouri, as well as certain environmental improvements to Iatan 1 and to facilities shared by both generating units ("common plant"). The project actually consisted of three interrelated segments: Iatan 1 Air Quality Control System (AQCS), Iatan 2 and Iatan Common Plant. Based on its construction audit and prudence review, Staff has proposed disallowances as follows:[23]

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[23] These are true-up numbers as appear in the true-up direct testimony of Charles R. Hyneman, KCPL Ex. 308, Schedule 1, corrected for AFUDC by Keith A. Majors in the True-Up Reconciliation filed by the Staff on March 2, 2011. The Staff and the Company have agreed that approximately $19 million in Common Plant adjustments raised by the Staff as an issue in the true-up hearing will be considered in the Company's next rate case.

This chart is highly confidential in its entirety

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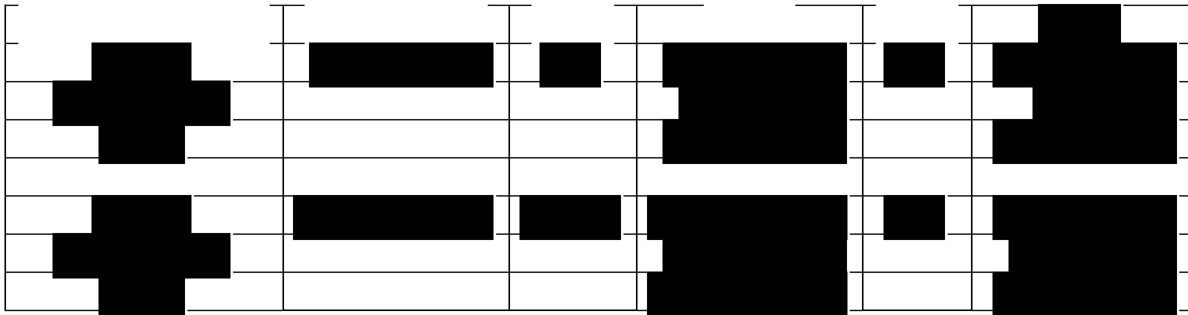

**

Staff's theme is the maxim, "*falsus in uno, falsus in omnibus.*"[24] KCPL completed the Iatan Project late, with significant cost overruns. Kris Nielsen, one of KCPL's principal consultants, filed testimony on behalf of KCPL in which he ** .**[25] As pointed out earlier, the question for the Commission is not whether KCPL was imprudent, but how much of its costs should therefore be disallowed.

Staff's adjustments include both disallowances for inappropriate and imprudent charges and reclassifications. Both the Iatan 1 and the Iatan 2 segments of the project were characterized by cost overruns significantly in excess of the Control Budget Estimate ("CBE") for each segment established pursuant to the Experimental Alternative Regulatory Plan ("EARP").[26] For Iatan 1, the overrun is at least $73.3 million; for Iatan 2, it is $186.6 million.[27]

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[24] "False in one thing, false in everything." ***Black's Law Dictionary,*** 1636 (1999). The maxim means, "Never trust a liar."

[25] True-up Dir., Hyneman, KCPL Ex. 308, Schedule 1.

[26] An overrun exceeds the budget, the contingency, and savings realized elsewhere. ***Audit Report*** at 3. In fact, the Regulatory Plan requires a Definitive Estimate; the Company never established a Definitive Estimate and used the CBE in its place. *Id.,* 4-5.

[27] ***Audit Report*** at 3-4, 6.

BURDEN OF PROOF

The law places the burden of proving the appropriateness of amounts proposed to be placed into rate base upon the Company: "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation[.]"[28] Because the Company bears the burden of proof, any failure of proof must be held against the Company.[29]

THE AUTHORITY OF THE COMMISSION

The Commission is authorized to value the property of electric utilities in Missouri.[30] Necessarily, that includes property and other assets proposed for inclusion in rate base. In determining value, "the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question . . . ."[31] The courts have held that this statute means that the Commission's determination of the proper rate must be based on consideration of all relevant factors.[32] Relevant factors include questions raised by stakeholders about the prudency and necessity of utility construction decisions and expenditures.

In making its determination, the Commission may adopt or reject any or all of any witnesses' testimony.[33] Testimony need not be refuted or controverted to be disbelieved by the

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[28] Section 393.150.2, RSMo.

[29] *State ex rel. GS Technologies Operating Co. v. Public Serv. Comm'n*, 116 S.W.3d 680, 693-94 (Mo.App. W.D. 2003).

[30] Section 393.230.1, RSMo.

[31] Section 393.270.4, RSMo.

[32] ***State ex rel. Missouri Water Co. v. Public Service Commission,*** 308 S.W.2d 704, 719 (Mo. 1957); ***State ex rel. Midwest Gas Users' Association v. Public Service Commission,*** 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); ***State ex rel. Office of Public Counsel v. Public Service Commission of Missouri,*** 858 S.W.2d 806 (Mo. App., W.D. 1993).

[33] ***State ex rel. Associated Natural Gas Co. v. Public Service Commission,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

Commission.[34] The Commission determines what weight to accord to the evidence adduced.[35] "It may disregard evidence which in its judgment is not credible, even though there is no countervailing evidence to dispute or contradict it."[36] The Commission may evaluate the expert testimony presented to it and choose between the various experts.[37]

A UTILITY'S BURDEN IN BUILDING NEW PLANT

The burden of a public utility engaged in building a new plant is "to build the best possible plant at the lowest cost."[38] That is the question that must guide the Commission's decision with respect to the Iatan Project. Did KCPL build the best possible plant at the lowest cost? The existence of significant cost overruns necessarily calls into question the "lowest cost" part of the equation; because KCPL bears the burden of proof, it is up to KCPL to explain these overruns to the Commission's satisfaction. Staff suggests that KCPL did not complete the Iatan Project at the "lowest cost" and that the evidence adduced in this case establishes that conclusively.

PRUDENCE

This is not the Commission's first prudence review and construction audit.[39] In a prior case involving a prudence review and construction audit, the Commission stated:[40]

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[34] ***State ex rel. Rice v. Public Service Commission,*** 359 Mo. 109, ___, 220 S.W.2d 61, 65 (banc 1949).

[35] *Id.*

[36] *Id.*

[37] ***Associated Natural Gas,*** *supra,* 706 S.W.2d at 882.

[38] ***In the Matter of Union Electric Company,*** 27 Mo.P.S.C. (N.S.) 183, 208 (1985)("UE was expected to build the best plant at the lowest cost. UE focused primarily on the best plant portion of this requirement and did not place sufficient attention on cost control to ensure that the plant was built at the least possible cost.")

[39] ***State ex rel. Capital City Water Co. v. Missouri Public Service Commission,*** 850 S.W.2d 903, 912 (Mo. App., W.D. 1993); ***State ex rel. General Telephone Company v. Public Service Commission,*** 537 S.W.2d 655, 664 (Mo. App., W.D. 1976).

> The Federal Power Act imposes on the Company the "burden of proof to show that the increased rate or charge is just and reasonable." Edison relies on Supreme Court precedent for the proposition that a utility's cost are [sic] presumed to be prudently incurred. However, the presumption does not survive "a showing of inefficiency or improvidence." As the Commission has explained, "utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent . . . However, where 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."

Thus, in the first instance, it is the parties challenging the decisions and expenditures of a utility that have the initial burden defeating the presumption of prudence accorded the utility.[41]

> Under the prudence standard, the Commission looks at whether the utility's conduct was reasonable at the time, under all of the circumstances. In applying this standard, the Commission presumes that the utility's costs were prudently incurred.[42]

Once the presumption of prudence is dispelled, the utility has the burden of showing that the challenged items were indeed prudent.[43]

How is prudence measured? The Commission has adopted a standard of reasonable care requiring due diligence for evaluating the prudence of a utility's conduct.[44] The Commission has described this standard as follows:[45]

> The Commission will assess management decisions at the time they are made and ask the question, "Given all the surrounding circumstances existing at the time,

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[40] ***In the Matter of Union Electric Company,*** 27 Mo.P.S.C. (N.S.) 183, 193 (1985) (*quoting* ***Anaheim, Riverside, etc. v. Federal Energy Regulatory Commission,*** 669 F.2d 779 (D.C. Cir. 1981)) (*citations omitted*).

[41] ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 954 S.W.2d 520, 528-529 (Mo. App., W.D. 1997).

[42] ***State ex rel. GS Technologies Operating Company, Inc. v. Public Service Commission,*** 116 S.W.3d 680 (Mo. App., W.D. 2003).

[43] ***Associated Natural Gas,*** *supra,* 954 S.W.2d at 528-529.

[44] ***Union Electric,*** 27 Mo.P.S.C. (N.S.) at 194.

[45] *Id.*

did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?"

Turning to the case at hand, the initial question is whether Staff has made a showing of inefficiency or improvidence sufficient to require KCPL to prove the prudence of its decisions and expenditures. Staff suggests that it has; and Staff further notes that KCPL's own witness, Kris Nielsen, ***has admitted imprudence on the part of KCPL***.[46]

The cost overruns allowed by KCPL in the Iatan Project are themselves a sufficient badge of inefficiency and improvidence. In a prior case, involving the construction by Union Electric Company of the nuclear generating facility in Callaway County, for example, the sufficient showing was a two-billion dollar cost overrun.[47] The cost overruns here, while not so extravagant as those at Callaway, are sufficiently large as to call the prudence of KCPL's Iatan Project into question. As noted previously, for Iatan 1, the overrun is $107.3 million, for Iatan 2, it is $303 million, for a project total of $410.3 million.[48]

Other factors raising questions sufficient to defeat the presumption of prudence are KCPL's unreasonable delay in hiring a project manager and its permitting a personnel matter to further delay the project's completion.[49] After February 2006, the relationship between KCPL's Senior Director of Construction and the Iatan Project Manager deteriorated to the point that there was no direct communication between them.[50] Assignments given to the Project Manager were

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[46] KCPL Ex. 46.

[47] ***Union Electric**, supra,* at 193.

[48] ***Audit Report*** at 3-4, 6.

[49] *Id.,* at 12.

[50] *Id.,* at 21.

never completed.[51] Another factor is KCPL's failure to show that it thoroughly assessed the risk and consequences of initiating construction before the project design was substantially completed.[52] The lack of documentation of this assessment, in and of itself, is a most significant indication of imprudence.[53]

Another factor raising serious questions of imprudence was KCPL's decision by late 2006 to implement a "multi-prime" delivery system whereby KCPL itself would act as the project manager or prime contractor.[54] This methodology, advocated by KCPL's construction law firm, Schiff Hardin, required that KCPL employ a strong, capable and experienced project or construction manager.[55] GPE's outside auditors, Ernst & Young, noted ** [redacted] .**[56] Exacerbating this problem was KCPL's decision to "fast-track" the Iatan Project, a construction method in which segments are built simultaneously while other segments are still in engineering.[57] The goal of "fast-tracking" is quick completion; budget issues are secondary.[58] As a result, "fast-tracking" has specific risks including:[59]

> Increased costs due to estimating errors;
> Work not completed as desired;
> Poor quality workmanship;
> Cost overruns;

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[51] *Id.*

[52] *Id.,* at 13.

[53] *Id.*

[54] *Id.,* at 21-22.

[55] *Id.*

[56] *Id.,* at 22-24.

[57] *Id.,* at 24.

[58] *Id.*

[59] *Id.,* at 25.

Overbillings;
Unapproved or undesirable changes from plan;
Problems may be duplicated, making corrections more costly; and
Increased "cascading" of problems.

Staff believes that the "multi-prime" and "fast-tracking" decisions were undeniably imprudent and resulted in cost overruns and documentation problems.[60] KCPL's own outside auditor, Ernst & Young, ** [redacted]

**[61]

… [redacted] .

The decision to hire Schiff Hardin was based on a personal relationship of the KCPL's President and Chief Operating Officer, Mr. William Downey, with a former colleague, peer, friend, and boss, Mr. Thomas J. Maiman. This individual was for a time in charge of Commonwealth Edison's troubled nuclear generating facilities and had experience on retrofits of coal plants. Mr. Downey first conferred with Mr. Maiman on an uncompensated basis

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[60] *Id.*

[61] *Id.,* at 22-24.

[62] KCPL's Hawthorn 5 generating unit required rebuilding because KCPL allowed it to be destroyed by an explosion resulting, in a chain of events worthy of Rube Goldberg, from a clogged and overflowing control-room toilet. It is important to keep the Hawthorn 5 incident in mind when wondering whether KCPL could possibly be imprudent. *See* ***In the Matter of Kansas City Power & Light Company Regarding an Incident at the Hawthorn Station, Kansas City, Missouri, on February 17, 1999,*** Case No. ES-99-581 (***Order Approving Stipulation and Agreement,*** eff. July 22, 2001), pp. 6-11; ***In the Matter of Kansas City Power & Light Co.***, 10 Mo.P.S.C.3d 372, 375-78 (2001).

[63] ***Audit Report,*** p. 22.

approximately once a month. Mr. Maiman recommended Schiff Hardin to Mr. Downey for the Iatan Project and Mr. Downey requested Schiff Hardin to have Mr. Maiman be part of the construction consulting part of the Schiff Hardin engagement. Mr. Maiman had worked with Schiff Hardin previously.[64] Schiff Hardin was not hired by KCPL by a competitive bid process and it was retained to provide management oversight services, project controls, commercial issues, and legal services. Thus, not all of the individuals for which Schiff Hardin is billing KCPL for services being provided to KCPL by Schiff Hardin are attorneys.[65]

Another matter of grave concern and an undeniable badge of imprudence was Staff's discovery that senior KCPL personnel improperly charged personal expenses and personal mileage to the Iatan Project.[66] Shockingly, KCPL did not cooperate with Staff in uncovering these items.[67] While these charges were not large compared to the amount of money involved in the Iatan Project, the applicable legal maxim –Staff's theme in this discussion -- states, "*falsus in uno, falsus in omnibus.*"[68] How can the Commission believe anything that KCPL says once it knows that the Company is willing to permit – and attempt to hide -- petty frauds of this sort?[69] What larger and more sophisticated frauds did KCPL commit and carefully conceal in the Iatan Project accounts?

Staff proposed disallowances totaling $100,000 to remove improper charges from the

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64 Tr.Vol. 21, p. 1328, ln. 24 – p. 1333, ln. 7; Tr.Vol. 15 (Brent Davis), p. 673, ln. 23 – p. 674, ln. 6).

65 Tr.Vol. 21, p. 1341, ln. 2 – p. 1342, ln. 10; p. 1343, ln. 21 – p. 1345, ln. 10.

66 *Id.,* at 25.

67 *Id.*

68 "False in one thing, false in everything." ***Black's Law Dictionary,*** 1636 (1999). The maxim means, "Never trust a liar."

69 The ***Audit Report*** notes that at least two persons had to cooperate to permit fraudulent charges of this sort to the Iatan Project accounts. ***Audit Report,*** at 26.

Iatan Project.[70]

In a similar fashion, KCPL acted with bad faith with respect to **

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Staff's comment on the behavior of KCPL management exposed in this instance is, "*falsus in uno, falsus in omnibus.*"[73]

Another factor indicating suggesting imprudence is KCPL's knowing and willful disregard of its obligations under the Experimental Alternative Regulatory Plan ("EARP")

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[70] *Id.,* at 27. The $100,000 is the total project figure and is allocated to Iatan 1 AQCS, $25,000, and Iatan 2, $75,000.

[71] *Paul Harrison Surrebuttal,*KCPL Ex. 223 and GMO Ex. 222, Schedule 1-4 (HC).

[72] *Id.*

[73] "False in one thing, false in everything." ***Black's Law Dictionary,*** 1636 (1999). The maxim means, "Never trust a liar."

Stipulation and Agreement,[74] approved in Case No. EO-2005-0329, which states:[75]

> III.B.1.q. Cost Control Process for Construction Expenditures:
>
> 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.

In reliance on this agreement – freely entered into by KCPL in order to obtain the benefits of the Experimental Alternative Regulatory Plan -- Staff requested by DR a list and explanation of all Iatan 1 and Iatan 2 cost overruns through April 2010.[76] KCPL failed to provide any such list of cost overruns or explanations.[77] Staff's attempt to audit the Iatan Project was rendered infinitely more difficult by KCPL's obstruction and gamesmanship, conduct that Staff believes KCPL would not have engaged in unless it had something to hide.

The Cost Control Process was included in the EARP at Staff's insistence, based on Staff's experience in attempting to perform a prudence review and construction audit of KCPL's Wolf Creek nuclear generating facility in 1985.[78] In that case, significant cost overruns coupled with a lack of appropriate documentation severely strained Staff's resources.[79] Staff believes that it is no accident that KCPL has ignored its obligation under the EARP – KCPL purposely sought thereby to impede and obstruct Staff's audit. Again, "*falsus in uno, falsus in omnibus.*"[80]

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[74] ***Audit Report***, at 33-34.

[75] EARP Stipulation And Agreement, Case No. EO-2005-0329, at 28.

[76] ***Audit Report*** at 34.

[77] Staff is preparing a complaint to seek monetary penalties from KCPL before the Commission for this willful misconduct.

[78] *Id.*, at 37.

[79] *Id.*

[80] "False in one thing, false in everything." ***Black's Law Dictionary,*** 1636 (1999). The maxim means, "Never trust a liar."

Mr. David M. McDonald, KCPL's Director of Procurement since approximately mid-2009, testified by deposition on January 25, 2011, that KCPL has a gift policy of gifts of nominal value are acceptable.[81] He stated that it creates the fewest questions if no gifts are offered or received.[82] He related that when he worked for GE, it initially had a policy that an employee could accept gifts as long as the gifts were reported, but by the time he left GE in 2009, GE had moved to a zero gifts policy.[83] He testified that Alstom distributed winter jackets as gifts within the Iatan Project and he was a recipient of one of the winter jackets and that he had not seen many gifts distributed or offered within Procurement.[84] The winter jackets that Mr. McDonald identified he described as "nominal gifts," but Alstom bought $150 winter jackets for KCPL employees in August 2006. Evidently initially there was concern that Michael Chesser, Chairman and Chief Executive Officer of GPE and KCPL, had an issue with these garments. Mr. Downey apparently determined such was not the case and Mr. Downey authorized in November 2007 the acceptance and wearing of these garments by KCPL employees.[85]

Mr. Steven Jones, who is an independent contractor currently working with Schiff Hardin on behalf of KCPL; was Director of Comprehensive Energy Plan Procurement for KCPL from March 16, 2006 through March 2009.[86] Mr. Jones was deposed by the Staff in Case No. EM-2007-0374, Great Plains Energy, Inc.'s acquisition of Aquila, Inc. on April 1, 2008 and portions of that deposition were read into the record in these proceedings in which Mr. Jones related that

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[81] McDonald Dep., KCPL Ex. 300HC, Tr. p. 37, 40.

[82] McDonald Dep., KCPL Ex. 300HC, Tr. p. 39 – 40.

[83] McDonald Dep., KCPL Ex. 300HC, Tr. p. 40, lns. 5-6, 22-25; p. 106, ln. 19 – p. 107, ln. 5.

[84] McDonald Dep., KCPL Ex. 300HC, Tr. p. 10, ln. 10 – p. 12, ln. 15; p. 37, ln. 14 – p. 38, ln. 24.

[85] Tr.Vol. 21, p. 1379, ln. 20 – p. 1384, ln. 18).

[86] Jones Dir., KCPL Ex. 38, p. 1.

there is a reciprocity rule and as an example he related a celebration dinner in September or October 2007 after the award of a contract that KCPL negotiated with Burns & McDonnell. He stated: "'Dave Price and the project leadership team took the entire Burns & McDonnell staff out for dinner as well. That's the reciprocity piece.'" He stated that he thought there were "'two specifically dinners with Burns & McDonnell.'"[87]

Mr. Downey went with the Alstom senior leadership to Pebble Beach, California, after negotiation of a settlement agreement with Alstom. KCPL paid for the airfare and Mr. Downey was a guest of Alstom. An event with Alstom involving Mr. Downey and his wife occurred involving a trip to Newport, Rhode Island.[88]

In conclusion, there is no question but that sufficient instances of inefficiency and improvidence have been shown to require KCPL to prove, item-by-item, the prudency of its expenditures as challenged by Staff in the ***Audit Report.*** Staff has shown that KCPL's own expert witness, Kris Nielsen, has admitted to imprudent expenditures in the Iatan Project. That admission alone is sufficient to shift the burden back to KCPL. Additionally, Staff has pointed out numerous and sufficient other instances in this brief, which is itself a distillation of the ***Audit Report.*** The ratepayers of the several companies that own pieces of Iatan deserve no less.

Staff believes that it was KCPL's decision to "fast-track" the Iatan Project that resulted in its loss of cost control and subsequent major cost overruns.[89] Staff believes that that decision, together with the equally ill-advised "multi-prime" decision, was clearly and unarguably

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[87] Tr.Vol. 17, p. 951, ln. 21, - p. 952, ln. 9.

[88] Tr.Vol. 19, p. 1252, ln. 2 – p. 1253, ln. 2; Tr.Vol. 21, p. 1377, ln. 8 – p. 1379, ln.11.

[89] ***Audit Report*** at 38.

imprudent.[90] For that reason, it is Staff's position that the cost overruns must be disallowed. Furthermore, in direct, blatant and willful violation of its obligation under the EARP, KCPL cannot document or explain the overruns.[91] That fact, as well, requires disallowance. KCPL must identify and explain the cost overruns that it seeks to charge its Missouri ratepayers and show that they are prudent, reasonable, appropriate, and of benefit to Missouri ratepayers. As detailed in the ***Audit Report,*** Staff has proposed disallowances with respect to other specific items. KCPL failed to meet other key Iatan Project objectives besides costs. These objectives were schedule and safety. These objectives were developed by KCPL itself. The Iatan Project was late, missing most of the 2010 summer when the unit was to be on-line serving its owners' customers. The construction of Iatan 2 resulted in fatalities when its objective of course was zero fatalities.

IATAN UNIDENTIFIED AND UNEXPLAINED COST OVERRUNS

The facts are that the Iatan Construction Project was completed late with cost overruns. The other fact is that even one of KCPL's principal consultants filing testimony in the case on behalf of KCPL, Dr. Kris Nielsen, found that KCPL was imprudent to some degree regarding the Iatan Construction Project.

The Staff made various individual discrete adjustments-disallowances to the Iatan 1 Air Quality Control System (AQCS) environmental enhancement and Iatan 2 construction projects. The Staff made transfers from Iatan 1 AQCS indirect costs and certain costs of a Permanent Auxiliary Electric Boiler to Iatan Common Plant that KCPL had assigned to Iatan 1 AQCS. In addition, the Staff made an Iatan 1 AQCS and Iatan 2 disallowance based on KCPL not fulfilling

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[90] *Id.*

[91] *Id.*

its very significant commitment on page 28 of the Stipulation And Agreement in the Kansas City Power & Light Company Experimental Alternative Regulatory Plan necessary for an audit of KCPL's costs, section III.B.1.q. Cost Control Process for Construction Expenditures:

> **q. Cost Control Process for Construction Expenditures**
> 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.

The Commission in its Wolf Creek rate case Report And Order, *Re Kansas City Power & Light Co.*, Case Nos. EO-85-185 and EO-85-224, Report And Order, 28 Mo.P.S.C.(N.S.) 228, 317 (1986) stated that "[t]he Definitive Estimate represents the estimated cost of an efficiently constructed plant."

As part of the KCPL Regulatory Plan, what KCPL/GMO received for the requirement of section III.B.1.q. Cost Control Process for Construction Expenditures was the section III.B.1.i. Additional Amortizations To Maintain Financial Ratios section which states in part at page 19 of the KCPL Regulatory Plan:

> i. **Additional Amortizations To Maintain Financial Ratios**
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> * * * *
>
> The non-KCPL Signatory Parties commit to work with KCPL to ensure that based on prudent and reasonable actions, KCPL has a reasonable opportunity to maintain its bonds at an investment grade rating during the construction period ending June 1, 2010. As part of this commitment, the non-KCPL Signatory Parties agree to support the "Additional Amortizations to Maintain Financial Ratios", as defined in this section and related appendices, in KCPL general rate cases filed prior to June 1, 2010. . . .

The February 2, 2011 Non-Unanimous Stipulation and Agreement Regarding Depreciation and Accumulated Additional Amortizations in File Nos. ER-2010-0355 and ER-2010-0356 indicates if the Commission accepts the Stipulation And Agreement that as of May 3, 2011 KCPL's ratepayers will be paying approximately $146.7 million Accumulated Additional Amortizations annually in rates as a result of the KCPL Regulatory Plan Stipulation And Agreement (Regulatory Plan).

The record will show that that the Iatan Construction Project's cost control system does not identify and explain the cost overruns above its definitive estimate as specified in KCPL's Regulatory Plan but only provides fragmented information regarding budget variances leaving for the Staff to identify and explain the cost overruns. The KCPL cost control system is deficient when compared to the cost control systems used at Wolf Creek and Callaway approximately 25 years ago. The companies in the Wolf Creek and Callaway cases made an after the fact attempt to identify and explain the cost overruns while KCPL's/GMO's answer here is that there is construction project information for the Staff and the other parties to use, if not protected by a privilege or immunity, to identify the cost overruns and then there is project documentation for the Staff and the other parties to search for the explanations for the cost overruns. The problem is that the documentation containing the supposed identifications and explanations does not track to the dollars that KCPL is seeking to include in the rates it charges its Missouri customers. Not only is there the deficiency of the KCPL cost control system, but there is an inability of the project management to identify the cost overruns and provide appropriate documentation respecting approval of expenditures. The Iatan construction project was not under appropriate control as evidenced by the inability of the Project Team to be able to identify and explain the items that caused the project costs to exceed budget. There were periods when the Iatan

Construction Project Team knew that its current budget was not sufficient, but did not know what would be sufficient for its budget, thus causing the project to go into a reforecast.

KCPL's/GMO's response to the Staff has been that the raw information is available for Staff to create its own identification and explanation of the cost overruns of the Iatan AQCS and Iatan 2 Projects. Under such scenarios it would be the Staff's cost overrun identification and explanation and not the identification and explanation required of the KCPL/GMO Iatan cost control system pursuant to the KCPL Regulatory Plan. KCPL's/GMO's non-performance under the KCPL Regulatory Plan is imprudence. Construction management has deprived itself of information necessary to mitigate costs instead of just paying invoices and settlements.

Regarding KCPL's cost control system, among other things, on February 21, 2008, the Staff sent a letter to counsel for KCPL regarding the relevant language noted in the KCPL Regulatory Plan asking for a meeting. The Staff had learned in the context of the GPE acquisition of Aquila, Inc. case that KCPL was engaged in a reforecast of the cost and schedule of the Iatan Construction Project.

In its Report And Order in the Wolf Creek case, the Commission said, in part, regarding cost overruns:

> The definitive estimate for Wolf Creek was $1,033,834,000. Thus, cost overruns amount to approximately $1,951,406,000. In the Commission's opinion the definitive estimate is the proper starting point for an investigation of cost overruns and a determination as to whether costs incurred on the project are reasonable.[92]

* * * *

[92] *Re Kansas City Power & Light Co.*, Case Nos. EO-85-185 and EO-85-224, Report And Order, 28 Mo.P.S.C.(N.S.) 228, 279 (1986).

> In the Commission's opinion, the existence of almost $2 billion in cost overruns raises doubts as to prudence in this case. Therefore, KCPL has the burden of proof regarding prudence.[93]

The Commission noted the statutory provision Section 393.230(1) that every unjust or unreasonable charge is prohibited.[94]

The Commission further stated in its Wolf Creek Report And Order that although it is sometimes contended that management prudence is presumed, the Commission agreed with the Washington, D.C. Circuit Court of Appeals in *Anaheim, Riverside, etc. v. FERC*, 669 F.2d 779 (D.C.Cir. 1981) quoting a FERC Opinion And Order that "where a 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."[95]

The Commission in its Report and Order in the Wolf Creek case related:

> The Commission reiterates its position set out in *Re Union Electric Co.,* 27 Mo.P.S.C.(N.S.) 183 (1985). Industry comparisons do not establish a standard of prudence. General statements regarding regulatory changes do not explain cost overruns. Finally, general statements regarding the complexity of the project with respect to design evolution and fast track construction do not explain cost overruns.[96]

The Commission's Wolf Creek Report And Order states that the owners of Wolf Creek (KCPL 47%, Kansas Gas & Electric Company (KGE) 47% (managing partner), and Kansas Electric Power Cooperative, Inc. (KEPCO) 6%) determined that a cost reconciliation process was needed in order to respond to Staff inquiries into the underlying reasons for various cost overruns above the definitive estimate. This resulted in the development of the Wolf Creek

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[93] *Id.* at 281.

[94] 28 Mo.P.S.C.(N.S) at 279.

[95] 28 Mo.P.S.C.(N.S.) at 280-81.

[96] 28 Mo.P.S.C.(N.S.) at 281.

Reconciliation Group and numerous reconciliation packages. The reconciliation process was deemed to be deficient. The Wolf Creek owners' first set of reconciliation packages rather than being corrected as the Staff desired were substituted by the owners with new reconciliation packages which the Staff still found to be deficient. The Staff presented a direct case, a rebuttal case, and a surrebuttal case respecting the KCPL reconciliation packages. The Commission rejected the proposed disallowances in the Staff's rebuttal and surrebuttal cases respecting the reconciliation packages.[97] The Commission's Wolf Creek Report And Order notes that Wolf Creek Reconciliation Group initially intended to coordinate reconciliation efforts with similar efforts at Union Electric Company's Callaway nuclear plant, but that "the coordination of reconciliation efforts was unable to take place because Callaway's reconciliation effort was farther along than Wolf Creek's and in addition UE apparently believed its own reconciliation effort was superior to the effort at Wolf Creek."[98]

Counsel for KCPL/GMO noted that Staff accountant Mr. Cary G. Featherstone was a witness in KCPL's Wolf Creek rate case, Case No. ER-85-128 and EO-85-185 and Mr. Featherstone confirmed that he was.[99] Mr. Featherstone testified that the Staff accountants sponsored Wolf Creek adjustments in the Wolf Creek case, such as an adjustment that dealt with welding issues. Mr. Featherstone also described the process whereby Staff accountants worked on the Wolf Creek reconciliation packages which were an attempt by the Wolf Creek partner

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[97] 28 Mo.P.S.C.(N.S.) at 343-46.

[98] *Id.* at 343.

[99] Tr.Vol. 14, p. 316, ln. 23 – p. 317, ln. 8.

utilities to identify Wolf Creek cost overruns. Mr. Featherstone indicated that the Commission ultimately made a disallowance of unexplained Wolf Creek costs.[100]

In the Commission's Union Electric Company Callaway Report And Order, the Commission held, in part, as follows:

> The Commission has found herein that some aspects of UE's management of the Callaway project were inefficient, imprudent and unreasonable. In particular, the Commission has found that UE failed to adequately integrate the construction and engineering schedules, resulting in waste and inefficiency at the project. Secondly, the Commission has found that UE failed to correctly assess the remaining amount of work to be completed until very late in the project. In addition, the Commission has found that UE failed to fully implement an effective cost accounting system. Based upon these findings, the Commission has made specific adjustments to rate base related to inefficiencies, direct labor, indirect costs, and AFUDC associated with those costs.[101]
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> *　　　*　　　*　　　*
>
> The Commission has a statutory duty to set just and reasonable rates and in doing so must consider all relevant factors while balancing the interests of shareholders and ratepayers.
>
>> Rate-making bodies, within the ambit of their statutory authority, are vested with considerable discretion to make such pragmatic adjustments in the rate-making process as may be indicated by the particular circumstances in order to arrive at a just and reasonable rate.[102]
>
> In considering all relevant factors concerning the prudence and efficiency of the Company's management in relation to the Callaway project, the Commission finds and concludes that an additional $100 million should be excluded from rate base. In arriving at this adjustment, the Commission has considered the interest of

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[100] Tr.Vol. 14, p. 333, ln. 23 – p. 334, ln. 16.

[101] *Re Union Electric Co.*, Case Nos. EO-85-17 and ER-85-160, Report And Order, 27 Mo.P.S.C.(N.S.) 183, 251 (1985).

[102] *State ex rel. Valley Sewage Co. v. Public Service Commission*, 515 S.W.2d 845, 850(Mo.App. 1974).

> ratepayers is not being solely responsible for bearing the risks of imprudent management by the Company. The Commission has balanced this ratepayer interest with the shareholders' interest in the financial integrity of the Company.[103]

In Missouri, the Commission is not limited to disallowing costs for imprudence, for example, the Commission can disallow costs that are not of benefit to ratepayers, and there does not need to be a showing of bad faith or abuse of discretion for the Commission to disallow costs. *State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*, 600 S.W.2d 222, 228-29 (Mo.App. W.D. 1980), *appeal dismissed*, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981); *State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n,* 645 S.W.2d 44, 55-56 (Mo.App. W.D. 1982).

For the construction of Wolf Creek, KCPL used what were termed "reconciliation packages" to attempt to explain the underlying reasons for cost overruns above the definitive estimate.[104] The Commission held as follows regarding the reconciliation packages at 28 Mo.P.S.C.(N.S.) at 345; 75 P.U.R.4th at 93, 106 – 07:

> Although the Commission agrees with Company's assertion that it may not be possible to assign reasons for overruns with absolute precision, the Commission believes that a system could have been and should have been implemented which at least attempted to classify the reasons for the overruns at the time they were incurred. After-the-fact estimates with wide-ranging accuracy, plugged numbers and pages of unquantified explanations constitute insufficient information from which a determination of reasonableness can be made. This is true in spite of Mr. Linderman's assertions to the contrary. The Commission finds that Mr. Linderman's testimony was often evasive and unresponsive, therefore, the commission is unable to rely upon his testimony.

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[103] *Id*. at 252.

[104] *Re Kansas City Power & Light Co*., Case Nos. EO-85-185 and EO-85-224, Report And Order, 28 Mo.P.S.C.(N.S.) 228, 343; 75 P.U.R.4th 1, 92 (April 23, 1986).

> The Commission finds the reconciliation packages were further deficient, as they did not properly assess the extent to which cost overruns were attributable to problems over which management had control. Thus, Company would have the Commission believe that all cost overruns were wisely and prudently incurred.

In 1980 Iatan 1 was determined to be fully operational and used for service (i.e., went into commercial operation / service) and KCPL, St. Joseph Light & Power Company, and The Empire District Electric Company started a series of separate rate cases were each sought to have Iatan 1 reflected in rates. The first rate case for KCPL was Case No. ER-80-48, the first rate case for SJLP was Case No. ER-81-43, and the first rate case for Empire was Case No. ER-81-229 (Report And Order, 24 Mo.P.S.C.(N.S.) 376 (1981)), an interim rate case in which the Commission denied interim rate relief to Empire (Empire's next rate case was Case No. ER-83-42). In both the KCPL Case No. ER-81-42 and the SJLP Case No. ER-81-43, the Staff proposed, among other things, a $2,155,000, disallowance for unauditable expenditures that the Commission accepted stating in both cases as follows:

> The last figure is $2,155,000, and was labeled by the Company as prior year's expenditures. The Staff maintains that there was no auditable material supporting this figure. The Company merely presented oral testimony that the "amount was based on actual expenditures which were booked at the time the estimate was made." The Commission notes that the Company has the burden of proof in presenting its case. A serious question was raised about the sufficiency of what the Company had included in its estimate as prior years' expenditures. No evidence was brought forward by the Company to resolve that issue to the Commission's satisfaction. Therefore, the Commission accepts Staff's position that the prior years' amount was unauditable.[105]

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[105] *Re Kansas City Power & Light Co.*, Case Nos. ER-81-42 and ER-80-48, Report and Order, 24 Mo.P.S.C.(N.S.) 386, 412-13, 43 P.U.R.4th 559 (1981); *Re St. Joseph Light & Power Co.*, Case Nos. ER-81-43, GR-81-44, HR-81-45, and OR-81-46, Report And Order, 24 Mo.P.S.C.(N.S.) 342, 355 (1981).

KCPL relitigated the unauditable costs issue in its next rate case, Case No. ER-82-66, and lost the issue again, but this time on arguably different facts:

> By the above mentioned cases the Commission indicated that the Company had not met its burden of proof in regard to the costs found by the Staff to be unauditable. The Company in this case has come forward with evidence of what it asserts explains the prior year's figure that led to the exclusion from rate base of some $2,155,000. Said evidence was the actual expenditures in the amount of $2,932,000 made in 1975 to show a paper trail indicating the $2,155,000 figure was based on actual and budgeted amounts for 1975, and therefore the Staff could audit those amounts.
>
> This created a dispute on two levels between the Company and Staff. First, the Staff maintains that the August, 1975, estimate, from which the prior year's caption and figure appears, has no indication that the prior year's figure included budgeted dollars for the last three months of 1975. Second and more importantly, the fact that the Company spent $2.9 million in 1975 does not create auditable material. Nowhere in the record does the Company present the work papers showing how the $2,155,000 figure was calculated so that the Staff can determine what construction it related to. However, the most important point is that in addition to not knowing what facts and figures the $2,155,000 number was based on, there were no cost controls in effect at the time of expenditure to later scrutinize the expenditure against. The $2,155,000 figure cannot even be broken down to functional accounts.
>
> The Commission is of the opinion that in light of the lack of evidence concerning the unauditable expenditures, that amount found by staff to be unauditable should be excluded from rate base.[106]

The next Commission case in which the term “unauditable” expenses appears is a KCPL case also and points out the importance of the reconciliation which the Staff spends many hours working on in each case. In KCPL’s next rate case, Case No. ER-83-49, the KCPL rate case preceding the Wolf Creek rate case, what might be termed a definitive reconciliation was not

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[106] *Re Kansas City Power & Light Co.*, Report And Order, Case No. ER-82-66, 25 Mo.P.S.C.(N.S.) 229, 251-52, 48 P.U.R.4th 598, 616 (1982).

completed until after the issues in the case had been presumably identified and tried before the Commission in the hearing room. After the hearings were completed a definitive reconciliation was sought to be completed. The Commission's Report And Order relates that amounts of dollars were identified associated with "untried" issues, i.e., dollars associated with items that had not been identified as issues needing to be addressed or "unexplained" dollar differences/amounts. The Staff and KCPL reached agreement how to address these items but OPC opposed the Staff's and KCPL's proposed resolution of these items. The Commission ruled against the Staff's and KCPL's proposed resolution and did not allow inclusion of the costs in KCPL's revenue requirement determination:

> As to amounts listed on the reconciliation as "unexplained" or "untried" differences in the Staff's and Company's cases, Public Counsel remains opposed to their inclusion to arrive at a revenue requirement for the Company. Public Counsel asserts that the reassignment of dollar values agreed to by the Staff and the Company in the June 10th reconciliation is unsupported by any competent and substantial evidence and the Company and Staff's explanation of these changes is theoretical and hypothetical, and does not address specific factors or causes for the changes. Public Counsel also contends that the affidavits furnished after the hearing constitute a concession that no one knows what the unexplained differences are attributed to. Public Counsel describes the proposed changes as a mechanistic convention to substitute for a logical or reasonable identification and justification of the listed amounts.
>
> Upon consideration of the posthearing pleadings and the argument of counsel, the commission finds the Public Counsel's position has merit and should be adopted.
>
> This determination is consistent with our treatment in the Company's last two rate cases of certain costs of the Iatan station which the staff claimed to be unauditable. In the report and order issued in Case No. ER-81-42 (43 P.U.R.4th 559) we found that the Company merely presented oral testimony that the amounts were based on actual expenditures booked at the time the estimates were made. The Commission noted that the Company has the burden of proof and that no evidence was brought forward to resolve the issue to the Commission's satisfaction.

> The same issue arose in Case No. ER-82-66 (48 P.U.R.4th 598) wherein the commission found the disputed unauditable item should be excluded from rate base because of the lack of supporting evidence.
>
> The commission finds that Exh 148 should be adopted as the proper reconciliation on which to base the revenue requirement in this case. The items designated therein as "unexplained differences" or "untried differences" shall not be considered in arriving at the company's revenue requirement.[107]

There is also an expense adjustment proposed by the Staff and OPC, which was accepted by the Commission in the Southwestern Bell Telephone Company - AT&T divestiture case, *Re Southwestern Bell Telephone Co.*, Report And Order – Part II, Case Nos. TR-83-253 and TR-83-288, 26 Mo.P.S.C.(N.S.) 442, 478-79 (1983) that is of relevance. SWBT allocated $12,779,000 in management costs out of its 1984 budget relating to interLATA toll service, which it would no longer provide post-divestiture (post-December 31, 1983), which additional amount of management costs AT&T Communications of the Southwest (ATTCOM)[108] claims it will incur

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[107] *Re Kansas City Power & Light Co*., 55 P.U.R.4th 468, 474-475 (1983).

[108] "As of January 1, 1984, pursuant to the MFJ, Southwestern Bell will be prohibited from providing interLATA toll service. Instead, that service will be provided by AT&T through its new subsidiary, AT&T Communications of the Southwest (ATTCOM). ATTCOM is a Delaware corporation presently owned by Southwestern Bell, which will transfer ATTCOM to AT&T at divestiture. The Commission considers ATTCOM to have intrastate Missouri interLATA toll authority without the specific necessity of authority from this Commission, by virtue of Southwestern Bell's Missouri intrastate authority and the operation of the MFJ. No party has suggested to the contrary, although comments on that point were solicited by the Commission in its Report and Order, Part I."

"Therefore, AT&T Communications of the Southwest (ATTCOM) will, at January 1, 1984, be a Delaware corporation, wholly-owned by American Telephone & Telegraph Company, with authority to provide intrastate interLATA toll services within the State of Missouri. As such, ATTCOM will be a public utility corporation under the jurisdiction of this Commission pursuant to Chapters 386 and 392, RSMo 1978. The headquarters and principal place of business of ATTCOM are located at 1100 Main, Kansas City, Missouri 64105. Since ATTCOM is being created out of Southwestern Bell, and will exist as a separate regulated entity as of January 1, 1984 for the first time, the Commission must establish in this case a revenue requirement (including an appropriate rate of return on equity) and rate design for ATTCOM, in addition to Southwestern Bell." *Re Southwestern Bell Telephone Co.*, Report And Order – Part II, Case Nos. TR-83-253 and TR-83-288, 26 Mo.P.S.C.(N.S.) 442, 445-46 (1983).

to provide this same service post-divestiture. The Staff and OPC asserted that ATTCOM's budget was unreliable, this $12,779,000 in additional costs were unexplained, and that these unexplained management costs should not be allowed recovery in rates by the Commission. Even though ATTCOM submitted the testimony of four witnesses, the Commission disallowed recovery of the $12,779,000 in rates:

> With respect to Public Counsel's and Staff's "cost of divestiture" allegation, it is ATTCOM's position that no such allocation can properly be performed. ATTCOM further asserts that such allegations have no relation whatsoever to ATTCOM's demonstrated revenue requirement. ATTCOM argues that through the testimony of witnesses Donat, LeMay, Vrooman and Mueller, it has fully supported its revenue requirement.
>
> The Commission is of the opinion that ATTCOM has failed to establish the reasonableness of the projected management expenses at issue here. ATTCOM has the ultimate burden of proof and persuasion that the proposed rates are just and reasonable. Although ATTCOM has produced some evidence in the form of budget projections as to the reasonableness of its management expenses, the Commission is not persuaded as to the accuracy of those projections.
>
> Based on the foregoing, the Commission finds that $12,779,000 in costs associated with ATTCOM's management expenses should be disallowed as recommended by Public Counsel and Staff.[109]

Mr. Blanc alleges that KCPL/GMO did not know until the Staff's November 3, 2010 Iatan Construction Audit And Prudence Review that the staff did not believe that the KCPL/GMO cost control system was consistent with the requirements of the KCPL Regulatory Plan and, as a consequence, the Staff's intention to propose to the Commission disallowance of unidentified and unexplained cost overruns:

At page 5, lines 8-6 of his rebuttal testimony (KCPL Ex. No. 8), Mr. Blanc states:

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[109] *Id*. at 478-79.

> If it was Staffs intent simply to recommend to disallow every dollar spent above the December 2006 CBE, it could have saved itself, KCP&L, and the Commission a lot of time, trouble, and expense by saying so at some point prior to its November 3, 2010 Iatan Report. To my knowledge prior to its Iatan Report, Staff never explained to KCP&L, or more importantly the Commission, its intent to adopt such a simplistic approach. Had Staff done so, KCP&L would have disputed Staffs approach as inadequate at that time, and the Commission could have given Staff guidance as to whether its approach was consistent with how the Commission intended Staff to conduct its construction audit and prudence review of Iatan 2.
>
> At page 11, line 19 through page 20, line 6 of his rebuttal testimony (KCPL Ex. No. 8), in part, Mr. Blanc states:
>
> Q. Are you surprised by the timing of Staff's allegation that KCP&L "disregarded [its] responsibility" under the Regulatory Plan to "develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate"?
>
> A. Yes. Although Staff has requested and received on several occasions an explanation as to how the cost control system works and how costs can be tracked through the system, to my knowledge the November 3, 2010 Iatan Report is the first time Staff has told KCP&L, or more importantly the Commission, that it believes KCP&L "disregarded," or somehow failed to satisfy its obligation in the Regulatory Plan to implement an adequate cost control system. . . .

Mr. Blanc sought to ignore a number of events preceding the Staff's November 3, 2010 Iatan Construction Audit And Prudence Review Report such as page 5 of the Staff's December 31, 2009 Iatan Construction Audit And Prudence Review Report and KCPL's/GMO's efforts to have the Commission terminate any further construction audit/prudence review activity by the Staff relating to Iatan 1 AQCS after the Staff filed the December 31, 2009 Iatan Construction Audit And Prudence Review Report show KCPL/GMO were aware of the potential adjustment much earlier than Mr. Blanc testified was the date. Mr. Blanc said:

> Q. So you weren't aware prior to that that Staff was considering disallowing those costs?
>
> A. No. The earlier reports basically just said that they were -- certainly questioned our cost control system. But when you read those reports, it was in the

context of why Staff's audit wasn't done as of that time. And then I believe going back to the December 31st, 2009 report, they explained that's why they were going to have to take an alternative approach. They just suggested it -- they were going to have to do their audit differently than they originally anticipated based on how the cost control system was working. But they -- they had never suggested that disallowance was the appropriate remedy.

> Q. But would you agree that Staff had said that the inclusion of those costs was not -- also not the appropriate remedy at that time?

> A. I believe the language was something that they couldn't recommend inclusion or something to that effect. But that is a -- a far cry from seeking a disallowance.

> Q. What's the difference? If they weren't going to include the cost at that point, didn't that mean they could possibly disallow the cost?

> A. Consistent with Staff's prior statements in the earlier report, we took that to mean what they -- an extension of what they had said before, that the audit was taking them longer because they were getting something different than they thought they were going to get and that they were having to seek alternative methods. But we read it to mean as they weren't done yet, not that the remedy would be disallowance.[110]

The Staff placed KCPL on notice of concerns / problems with its cost control system much earlier than December 31, 2009. Section III.B.1.o. of the KCPL Regulatory Plan Stipulation And Agreement provides, in part, that if KCPL determines that its Resource Plan should be modified because changed factors or circumstances have impacted the reasonableness and adequacy of the resource plan, then it shall notify all Signatory Parties in writing within forty-five (45) days of any such determination. The KCPL Regulatory Plan Stipulation And Agreement further provides, in part, if any Signatory Party believes that there have been significant changes in factors or circumstances that have not been acknowledged by KCPL, any Signatory Party may notify KCPL and all other Signatory Parties and request a meeting of all

[110] Tr.Vol. 15, p. 448, ln. 1 – p. 449, ln. 11.

Signatory Parties to discuss the specific changes in factors or circumstances that give rise to the concern of the Signatory Party giving such notice. The factors and circumstances giving rise to these provisions include, but are not limited to: a significant change in the construction costs of elements of the resource plan and material changes in the projected rates and costs to ratepayers resulting from the resources plan.[111]

Counsel for the Staff sent a letter to Messrs. William G. Riggins, James M. Fischer, and Karl Zobrist for KCPL on February 21, 2008 requesting a meeting to talk about six topics including, among things, (1) the decision to construct and build Iatan 2 without completion of substantial engineering design; (2) the status of the construction schedule and definitive cost estimate for the completion of the Iatan 2 and 1 projects; and (3) the cost and schedule controls that have resulted in the expected cost and schedule of the Iatan 2 and 1 projects being unknown at this time.[112]

Another indication that KCPL/GMO understood from the Staff's December 31, 2009 Iatan Construction Audit and Prudence Review Report where the Staff was going with its construction audit and prudence review is KCPL's/GMO's major undertaking in Case Nos. ER-2009-0089 and ER-2009-0090, in which the Staff's December 31, 2009 Iatan Report was filed, and then in File No. EO-2010-0259 (In the Matter of the Construction Audit and Prudence Review of Environmental Upgrades to Iatan 1 Generating Plant, and Iatan Common Plant, and the Iatan 2 Generating Plant, Including All Additions Necessary for these Facilities to Operate) to have the Commission terminate the Staff's construction audit / prudence review activity

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[111] *Re Kansas City Power & Light Co.*, Case No. EO-2005-0329 (2005) (Report And Order, July 28, 2005, Attachment No. 1, pp. 24-27)(Order Approving Amendments To Experimental Regulatory Plan, Aug. 23, 2005, p. 3.

[112] Tr. Vol. 15, p. 460, ln. 23 – p. 462, ln. 3; Ex. KCPL-286HC, p. 1.

respecting Iatan 1 AQCS and direct the Staff that it could not propose any additional disallowances. KCPL/GMO also sought to have the Commission make the finding that the Companies' cost control system adequately tracks the costs of the projects and is consistent with accepted industry standards. The Commission noted in its July 7, 2010 Order Making Findings in File No. EO-2010-0259 that KCPL/GMO requested that the Commission issue an Order to this effect. The Commission declined to do so.

Mr. Blanc asserts at page 13, lines 1-5 that the KCPL cost control system does exactly what section III.B.1.q. of the KCPL Regulatory Plan requires:

> . . . Consistent with what KCP&L has been explaining to Staff since it began its audit work on Iatan 2, understanding how to "track budget variances" in the cost control system is how Staff can use the system to identify and explain costs in excess of the CBE, precisely what Staff claims to be unable to do. . . .

But track budget variances is not what the KCPL Regulatory Plan requires. First of all, budget variances and cost overruns are not necessarily the same thing.

When pressed on this matter at hearing, Mr. Blanc deferred to Mr. Forrest Archibald, who is presently KCPL's Senior Manager of Cost for the Iatan Unit 2 Project. Mr. Archibald joined the Iatan Project in October 2006 as the Iatan Project's Senior Cost Engineer and in August 2007 he was promoted to the position of Senior Manager of Cost. He is responsible for managing the team that processes and maintains the cost records for the Iatan Project that affect the Iatan Project's budget. He is responsible for all of the various cost reports that are generated on the Iatan Project. Further, he is responsible for reporting the Iatan Project's cost trends including the velocity of certain costs over time to Project's senior leadership team, KCPL's Senior Management and KCPL's joint owners. He has prepared and provided similar reports to the Staff at the quarterly meetings as required under KCPL's Regulatory Plan Stipulation And

Agreement. He provided cost information requested by the Staff in response to data requests, and he has met on multiple occasions with members of the Staff and to respond to questions regarding cost controls and status of cost trends for the Iatan Project. Finally, he is responsible for all cost forecasts and reforecasts that have been prepared by the Iatan Project.[113]

But Forrest Archibald was not the only KCPL/GMO person interfacing with the Staff and responding to Staff Data requests for example. Mr. Archibald on the witness stand disavowed the KCPL/GMO February 3, 2009 response to Staff Data Request No. 445 in File No. EO-2010-0259 that the Iatan 1 AQCS environmental upgrade Construction Project has not incurred cost overruns. Mr. Archibald stated: "I do not agree with the first statement on we have not incurred cost overruns, no."[114] Mr. Blanc identified Mr. Archibald as the KCPL/GMO expert on the cost control system:

> [Ms. Ott] Q. . . . How could Staff use your system to identify -- to be able to track these cost overruns?
>
> [Mr. Blanc] A. Sure. As I explained earlier, the mechanics of how you would walk through that I'm going to leave to Forrest Archibald. He's our expert in that area. But we had a series of meetings with Staff and at each of those meetings, they would ask Mr. Archibald, How do I track this, and then he would explain the columns they have to look at, the documents they have to look at. And that would typically be followed up with, okay, then how do I track that and the same process. I don't recall Mr. Archibald ever not being able to answer one of those questions.
>
> Q. So then are you saying that Mr. Archibald would have been the person at KCPL that would have used the cost control system to give Staff a complete analysis on how they could perform that evaluation?

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[113] Ex. KCPL-4, *Archibald* Rebuttal, p. 1, ln. 12 – p. 2, ln. 6.

[114] Tr.Vol. 25, p. 2203, ln. 6 - p. 2204, ln. 5.

A. I'm saying Mr. Archibald explained to them many times how it could be done and answered their questions as to how it could be done, as did Dan Meyer. So those two together.[115]

Q. Now, does that K-Report address contingencies?

A. Contingencies are listed on the K-Report.

Q. But that K-Report doesn't explain the costs charged to the contingencies. It just provides a number. Correct?

A. Correct. As I mentioned before, it's a summary and you have to go to the back-up documentation. And in response to that question, that would be the contingency logs. But again, the details of how to get to A to B are really better questions for Mr. Archibald.[116]

Q. Okay. Where has the company identified and explained the cost overruns?

A. We've identified and explained the cost overruns in a lot of different ways. And Mr. Archibald and Mr. Meyer are the experts in this area, but as described earlier in the mini opening, each of the reforecasts -- that's probably the easiest place to start because by definition, the reforecasts showed a deviation from the control budget estimate, the definitive estimate which is what -- how the regulatory plan defines a cost overrun. And in each of those reforecasts, there were binders of material that identified and explained each deviation from the control budget estimate. And then we came down and met with the Staff and the other parties after each of those reforecasts to go over that, explain that, answer any questions. And in addition to that, there's the change orders, the purchase orders, the contingency logs. All of those explain -- identify and explain cost overruns above the control budget estimate.

Q. So are you saying you have to have all of that information and be able to use all of those documents to identify and explain the cost overruns?

A. I'm saying we have a cost control system and I explained that in my testimony. And then the1 mechanics of walking through particular questions I would have to leave to Mr. Archibald and Mr. Meyer. But yes, if you look at those documents -- and in the instance of the reforecast binders, we're not talking about a mammoth

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[115] Tr.Vol. 15, p. 465, ln. 7- p. 466, ln. 3.

[116] Tr.Vol. 15, p. 474, lns. 6-17.

> amount of documents. We're talking several binders. But, yeah, you would have to look at several binders of material to identify and explain each of the cost overruns.[117]

Mr. Blanc testified that the risks and opportunities (R&Os) were a large part of the Iatan 1 reforecast binders and the reforecast for Iatan 1 was largely built around the R&Os but "the R&Os were to identify risks and opportunities, things that were on the horizon, not things that actually - - expenditures that were actually incurred."[118] Mr. Blanc indicated that it was his understanding that the cost reforecast binders for Iatan 2 consisted of cost projection folders in addition to R&Os."[119]

Mr. Archibald testified that neither the R&Os nor the cost projection folders (CPs) were ever intended to track actual costs or cost overruns, they are budgeting tools.[120] Mr. Majors also noted in his surrebuttal testimony that Mr. Archibald verified to the Staff numerous times in some of the meetings that he cites in his rebuttal testimony that KCPL/GMO did not track actual project costs by R&Os or CPs.[121] KCPL/GMO used purchase orders, change orders, and invoices to track costs;[122] KCPL/GMO used purchase orders, change orders, recommendations to award (RTAs), reforecast documents, K reports, contingency logs and transfer logs to explain cost overruns to senior management and the Staff;[123] and KCPL/GMO used the RTAs, purchase

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[117] (r.Vol. 15, p. 443, ln. 25- p. 445, ln. 8.

[118] Tr.Vol. 15, p. 527, lns. 19-22, 8-14.

[119] Tr.Vol. 15, p. 528, lns. 19-22, 8-14.

[120] Tr.Vol. 25, p. 2183, ln. 15 – p. 2184, ln. 4.

[121] Ex. KCPL-231, *Majors* Surrebuttal, p. 24, lns. 26-27.

[122] Tr.Vol. 25, p. 2184, lns.6-8

[123] Tr.Vol. 25, p. 2186, lns. 7-20

orders, change orders, and reforecast documents to explain cost overruns and underruns.[124] Mr. Archibald estimated that there were between approximately 2700 - 2800 change orders for Iatan 2. For Iatan 1 and Iatan 2 he said he would guess that there were somewhere between 1500 – 1600 purchase orders. For Iatan 1, he would estimate that there have been thousands of invoices, and for Iatan 2 he would say in the tens of thousands.[125] Mr. Archibald testified that it is not possible to trace the actual costs of the Iatan Common Plant facilities to actual invoices.[126]

Mr. Keith Majors addressed in his surrebuttal testimony Messer's. Forrest Archibald's and Daniel F. Meyer's attempt to contend that KCPL/GMO complied with the III.B.1.q. Cost Control Process For Construction Expenditures section of the KCPL Regulatory Plan respecting identifying and explaining any cost overruns above the definitive estimate for Iatan 1 AQCS and Iatan 2. Mr. Majors drew the distinction between "budget variances" and "cost overruns," that it is very important that not all budget variances are cost overruns. Mr. Majors testified that "[c]ost overruns occur when the sum of all negative (increased costs) budget variances exceed the sum of all positive (decreased cost) budget variances plus the contingency level plus the baseline budget." "KCPL/GMO defined its contingency as an amount that 'consists of funds for unforeseeable elements of cost within the defined project scope.' (KCPL response to Staff Data Request No. 819, Case No. ER-2009-0089)." The Staff requested from KCPL/GMO support for the contingency for both Iatan 1 AQCS and the Iatan 2 control budget estimates, but KCPL/GMO has not provided sufficient documentation to explain the causes for KCPL/GMO exhausting its contingency rather than the items that caused KCPL/GMO to incur actual costs in

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[124]Tr.Vol. 25, p. 2193, lns. 13-19.

[125] Tr.Vol. 25, p. 2184, ln. 24 - p. 2186, ln. 6.

[126] Tr.Vol. 25, p. 2186, lns. 21-24.

excess of the definitive estimate, including KCPL's/GMO's determination of adequate contingency to prevent actual costs exceeding the definitive estimate total.[127]

Mr. Archibald that stated the control budget estimate and the definitive estimate are one in the same and identified the quantification as $1.685 billion.[128] Of the $1.685 billion, $220 million is the contingency for Iatan 2, i.e., this $220 million does not include the contingency for Iatan I AQCS and the contingency for Iatan 1 AQCS and Iatan is part of the definitive estimate /control budget estimate $1.685 billion.[129]

Mr. Daniel F. Meyer attached to his direct testimony in File Nos. ER-2010-0355 and ER-2010-0356, as Schedule DFM2010-1, The Association for the Advancement of Cost Engineering International, *Cost Engineering Terminology* (2004). The definition of "contingency" that appears in that document follows:

> **CONTINGENCY – An amount added to an estimate** to allow for items, conditions, or events for which the state, occurrence, and/or effect is uncertain and that experience shows will likely result, in aggregate, in additional costs. Typically estimated using statistical analysis or judgment based on past asset or project experience. **Contingency usually excludes; 1) major scope changes such as changes in end product specification, capacities, building sizes, and location of the asset or project (see management reserve),** 2) extraordinary events such as major strikes and natural disasters, 3) management reserves, and 4) escalation and currency effects. Some of the items, conditions, or events for which the state, occurrence, and/or effect is uncertain include, but are not limited to, planning and estimating errors and omissions, minor price fluctuations (other than general escalation), design developments and changes within the scope, and variations in market and environmental conditions. Contingency is generally included in most estimates, and is expected to be expended. (1/04) [Emphasis added].[130]

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[127] Ex. KCPL-231, *Majors* Surrebuttal, pp. 21-22.

[128] Tr.Vol. 25, p. 2188, lns. 6-8.

[129] Tr.Vol. 25, p. 2176, lns. 2-6, 13-22; p. 2181, lns. 7-13.

[130] Ex. KCPL-43, *Meyer* Direct, Schedule. DFM2010-1, pp. 13-14.

While the Staff and KCPL/GMO do not appear to have a significant issue regarding the definition of the term "contingency," the Staff and KCPL/GMO do disagree regarding whether KCPL/GMO have provided adequate documentation to support its contentions regarding contingency, an essential matter in the tracking of cost overruns. A budget variance that is covered by a contingency amount is not a cost overrun. KCPL's/GMO's cost control system failed to identify or explain cost overruns for Iatan. The Staff was not able to perform an independent examination of the cost overruns identity nor were explanations provided by KCPL/GMO.

As detailed in the ***Audit Report,*** Staff has also proposed disallowances with respect to other specific items. Those adjustments are discussed below.

CONSTRUCTION RESURFACING PROJECT

KCPL paid ** ** to Alstom in connection with claims related to delays to Alstom's work and acceleration of other Alstom work related to the Iatan site being resurfaced.[131] KCPL paid ** ** to have the site resurfaced.[132] KCPL did not challenge the KCC Staff's adjustments to remove these imprudent costs in connection with KCPL's Kansas rate case.[133] KCPL's ratepayers should not bear financial responsibility for these charges.

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[131] ***Audit Report*** at 47.

[132] *Id.*

[133] *Id*.

.[135]** KCPL made its payment to Alstom to settle claims related to this issue.[136] Missouri ratepayers should not bear these charges, and these adjustments made by Kansas should be adopted in Missouri.

JLG ACCIDENT AUGUST 25, 2007

KCPL made a payment to Alstom related to costs incurred in connection with a JLG man lift incident, for which KCPL believes KCPL bore no responsibility.[137] KCPL's decision to pay costs for which it bore no responsibility should not be borne by Missouri ratepayers.

CAMPUS RELOCATION FOR UNIT 2 TURBINE BUILDING

Because KCPL's original design and location of the Iatan campus was faulty, KCPL incurred expenses in moving construction trailers at the Iatan site approximately 100 feet east when construction began on the turbine generator building.[138] Correction of KCPL's failure to engage in adequate planning prior to initially siting the trailers – or KCPL's failure to adequately design the initial siting of the trailers – is not of benefit to Missouri ratepayers. Costs incurred to correct this faulty design should not be borne by Missouri ratepayers.

SEVERANCE ADJUSTMENT

Consistent with the Commission's recent decision in Case No. ER-2006-0314 that severance costs should not be recovered from ratepayers, Staff recommends an adjustment to remove from $41,568 from Iatan 1 plant balances, and $35,953 from Iatan 2 plant balances

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[134] *Audit Report* at 47 - 48.

[135] *Audit Report* at 48

[136] *Audit Report* at 47.

[137] *Audit Report* at 46.

[138] *Audit Report* at 43.

booked by KCPL for severance payments to employees.[139] Further, even if recoverable from ratepayers, these costs should not be capitalized to the Iatan projects, but should be treated instead as expense items.[140]

KCPL's JULY 18, 2008 IATAN 1 AQCS ALSTOM SETTLEMENT

Staff has proposed the disallowance of $22 million in Iatan Construction Project costs representing an amount of liquidated damages that KCPL chose not to seek from Alstom and, therefore, chose not to attempt to seek to reflect in rates. Staff has also proposed the disallowance of $22 million in costs that KCPL is charging to the Iatan Construction Project for the $22 million settlement payment to Alstom respecting a settlement of Alstom claims against KCPL, and KCPL claims against Alstom that KCPL/GMO is seeking to reflect in rates and recover from ratepayers. Staff has found no documentation supporting KCPL's decisions respecting these matters.[141]

Alstom asserted claims against KCPL in the amount of ** [redacted] ** based on what Alstom contended were delays to Alstom's work on Iatan 1 AQCS due to contract performance delays caused by KCPL and force majeure events.[142] The KCPL Iatan Project Team evaluated a potential cost exposure in the ** [redacted] _** range.[143] KCPL decided to carry these claims at an amount of ** [redacted] ** and moved this amount into its current budget for purposes of its Iatan 1 AQCS cost projection.[144] In its analysis, KCPL believed that it

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[139] ***Audit Report*** at 42.

[140] *Id.*

[141] Ex. KCP&L-205, p. 57.

[142] Ex. KCP&L-205, p. 54, lines 19-23.

[143] Ex. KCP&L-205, p. 54, lines 23-24.

[144] Ex. KCP&L-205, p. 54, lines 24-25.

was entitled to receive liquidated damages from Alstom in the amount of ** ** if Alstom continued to fall behind schedule.[145] The net contingency range amounted to ** . **[146]

KCPL and Alstom entered into a settlement agreement, executed on July 18, 2008, whereby KCPL and Alstom settled all existing claims by KCPL paying Alstom ** **, which amount exceeded the high end of KCPL's contingency range.[147]

KCPL made no attempt to quantify the events that may have caused the costs regarding the Iatan 1 AQCS matters that comprise the July 18, 2008 Iatan 1 AQCS Alstom Settlement, i.e., items that may have arisen from its own project management team, Burns & McDonnell (the owner-engineering firm KCPL retained), or any other Iatan 1 contractor or subcontractor.[148] In performing its audit and prudence review, it appeared to the Staff that a ** .**[150]

Staff's positions are based in part on the Staff's review of various internal audit reports performed for KCPL.[151] **

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[145] Ex. KCP&L-205, p. 54, lines 26-28.

[146] Ex. KCP&L-205, p. 55, lines 2-3.

[147] Ex. KCP&L-205, p. 55, lines 4-6.

[148] Ex. KCP&L-205, p. 57, lines 11-14.

[149] Ex. KCP&L-205, p. 57, lines 14-16.

[150] Ex. KCP&L-205, p. 57, lines 18-20.

[151] *See* Ex. KCP&L-205, p. 57-61.

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**[155]

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[152] *Id.*

[153] Ex. KCP&L-205, p. 61, lines 5-12.

[154] Ex. KCP&L-205, p. 61, lines 13-17.

[155] Ex. KCP&L-205, p. 61, lines 14-17.

**[156] KCPL's own internal audit identified that Alstom was ** ** Well, it is apparent Alstom succeed in its endeavors. KCPL paid out ** ** in a settlement, to the detriment of ratepayers.[157] KCPL has failed to support its settlement agreement was beneficial for ratepayers.[158]

The Commission should disallow the ** ** which KCPL chose not to seek from Alstom because this inaction has harmed ratepayers and the ** ** settlement payment KCPL made to Alstom as those costs are not beneficial to ratepayers.

KCPL's IATAN 2 ALSTOM SETTLEMENT

The Commission should not allow KPCL to recover the ** _** in incentive payments paid out to Alstom and should impute ** ** in forgone liquidated damages.

Alstom was a fixed-priced Engineer, Procure, and Construct (EPC) contract for the Iatan 1 AQCS and Iatan 2 boiler, with the responsibility of completing the contract work scope under the contract price.[159] Under the Alstom contract, it was to meet **

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[156] Ex. KCP&L-205, p. 61, line 18 – p. 62, line 7.

[157] Ex. KCP&L-205, p. 63, lines 14-16.

[158] Ex. KCP&L-205, p. 63, lines 14-16.

[159] *Id.* at lines 22-24.

. **[166]

On January 13-14, 2010, KCPL entered into a settlement agreement with Alstom regarding the Iatan 2 unit.[167] **

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[160] Ex. 317HC, Staff Data Request No. 658.

[161] Ex. KCP&L-308HC, *Hyneman* True-up Direct, p. 3, lines 14-15.

[162] *Id.* at lines 17-23.

[163] *Id.* at p. 5, lines 13-15.

[164] *Id.* at line 12.

[165] *Id.* at lines 15-18.

[166] *Id.* at p. 6, lines 3-6.

[167] Ex. KCP&L-205 Nov. 3, 2010 *Audit Report,* p. 63, lines 27-29.

[168] *Id.* at p. 63, line 30 – p. 64, line 2.

[169] *Id.* at p. 64, lines 3-5.

[170] *Id.* at lines 7-8.

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__This chart is highly confidential in its entirety__

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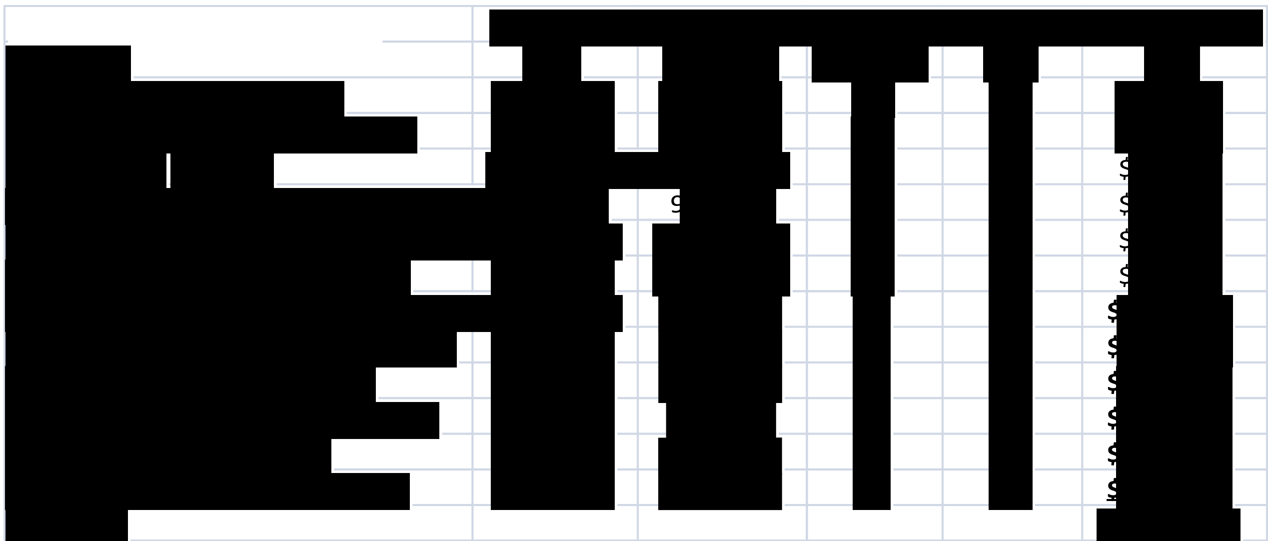

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Since KCPL has failed to provide any evidence for its failure to access liquidated damages for Alstom's failure to meet provision acceptance the Commission should disallow $34,200,000 for the Iatan Unit 2 costs. Also, the Commission should also disallow the incentive payments paid to Alstom because it failed to meet the milestone dates and the milestone achieved happened prior to a contract in which established the incentive payments.

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[171] Ex. KPC&L-308, p. 7.

[172] *Id.*

ALSTOM WELDING SERVICES INCORPORATED (WSI) CHANGE ORDER ADJUSTMENT

KCPL's Prudence consultant, Dr. Kris Nielsen of Pegasus-Global, has asserted that expenditures paid to Alstom in connection with work performed by WSI in an effort to overcome Alstom's failure to adhere to schedule were imprudent. KCPL's consultant further determined that costs incurred by KCPL in connection with the Alstom/WSI work, were imprudent.[173] Dr. Nielsen, KCPL's consultant, recommended a $12.7 million disallowance in connection with the Alstom/WSI work and concomitant KCPL costs. Staff concurs in Dr. Nielsen's quantification of these imprudent costs, and recommends their disallowance from rate base.[174]

As described by Dr. Nielsen, Alstom was responsible for costs due to delays unless the delays were the result of actions by KCPL or a third party responsible to KCPL.[175] Staff reviewed relevant WSI change orders and found no evidence that the Alstom-related delays were the responsibility of KCPL or any party responsible to KCPL.[176] KCPL's prudent course would have been to hold Alstom responsible financially for the costs associated with recovering the Alstom work schedule, including work performed by WSI. KCPL's ratepayers should not bear financial responsibility for these charges that should have been appropriately borne by Alstom.

KCPL's own witness determined that $12.7 million of the expenditures incurred in connection with the recovery of the Alstom schedule were imprudently borne by KCPL. Clearly, KCPL's ratepayers should not bear financial responsibility for charges that KCPL imprudently

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[173] ***Audit Report*** at 100-101.

[174] *Id.*

[175] *Id.*

[176] *Id.*

incurred. Thus, Staff recommends adoption of Dr. Nielsen's recommended disallowance of these $12.7 million of imprudent costs from KCPL's rate base.

ADJUSTMENTS FROM KCC STAFF IATAN 1

KCPL did not challenge certain adjustments to remove imprudent costs from Iatan plant balances made by the KCC Staff in connection with KCPL's Kansas rate case.[177] Imprudently incurred costs should not be borne by Missouri ratepayers. The basis of these recommended disallowances were KCPL's imprudence in accelerating the delivery of steel for an ash pipe rack and KCPL's imprudence in accelerating the addition of pilings beneath pre-engineered tanks and buildings.[178] Both of these instances of imprudence were occasioned by a late start on engineering and inadequate devotion of resources by Burns and McDonald.[179] Missouri rate payers should not bear the cost of KCPL's inadequate project management, and these adjustments made by Kansas should be adopted in Missouri.

AFFILIATE TRANSACTION – GREAT PLAINS POWER (GPP)

KCPL has sought inclusion in its Missouri rate base of certain amounts paid to its affiliate, GPP, an independent power producer.[180] Further, KCPL has accounted for this transaction by placing the dollars paid to its affiliate in a project account created to record costs that it cannot or will not charge to the other Iatan partners.[181] Staff recommends disallowance of these costs because KCPL has not demonstrated the usefulness of its payment to its affiliate to

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[177] ***Audit Report*** at 99 -100.
[178] *Id.*
[179] *Id.*
[180] ***Audit Report*** at 50.
[181] *Id.*

Missouri ratepayers, and KCPL incurred these costs in a manner that violated the Commission's affiliate transaction rule.[182]

During the late 1990's, following the cues of Aquila and Enron, GPE decided to dip its toes into the deregulated waters.[183] The resulting GPE subsidiary – GPP – explored the development of a market facility near Weston, Missouri.[184] Staff met with KCPL personnel on September 23, 2009, to discuss the acquisition of GPP's assets by KCPL, into an account that KCPL was not charging to the other Iatan entities.[185] KCPL was unable to provide a satisfactory response as to the benefit to Missouri ratepayers of this affiliate transaction, nor as to why these purportedly beneficial costs should not be allocated among all Iatan investors.[186]

Further clouding the prudency of this transaction is the fact that KCPL did not follow the Commission's affiliate transaction rule when it acquired GPP's assets.[187] Not only did KCPL fail to report this transaction as required within the time designated by the Commission's affiliate transaction rule, but also KCPL admitted that it did not perform an evaluation of the market value of the assets acquired from GPP.[188] Unless and until KCPL can show the market value of the assets, and demonstrate that such market value is greater than KCPL's payment to GPP, it is inappropriate to include this payment to an affiliate in contravention of the Commission's affiliate transaction rule in rate base.

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[182] ***Audit Report*** at 51, 53.

[183] ***Audit Report*** at 50.

[184] ***Audit Report*** at 50 - 51.

[185] ***Audit Report*** at 52.

[186] *Id.*

[187] ***Audit Report*** at 53.

[188] *Id.*

KCPL can neither demonstrate how the former assets of its independent power producer affiliate are of benefit to Missouri ratepayers, nor the proper valuation of those assets due to its failure to abide by the Commission's affiliate transaction rule. KCPL certainly has not demonstrated why it is appropriate to foist these imprudent expenses entirely on its own ratepayers, as opposed to sharing them with the Iatan partners. The Commission should not hold KCPL's Missouri ratepayers responsible for GPE's experiments in deregulation, and thus must disallow the costs of this improper affiliate transaction.

EMPLOYEE MILEAGE CHARGES

Staff has determined that KCPL requested inclusion in rate base of at least $51,113 paid to reimburse employees for travel to their designated primary work site - Iatan.[189] These inappropriate costs, as well as related AFUDC, and approximately $8,000 for similar charges[190] made after KCPL modified its practices should not be borne by Missouri's ratepayers.

INAPPROPRIATE CHARGES

KCPL has, throughout the Iatan project, demonstrated an unwillingness to accept financial responsibility for the inappropriate charges of its employees, or to have adequate controls in place to detect such inappropriate charges. Sundry examples include charging of personal expenses to the Iatan project by high level personnel, the billing of a $405 lunch to the Iatan 2 project, and billing personal expense items to Iatan for inclusion as capital in Iatan rate base.[191] KCPL's lack of cooperation in discerning such charges is especially troubling to Staff, as is KCPL's lack of controls to prevent such actions in the first place. As Staff, and surely the

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[189] ***Audit Report*** at 48.

[190] ***Audit Report*** at 49.

[191] ***Audit Report*** at 25 - 27.

Commission, has observed, in corporate culture, little problems are indicative of big problems. These items may be of relatively low dollar value, but that makes KCPL's lack of cooperation in resolution of these charges pathetic in the truest sense of the word. The Commission should disallow $25,000 and $75,000, for Iatan Units 1 and 2, respectively, to account for Staff's observed level of these inappropriate charges.

PERMANENT AUXILIARY ELECTRIC BOILERS

The Commission should transfer the cost of the permanent auxiliary electric boilers from Iatan Unit 1 cost to Iatan Common cost. Staff proposes to transfer the cost related to the placement of three additional permanent auxiliary electric boilers at the Iatan site from the costs related to the Iatan Unit 1 AQCS to the Iatan Common Plant costs.[192] The auxiliary boilers feed steam to both Iatan Units 1 and 2 as needed.[193] These boilers will serve both Iatan Units 1 and 2 and, therefore, the costs for this equipment should be charged to the Iatan Common Plant work order.[194]

IATAN CHIMNEY PULLMAN ADJUSTMENT

The Commission should not include the full amount of costs paid to Pullman for the Iatan Chimney. Pullman was a contractor on the Iatan Construction Project and part of its duties was to install the new chimney liner.[195] KCPL documented that "Pullman's performance on the Project was well below expectations."[196] Pullman adversely impacted the Iatan Project's safety

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[192] ***Audit Report,*** p. 98.

[193] *Id.*

[194] *Id.*

[195] Ex. KCP&L—250, p. 8.

[196] *Id.*

record and caused significantly delays in installing the chimney liner.[197] Staff proposes adjustments to the costs related to Pullman's performance on the Iatan Construction Project. These adjustments should be accepted in their entirety.

CUSHMAN AND ASSOCIATES

The Commission should reduce the level of the Cushman & Associates charges included in the costs of Iatan Unit 1 and Iatan Unit 2. Cushman & Associates primarily assisted KCPL in the creation of the Iatan Construction Project Execution Plan.[198] The award of this work to Cushman & Associates on a sole-source basis was a clear violation of KCPL's own procurement policies.[199] KCPL has no documentation to support the excessive hourly rates paid to Cushman & Associates.[200] Staff proposes an adjustment to the fees paid to Cushman & Associates based upon fees paid to LogOn Consulting, another firm who provided services to the Iatan Project.[201] The fees paid to LogOn were more reasonable, considering that most of the individuals employed by that firm had in excess of 25 years of experience working on various aspects of power plant construction projects, in addition to being well-known within this industry.[202] Staff's proposed adjustment reduces the fees paid to Cushman & Associates to a more reasonable level and should be adopted.

Due to among other things, a pattern of excessive charges, KCPL's failure to manage the contract with Schiff Hardin, and blatantly self-serving manipulation of the relationship the

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[197] *Id.*

[198] Ex. KCP&L—205, Staff Construction Audit and Prudence Review, p 97.

[199] *Id. at* p. 96.

[200] *Id. at* p. 97.

[201] *Id.* at p. 98.

[202] *Id.*

Commission should disallow ** [redacted] ** related to costs the Company incurred in cost overruns from Schiff Hardin. Schiff Hardin is a significant cost overrun and KCPL has failed to identify and explain the cost over and beyond the control budget estimate.[203]

Schiff Hardin, LLP, (Schiff) is a law firm with its principle place in business in Chicago, Illinois.[204] Schiff operates its construction law enterprise under a variety of services and engages in the practice of hiring consultants to provide non-legal services to KCPL.[205] While, Schiff is a law firm it also provides project management services, as well as, it hires subcontractors, which result in the ability to invoke the attorney-client privilege, work product privilege or other qualified privilege; whereas, if KCPL would directly hire the subcontractor those privileges would not apply.[206] The result of this arrangement allowed KCPL to invoke privileges and withhold a significant amount of documentation from Staff.

Schiff Hardin's equity partner and Company witness, Kenneth M. Roberts stated that KCPL "engaged Schiff: (i) to help the Company develop project control procedures to monitor the cost and schedule ('Project Controls') for the infrastructure projects contained in the Company's Comprehensive Energy Plan ('CEP'); (ii) to monitor the CEP's progress and costs, including the review and management of change order requests; (iii) to negotiate contracts with

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[203] Tr. p. 2191, lines 1-9.

[204] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 65, lines 16-17.

[205] Tr. p. 497, lines 17-21; Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 65, lines 18-19; Tr. p. 789, lines 14-15.

[206] Tr. p. 1905, lines 6-9.

vendors related to the CEP; and (iv) to resolve disputes with vendors that might arise on CEP projects."[207]

SCHIFF HARDIN

KCPL retained Schiff on a sole source basis, without a formal procedure or contacting any other comparative law firms, when the KCPL President, William Downey introduced Schiff to the Executive Oversight Committee (EOC).[208] KCPL failed to follow its sole source procedures to document the reason a vendor was hired on a sole source basis. Mr. Downey testified that KCPL retained Schiff to provide both management oversight services, legal services, and other services for the Iatan Project.[209] In 2005, the EOC approved Schiff to work on the project, but the agreement was not official memorialized until 2007.[210] From 2005 until January 2007, KCPL and Schiff operated under the terms of an engagement letter.[211]

January 17, 2007, is the date of the first written contract between KCPL and Schiff for services on the Iatan Project.[212] This contract indicates that Schiff roles and responsibilities as:

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[207] Ex. KCP&L-50, *K. Roberts* Direct, p. 3, lines 7-22.

[208] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 68, lines 29-30; p. 69, lines 22-23; p. 72, lines 17-19; Tr. p. 1341, lines 2-6.

[209] Tr. p. 1341, lines 11- 25.

[210] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 68, lines 33-36.

[211] Tr. p. 1797, lines 1-8.

[212] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 74, lines 13.

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According to the KCPL/Schiff contract, paragraph 2, **

**[214] However, there is no written documentation of KCPL's General Counsel approving rate changes. In response to Staff Data Request No. 852, KCPL stated that "generally, KCPL approved proposed annual rate increased verbally."[215] This practice adds to the imprudence of KCPL's cost control of vendors charging cost to the Iatan Project. Fitting, that KCPL's General Counsel, William Riggins, and Construction Attorney, Gerald Reynolds are no longer employees of KCPL that can verify that either one of them "verbally" approved rate increases with at least 30 days prior approval.[216] During the evidentiary hearing, no one from KCPL could actually verify that Mr. Riggins or Mr. Reynolds approved Schiff's rate increase pursuant to the terms of the contract.

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[213] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 74, line 16 – p. 75, line 2.

[214] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 76, lines 3-7.

[215] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 76, lines 8-11.

[216] Tr. p. 507, lines 15-19.

The contract between KCPL and Schiff paragraph 6 states, **

**[217] Paragraph 5 of the contract indicates, ** **[218] According to Company witness, Mr. Roberts, a future change in rates ** he **[219] This logic is completely arcane. The contract explicitly states that ** ** For some strange reason, Mr. Roberts does not believe that a **

. ** This is another example of KPCL's lack of documentation and failure to identify and explain cost controls and change in scope to the Iatan Project.

Schiff's employees and contractor's hourly rates are excessive. One example of Schiff's excessive rates is with Procurement advisor, Steve Jones. Mr. Jones was initially hired by KCPL at an hourly rate **[220] However, Mr. Jones left KCPL and instantly became a

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[217] Tr. p. 1799, lines 12-19 (emphasis added).

[218] Tr. p. 1800, lines 7-21.

[219] Tr. p. 1799, lines 20-24; p. 1780, lines 2-6.

[220] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 76, lines 26-28.

subcontractor for Schiff at the hourly rate of ** [redacted] **[221] Mr. Jones' job duties did not change upon becoming a subcontract with Schiff, yet the cost of his services increased by ** [redacted] ** Mr. Jones, direct replacement at KPCL was David McDonald[222], While Mr. Jones remained consulting on the Iatan Project, he and Mr. McDonald never had professional interactions or discussions about Mr. Jones' role as Director of Procurement.[223] A portion of Staff's adjustment for Schiff's excessive cost reflects the difference in Mr. Jones' hourly rate at Schiff and his hourly rate when contracted directly with KCPL. KCPL has failed to provide any documentation to justify the increase in value of Mr. Jones' services while subcontracted through Schiff versus the services he provide when contracted with KCPL, especially because KCPL hired Mr. McDonald as his replacement.

Additionally, Staff noticed an alarming trend, that Schiff's subcontractors hourly rates were significantly higher than other KCPL hired contractors with the same or even greater experience.[224] Furthermore, attorney's for Schiff provide both legal and non-legal services. However, the attorney's billable rate was the same for both services performed. In order to ascertain what type of services the attorney was performing, Staff reviewed the work descriptions on the redacted Schiff invoices.[225] The burden of a public utility engaged in

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[221] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 76, lines 28-29.

[222] Ex. KCP&L -300 *Deposition of D. McDonald,* p. 22, lines 3-10.

[223] Ex. KCP&L-300, *Deposition of D. McDonald,* p. 22, line 14 – p. 23, line 11.

[224] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 80, lines 19-24.

[225] Tr. p. 498, lines 6-15.

building a new plant is "to build the best possible plant at the lowest cost."[226] This includes keeping legal and consulting costs for being in excesses.

Staff witness, Charles Hyneman, audited and reviewed the services provide by Schiff, in particular he focused on: (1) the review of the worked performed by Schiff to determine if the work was beneficial and relevant to the Iatan Project; (2) determined how and why KCPL selected Schiff for the Iatan Project; and (3) determine if the costs for the services performed by Schiff were reasonable given the type of worked performed and quantity of work performed.[227]

Staff believes the hourly rates charged by Schiff were excessive and additional charges were not supported by adequate documentation, thus should not be borne exclusively by the ratepayers.[228] When asked for documentation to support Schiff's costs to the Iatan Project, KPCL invoked the attorney client privilege and/or work product doctrine.[229] Thus KCPL failed to support these costs with adequate documentation.

According to KCPL's response to Staff's Data Request No. 622, for the Iatan 1 AQCS, the control budget estimate for Schiff's services was ** [redacted]. **[230] As of June 30, 2010, Schiff had charged the Iatan 1 AQCS project approximately ** [redacted] ** with an additional ** [redacted] ** to still be incurred.[231]

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[226] ***In the Matter of Union Electric Company,*** 27 Mo.P.S.C. (N.S.) 183, 208 (1985).

[227] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 66, lines 21-32.

[228] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 67, lines 1-6.

[229] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 67, lines 7-11.

[230] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 66, lines 6-7.

[231] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 66, lines 8-10.

KCPL incurred significant cost overruns in relationship to the Iatan 2 project. KCPL provide the Board of Direct meeting minutes in which they approved the budget for the Iatan 2 construction project. This document identified that the Board approved a budget of ** [redacted] **for the services of Schiff.[232] KCPL has not provided a subsequent document to show that the Board of Directors approved changes to this line item. The control budget estimate indicates a budget of ** [redacted]** for Schiff services, but there is no documentation to illustrate the Board of Directors approved this change from a sole sourced vendor.[233] However, Schiff has billed KCPL more than ** [redacted] ** for services for Iatan Project, with Mr. Roberts charging approximately $2,500,000 for his services alone.[234]

Another concern with KCPL's apparent lack of regard for the excessive Schiff charges is the fact KCPL did not obtain a volume pricing discount.[235] Schiff charged over ** [redacted] **_to the Iatan Projects over a period of six years.[236] Schiff's paralegal was charging **[redacted]. **[237] It seems strange that KCPL would not obtain a volume discount when KCPL did received a volume discount with firm Spencer, Fane, Britt, and Brown who charged on much smaller scale costs to the Iatan Project.[238]

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[232] Ex. KCPL 261HC, *Project Control Budget Estimate Iatan 3 Project Board of Directors Meeting, December 4-5, 2006,* Appendix B.

[233] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 66, lines 15-16.

[234] Tr. p. 1889, lines 9-12; Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 66, lines 16-17.

[235] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 78, lines 17-18.

[236] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 78, lines 17-19.

[237] Tr. p. 506, line 10-25.

[238] Tr. p. 518, lies 17-23.

Furthermore, Schiff had free reign on the amount of hours it billed.[239] During the six-year period, KPCL's legal department never once contacted Schiff to clarify or question an invoice.[240] KCPL did not enforce its contract terms with Schiff. KCPL allegedly verbally approved rate increase and failed to require Schiff to submit monthly receipts for travel and other expenses charged to the project, both which are required under the contract terms.[241] KCPL did not require Schiff to submit monthly travel invoices, some of which monthly travel was greater than ** [redacted] **[242] Staff determined that six percent of the monthly invoice charges were related to unsupported and undocumented expenses.[243] Thus, Staff removed six percent of the Schiff charges for KCPL failing to support, document and explain the expenses paid out to Schiff.

In Commission Case No. GR-2004-0209, the Commission accepted Mr. Hyneman's adjustment regarding legal expenses.[244] In the Order the Commission specifically addressed the cost

> In this case, MGE or perhaps Southern Union choose to hire Kasowitz, Benson, Torres, Friedman Law Firm out of New York, MGE explained that it chose that firm because it had previously represented Southern Union in other complex litigation and the company was very pleased with the results obtained in that case. The other litigation for which the Kosowitz firm had represented Southern Union was, however, a merger and acquisition case and this case was the firm's first litigated regulatory rate case.

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[239] Tr. p. 499, lines 9-10.

[240] Tr. p. 501, lines 1-3.

[241] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 78, lines 20-23.

[242] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 79, lines 2-6.

[243] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 80, lines 15-17.

[244] *In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service,* Case No. GR-2004-0209, Issued September 21, 2004, Effective October 2, 2004.

> Eric Herschmann and Michael Fay of the Kasowitz firm did a good job of representing their client at the hearing. But the firm charged up to $690 per hour of its work. That rate is far higher than the typically rates charged by lawyers appearing before the Commission. The company is certainly entitled to hire lawyers with whom it is comfortable, but it would not be fair to require ratepayers to pay such high rates. The Commission will reduce the rate to $200 per hour, which is the rate charged by MGE's local counsel. The $16,250.75 in expenses incurred by the Kasowitz firm will be allowed. The total allowed for representation by Kasowitz, Benson, Torres and Friedman is $188,200.75.

Thus the Commission has already found in the past that Mr. Hyneman has provided competent evidence regarding the appropriateness legal costs to be included in rates to be charged to Missouri customers.

Staff strongly encourages the Commission to adopt similar treatment in this case. Schiff's hourly rate is far greater than rates typically seen by this Commission. Further, KCPL paid out invoices for expenditures not support by documentation, contrary to the terms of the contract between KPCL and Schiff. This practice is clearly imprudent. Schiff Hardin is a significant cost overrun and KCPL has failed to identify and explain the cost over and beyond the control budget estimate.[245] The Commission should disallow ** [redacted] ** related to costs the Company incurred in cost overruns from Schiff Hardin.

REGULATORY ASSETS

Based upon the Commission's decisions regarding each of Staff's proposed disallowances for the Iatan 1, Iatan 2, and Iatan Common Plant costs, Staff requests that the Commission appropriately reduce the regulatory assets to remove the costs in the regulatory assets associated with each disallowance the Commission accepts. The issue is what level of

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[245] Tr. p. 2191, lines 1-9.

regulatory assets should be included in rates, and whether or not the regulatory assets should be reduced by the carrying cost of those assets that are disallowed by the Commission.

KCPL's Regulatory Plan states that KCPL is allowed to treat the Iatan 2 project under "construction accounting" principles until the effective date of the new rates in the fourth rate case.[246] This current rate case is the fourth rate case under KCPL's Regulatory Plan.[247] GMO sought and received construction accounting for Iatan 2 through an accounting authority order (AAO) the Commission issued in File No. EU-2011-0034.[248]

Staff supports treatment of construction accounting for Iatan 1, Iatan 2, and Iatan Common Plant Regulatory Asset for both KPCL and GMO. However, based upon Staff's findings in the Iatan 1 Construction Project Audit and Prudence Reviews (KCP&L Exhibit 205), it would be improper to include disallowed cost in a regulatory asset.[249] It would be improper ratemaking to disallow a cost but then allow recovery of the same cost in a regulatory asset.[250] If the Commission does not accept Staff's disallowances then it would be proper ratemaking treatment to include those costs in a regulatory asset.[251] During cross-examination, Company witness John Weisensee agreed with Staff that an adjustment should be made to the regulatory asset if the Commission determined a cost was imprudent.[252] Mr. Weisensee further stated that

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[246] Kansas City Power & Light Company's, Experimental Regulatory Plan, Case No. EO-2005-0329, p. 43, § III.3.d.vii.

[247] Ex. KCP&L—210, *Cost of Service Report,* ER-2010-0355, p. 53, lines 23-24.

[248] Ex. GMO—210, *Cost of Service Report*, ER-2010-0356, p. 56, line 22 – p. 57, line 4.

[249] Ex. GMO—229, *Majors* Rebuttal, ER-2010-0356, p. 24, lines 2-4.

[250] Ex. KCP&L--230, *Majors* Rebuttal, ER-2010-0355, p. 23, lines 12-13; Ex. GMO-229, *Majors* Rebuttal, ER-2010-0356, p. 24, lines 4-5.

[251] Ex. GMO—229, *Majors* Rebuttal, ER-2010-0356, p. 24, lines 6-8.

[252] Tr. p. 3234, lines 21-24.

"[i]f we determine anything's [sic] imprudent, then the associated carrying costs should also be disallowed. . . ."[253]

The main disagreement between the Company and Staff is the carrying costs related to Allowance for Funds Used in Construction (AFUDC). The Company disagrees with Staff that if the Commission accepts Staff's proposed disallowances related to Iatan 1, Iatan 2, and Iatan Common Plant, that the Commission should make an associated adjustment for the disallowance in relationship to AFUDC and the regulatory asset.

Staff expert, Keith Majors testified that "allowance for funds used . . . in construction is while the plant is actually being constructed and is accrued until it goes into service."[254] Whereas, a regulatory asset (construction accounting) is "the carrying costs portion of the construction accounting is based on the costs that were incurred after the plant went in service."[255] AFUDC and regulatory assets have similar carrying costs; however, the carrying cost associated with each of them is for a different point in time and at a different rate.[256] Further, Mr. Majors testified that "[w]hen [Staff] agreed to construction accounting, you defer that depreciation into a regulatory asset account and you also have carrying costs similar to AFEUDC [sic], so when you . . . if it was determined that there was an imprudent, inappropriate cost in the plant balance amount, you would both . .. . remove the AFEUDC [sic] that was

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[253] Tr. p. 3235, lines 12-14.

[254] Tr. p. 3253, lines 16-19.

[255] Tr. p. 3253, lines 19-22.

[256] Tr. p. 3254, lines 3-5.

initially accrued on it and the construction accounting accrual for the carrying costs that was incurred in the regulatory asset."[257]

The Company's position that the removal of both AFUDC and the regulatory asset would result in double-dipping is completely false. If the Commission accepts Staff's disallowances for Iatan 1, Iatan 2, and/or Iatan Common Plant, then for ratemaking purposes the carrying costs associated with AFUDC and the regulatory asset would not have existed. Therefore, it would be improper ratemaking treatment to include carrying costs with plant that does not exist. The Staff requests that the Commission remove any regulatory assets associated with Staff's disallowances relating to Iatan 1, Iatan 2, and Iatan Common Plant the Commission accepts.

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

Staff proposed specific disallowances for the Iatan 1, Iatan 2, and other separate adjustments based upon financing costs incurred on the Iatan Project. Based on these specific adjustments, Staff made a corresponding adjustment related to allowance for funds used during construction (AFUDC). The Commission should accept Staff's disallowance for AFUDC related to the Iatan 1, Iatan 2 based upon its determination of Staff's overall disallowance adjustments for the Iatan Project. Staff also proposed several separate adjustments for excess property taxes and AFUDC reductions. The Commission should accept Staff's separate adjustments because they represent a more appropriate level of costs that should be charged to ratepayers.

Allowance for Funds used During Construction (AFUDC) is the non-cash cost of financing a particular construction project associated with financing costs during construction

[257] Tr. p. 3251, lines 12-20.

and prior to in-service.[258] Under the FERC's USOA, Electric Plant Instructions, paragraph 17, AFUDC is defined as:

> . . . includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed in paragraph (a) of this subparagraph. No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction project which have been abandoned.

The Commission's rule 4 CSR 240-20.030 on the USOA for electric utilities states, in part:

> Purpose: This rule directs electric corporations within the commission's jurisdiction to use the uniform system of accounts prescribed by the Federal Energy Regulatory Commission for major electric utilities and licensees, as modified herein . . . .
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> * * * *
>
> (4) In prescribing this system of accounts, the commission does not commit itself to the approval of acceptance of any item set out in any account for the purpose of fixing rates or in determining other matters before the commission. This rule shall not be construed as waiving any recordkeeping requirement in effect prior to 1994.

AFUDC ACCRUED ON STAFF'S PRUDENCY ADJUSTMENTS

The issue before the Commission is whether or not a corresponding adjustment to the AFUDC based on the amount accrued on the proposed specific disallowances is appropriate. Staff obtained the AFUDC costs of the individual prudence disallowances by calculating the value of AFUDC accrued for Staff's specific disallowances.[259] The monthly AFUDC rates for the Iatan Project was applied to the monthly AFUDC rates of each disallowance by the months in

[258] Ex. KCP&L--205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 89, lines 17-20.

[259] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 95, lines 5-7.

which the costs were charged to the project.[260] The Company failed to refute Staff's AFUDC adjustments based upon its disallowances for the Iatan Project during its direct case. It was not until the true-up rebuttal testimony of Company witness Darrin Ives that the Company addressed Staff's proposed adjustments to AFUDC. The Company's last minute attempt fails to recognize that if the Commission accepts Staff's disallowances then, for ratemaking treatment, AFUDC should not exist on those disallowed costs. If the Commission accepts all or specific adjustments relating to Staff's proposed Iatan Project disallowance, the Commission should also accept the corresponding AFUDC adjustment.

IATAN 1 TURBINE START-UP FAILURE

The Commission should disallow the ** ______ ** costs and associated ** ______ ** of AFUDC KCPL accrued during the Iatan 1 unplanned outage that resulted because of a turbine trip during start-up. During a planned outage, General Electric was contracted to replace the high pressure turbine on Iatan 1.[261] On February 4, 2009, the Iatan 1 turbine tripped during start-up activities due to vibrations in the turbine beyond operating parameters.[262] As of March 9, 2009, thirty-three days later, the unit was repaired and place back in-service.[263] The cost associated with repairing the turbine was not within the scope of the Iatan

[260] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 95, lines 7-9.

[261] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 90, lines 14-15.

[262] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 90, lines 13-15.

[263] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 90 lines 18-19.

1 AQCS project.[264] Yet, the Company seeks to include the AFUDC cost accrued during the thirty-three day delay in the return to availability for in-service testing.

In Brent Davis' rebuttal testimony, he states, "Regardless of the accounting of these costs, the turbine work was relevant to the Iatan Unit 1 Project."[265] KCPL in that testimony mischaracterized Staff's argument as one of relevancy. In Mr. Davis' testimony, he makes no determination of "the accounting of these costs", instead he states the obvious, that "this work was relevant to the Iatan Unit 1 Project."[266] KCPL, through Darrin Ives' untimely true-up rebuttal testimony, attempts to address Staff's actual argument, but to no avail.

The treatment of the additional financing costs is improper and the Commission should not allow the AFUDC costs accrued during this time period in rates, as the cost of turbine incident is outside the scope of the Iatan 1 AQCS project, KCPL did not seek reimbursement from GE for the additional AFUDC caused by the turbine incident, and ratepayers should not be responsible for KCPL's recovery on costs that it shared responsibility with a third party.

AFUDC CAUSED BY GPE ACQUISITION OF AQUILA

The Commission should remove the incremental AFUDC costs for Iatan Unit 1 and 2 related to the GPE's acquisition of Aquila. GPE's and KCPL's commercial paper rate decreased after the announcement of the acquisition of Aquila which occurred during the Iatan Project. KCPL's short-term debt rate is used in calculating AFUDC.[267] On February 7, 2007, Standard &

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[264] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 90, lines 15-17.

[265] Ex. KCP&L—19, *Brent Davis Rebuttal Testimony, Case No. ER-2010-0355, p. 61, lines 1-10.*

[266] Id.

[267] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 91, lines 3-5.

Poors lowered GPE's and KCPL's debt rating to from A-2 to A-3.[268] On July 14, 2008, Standard & Poors raised GPE's and KCPL's debt rating from A-3 to A-2.[269]

In response to Staff Data Request No. 414 issued in File No. ER-2009-0090, the Company stated "[w]hile the change in spread cannot with certainty be attributed entirely to the downgrade, it is a reasonable assumption."[270] In Case No. EM-2007-0374, the Commission stated in its July 1, 2008 Report and Order:

> **IT IS ORDERED THAT**:
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> * * * *
>
> 8. In addition to the conditions outline in Ordered Paragraph Number Three, the Commission conditions its authorization of the transactions described in Ordered Paragraph Number One of this Report and Order upon a requirement that **any post-merger financial effect of a credit downgrade** of Great Plains Energy Incorporated, Kansas City Power & Light Company, and/or Aquila, Inc., that occurs as a result of the merger **shall be borne by the shareholders** of said companies and not the ratepayers. (emphasis added)

GPE and KCPL's credit downgrading is a result of the acquisition of Aquila. In Case No. EM-2007-0374, the Commission expressly stated that any costs that resulted in a credit downgrade should be borne by shareholders and not ratepayers. The Commission should accept Staff's adjustment for AFUDC accrued based on GPE's and KCPL's lower crediting rating predicated upon the acquisition of Aquila.

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[268] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 91, lines 8-14.

[269] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 91, lines 15-22.

[270] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 91, lines 23-26.

EQUITY RATE USED IN CALCULATION OF AFUDC

The Commission should remove the AFUDC cost related to the equity rate used in the calculation of AFUDC for the Iatan Projects because the Company failed to provide support for the rate it was using. FERC USOA, Electric Plant Instruction, paragraph 17(b) states "[t]he cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdictions. If such cost rate is not available, the average rate actually earned during the preceding three years shall be used."

In Case No. ER-2006-0314, effective January 1, 2007, the equity rate for AFUDC on Iatan 1 was 11.25% and the equity rate for for AFUDC on Iatan 2 was 8.75%.[271] In its response to Staff Data Request No. 719 in Case No. ER-2009-0089 KCPL failed to substantiate the equity rate used from April 1, 2006 – December 31, 2006.[272] Prior to Case No. ER-2006-0314, KCPL used an equity rate from Case No. HO-86-139; which was not a general rate case.[273]

KCPL's failure to provide support for the cost rate of common equity under FERC USOA, Electric Plant Instructions, 17(b), requires Staff to use a three-year average of the average rate actually earned. Staff's adjustment is based upon the "average Missouri jurisdictional earned return on equity rate of 2003, 2004, and 2005" obtained from the Missouri Surveillance Reports prepared by KCPL.[274] The Commission should remove the AFUDC cost related to the equity rate used in the calculation of AFUDC for the Iatan Projects because the

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[271] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 36-28.

[272] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 1-3.

[273] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 28-32.

[274] Ex. KCP&L—205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 6-9.

Company failed to provide support for the rate it was using and, instead, use the Staff imputed three-year average based upon FERC USOA.

ADDITIONAL AFUDC DUE TO TRANSFER OF IATAN 1 COMMON PLANT

The Commission should remove the AFUDC cost related to the transfer of Iatan I AQCS to Iatan Common Plant. KCPL does not have the same ownership share in Iatan 1, Iatan 2 and Iatan Common Plant.[275] In April 2009, $113,767,821 was transferred from Iatan 1 to Iatan Common Plant.[276] Prior to the transfer, KCPL had a 70% ownership interest in Iatan 1; however, this transfer of assets reduced its ownership interest to 61.45%.[277] Staff removed the AFUDC costs associated with the 8.55% differential portion directly related to KCPL's ownership interests in Iatan 1 and Iatan Common Plant.[278] The Commission should remove the excess AFUDC based upon the transfer to Iatan Common Plant based upon KCPL's different ownership interest in the two facilities.

Additionally, Staff proposed to remove the excess AFUDC on the proposed transfer of Iatan Unit 1 Indirect costs to Iatan Common.[279] This proposed adjustment uses the same principle as the adjustment described above. Both of these adjustments account for excess AFUDC accrued on the Iatan Construction Project.

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[275] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 6-9.

[276] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 17-19.

[277] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 17-19.

[278] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 93, lines 19-21.

[279] IBID

SECTION 48A ADVANCED COAL PROJECT TAX CREDIT AFUDC

The Commission should remove the AFUDC cost related to KCPL's Section 48A advanced coal investment tax credits (ITC). KCPL was awarded $125 million in ITC from the IRS.[280] In its response to Staff Data Request No. 386 in File No. ER-2010-0355 KCPL stated it generated and used $29,151,586 of the ITC on a 2007 GPE consolidated federal tax return.[281] In 2008, KCPL generated $46,921,017 of ITC and in 2008, KCPL generated $31,214,900 of ITC.[282]

AFUDC is designed to compensate a utility for financing the cost of building a power plant. Since KCPL had a free source of cash from the Section 48 advanced coal investment credits, it had access to free cash flow to offset the financing costs of construction for Iatan 2. Thus, the Commission should remove the AFUDC cost related to KCPL's Section 48A advanced coal investment tax credits (ITC).

Jaime Ott

II. KCP&L ONLY ISSUES

4. Off-System Sales Margins:

a. 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?

No. Staff urges the Commission to set the amount of off-system sales margins[283] "baked into" KCPL's rates at ** [redacted] **, which is the 40th percentile as determined by the

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[280] *See* Infra Section (ADD SECTION ABRITRATION)

[281] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 94, lines 3-5.

[282] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 94, lines 5-6.

[283] Off-system sales are sales of electricity made at times when the company has met its obligations to its customers and has excess electricity available to sell at wholesale. Off-system sales margins are the profits made on

analysis conducted by Company witness Schnitzer and updated in his True-up Direct testimony.[284] Staff also urges the Commission to include an appropriate level of off-system sales margins in the rates for GMO's two service areas, MPS and L&P.

For the last several years, the Commission has accorded extraordinarily favorable treatment to KCPL in order to safely accomplish the important project of building the Iatan 2 generating facility. That project is now accomplished and Iatan 2 is now in service. It will be placed into rates in this case. Now it is appropriate for the Commission to think of the ratepayers. The Commission cited this project as one of its justifications for including off-system sales margins at the 25th percentile in prior rate cases.[285]

In support of this revised recommendation, Staff notes:

- KCPL has more power available for off-system sales now that Iatan 2 is on-line – an additional 472 MW at Iatan 2 alone.[286] Mr. Schnitzer testified, "Other things being equal, it is more likely that KCPL will make a higher volume of off-system sales than it would without the addition of Iatan 2 because there are additional MWs to sell."[287]

- KCPL has more power available for off-system sales with the completion of additional 48 megawatts of wind generation at Spearville 2.[288]

- KCPL will significantly increase the generating capacity of Wolf Creek Nuclear Station in the spring of 2011 with an upgrade to its steam turbine generator.[289]

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such sales. Off-system sales margins reduce the amount of money that must be collected from customers in rates. V. William Harris in *Staff's Revenue Requirement Cost-of-Service Report,* Case No. ER-2010-0356 ("*GMO RR Report*"), p. 77.

[284] Schnitzer, True-up Direct, KCPL Ex.

[285] Greg R. Meyer, *Surrebuttal Testimony* (Case No. ER-2010-0355), p. 27. The other justification was the unusually high level of KCPL's off-system sales. The latter point no longer applies.

[286] Michael Schnitzer, *True-up Direct Testimony* (Case No. ER-2010-0355), p. 2, V. William Harris, *Rebuttal Testimony* (Case No. ER-2010-0355), p. 5.

[287] Schnitzer, *supra,* at pp. 2-3.

[288] Ex. KCP&L—307, Harris true-up direct testimony, p. 3.

[289] Id.

- A significant capacity sale agreement with Missouri Joint Municipal Electric Utility Commission (MJMEUC) ended December 31, 2010, releasing energy commitments that will result in more off-system sales.[290]

- The 40th percentile would necessarily be a greater incentive to KCPL to engage in off-system sales.[291] KCPL's off-system sales margins have declined every year since 2004.[292] KCPL's off-system sales in 2009 were about half of the 2007 figure; the 2009 figure is roughly one-third of the 2004 figure.[293] Clearly, setting the off-system sales margins level presumed in rates at the 25th percentile has done nothing to encourage KCPL to exceed that level.[294]

- KCPL would still have a 60% chance of exceeding the off-system sales margins level presumed in rates.[295]

- The 40th percentile figure is estimated by Mr. Schnitzer at ** [redacted] **.[296]

The reality is that Iatan 2 was built through a forced loan, by the ratepayers, to KCPL via the mechanism of additional regulatory amortizations. Not only was it a forced loan, it was a forced, interest-free loan. That mechanism would never have withstood appellate scrutiny and was possible only because the various stakeholders agreed to let this important project go forward. Now that the Iatan Project is complete, the Commission must redress the balance of interests, which has shifted decidedly in the Company's favor under the Comprehensive Energy Plan (CEP). Now the Commission must require KCPL to "give back" to the community it serves. The Company must step up and deliver improved performance in the area of off-system

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[290] Id. at p. 6

[291] Harris, *supra.*

[292] *See* Harris, *supra,* Chart at the foot of p. 5.

[293] *Id.*

[294] Expert witness Greg Meyer pointed out, "Despite having a 50 / 50 probability of exceeding the 50th percentile, KCPL has not exceeded the 50th percentile once during the past four years under the Regulatory Plan"; and "I believe that KCPL has not achieved higher levels of OSS largely because of a lack of incentive[.]" Meyer, *op. cit.,* p. 28.

[295] Harris, *supra.*

[296] Schnitzer, testimony at true-up hearing, March 4, 2011.

sales. One way to do that is to set the "baked in" margins at Mr. Schnitzer's 40th percentile, which would force KCPL to perform at that level.

A traditional treatment of off-system sales margins is to "bake" them into rates at the 50th percentile and to share any earnings above that level between the ratepayers and the shareholders between rate cases. In that scenario, a monetary incentive ensures that the utility will maximize off-system sales – the laws of corporate governance require no less. Under traditional treatment of off-system sales, an electric utility benefits from increases above the levels set in rates for off-system sales while those rates are in effect. In fact, the utility benefits in the increases for those sales during the entire period between rate cases. The present case, however, is asymmetrical. There is no sharing. As Mr. Schnitzer explained it on the stand, it is "below 40% we lose, above 40% we break even."[297]

Why is this fair? Because KCPL agreed to it as an aspect of the regulatory plan that took large amounts of money as an interest-free loan from its customers and thereby enabled KCPL to build Iatan 2, the Iatan 1 AQCS, and the Iatan Common Plant. The fact that the completion of the Iatan Project is an eventual benefit to all KCPL ratepayers is small comfort to a low-income customer wondering how to pay an electric bill bloated with additional regulatory amortizations. Now that the construction program and interval of heightened risk for KCPL has ended, it is time for KCPL to give back to those ratepayers and return to a more traditional approach to determining rates. One way it can and should give back is to shoulder a larger amount of "baked in" off-system sales margins for the benefit of its customers.

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[297] Id.

In summation, Staff strongly urges the Commission to include off-system sales in KCPL's base rates at the 40th percentile level identified by Mr. Schnitzer, ** [redacted] **.

b. Should the Commission include the Adjustments to the 25th percentile projection recommended by KCP&L as components to the Off-System Sales Margin calculation?

KCP&L's witness Burton Crawford recommends three adjustments related to (1) Purchases for Resale, (2) Southwest Power Pool (SPP) line loss charges, and (3) SPP Revenue Neutrality Uplift charges.[298] Staff does not oppose either the first or third of these, relating to Purchases for Resale and SPP Revenue Neutrality Uplift charges, although Staff believes they should be applied to Mr. Schnitzer's 40th percentile figure rather than to the 25th percentile. Staff is opposed to the second of Mr. Crawford's adjustments, relating to SPP line loss charges.

Staff objects to Mr. Crawfords' proposed adjustment for SPP line loss charges because it violates the matching principle. The database used by Mr. Schnitzer to forecast KCPL's off-system sales margins did not include sales made outside of the SPP "thumbprint."[299] The line loss charges refer **only** to sales of power outside the SPP "thumbprint."[300] Because of the associated charges, Staff presumes that KCPL would only make such sales if the price nonetheless allowed a net profit.[301] Since KCPL is already receiving the amount of these charges from the customers who buy the power as part of the purchase price, the ratepayers should not also pay the charges because that would be a double recovery for KCPL.[302]

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[298] Burton Crawford, Direct Testimony (Case No. ER-2010-0355).

[299] V. William Harris, Surrebuttal Testimony (Case No. ER-2010-0355), pp. 2-3.

[300] Id.

[301] Id., p. 3.

[302] Id.

KCP&L GREATER MISSOURI OPERATIONS COMPANY

Off-System Sales Margins

a. How should KCP&L Greater Missouri Operations Company's non-firm Off-System Sales Margins be determined for setting rates?

The Commission should include in the revenue requirements of MPS and L&P off-system sales margin levels based on the off-system sales margins level for GMO the Staff proposes in the rebuttal testimony of Staff witness Harris. That level is a two-year average based on the historical levels of off-system sales margins GMO experienced during 2007 and 2008—the most recent two years immediately prior GPE's acquisition of Aquila in July 2008.[303]

Since GPE acquired GMO, GMO has experienced negative off-system sales margins, in particular for years 2009 and 2010.[304] Considering the levels of off-system sales at GMO before GPE acquired GMO, Staff believes it to be completely unreasonable that the off-system sales margins in 2009 and 2010 are negative. In every year prior to 2009—the first full year after GPE acquired GMO—GMO had positive off-system sales margins, margins which are identified in a table on page 3 of Staff witness Harris' rebuttal testimony.[305]

As recently as 2006, GMO had ** ██████ ** of off-system sales margins. During the last full calendar year before GPE acquired it, -2007, GMO had ** ██████ ** of off-system sales margins. In 2009, the first full calendar year after GPE acquired GMO, GMO had ** ██████ ** off-system sales margins. Through October 2010, GMO had ** ██████ ** of off-system sales margins. In each calendar year from 2002 to 2008, GMO

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[303] Ex. GMO—220, Harris rebuttal testimony, p.4.

[304] Id.

[305] Id.

had positive off-system sales margins. Because Staff believes GMO is not properly managing its off-system sales margins, Staff proposes that the rely on GMO's off-system sales margins levels in the two years immediately preceding GPE's acquisition of GMO to determine the level of off-system sales margins for GMO that are used for setting rates for MPS and L&P.[306]

Staff believes that one of the reasons that GMO's off-system sales margins have declined is because these sales margins are now included as part of GMO's fuel adjustment clause. The incentive of companies to make off-system sales is lessened when the margins from those sales are passed-through a fuel adjustment clause mechanism.[307]

Staff urges the Commission to include off-system sales margins in GMO's cost of service for setting the general electric rates for MPS and L&P using the two-years average level based on the years 2007 and 2008 as supported by Staff witness Harris.

9. <u>Hawthorn Settlement Payments</u>

a. Should Hawthorn SCR settlement payments be included in either the depreciation reserve or plant cost?

b. Should Hawthorn settlement payments be included in either the depreciation reserve or plant cost?

<u>HAWTHORN 5 SELECTIVE CATALYTIC REDUCTION WARRANTY SETTLEMENT SUMMARY</u>

The Staff's January 7, 2011 *List Of Issues* asked the Commission to consider the following issue regarding the Hawthorn Unit 5 Selective Catalytic Reduction Warranty Settlement (Warranty Settlement): "Should a settlement payment from Hawthorn 5 SCR [Selective Catalytic Reduction]

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[306] Id. at 3.

[307] Id. at 4.

warranty litigation be used to offset the costs that KCPL seeks to charge customers now and into the future because the Hawthorn 5 SCR has not, does not and will not operate within its design parameters?" After the Staff's Position Statement filed January 12, 2011, and the Staff's uncontested testimony at evidentiary hearing, it remains the Staff's position that KCPL's customers should receive the benefit of the Warranty Settlement payment received by the Company for the defective SCR in service. The testimony supports a finding by the Commission that KCPL's customers have paid increased capital and operation and maintenance costs in past rates, the Company's currently effective rate, and will continue to pay such costs until the retirement of the defective plant. And as such, the Staff recommends the Commission issue and order that allows the ratepayers, instead of the Company's shareholders, to receive the benefit of the Warranty Settlement.

BACKGROUND

In February 1999 an explosion completely destroyed the Hawthorn Unit 5 boiler.[308] Thereafter, KCPL and Babcock & Wilcox (B&W) contracted for the construction of a coal fired boiler island at the Hawthorn Unit 5 (Agreement).[309] The Agreement also required B&W to install an SCR at Hawthorn Unit 5 that would meet a guaranteed ammonia slip performance standard, while controlling NOx emissions associated with coal-fired unit operations.[310] B&W guaranteed an SCR standard of 2 parts per million (ppm) ammonia slip at 3% O_2 with 24,000

[308] KCPL-229, p. 34

[309] Id.

[310] KCPL-229, Sch. 8-1

operating hours, while controlling NOx [nitrous oxide] emissions to 0.08 lbs/mmBtu.[311] After the SCR was placed in service in June 2001, it failed to meet this standard.[312]

As a result of the failed performance standard, B&W and KCPL worked together in the attempt to resolve the issue, including B&W completing additional work in 2002.[313] Although attempts were made by B&W to adhere to the guaranteed performance standards, problems with the equipment remained through 2004.[314] In October 2004, KCPL agreed to revise and lower the performance requirements for the ammonia slip test by entering into a Memorandum of Understanding (MOU) with B&W.[315] Specifically, KCPL agreed that measurements should occur at 16,000, 20,000 and 24,000 operating hours, with the slip rate not to exceed 5 ppm at 16,000 operating hours, and 10 ppm at 20,000 operating hours.[316] Subsequently, the SCR failed to meet even the lowered operating standards and on December 12, 2007, KCPL entered into a settlement agreement with B&W for the payment of ** ** for the under performance of the SCR.[317]

ARGUMENT

At hearing, the Company's witness on this issue sponsored live and pre-filed testimony, although he could not profess he was an expert in determining the Company's cost of service, had never worked on the area of fuel or determined how fuel costs were determined in a rate

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[311] Id.

[312] KCPL-229, p. 34

[313] Id.

[314] Id.

[315] Id.

[316] KCPL-229, Sch. 8-1

[317] KCPL-229, p. 35.

case, was neither qualified as an accountant or auditor, has neither examined the Company's books and records to develop a cost of service, nor managed the Company's books and records for recording liability and asset amounts.[318] The testimony alleged that KCPL customers are not entitled to the Warranty Settlement proceeds because the proceeds represented reimbursement for purchased power and increased ammonia costs incurred by the Company, and never paid for by the customers.[319] The Company's witness relies on four points to support his position, a position that is not only disagreed to by the Staff, but in complete contradiction to the Company's earlier response in Case No. ER-2009-0089 (discussed infra). The Company witness' four points are: (1) the proceeds of this [Warranty Settlement] litigation have nothing to do with the test year in this case; (2) the cost of replacement power and additional ammonia expenses that resulted from the H5 [Hawthorn 5] catalyst outage (representing 90% of the settlement proceeds) was never paid by the customers; (3) To the extent KCP&L personnel were included in the process there would not have been any incremental costs to the Company or in turn its customers; and (4) this issue represents retroactive ratemaking, which is not appropriate, where for the Company's benefit or detriment.[320] The Staff addresses each of these issues below.

I. Damages Related to the Under Performance of the Hawthorn 5 SCR are part of the Expenses Incurred and Recorded by KCPL and Moved Below the Line During the Test Year

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[318] Tr. Vol. 34, pp. 3667-3668, 3703

[319] KCPL-229, p. 37.

[320] Id.

The issue of Hawthorn 5 SCR's under performance in this case is a continuation of the same issue in Case No. ER-2009-0089. Staff addressed the issue in its *Cost of Service Report* and again in the *Surrebuttal Testimony* of Staff witness Hyneman in Case No. ER-2009-0089. The Commission did not hear the Staff's arguments because a settlement was reached between the parties in that case. And as recognized by the Company's witness, the Stipulation and Agreement contained the standard "boilerplate language" that read as follows:[321]

> This 2009 Stipulation is being entered into solely for the purpose of disposing of Case No. ER-2009-0089. Except as expressly and specifically addressed otherwise in this 2009 Stipulation, none of the Non-Utility Signatories to this 2009 Stipulation shall be deemed to have approved, accepted, agreed, consented, or acquiesced in, including without limitation…ratemaking principle…[or] cost of service methodology or determination….

But, regardless of the last case, the Warranty Settlement proceeds are a direct result of increased capital and O&M maintenance costs from 2001 through the 2009 test year of this case, and that continue today. There are direct costs included in this case by both the Company and Staff that relate to the failure of the SCR to meet performance standards of the contract. In Case No. ER-2009-0089, Data Request No. 133, the Company states that the damage related to under performance has manifested itself in several ways, those being increased ammonia consumption, increased catalyst cleaning, increased frequency of catalyst replacement (full replacements capitalized and partial replacements expensed):[322]

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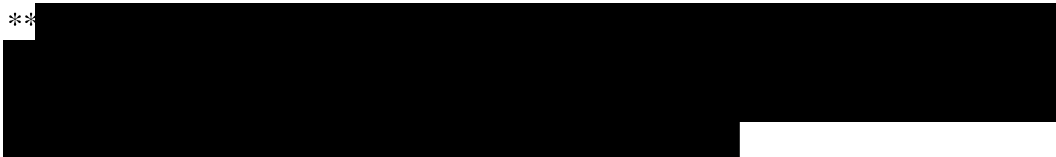

[321] Tr. Vol. 34, p. 3688.

[322] KCPL-229, p. 38.

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(emphasis added). By KCPL's own admission, the Company has incurred since 2001, and will continue to incur, increased costs for the under performance of the SCR for the life of the plant. KCPL should have reflected the proceeds as a reduction to rates at the time of the Company's receipt of the Warranty Settlement, but chose not to. Further, the Staff would have specifically reviewed the Warranty Settlement line items had the Company not removed it below the line prior to the Company's rate increase request in this case. The Commission's Report and Order should not penalize the ratepayers based on the Company's removal of the proceeds below-the-line.

II. Since 2001 Customers Have Paid In Rates the Increased Costs Incurred Due to the Under Performance of the SCR.

In addition to KCPL's admission in Data Request No. 133, the Company admitted increased costs within its response to Data Request (DR) No. 530 in Case No. ER-2009-0089. KCPL's response to DR 530 contained a *Memorandum* prepared by Company personnel to **

**[323]

The Company's response identifies the costs KCPL anticipates to incur over the life of the plant and as a direct result of the SCR's failed performance standards. The *Memorandum* estimated the Company's expected catalyst change out costs at ** **, if the SCR would have met the original contract's performance standards of up to 2 ppm ammonia slip for every 24,000 operating hours.[324] Now, KCPL is expecting its customers to absorb costs over the life of the plant ranging from ** **, costs solely due to

[323] KCPL-229, p. 39, Sch. 8

[324] KCPL-229, p. 40.

increased catalyst change outs required by the SCR's failure.[325] When additional ammonia costs and other operation and maintenance costs are included, KCPL customers will pay significantly higher costs over the life of the Hawthorn 5 boiler plant than originally anticipated.[326] And while the Warranty Settlement leaves much of the additional costs estimated by KCPL uncovered, the customers should unquestionably receive the benefit of the settlement dollars regardless of how miniscule they are. In fact, the settlement amount is a fraction of the costs KCPL has and will continue to incur to operate the SCR—costs the Company has every expectation that it will receive full recovery in rates. Yet, despite these significant cost increases, the Company's position is that its customers are not entitled to settlement proceeds.

The Company's claim that it has incurred increased costs for purchased power and fuel costs (ammonia costs) is simply incorrect. In the uncontested and unchallenged testimony of Staff on the subject of fuel and purchased power costs, Staff stated it included in this and past rate cases increased costs for fuel and purchasesd power for the failure of the SCR. In addition, maintenance costs has been increased for the SCR failure and those costs have been reflected in rates and included in this case.[327]

It is disingenuous for KCPL to argue that the Staff has not captured these increased costs in rates during any of the Company's four rate cases since 2005. The following table identifies the test year and update period for each of the three cases prior to the current case:[328]

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[325] KCPL-229, p. 40.

[326] Id.

[327] Id. at 42

[328] Id.

Case Number	Test Year	Update Period	True-Up Period	Effective Date of Rates
ER-2006-0314	Calendar Year 2005	June 30, 2006	September 30, 2006	January 1, 2007
ER-2007-0291	Calendar Year 2006	March 31, 2007	September 30, 2007	January 1, 2008
ER-2009-0089	Calendar Year 2007	September 30, 2008	March 31, 2009	September 1, 2009

The Staff clearly reflected the SCR's higher maintenance costs in the last three rate cases and ultimately in rates. The Staff also included increased plant costs in each of the last three rate cases—not just the 2009 rate case. And the Staff reflected increased replacement purchased power and additional ammonia costs for the SCR outage that occurred during the 2009 rate case test year. As such, KCPL customer's rates today reflect higher depreciation and return and it is simply incorrect for the Company's witness to infer KCPL customers have never paid for expenses related to the underperforming SCR equipment.

The Company's witness further argues that the Warranty Settlement is only for the recovery of the Company's purchased power expense during the SCR's outages. The Staff requested all documents related to the SCR settlement in Data Requests No. 133 and 530 mentioned above. As a result, the Staff received correspondence to and from B&W addressing the Company position on the SCR performance, the MOU revising the SCR performance to lower standards and the Settlement Agreement. None of these documents indicated KCPL's

intent to seek or recovery of damages for replacement power costs. Again, the documents provided KCPL's own admission that the Company sought damages for ** [redacted] **

III. KCPL Utilized Company Personnel To Obtain the Warranty Settlement for the Increased Cost Incurred Due to the Under Performance of the SCR Since 2001

As noted earlier, the Staff set rates in the last three KCPL rate cases based on the costs KCPL incurred during the test year, update, and true-up periods established in each case. The Company's witness argues that to the extent KCPL utilized Company personnel to obtain a settlement, neither the Company nor its customers incurred incremental costs for such. The statement of incremental costs is irrelevant. KCPL and B&W discussed and negotiated the SCR performance standards during the time periods covered by each of Company's rate cases identified above.[329] As such, the Staff would have included employee costs related to this issue in KCPL's cost of service.[330] As shown in KCPL's response to Data Request No. 271 in Case No. ER-2009-0089, the Company utilized a long list of senior executives and employees on the issues of Hawthorn SCR performance, litigation, settlement discussions and settlement agreement over several years.[331] KCPL's customers paid the salaries and benefits received by each of the identified executives and employees who worked towards the receipt of the Warranty Settlement.[332] KCPL's shareholders did not. The Company's response to DR No. 271 follows:

> **Question No. 0271:**
> Please provide a list of all KCPL/GPE employees who were directly or indirectly involved with the Hawthorn SCR performance issues,

[329] KCPL-229, p. 44.

[330] KCPL-229, pp. 44-45.

[331] KCPL-229, p. 45.

[332] Id.

litigation, settlement discussions and settlement agreement. For each, please describe this involvement.

Response:
Steve Easley's (Senior Vice President, Supply) involvement was lead negotiator regarding the settlement and was involved with George Burnett (Consulting Engineer, Production Engineering Services), Gerald Reynolds (Assistant General Counsel, Law Department) and Peter Vanderwarker (Senior Attorney, Law Department) in developing the "damages" KCP&L was expected to incur due to the SCR/catalyst's inability to meet its ammonia slip performance guarantee. The following individuals had indirect involvement in this process: Lora Cheatum (Vice President of Procurement, Procurement), David Price (Vice President of Construction, Construction Management) and William Riggins (Vice President of Legal and Environmental Affairs and General Counsel, Law Department).[333]

It is also reasonable for the Staff to believe additional KCPL personnel were involved in the operation and maintenance issues relating to the SCR under performance, such as Company engineers located at the corporate office, associates responsible for the Company's procurement of the additional ammonia required beyond that originally anticipated under the original SCR performance standards.[334] Regardless, the above-identified individuals or departments had first-hand knowledge and involvement in the inter-Company supplying of information on the performance of the SCR and evaluation of options for correction; all of which is relevant information analyzed by the Company and/or included in the Warranty Settlement process.

Nonetheless, there likely were incremental costs, as well as direct out of pocket costs, associated with the Warranty Settlement. The important point to recognize is that KCPL had an employee infrastructure in place to work on the Warranty Settlement, as well as other day-to-day operating tasks of the Company. Customers pay for all of these costs—not the shareholders. It is

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[333] KCPL-229, p. 45.

[334] KCPL-229, pp. 44-45.

plainly inaccurate for the Company's witness to suggest KCPL alone, without customer rate support, was responsible for the Warranty Settlement.

IV. <u>The Staff's Treatment of Costs Incurred During the Test Year and Moved Below the Line by the Company for This Case Does Not Qualify as Retroactive Ratemaking</u>

The Company witness' allegation of retroactive ratemaking, is very similar to the allegation that the proceeds of this SCR litigation have nothing to do with the test year in this case. While, the Staff agrees that the settlement proceeds were received two years prior to the 2009 test year established in this case, it does not agree for all of the reasons stated in the three (3) above arguments that this issue represents retroactive ratemaking.

KCPL received settlement proceeds as a direct result of B&W's failure to meet performance standards for the SCR. The failed performance standards have led to increased capital, operational and maintenance costs. Although the settlement was received in 2007, KCPL's customers have paid and will continue to pay for these increased capital and maintenance costs throughout the life of the plant. And as stated above, the Staff would have specifically reviewed the Warranty Settlement line items had the Company not removed them below the line prior to the Company's rate increase request in this case. For all of these reasons the Company's retroactive ratemaking theory is inapplicable and the Commission's Report and Order should not penalize the ratepayers based on the Company's removal of the proceeds below-the-line.

<u>CONCLUSION</u>

The Staff recommends that the Commission determine KCPL's rates in this case by reflecting the settlement amount received for the SCR failure as an increase to the accumulated

depreciation reserve. In the alternative, the settlement amounts could directly reduce plant in service for Hawthorn 5—this treatment will have the same effect to reduce rate base.[335]

Hawthorn Transformer Settlement

SUMMARY

The Staff's January 7, 2011 *List Of Issues* asked the Commission to consider the following issue regarding the Hawthorn Transformer Settlement (Transformer Settlement): "Should a settlement payment from defective product litigation over the Hawthorn 5 transformer be used to offset the increased costs KCPL is seeking to recover from its customers through rates in this case for the more expensive replacement transformer and the premature retirement of the defective transformer?" After the Staff's Position Statement filed January 12, 2011, and the Staff's uncontested testimony at evidentiary hearing, it remains the Staff's position that KCPL's customers paid for the costs to replace the defective transformer, in addition to increased purchased power costs for power KCPL acquired to serve customers during the Company's outage. Therefore, KCPL customers should receive the benefit of the Transformer Settlement received by the Company for the defective plant in service.

BACKGROUND

In August 2005, the generator step-up transformer on KCPL's Hawthorn Unit 5, manufactured by Siemens Power Transmission & Distribution, Inc. (Siemens), failed.[336] The first outage was from August 29, 2005, until September 29, 2005, when a temporary backup step-up transformer was installed.[337] The back-up transformer was used until KCPL received a

[335] KCPL-210, p. 11-112

[336] KCPL-217, p. 29.

[337] KCPL-217, p. 29.

new transformer to replace the Siemens transformer.[338] The second outage occurred from June 6, 2006 to June 19, 2006 when KCPL replaced the old back-up transformer with a new GE Transformer.[339] Thereafter, KCPL sued the contractors and subcontractors claiming they were responsible for the transformer failure.[340] The case settled at the end of 2007, and was finalized in 2008 with payment made to KCPL from Siemens.[341] Although, KCPL received the Transformer Settlement, the Company has not made an adjustment in its books and records to provide any of the benefit to its customers.[342] The Staff challenges this position. It is Staff's position that KCPL's customers should receive the full benefit of the settlement since they are the ones who paid higher costs for the substandard plant performance due the transformer failure.

ARGUMENT

Since the transformer's failure in 2005, customers have paid in rates the associated increased costs incurred due to the substandard plant performance On February 7, 2008, KCPL received the Transformer Settlement from Siemens in the amount of ** [redacted] **, with ** [redacted] ** as the net amount after costs incurred for the settlement.[343] Upon receipt, the Company accounted for the settlement proceeds in FERC accounts 108, 555 and 923.[344] According to KCPL's response to Data Request No. 529 in Case No. ER-2009-0089:

** [redacted]

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[338] Id.

[339] Id.

[340] Id.

[341] Id.

[342] Id.

[343] KCPL-229, p. 52-53

[344] KCPL-229, p. 52-53

**[345]

<u>The highly confidential dollar settlement distribution is identified in the following chart</u>:

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The Staff proposed treatment of the settlement proceeds be passed to customers in the 2009 rate case. However, the Commission did not hear the Staff's arguments because a settlement was reached between the parties in that case. As recognized by the Company's witness, the Stipulation and Agreement contained the standard "boilerplate language" that read as follows:

> This 2009 Stipulation is being entered into solely for the purpose of disposing of Case No. ER-2009-0089. Except as expressly and specifically addressed otherwise in this 2009 Stipulation, none of the Non-Utility Signatories to this 2009 Stipulation shall be deemed to have approved, accepted, agreed, consented,

[345] KCPL-229, p. 56.

> or acquiesced in, including without limitation…ratemaking principle…[or] cost of service methodology or determination….

But, regardless of the carry over ability of the issue from the last rate case, the Warranty Settlement proceeds are a direct result of increased capital and purchased power costs that customers have incurred staring with the 2006 rate case, and reflected in the rates paid by customers today.[346]

As testified to by KCPL's witness, the Company is opposed to any of the Transformer Settlement being reflected in rates, asserting that the customers never paid in rates any of the costs relating to the transformer failure. This simply is not so. The witness testified that besides his related recommendation in this case, he had never proposed adjustments in a rate case for fuel costs, nor had he proposed adjustments in a rate case for purchase power costs. By this lack of experience, the witness was just plain unaware that through the Staff's method of outage and purchase power calculations, increases in fuel and purchased power costs relating to the transformer failure were first reflected in rates in Case No. ER-2006-0314—the 2006 rate case.[347] Higher costs were also included in the 2007 rate case and again in the 2009 rate case.[348] Similar to the way the increase fuel and purchased power costs were included in rates for the Hawthorn 5 SCR discussed previously, these higher costs for the transformer failure were normalized in the last three rate cases.

KCPL effectively gave all the benefits from the settlement proceeds to Great Plains, while KCPL customers paid all employee-related costs of KCPL's attorneys and employees who

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[346] KCPL-229, p. 56

[347] KCPL-217, p. 30, ER-2006-0314, Report and Order at 64.

[348] KCPL-217, p. 30.

worked on KCPL's dispute with the contractors and subcontractors, increased maintenance, fuel and purchased power expense, and increased expenses that were capitalized to the new plant. All of these costs have been reflected in rates starting with the 2006 rate case. The uncontested testimony of the Staff stated that the higher costs were also reflected in the 2007 and 2009 rate cases.

By the method used by the Staff, increased fuel costs show up in Staff's model through higher Hawthorn Unit 5 outages reflected in the 2005 maintenance schedule—the 2005 time period was the test year used in the 2006 KCPL rate case.[349] In 2005, Hawthorn 5 was one of the lowest or the lowest cost fuel source of KCPL's coal-fired units.[350] Any time the Hawthorn 5 unit did not generate electricity, KCPL experienced higher fuel costs.[351] The test year in the 2006 rate case was 2005, which had the higher costs reflected in KCPL's financial statements.[352] Staff determined an average outage rate based on the Hawthorn Unit 5's maintenance schedule.[353] Since the transformer failed in August 2005, higher fuel costs existed in the 2006 rate case, with customers paying increased rates beginning January 1, 2007.[354] This position is supported by the Commission's Report and Order in the ER-2006-0314 case, where the Order states KCPL has accepted the Staff's fuel and purchased power numbers.[355] The Order also supports the Staff's position that the transformer failure resulted in increases to purchased power

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[349] KCPL-217, p. 30.

[350] Id.

[351] Id.

[352] Id.

[353] Id.

[354] Id. at 30-31

[355] ER-2006-0314, Report and Order at 64.

costs, ultimately paid for by the customers. The fall 2005 outage for the transformer failure resulted in the need to replace the lower cost Hawthorn 5 unit with not only higher cost KCPL generation but also higher purchased power costs. This cost increase was included in rates starting in January 1, 2007.

The 2007 rate case also included higher fuel and purchased power costs for the transformer failure. The 2007 rate case used a test year of 2006.[356] The new transformer was installed June 2006, so higher fuel costs through increased Hawthorn 5 outages occurred in this rate case by virtue of the use of average outage schedules in the fuel model.[357] Purchased power costs also increased because this case used the 2006 test as its basis, which included the 2007 outage to install the new transformer.[358] This cost increase was included in rates starting in January 1, 2008.[359]

Further, the 2009 rate case included higher costs for the transformer failure. The 2009 rate case used a test year of 2007.[360] The transformer failure resulted in higher fuel costs because both the 2006 and 2007 outages were included in the unit outage for the fuel model.[361] Purchased power was also impacted for the transformer failure in the 2009 because the 2007 test year was used as basis for this cost.[362] Customers started paying the higher fuel costs starting in

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[356] KCPL-217, p. 31.

[357] KCPL-217, p. 31.

[358] Id.

[359] Id.

[360] Id.

[361] Id.

[362] Id.

September 1, 2009, and will continue to pay those higher rates up through the rate change in May 2011.[363]

The 2005 transformer failure will continue to increase rates for customers even in the present day rate case. Both the 2006 and 2007 outages continue to be included in both the Staff's and the Company's outage averages used in the fuel model. These outages result in higher outage rates and therefore, higher fuel costs.

Consequently, despite repeated statements in rebuttal testimony that customers have not paid for any of the costs of the transformer failure, such is not the case. In each of the last three rate cases and now in this fourth rate case, customers have and will continue to pay for the 2006 Hawthorn 5 transformer failure. As with the Hawthorn 5 Warranty Settlement, customers have paid costs related to KCPL's recovery of the Transformer Settlement. These costs include the fuel and purchased power costs, maintenance costs, salaries and benefits, office space, and all employee-related costs of KCPL's attorneys and employees who worked on KCPL's dispute with the contractors and subcontractors. It would be unfair and unreasonable for customers to pay for all the costs associated with the transformer failure, yet receive none of the benefits from the settlements.

In addition, customers have paid higher capital costs and depreciation for the replacement transformer. According to KCPL's response to Data Request No. 366.1 in Case No. ER-2006-0314, KCPL included ** [redacted] ** in new plant in its rate base for the purchase of the new GE transformer and retired ** [redacted] ** from plant-in-service for the original

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[363] Id.

transformer.[364] At a minimum, KCPL customers were charged for additional plant of ** ██████ **[365]

Customers have also paid for the transformer from its installation in 2001, through the years of maintenance and retrofitting until its failure in 2005. The Company admitted the transformers defect and increased costs in the following data request response: ** ██████

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██████████████████████████████ — ██████████

██████████████████████ **[366] In the 2006 Case, KCPL normalized production maintenance expense using a six (6) year average of 2000-2005.[367] The costs related to the services identified above occurred during this period, and included by the Commission to set rates effective January 1, 2007, and that continue being paid in rates today.[368]

For the same reasons set forth for the Hawthorn Unit 5 Warranty Settlement, as well as the discussion of setting rates above, the Staff's treatment of the Transformer Settlement in this case is not retroactive ratemaking. But KCPL raises the argument that the proceeds received by the Company are related to the Hawthorn subrogation proceeds litigated in Case No. ER-2007-0291. What the Company fails to explain is that the subrogation proceeds received by KCPL in 2006 are distinctly different than the settlement proceeds for the failed Siemens transformer.

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[364] KCPL-229, p. 57

[365] Id.

[366] Id.

[367] Id.

[368] KCPL-217, p. 31.

KCPL recovered the costs related to the transformer failure through rates set in the last three rates cases, unlike that of the subrogation proceeds.[369]

CONCLUSION

The Staff recommends that the Commission determine KCPL's rates in this case by reflecting the settlement amount received for the transformer failure as an increase to the accumulated depreciation reserve. In the alternative, the settlement amounts could directly reduce plant in service for Hawthorn 5—this treatment will have the same effect to reduce rate base.[370]

RATE CASE EXPENSE

SUMMARY

The Staff's January 7, 2011 *List Of Issues* asked the Commission to consider the following issue regarding Rate Case Expense: "What is the appropriate amount of rate case expense that should be included in revenue requirement for setting rates?" After the Staff's Position Statement filed January 12, 2011, and the Staff's uncontested testimony at evidentiary hearing, it remains the Staff's position that rate case became a true up issue due to the delay in both KCPL and GMO providing invoices for the Staff' review of prudence and reasonableness. The Staff's direct case cannot support any level of rate case expense for several vendors because it did not receive actual invoices, originally requested in June 2010 for KCPL, and July 2010 for GMO, until November 29, 2010, after the filing deadlines for direct in both cases. Prior to that time, KCPL and GMO had only provided "face sheets" to invoices, which makes no mention of the hourly rates charged, the number of hours worked, a description of the work done and by whom,

[369] KCPL-229, p. 58.

[370] KCPL-210, p. 11-112

or any additional expenses incurred by the vendor to perform the work; information necessary for any review of prudence or reasonableness.

Within this brief, the Staff will address the issues raised in the direct case submitted. The Staff intends to file a true-up brief for this issue on March 18, 2010, to address the adjustments made after receipt and review of both Company's invoices.

ARGUMENT

The prudent and reasonable costs incurred by a utility in presenting a rate case are generally included in the Company's revenue requirement, and thus set rates. However, the "prudent and reasonable" language implies that the Staff, or any other party to the case, have an opportunity to complete a through audit of such expense before providing a recommendation to the Commission.

On June 25, 2010, the Staff requested in Data Request No. (DR) 141 all rate case expense invoices from KCPL.[371] On July 12, 2010, the Company response stated that "…[t]o provide all invoices is a voluminous request. If a specific vendor invoice or invoices is required, please advise."[372] Staff followed up with DR 141.1 on September 3, 2010, for rate case invoices over $5,000 for a more narrow review.[373] KCPL responded on September 23, 2010, but only provided the "face sheets" of a significant amount of legal invoices, which were insufficient and incomplete.[374]

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[371] Ex. KCP&L-291, KCP&L-231, p. 27

[372] Id.

[373] KCP&L-231, p. 27

[374] Id., KCP&L-292

Staff submitted yet another data request, DR 141.2, on November 3, 2010, to obtain invoices previously requested from the Company back in July 2010.[375] The DR requested complete invoice support for the vendors: Morgan Lewis & Bockius, Pegasus Global Holdings, Schiff Hardin, and Stinson Morrison & Hecker.[376] At that time, the listed vendors took priority due to the level of expense paid by KCPL when compared to the other vendors.[377] Due to the lack of support, the expenses from the listed vendors comprised the Staff's $1.7 million adjustment to rate case expense in the November 10, 2010 *Cost of Service Report*.[378] KCPL later provided the invoices on November 29, 2010.[379]

After a review of the invoices provided by the Company in response to DR 141.1, on November 24, 2010, the Staff was required to expanded its scope to "all rate case invoices over $1,000" in DR 141.3 to obtain all rate case invoices covered by its June 2010 request.[380] KCPL eventually provided the legal invoices requested on December 30, 2010, **(six) 6 months** after the Staff's initial request.[381] KCPL's delay in providing the Staff with the requested discovery placed the Staff in a difficult situation at the end of the pre-filed direct case. Finally, the Staff was in possession of the invoices requested from the Company six (6) months prior, and telling is the fact that this request produced no objection or assertion of privilege, But the six (6) month

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[375] KCP&L-231, p. 28

[376] Id.

[377] Id.

[378] Id.

[379] Id.

[380] Id.

[381] Id.

delay gave the Staff six (6) days to audit the invoices and recommend a level of prudent and reasonable amount of rate case expense to the Commission.

As for GMO, on July 20, 2010, the Staff requested all rate case expense invoices in DR 154.[382] On August 9, 2010, GMO responded that " …[t]o provide all invoices is a voluminous request. If a specific vendor invoice or invoices is required, please advise."[383] Staff then submitted DR No. 154.1 on November 16, 2010, to narrow GMO's review for rate case invoices over $5,000.[384] GMO responded to this DR on December 3, 2010.[385] In the response, GMO provided only "face sheets" for a significant amount of legal invoices, which are insufficient and incomplete for the Staff to complete a review for reasonableness and prudence.[386]

On December 18, 2010, the Staff submitted yet another data request, DR 154.2, to obtain copies of the invoices originally requested in July 2010, and to which the GMO should have provided in response to DR 154.1.[387] Staff received invoice support for GMO's rate case expense on December 30, 2010, **over five (5) months** after the initial request.[388] Again, telling is the provision of the invoices without objection or assertion of privilege, and leaving the Staff only six (6) days to audit the invoices and recommend a level of prudent and reasonable amount of rate case expense for GMO to the Commission.

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[382] GMO-230, p. 25

[383] Id.

[384] Id.

[385] Id.

[386] Id.

[387] GMO-230, p. 26

[388] GMO-230, p. 26-27.

For the Company's witness to state they provided face sheets to the Staff in a timely manner is covering up the real issue in the case; that is, the lack of the timely provision of invoices to the Staff for review. Even both the Company's witnesses on this issue testified at the evidentiary hearing that they would not pay on behalf of the Companies an amount owed to a vendor based off a face sheet.[389] And that the Company reviews the invoice and other supporting materials before making payments for vendor services.[390] Face sheets are nothing more than cover sheets that vendors attach to invoices for service, and only provide a summary of the services supplied and the lump sum due for said services.[391]

During a Staff review of expenses for reasonableness and prudence, face sheets are problematic because they make no mention of hourly rates, hours worked and by which vendor employee, a description of the work performed, and any additional expenses incurred by the vendor to complete the service(s).[392] The Staff cannot even begin a review for reasonableness and prudence from such sheets.[393] As an example, GMO's December 3, 2010, response to DR 154.1 stated "…see the attached CD for all invoices over $5,000 as requested."[394] As part of the response, the Company submitted a "Check Request."[395] The Company's witness testified that a check request is just a request sent by the legal department to the accounting department

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[389] Tr. Vol. 34, p. 3623, 3653 at lines 14-24.

[390] Tr. Vol. 34, p. 3623, 3654 at lines 5-13.

[391] GMO-230, p. 26

[392] Id.

[393] Id.

[394] Id.

[395] Id.

requesting they cut a check for payment to a specific vendor.[396] That step occurs after face sheets, invoices, and other information reviewed as support of vendor costs are examined by the Company. The Staff would need that same information as the Company before it could begin any review for expense prudence or reasonableness.

For this rate case, KCPL and GMO procured legal services from no less than nine (9) vendors, all of whom charged to Missouri rate case expense.[397] The following table is a list of legal vendors that the Staff is aware of:

DUANE MORRIS
FISCHER & DORITY
MORGAN LEWIS & BOCKIUS LLP
POLSINELLI SHALTON FLANIGAN SUELTHAUS PC
SCHIFF HARDIN LLP
SKADDEN ARPS SLATE MEAGHER & FLOM LLP
SONNENSCHEIN NATH & ROSENTHAL LLP
SPENCER FANE BRITT & BROWNE LLP
STINSON MORRISON HECKER LLP

[396] Tr. Vol. 34, p. 3653 at lines 1-4

[397] KCP&L-231, p.29, GMO-230, p. 28

During the cross examination on rate case expense, Company witness Weisensee identified two external counsel and two internal counsel present for KCPL and GMO.[398]

In KCPL's rate case before the Kansas Corporation Commission (KCC)[399], the KCC took issue with KCPL's level of rate case expense.[400] Even the KCC underwent difficulty in obtaining the necessary detailed information to make a review of the charges by specific consultants and attorneys that the Company sought to recover.[401] The KCC noted that"[t]he attempt to determine rate case expense is hampered by a lack of detailed information in the record…Because that detailed information is not contained in this record, *the Commission has considered denying recovery of all rate case expense in this proceeding*."[402] (emphasis added).

In its review, the KCC identified several vendors whose work was not fully documented and excluded such expenses from rate case expense.[403] Further, the KCC found the expenses requested for Schiff Hardin "particularly troubling."[404] The hourly rate charged by Schiff Hardin in the KCC case exceeded those for experienced attorneys in the Kansas City metropolitan area.[405] And while the KCC noted the case contained complex issues concerning the construction of a major generating facility, it found it "unreasonable to require ratepayers to be responsible for the entire rate case expense costs being sought by KCPL."[406]

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[398] Tr. Vol. 35, pp. 3629-3632

[399] KCC Docket No. 10-KCPE-415-RTS

[400] KCPL-231, Sch pp. 5-11 to 5-14.

[401] KCPL-231, Sch p. 5-11, 5-14.

[402] KCPL-231, Sch p. 5-8

[403] KCPL-231, Sch p. 5-11

[404] KCPL-231, Sch p. 5-13

[405] Id.

[406] Id.

The KCC did not include any expenses for NextSource as KCPL could not explain why its own employees could not perform the work of this vendor.[407] The KCC disallowed expenses from The Communication Counsel of America and Duane Morris as unjust and unreasonable.[408] The Communication Counsel trained KCPL witnesses for hearing.[409] While the KCC noted witness preparation as important, "such preparation is routinely part of the service counsel performs before a hearing."[410] For the Duane Morris expenses, the KCC record described the firm as providing rate case legal research to KCPL, but with no attorney participating in the rate case proceeding.[411] As noted by the KCC, "[t]his firm may have advised management during this proceeding, but it was not an active participant in the docket."[412] As such, the KCC found those expenses unjust and unreasonable.[413] Finally, the KCC noted the duplicative nature of Ms. Barbara Van Gelder's services of the firm Morgan Lewis & Bockius.[414] The KCC found that KCPL retained Ms. Van Gelder to cross examine one particular Staff witness, but that four (4) capable attorneys for KCPL were in the hearing room while she did so.[415] The KCC reasoned "KCPL is free to decide how it will present its case, but this firm's involvement clearly duplicated work being performed by other very capable attorneys. Allowing expenses for Morgan Lewis to be recovered from ratepayers in rate case expense would be unjust and

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[407] KCPL-231, Sch p. 5-11

[408] Id.

[409] Id.

[410] Id.

[411] KCPL-231, Sch p. 5-12

[412] Id.

[413] Id.

[414] Id.

[415] Id.

unreasonable."[416] All four of these vendors have also charged Missouri rate case expense for similar services, for which the Company seeks to recover in the current case.

In making its decision, the KCC stated that "[i]n deciding to take this course, the Commission has concluded that the amount of rate case expense established in this Order for KCPL to recover from its ratepayers will be Interim Rate Relief.[417] The KCC estimated total rate case expense costs of $7.2 million, and of this amount, $5 million was estimated for legal services alone.[418] The KCC concluded that $4.5 million was an appropriate amount of rate case expense for recovery by KCPL.[419]

The table below is KCPL and GMO's projected rate case expense deferral through the remainder of the ER-2010-0355 and 0356 cases:[420]

Company	**Total**
KCPL	**7,214,541**
MPS	**2,073,235**
L&P	**1,744,890**
Total 2010 Rate Case	**$ 11,032,666**

[416] Id.

[417] KCPL-231, Sch p. 5-9.

[418] KCPL-231, Sch p. 5-9 and 5-10.

[419] KCPL-231, Sch p. 5-14

[420] GMO-230, p. 27

These above totals are for the 2010 rate cases only. They are significantly higher than the prior rate case expense deferrals:[421]

Company	Total
KCPL	**1,045,991**
MPS	**280,801**
L&P	**187,412**
Total 2009 Rate Case	**$ 1,514,203**

The Staff submitted data requests for invoice support for rate case expenses that have increased **to over seven times the prior cases expenses**, but has not received a significant number of invoices, particularly for legal expenses.[422] Given the significant delay in receiving complete invoices, the Staff could not determine the prudence and reasonableness of KCPL's and GMO's rate case expenses, and thus recommended disallowances. The significant delays in essence, made this issue into a true up issue. The Staff could not have tried this issue in the "direct case" as the Company did not provide a reasonable amount of time for the Staff to review and file any substantive testimony on the issue. For the Commission to accept KCPL's and GMO's position in its Report and Order would be to awarded the Companies for inappropriate behavior, while penalizing the rates payers who will bear the brunt of any significant increase in costs allowed.

[421] GMO-230, p. 27

[422] GMO-230, p. 28

CONCLUSION

It is anticipated that between the Missouri and Kansas jurisdictions, KCPL will seek the recovery of approximately $18 million in rate case expense. And even conceding the complex nature of the proceedings, one must be particularly struck by the level of rate case expense requested from the ratepayers. An anticipated $11 million between KCPL and GMO in Missouri. And it is unreasonable for the Company to expect the Staff to audit rate case expense at such a large magnitude on one-twenty fifth (1/25) of the time when compared to Staff's original discovery requests of the Companies.

If the Staff could have tried this issue as part of the direct case, it certainly would have. But it couldn't. Even the KCC stated in its Report and Order that "**Staff noted an adjustment for rate case expense could not be reasonably estimated at the time Staff's testimony was filed and stated these costs can be trued-up later in the proceeding.**"[423] The Commission should not reward the Companies for their inappropriate behavior, while in effect penalizing the ratepayers who will bear the brunt of any significant increase in costs allowed. And for the above-stated reasons, the Staff requests that the Commission allow this matter to be fully briefed by the parties during the true-up portion of this case. In the alternative, the Commission should disallow rate case expense for lack of expense support as originally proposed by Staff witness Majors in his rebuttal and surrebuttal testimonies for both the KCPL and GMO cases.[424]

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[423] KCPL-231, Sch p. 5-5.

[424] KCPL-230, KCPL-231, GMO-229, GMO-230.

DEMAND SIDE MANAGEMENT

KCPL

a. Should KCPL be required to fund its demand-side programs and, if so, at what level?

Staff's position: Yes. KCPL should continue to fund all DSM programs in its Regulatory Plan and in its last adopted preferred Integrated Resource Plan (IRP) at the levels established within those filings to achieve all cost effective demand-side savings.

b. Should KCPL be ordered to continue to fund and promote or implement each of the DSM programs in its Regulatory Plan and in its last adopted preferred resource plan, unless it has filed with the Commission documentation that explains why continuing, or initiating the program as planned, does not promote the Missouri Energy Efficiency Investment Act goal of achieving all cost-effective demand-side savings?

Staff's position: Yes. With the enactment of MEEIA, the State of Missouri made it state policy to value demand-side investments equal to traditional investments in supply and delivery infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs. The Company's Regulatory Plan and IRP contained DSM programs. Until the Company can establish that these programs are no longer cost-effective, the Company is required by law to comply with MEEIA and fund and promote or implement each of the DSM programs.

1. Should the Commission require KCPL to expand its DSM programs if the current DSM portfolio does not meet the Act's goal of achieving all cost-effective demand-side savings?

Staff's position: Yes. The Company has not established that its DSM portfolio meets MEEIA's goal of achieving all cost-effective savings. Until then, the Company is required by law to comply with MEEIA and fund and promote or implement each of the DSM programs within the portfolio. However, regardless of whether the Company's current DSM portfolio meets MEEIA's goals, the Company is required to achieve all cost-effective demand-side savings and implement any new plan outside the current portfolio that does such.

GMO

a. Should GMO be required to fund its demand-side programs and, if so, at what level?

> Staff's position: Yes. GMO should fund all DSM programs in its last adopted preferred Integrated Resource Plan (IRP) at the levels established within those filings to achieve all cost effective demand-side savings.

b. Should GMO be ordered to continue to fund and promote or implement each of the demand-side management programs in its last adopted preferred resource plan, unless it has filed with the Commission documentation that explains why continuing, or initiating the program as planned, does not promote the Missouri Energy Efficiency Investment Act goal of achieving all cost-effective demand-side savings? (Rogers)

> Staff's position: Yes. With the enactment of MEEIA, The State of Missouri directed that it shall be the policy of the state to value demand-side investments equal to traditional investments in supply and delivery infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs. The Company's filed IRP contained DSM programs. Until the Company can establish that these programs are no longer cost-effective, the Company is required by law to comply with MEEIA and fund and promote or implement each of the DSM programs.

> i. Should the Commission require GMO to expand its DSM programs if the current DSM portfolio does not meet the Act's goal of achieving all cost-effective demand-side savings?
>
> Staff's position: Yes. The Company has not established that its DSM portfolio meets MEEIA's goal of achieving all cost-effective savings. Until then, the Company is required by law to comply with MEEIA and fund and promote or implement each of the DSM programs within the portfolio. However, regardless of whether the Company's current DSM portfolio meets MEEIA's goals, the Company is required to achieve all cost-effective demand-side savings and implement any new plan outside the current portfolio that does such.

COMBINED KCPL AND GMO ARGUMENTS

The "Missouri Energy Efficiency Investment Act" (MEEIA) was established in Senate Bill 376 and became law on August 28, 2009. With the passage of Senate Bill 376 and the enactment of MEEIA, the State of Missouri has declared and directed the following:

> 3. It shall be the policy of the state to value demand-side investments equal to traditional investments in supply and delivery infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs. In support of this policy, the commission shall:
>
> (1) Provide timely cost recovery for utilities;
>
> (2) Ensure that utility financial incentives are aligned with helping customers use energy more efficiently and in a manner that sustains or enhances utility customers' incentives to use energy more efficiently; and
>
> (3) Provide timely earnings opportunities associated with cost-effective measurable and verifiable efficiency savings.
>
> 4. The commission shall permit electric corporations to implement commission-approved demand-side programs proposed pursuant to this section *with a goal of achieving all cost-effective demand-side savings.* Recovery for such programs shall not be permitted unless the programs are approved by the commission, result in energy or demand savings and are beneficial to all customers in the customer class in which the programs are proposed, regardless of whether the programs are utilized by all customers. The commission shall consider the total resource cost test a preferred cost-effectiveness test. Programs targeted to low-income customers or general education campaigns do not need to meet a cost-effectiveness test, so long as the commission determines that the program or campaign is in the public interest. Nothing herein shall preclude the approval of demand-side programs that do not meet the test if the costs of the program above the level determined to be cost-effective are funded by the customers participating in the program or through tax or other governmental credits or incentives specifically designed for that purpose.

Subsections 393.1075.3 and 4, RSMo. Supp. 2009. After the passage of MEEIA, the Staff organized a stakeholder process including a series of workshops to obtain stakeholder input and propose rules in compliance with MEEIA (File No. EW-2010-0265).[425] Regardless of whether or not these proposed rules become effective, utilities subject to the Commission's jurisdiction must abide by Missouri state laws, including MEEIA.[426]

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[425] KCPL-210, p. 129.

[426] KCPL-239, p. 4.

In KCPL's last Chapter 22 Electric Utility Resource Planning filing (Case No. EE-2008-0034), KCPL's adopted preferred integrated resource plan (IRP) included five residential DSM programs and four commercial and industrial programs[427].

__This chart is highly confidential in its entirety__

**

**

These programs are in addition to KCPL's Energy Optimizer and MPower programs that it implemented as part of its EARP.[428]

[427] Kansas City Power & Light Integrated Resource Plan, Case No. EE-2008-0034, Book 1 of 2, Volume 5: Demand-Side Resource Analysis, pages 54 through 69.

As part of GMO's Chapter 22 compliance filing (EE-2009-0237), GMO's adopted preferred integrated resource plan included the following DSM programs:[429]

Programs	Life (Years)	TRC	NPV Net Benefits (1)
Change A Light (2)	3	5.06	** **
Home Performance with Energy Star (2)	5	1.36	** **
Low-Income Weatherization (2)	4	0.99	** **
Low-Income Affordable New Homes (2)	5	1.67	** **
Energy Star New Homes (2)	5	1.86	** **
Building Operator Certification (2)	5	1.36	** **
Energy Optimizer (2)	20	4.92	** **
Mpower (2)	20	4.15	** **
Appliance Turn-In	5	2.24	** **
Blue Line	3	4.13	** **
Cool Homes (2)	5	2.70	** **
Energy Star Products (2)	5	4.44	** **
On-Line Audit (2)	5	12.37	** **

[428] KCPL-239, p. 6.

[429] GMO-240, p. 14.

C&I Custom Rebate	5	3.49	** [redacted] **
C&L Prescriptive Rebate	5	3.19	** [redacted] **
Total			** [redacted] **

(1) Net Present Value (NPV) of Total Resource Cost (TRC) test (over the life of program and program measures) = NPV benefits less NPV costs = NPV total avoided costs less NPV total program costs less NPV participants' costs plus NPV program incentives.

(2) Original tariffs approved in 2008

Despite the success and forward momentum created by the implementation of their DSM programs, both KCPL and GMO have expressed a position to slow spending for the programs.[430] This decision comes even though both companies realize that they, as well as the ratepayers, stand to benefit from continuing efforts to achieve more DSM programs and improved DSM penetration.[431] And in the case of KCPL, increasing DSM funding is preferred to curtailing program spending when evaluating the need for additional supply-side resources over the next 25 years.[432] During its Customer Programs Advisory Group (CPAG) meetings throughout 2010, KCPL stated to Staff that it had stopped processing new customer applications for its voluntary large customer MPower demand response program.[433] During the similar DSM Advisory Group

[430] KCPL-239, p.6, GMO-240, p. 12.

[431] KCPL-239, p. 6-7, GMO-240, p .15

[432] KCPL-239, p. 7

[433] KCPL-239, p. 6

meetings held for GMO in 2010, GMO also made statements regarding the curtailing of current DSM programs and delaying implementation of planned DSM programs.[434]

Both KCPL's and GMO's curtailing of DSM programs goes directly against MEEIA's statutory mandate to "implement commission-approved demand-side programs proposed pursuant to this section *with a goal of achieving all cost-effective demand-side savings.*" While, the companies argue that an appropriate cost recovery mechanism must be in place to pursue the DSM programs, both have failed to recommend in these rate proceedings what they consider to be an "appropriate" cost recovery mechanism.[435] In fact, in their direct filings both KCPL and GMO only requested the continuation of their current cost recovery mechanisms.[436]

The State of Missouri has determined the future direction of DSM. Both KCPL and GMO are presently required by MEEIA to have the goal of achieving all cost-effective demand-side savings. The language of MEEIA allows KCPL and GMO to propose a different method of recovery regardless of whether specific Commission rules are in place or not. Companies' witness Rush admitted this during cross examination.[437] He also admitted that neither company has filed reasoning in either case to suggest that the companies' preferred DSM programs are no longer cost effective.[438] Yet the companies have failed to implement all DSM programs to date, and have affirmatively stated that they will not do so without the "appropriate" cost recovery mechanisms.

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[434] GMO-240, p. 12.

[435] KCPL-239, p. 5, GMO-240, pp 13-14, GMO-241, p. 3. KCPL-240, p. 3

[436] KCPL-239, p. 5, GMO-240, pp 13-14

[437] Tr. Vol. 32, p.3547, line 1-4.

[438] Tr Vol. 32, p. 3551, lines 17-24, p. 3552, lines 16-20.

To allow the companies to talk out both sides of their mouths (one side saying it is necessary to have an appropriate cost recovery mechanism, while the other says it chooses not to recommend a new recovery mechanism in this case) would be a detriment to Missouri ratepayers. Staff recommends the Commission issue an order directing both KCPL and GMO to comply with the MEEIA goal of achieving all cost-effective demand-side savings by: 1) filing with the Commission written documentation for each DSM program in the EARP and in its last adopted preferred integrated resource plan explaining why continuing or adding the programs as planned does not promote the MEEIA goal of achieving all cost-effective demand-side savings; or 2) continuing to fund and promote, or implement, the DSM programs in the EARP and in its last adopted preferred resource plan. [439]

DEMAND SIDE MANAGEMENT PROGRAM AMORTIZATION EXPENSE

KCPL

c. Does KCPL's Regulatory Plan require the return on KCPL's demand-side management program costs authorized in this case be the allowance for funds used during construction rate specified in the Regulatory Plan or should they be treated as a rate base item in this proceeding?

Staff's position: Apply the AFUDC rate. In EO-2005-0329, the signatories agreed to, and the Commission approved a Stipulation and Agreement (Agreement) setting forth an Experimental Regulatory Plan (Regulatory Plan) for KCPL. The Regulatory Plan at page 53, Paragraph 10 (f), states "[w]hen approved and adopted by the Commission, this Agreement shall constitute a binding agreement among the Signatory Parties hereto. The Signatory Parties shall cooperate in defending the validity and enforceability of this Agreement and the operation of this Agreement according to its terms." The Regulatory Plan established a return on the Company's DSM program costs at the Allowance for Funds Used During Construction (AFUDC) rate. Since KCPL stipulated to this rate along with other signatories to the Agreement, KCPL is bound by the terms therein and to which the signatories obligated themselves to carry out.

[439] KCPL-239, GMO-240, GMO-241, KCPL-240

d. Should the amortization period for the energy efficiency regulatory asset account be shortened from 10 years to 6 years?

Staff's position: No. In EO-2005-0329, the signatories agreed to, and the Commission approved a Stipulation and Agreement (Agreement) setting forth an Experimental Regulatory Plan (Regulatory Plan) for KCPL. The Regulatory Plan at page 53, Paragraph 10 (f), states "[w]hen approved and adopted by the Commission, this Agreement shall constitute a binding agreement among the Signatory Parties hereto. The Signatory Parties shall cooperate in defending the validity and enforceability of this Agreement and the operation of this Agreement according to its terms." The Regulatory Plan established an amortization period of ten (10) years for the energy efficiency regulatory asset account. Since KCPL stipulated to this rate along with other signatories to the Agreement, KCPL is bound by the terms therein and to which the signatories obligated themselves to carry out.

i. Should the shortening of the amortization period be contingent on KCPL's continuation and/or expansion of its DSM portfolio, if required by the Commission?

Staff's position: No. As part of the EO-2005-0329 Agreement, the Company stipulated to a ten (10) year amortization period for costs part of the energy efficiency regulatory asset account and remains obligated to carry out the Agreement's terms.

e. How should demand-side amortization expense be determined?

Staff's position: The Regulatory Plan in EO-2005-0329 established an amortization period of ten (10) years for the energy efficiency regulatory asset account. Since KCPL stipulated to this treatment and rate for "return on" the program costs, the Company is bound by the terms of the Agreement and obligated to carry them out.

ARGUMENT

In the Stipulation and Agreement that KCPL, Staff and OPC (among other parties) signed in the Experimental Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329 ("EARP"), KCPL made commitments in regard to certain Demand Response, Efficiency and Affordability Programs.[440] *Among other things, these commitments related to the creation of a*

[440] KCPL-226, p. 60

regulatory asset for the stated programs, the amortization of that asset, and the financial return the Company can earn on that asset. The specific commitments made by KCPL are reflected in the language of the EARP at pages 43 and 49, shown below, respectively: [441]

> (v) Demand Response, Efficiency and Affordability Programs. The 2009 Rate Case will also include the amortization related to the Demand Response, Efficiency and Affordability Programs, as more fully described in Paragraph III.B.5 below. The Signatory Parties agree not to contest the continuation of this amortization in the 2009 Rate Case on any basis other than KCPL's failure to prudently implement the Demand Response, Efficiency and Affordability Programs described in Paragraph III.B.5 below.
>
> KCPL will accumulate the Demand Response, Efficiency and Affordability Program costs in regulatory asset accounts as the costs are incurred. Beginning with the 2006 Rate Filing, KCPL will begin amortizing the accumulated costs over a ten (10) year period. *KCPL will continue to place the Demand Response, Efficiency and Affordability Program costs in the regulatory asset account, and costs for each vintage subsequent to the 2006 Rate Filing will be amortized over a ten (10) year period.* Signatory Parties reserve the right to establish a fixed amortization amount in any KCPL rate case prior to June 1, 2011. *The amounts accumulated in these regulatory asset accounts shall be allowed to earn a return not greater than KCPL's AFUDC rate.* The class allocation of the costs will be determined when the amortizations are approved.

(emphasis added). The EARP also contained language establishing the binding effect of the negotiated settlement.[442] Paragraph 10 (f) at page 53 states "[w]hen approved and adopted by the Commission, this Agreement shall constitute a binding agreement among the Signatory Parties hereto. The Signatory Parties shall cooperate in defending the validity and enforceability of this Agreement and the operation of this Agreement according to its terms."[443] As such, KCPL agreed to accumulate the costs of certain DSM programs in an asset account, to amortize the account over a ten (10) year period to earn a return not greater than KCPL's AFUDC rate.

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[441] KCPL-226, p. 60

[442] KCPL-226, p. 61

[443] Id.

The company failed to propose any changes to the terms of the EARP within its direct case; "[t]he Company has not taken any action in this filing beyond what is currently in place and was established in the Regulatory Plan" and "….the Company is not seeking to change the cost recovery mechanism in its initial filing."[444] However, KCPL proposed changes to the accepted ratemaking treatment of the DSM deferrals within its rebuttal testimony. KCPL now proposes the following:

1. Change KCPL's current amortization period for the DSM regulatory asset from 10 years to 6 years for DSM costs deferred after to September 30, 2008.
2. Include the unamortized balance of DSM deferrals in rate base for actual expenditures booked to the DSM regulatory asset up through December 31, 2010.
3. Starting on December 31, 2010, calculate the AFUDC rate of return applicable to the DSM regulatory asset on a monthly basis by using the monthly value of the annual AFUDC rate.[445]

The Commission should not allow KCPL to unilaterally change the provisions of the EARP which was entered into by numerous parties. KCPL's' proposals clearly contradict the agreed to treatment of the regulatory asset, the amortization of the asset, and the financial return on the asset.[446] It is not clear why KCPL would pick and choose selected components of the EARP that it feels no longer applies, and provide no support as to why it believes this so.[447] Staff is not aware of any party to the case taking the position that the terms and conditions of the EARP have expired.[448] As such, the EARP remains in effect through this case and it is improper

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[444] Id.

[445] KCPL-226, p. 61

[446] Id. at 61-62.

[447] Id. at 62

[448] Id.

for KCPL to propose being "excused" from the terms and conditions of a contract they obligated themselves to carry out.

To determine the appropriate amortization and return amounts, Staff netted various components to calculate KCPL's "net" investment in DSM deferrals and amortized this net investment.[449] Staff could set up and keep track of these separate cost items, but this would be cumbersome and inefficient.[450] Staff's method does not require KCPL to make any changes to its books and records; Staff merely reflected this netting in its own work papers.[451] Although KCPL takes issue with the Staff's methodology, it has proposed no reasoning as to why the Staff's accounting results in an inappropriate ratemaking calculation or adjustment in this rate case.[452] In fact, Staff cannot discern any substantive basis for KCPL's position on this issue.[453]

Staff recommends the Commission accept Staff's ratemaking calculations for DSM deferrals and AFUDC returns in Staff Adjustments E-144.4 through E-144.7, and E-144.8 through E-144.11.[454] Staff included annual amortizations (10-year deferral period) for the following DSM vintage deferrals:[455]

DSM deferral	Case	Amount
Vintage 1	ER-2006-0314	$239,666
Vintage 2	ER-2007-0291	$448,624

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[449] KCPL-226, p. 63

[450] Id.

[451] Id.

[452] KCPL-226, p. 63

[453] KCPL-226, p. 63

[454] KCPL-225, As updated in true up

[455] KCPL-225, As updated in true up.

Vintage 3	ER-2009-0089	$193,663
Vintage 4	ER-2010-0355	$1,810,223

At December 31, 2010, the total unamortized balance of DSM Vintages 1 through 4 was $24,368,761.[456] The AFUDC rate Staff applied to this unamortized DSM balance was 3.46%, and is KCPL's December 2010 AFUDC rate.[457] The AFUDC return amount totals $843,159 million, for a total increase in revenue requirement from DSM deferrals of approximately $3.5 million.[458]

III. KCP&L -- GMO COMMON ISSUES

1. Demand-Side Management

a. Should DSM investments be included in rate base in this proceeding?

c. How should DSM amortization expense be determined in this case?

e. Should the Company be required to fund DSM programs at the current level?

f. Should KCP&L be required to make a compliance filing with the Commission regarding MEEIA legislation as proposed by Staff?

3. Cost of Capital:

a. Return on Common Equity: What return on common equity should be used for determining KCP&L's rate of return?

INTRODUCTION

[456] KCPL-225, As updated in true up

[457] KCPL-225, As updated in true up

[458] KCPL-225, As updated in true up

The rate of return is the profit opportunity allowed to the utility's shareholders. It is often the highest value issue in controversy in a rate case. The Due Process Clause requires that the shareholders be allowed an opportunity to earn a reasonable return on their investment.[459] Pursuant to financial theory, a fair rate of return is an amount sufficient to meet the utility's capital costs. For this reason, the rate of return is considered to be equivalent to the Weighted Average Cost of Capital ("WACC").

The WACC is computed by multiplying a ratio reflecting the proportion that each capital component constitutes of the whole by its cost and summing the results. For all components except common equity, the cost is "embedded," that is to say, historical. The cost of debt and the cost of preferred equity are easily ascertained from the instruments in question and are usually not controversial.[460] The cost of common equity, also referred to as the return on equity (ROE), however, is a matter of expert analysis and testimony and is inevitably controversial.

In this case, the Commission has heard testimony from three cost-of-capital experts who offered three different opinions of the appropriate value to select for the ROE. Those experts, and their recommendations, are:

Expert	Party	Recommendation[461]
Hadaway[462]	KCPL-GMO	10.75%[463]
Gorman[464]	Industrials	9.65%

[459] ***Utility Consumers Council,*** *supra,* 585 S.W.2d at 49.

[460] This case, of course, is the exception that proves the rule. The cost of debt is also in controversy in this case.

[461] Midpoints.

[462] Hadaway Rebuttal Testimony, p. 23.

[463] With 25-basis point adder, worth about $7 million.

[464] Gorman Direct Testimony, p. 37.

Murray[465]	Staff	9.00%

As indicated in the reconciliation filed in this case, the issues involving rate of return and capital structure are worth about $29 million.

RETURN ON EQUITY

The cost of common equity capital must be estimated. This is a difficult task, as academic commentators have recognized.[466] It is said that this "is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony."[467] The evaluation of expert testimony is left to the Commission, which "may adopt or reject any or all of any witness's [sic] testimony."[468]

The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must be met in setting the cost of common equity.[469] In the earlier of these cases, ***Bluefield Water Works***, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[470]

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[465] Murray Direct Testimony.

[466] Phillips, *supra*, at 394; Goodman, supra, 606.

[467] Goodman, *supra*, 606.

[468] **State ex rel. GS Technologies Operating Company, Inc. v. Public Service Commission of Missouri,** 116 S.W.3d 680, 690 (Mo. App., W.D. 2003); **State ex rel. Associated Natural Gas Company v. Public Service Commission,** 37 S.W.3d 287, 294 (Mo. App., W.D. 2000) (quoting **State ex rel. Associated Natural Gas Company v. Public Service Commission,** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985)).

[469] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[470] ***Bluefield***, *supra,* 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

In the same case, the Court provided the following guidance as to the return due to equity owners:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[471]

The Court restated these principles in ***Hope Natural Gas Company***, the later of the two cases:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[472]

From these two decisions, three guiding principles can be discerned:

(1) An adequate return is commensurate to the returns realized from other businesses with similar risks.

(2) An adequate return is sufficient to maintain the utility's credit and to enable it to obtain necessary capital.

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[471] *Id.,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

[472] ***Hope***, *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

(3) An adequate return is sufficient to assure confidence in the financial integrity of the utility.

The first of these principles requires a comparative process. The return on common equity set by the Commission must be about as much as investors would realize from other investments with similar risks. The second principle, simply stated, refers to the effect of the PSC's decision on the utility's credit rating. If the Commission's decision will not cause it to drop, then the utility's credit is maintained and its ability to attract capital is unimpaired. The third principle is forward-looking: confidence in a utility's financial integrity refers to the expectation that the utility will continue in business in the future, meeting its obligations as they come due, providing safe and adequate service to its customers, and yielding a fair return to its shareholders. The requirements imposed by this parameter necessarily vary with economic conditions. For example, a higher return on equity in troubled times, when the cost of money is higher due to general uncertainty, or when a utility faces a period of heightened risk, as KCPL did while building Iatan. When, as now, the period of heightened risk has ended, the Commission should reduce its ROE award to normal levels.

Two principal methods have emerged for determining the cost of common equity: these are the "market-determined" approach and the "comparable earnings" approach.[473] The market-determined approach relies upon stock market transactions and estimates of investor expectations.[474] Examples of market-determined methods are the Discounted Cash Flow method ("DCF") and the Capital Asset Pricing method ("CAPM").[475] The comparative earnings

[473] Phillips, *supra,* 394.

[474] *Id.*

[475] *Id.*

approach is a comparative method and relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use.[476] The comparative earnings approach requires a comparative study of earnings on common equity in both regulated and unregulated enterprises of similar risk.[477]

Another often-encountered method that does not fall within the boundaries of either of the principal approaches referred to above, is the Risk Premium method. This method is "relatively straightforward" and requires that the analyst "(1) determine the historic spread between the return on debt and the return on common equity, and (2) add this risk premium to the current debt yield to derive an approximation of current equity return requirements."[478]

In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements.[479] "If the total effect of the rate order cannot be said to be unjust or unreasonable, judicial inquiry is at an end."[480] "It is the impact of the rate order which counts; the methodology is not significant."[481] Within a wide range of discretion, the Commission may select the methodology.[482] The Commission may select its methodology in determining rates and make

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[476] *Id.,* at 397.

[477] *Id.,* at 397-98.

[478] *Id.,* at 399.

[479] ***State ex rel. Arkansas Power & Light Company v. Missouri Public Service Commission,*** 736 S.W.2d 457, 462 (Mo. App., W.D. 1987); ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

[480] ***Hope***, *supra,* 320 U.S. at 602, 64 S.Ct. at 287, 88 L.Ed. 345 at ___ .

[481] **State ex rel. GTE North, Inc. v. Public Serv. Commission,** 835 S.W.2d 356, 361, 371 (Mo. App., W.D. 1992).

[482] ***Missouri Gas Energy v. Public Service Commission***, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; ***State ex rel. Associated Natural Gas Company v. Public Service Commission***, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); ***State ex rel. Missouri Public Service Company v. Fraas***, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981).

pragmatic adjustments called for by particular circumstances.[483] It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company.[484] "No methodology being statutorily prescribed, and ratemaking being an inexact science, requiring use of different formulas, the Commission may use different approaches in different cases."[485] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[486] "Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."[487]

THE APPROPRIATE COST OF CAPITAL FOR KCPL and GMO

Staff's opening statement on this issue made certain points:

- The United States is emerging from a severe recession. As a result, projected economic growth is expected to be on the low side for the next few years.
- Economists generally expect the long-term GDP growth rate to be in the 4-5% range, approximately 2% of which is attributed to inflation.
- The Fed Funds rate, which affects short-term debt costs, is at an all-time low.
- Recent utility bond yields on investment-grade debt have dropped to levels not experienced in the last 40 years.
- In view of the well-known relationship between the cost of debt and the cost of equity, the points set out above imply a fairly low cost of equity.

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[483] ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

[484] ***State ex rel. City of Lake Lotawana v. Public Service Commission***, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

[485] ***Arkansas Power & Light,*** *supra,* 736 S.W.2d at 462.

[486] ***Federal Power Commission v. Natural Gas Pipeline Company***, 315 U.S. 575, 586, *62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50* (1942).

[487] *Id.*

Staff's case on cost of capital is simple and straightforward and is based on the few points set out above. Under present conditions, with the nation emerging from a recession, the economy is sluggish. Growth is not robust, and is not expected to be robust in the near future. The growth rate that drives Mr. Hadaway's recommendation is mythical, unreal, unattainable and unsustainable. The Commission cannot rationally award a ROE based on analyses driven by a wildly inflated growth rate. It's just that simple.

Staff's analyses used a growth rate of 4-5% in its Constant Growth DCF analysis and 3-4% in the final stage of its Multi-Stage DCF analysis. Mr. Hadaway, by contrast, used 6% in his analyses, based on his calculation of the expected growth in the Gross Domestic Product (GDP). Mr. Hadaway's view of expected growth is not widely shared.

In attempting to provide a fair estimation of a perpetual growth rate, Staff examined a variety of information and found Staff's proposed rates consistent with the following items:

- The expected long-term growth in electricity demand, plus inflation.[488]
- The "Rule of Thumb": a rough estimate of the current cost of equity calculated by adding a 3-4% risk premium to the cost of long-term debt. In this case, the "rule of thumb" suggests a cost of common equity in the range of 8.14%-9.71%.[489]
- The perpetual growth rate used by Goldman Sachs when performing DCF analyses of regulated electric companies, which is 2.5%.[490]
- The implied perpetual growth rates used by financial advisors hired by Aquila to provide an opinion on a fair price to pay for the GMO properties and included by these advisors in publically-available documents filed

[488] Staff points out that the Commission examined this approach in the last AmerenUE case and did not accept this reasoning. ***In the Matter of Union Electric Company d/b/a AmerenUE,*** Case No. ER-2010-0036 (***Report & Order,*** issued May 28, 2010) pp. 18-19. Staff repeats it here because it is, in fact, a good indicator of the growth that KCPL and GMO may expect.

[489] David Murray, *Surrebuttal Testimony* (Case No. ER-2010-0355), p. 5.

[490] *Id.,* p. 9.

with the SEC.

- Sagent Advisors, Inc., used an implied perpetual growth rate of 1.79%.
- Credit Suisse used an implied perpetual growth rate of 1.0%-1.7%.

Staff offers these items as corroboration of its growth rate estimate, not as alternative analyses. Because Staff's ROE recommendation is generally the lowest presented in a rate case, Staff is often subjected to undeserved criticism and frank disbelief, as though Staff was somehow fudging its numbers to reach a low result. Nothing could be farther from the truth.[491] Staff is very aware of the "credibility gap" that its recommendations face. For that reason, Staff goes the extra mile in seeking out evidence that corroborates its positions, which are always offered as the "best regulatory practice" for the Commission's consideration.

Two additional areas of corroboration are important. Staff also found a presentation made by Goldman Sachs, when hired by GPE as a Joint Book Running Manager in conjunction with its May 2009 issuance of common equity. According to the Goldman Sachs presentation, delivered to GPE's Board of Directors on April 6, 2009, its implied cost of equity estimate for the electric utility industry is closer to ** [redacted] **[492]

The last area of corroboration is GDP. While Staff doesn't particularly care for the use of GDP, the Commission expressed a preference for this growth rate proxy in the last AmerenUE case.[493] If the Commission does want to use GDP, Staff strongly urges the Commission to use a reliable and independent measurement of long-term GDP growth. One such measure is provided

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[491] *Id.,* p. 16.

[492] *Id.,* at pp. 21-22.

[493] ***In the Matter of Union Electric Company d/b/a AmerenUE,*** Case No. ER-2010-0036 (***Report & Order,*** issued May 28, 2010) pp. 18-19.

by the Congressional Budget Office (CBO). CBO currently estimates long-term GDP growth to be approximately 4.5 percent (4.5%).[494] GPE itself uses this discount rate outside of the regulatory context, for example, in assets impairment testing and in doing so describes the CBO data "as one of the best published views of go forward growth and inflation." However, Dr. Hadaway uses of a self-calculated measure of GDP equaling six percent (6%).

CONCLUSION

The recommendations of Staff witness Murray and Industrial Intervenors' witness Gorman are both below 10.00% and are not so very far apart at 9.00% and 9.65%. The "outlier" is Samuel Hadaway's recommendation, for the Companies, of 10.75%. That very high recommendation is driven entirely by Mr. Hadaway's subjective growth rate of 6.00%. No evidence supports the notion that investors expect KCPL and GMO to enjoy that rate of growth. Staff therefore urges the Commission to set the value of the ROE of KCPL and GMO at 9.00%.

Eric Dearmont and Kevin A. Thompson

b. Capital Structure: What capital structure should be used for determining the rate of return? Should GPE's equity-linked convertible debt be included in KCP&L's capital structure, and if so at what interest rate?

Staff suggests the following ratios of capital components:[495]

Component	KCPL	GMO
Long Term Debt	48.57	48.87
Preferred Equity	0.61	--
Equity Units	4.52	4.55
Common Equity	46.30	46.58

[494] Murray, *supra,* p. 15 and Schedule 3. This compares well with the consensus economists' projections of 4.75% cited by Mr. Gorman, Surrebuttal at 9-10.

[495] Murray, *True-up Direct Testimony* (Case Nos. ER-2010-0355 and ER-2010-0356).

Staff suggests these component values:

Component	KCPL	GMO
Long Term Debt	6.825	6.36
Preferred Equity	4.29	--
Equity Units	11.14	12.35
Common Equity	9.00	9.00

It is Staff's position that the cost of long-term debt of The Empire District Electric Company should be used as a proxy for GMO's cost of long-term debt to protect ratepayers from the effects of Aquila's legacy debt. GMO does not agree.

c. <u>High-end of ROE Request</u>: Should KCP&L and GMO be awarded the high end of their requested ROE's based on Customer Service and Reliability achievements, as awarded by JD Power and Associates?

Summary: No. The Staff's position is that KCP&L and GMO customers already pay for all aspects of the award-winning service they receive. The Shareholders and the Companies do not deserve what is, in effect, a gift in the form of a higher ROE, above and beyond what has been determined by the Commission to be just and reasonable. Furthermore, Staff is of the opinion that KCP&L has actually shown out-of-the ordinary declines in service performance in the recent past.

The Staff does not support awarding the companies the high end of their requested ROEs based on "Customer Service and Reliability Achievements," for three reasons: (1) Customers pay for all aspects of Customer Service they receive; the companies determine, dictate and control the level of service performance they will offer, and customers are subsequently billed for it; (2) neither company has stellar service and, in fact, both have demonstrated areas of service decline in recent history; (3) awarding the high-end of the ROE based on "customer satisfaction and reliability achievements" is a slippery slope.

Staff's first reason for not supporting this request is that KCPL and GMO customers already pay, in rates, all costs associated with the provision of electric service.[496] The companies acknowledge that the rates customers pay include rent for office space, employee salaries, the companys' utility bills, the paper the bills are printed on, customer service systems, etc.[497] customers also pay the costs related to KCPL and GMO winning the J.D. Power award.[498] The companies are now asking customers to pay all the costs to provide utility service, and an additional amount—in this case a 25 basis point increase to the midpoint of their proposed rate of return—over and above their costs to serve these customers, what company witness Alberts characterizes as an "incentive."[499] Though later questioning confused his response, during cross-examination Mr. Alberts agreed an ROE at the top end of Dr. Hadaway's ROE range would require customers to pay more for customer service that it costs the companies to provide that service.[500]

Customers of Missouri regulated utilities have no choice between "basic" service, "award" winning service, or "poor" service, and it would be unreasonable to force them to pay an incentive to the companies for a point-in-time award.. Furthermore, if granted, once the ROE is in rates there is no guarantee that KCPL and GMO would continue providing their "award-winning" level of service. When questioned in a Staff data request whether or not they would refund a higher ROE to their customers should service decline, the companies were coy in their

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[496] Ex. KCPL-227 and Ex. GMO-266, Rebuttal Testimony of Lisa Kremer.

[497] Transcript, Vol. 29, January 28, 2011, p. 2930-2931).

[498] Staff Ex. KCPL 227, Kremer Rebuttal, p. 17.

[499] KCP&L Ex. 3. Surrebuttal of Jimmy D. Alberts, p. 2.

[500] Transcript, Vol. 29, January 28, 2011, p. 2943.

response, indicating that they would have to evaluate the root causes of the declines.[501] Should the Commission accept the companies' ROE request, Staff and others will be forced to consider proposing for the return of such an award should the companies' JD Power and other award positions slip. Further, there is no mechanism to take such a reward out of rates once they are included. Giving the companies the high-end of their ROE request based on customer service and reliability achievement would, in effect, be asking customers to pay more in rates than it costs to serve them, more than is just and reasonable, and should not be allowed.

The second reason that Staff does not support awarding KCPL or GMO the high-end of their requested ROE based on customer satisfaction and reliability achievements, is that neither company's customer service is stellar. Staff is concerned that these awards make comparisons between companies that have different regulatory demands, weather patterns, operating characteristics, managements, managerial philosophies, and customer bases, and that it is far more appropriate to compare KCPL and GMO against their own past performance. Aside from celebrating their awards, neither company has demonstrated to Staff that it is providing its customers with any manner of superior service quality, and therefore should not be rewarded for their "achievements."[502]

Certain levels of reliability and customer service are expected and required of regulated utilities, and while neither KCPL nor GMO are currently performing below those levels, both have demonstrated service quality declines. For example, GMO's Call Center performance has

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[501] Staff Ex. KCPL 227, Staff witness Kremer Rebuttal p. 14, (Referencing Data Request No. 279).

[502] Staff Ex. KCPL 227, Kremer Rebuttal p. 20. (Response to Data Request No. 275).

declined.[503] "At the present time, Staff is of the opinion that GMO's call center performance is within an acceptable range; however, its call center performance does not rise to the level that was experienced by GMO customers even a few years ago…"[504] This statement is supported by Schedule 4 of Staff witness Kremer's rebuttal testimony which shows that from 2007 to 2010, GMO's Abandoned Call Rate (ACR) trending upward, Average Speed of Answer (ASA) is also trending upward, and the number of calls Offered to Customer Service is trending downward.[505]

Another example of decline is KCPL's dramatic increase in customer complaints, a 48 percent increase from 2008 to 2010.[506] KCPL attempts to explain away its increasing level of customer complaints as being a product of the current economic recession, and insinuating that all companies have had an increase in complaints in difficult economic times.[507] However this explanation does not hold water here in Missouri, as Staff witness Lisa Kremer indicated in her hearing testimony, in fact, KCPL was the only company to see such a dramatic increase in customer complaints. "If I calculated this correctly, they [KCPL] are actually 48 percent higher in residential complaints from 2010 to 2008. Empire has declined. Ameren has I would say remained relatively constant. GMO, a little bit of increase."[508]

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[503] Staff Ex. GMO 226, Kremer Rebuttal p. 23.

[504] *Id.*, lines 12-15.

[505] *Id.* Schedule 4.

[506] Transcript, Vol. 29, January 28, 2011, p. 2962.

[507] KCP&L Ex. 3. Surrebuttal of Jimmy D. Alberts, p. 5, Transcript, Vol. 29, January 28, 2011, p. 2962, (Question posed to Staff Witness Lisa Kremer, "And in terms of customer complaints, would it be fair to say that customer complaints increased for all utilities from 2009 to 2010?"

[508] Transcript, Vol. 29, January 28, 2011, p. 2962.

Furthermore, neither company has seen an improvement in reliability over the last several years, as stated by Staff witness Greg Brossier, both KCPL's and GMO's reliability, "has had no significant trends upward or downward over the past five years," which means their reliability has not gotten any better or any worse.[509] While this may be an accomplishment of sorts, Staff believes that reliability is a portion of the safe and adequate service required by law, and in no way demands recognition in the form of a higher ROE or a 25 basis points adder.

Lastly, the Staff recommends the Commission reject the request for the high-end of the ROE, because awarding a high ROE based on such "achievements," would be a slippery slope. KCPL and GMO have already received significant recognition for their JD Power and EEI awards in publicity, trophies, and banners. The critical fact to remember is that KCPL and GMO customers have paid for the companies' participation in JD Power and for every aspect of service that supported the companies' awards in the first place.[510] If the Commission gives both KCPL and GMO the ROE reward they seek in these cases, next time they come in for a rate case, they are going to be looking for another reward, and another, and another. Then what happens? Do not be surprised when the utility companies insist upon rewards and incentives, too. It is not just and reasonable for a utility company to demand that its customers pay more in rates so it feels rewarded and incentivized to continue doing well. Missouri regulated utilities are incentivized to perform well and to strive to improve performance by the fact of having a dedicated service territory in which they serve captive customers that have little if any control in the service they

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[509] Staff Exs. GMO--213, p. 6, and KCPL--213, p. 5.

[510] Staff Ex. KCPL 227, Kremer Rebuttal p. 17.

receive.[511] The Commission should not award KCPL or GMO the high-end of their requested ROEs based on "Customer Satisfaction and Reliability Achievements."

5. <u>Fuel & Purchased Power Expense:</u>

a. How should natural gas costs be determined?

d. How should spot market purchased power prices be determined?

Staff urges the Commission to rely upon Staff's method for determining spot market purchased power prices because, unlike the companies' method, it is based on historical test year data.[512] The Commission traditionally uses a historical test year for ratemaking and has done so in this case. The companies' forecasting method is a violation of the Commission's historical test year ratemaking method and should be rejected. The Commission did not adopt a forecast test year in this case.

Staff employs a statistical calculation based upon the historical weather adjusted loads and the truncated normal distribution curve to represent the hourly purchased power prices in the spot market.[513] Staff obtained the actual hourly non-contract transaction prices from the companies and used this data in its calculation.[514] Staff used the combined data from both KCPL and GMO to reflect the market that exists in this region.[515] Staff's method yields a spot energy

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[511] Staff Ex. KCPL 227, Kremer Rebuttal p. 6.

[512] Erin L. Maloney, *Rebuttal Testimony* (Case No. ER-2010-0356), pp. 1-2.

[513] Staff's Revenue Requirement Cost of Service Report (Case No. ER-2010-0355), pp. 77-78; (Case No. ER-2010-0356), pp. 84-85; Maloney, *supra*.

[514] *Id.*

[515] *Id.*

price for each hour of the year.[516] This data set, containing 8,760 hourly spot energy prices, is then used as one of the inputs to Staff's production cost model.[517]

The companies' MIDAS method is not based on the historical test year data, but on forecast data.[518] The companies used forecasted loads, forecasted fuel prices and a "host of other forecasted inputs."[519] While Staff relies upon historical, factual data, the Companies rely upon forecasts that are "only as good as the input assumptions."[520] The companies' method adds "another level of possible inaccuracy"[521] and should be rejected.

b. How should Wolf Creek fuel oil expense be determined? (KCP&L only).

There is no longer any dispute between Staff and KCPL concerning fuel oil is used at the Wolf Creek Nuclear Plant.

c. Should Missouri Joint Municipal Electric Utility Commission (MJMEUC) margin be included in native load and off-system sales margins? (KCP&L only).

Yes. KCPL witness Michael Schnitzer has testified repeatedly that he included the former MJMEUC megawatts as being available for sale in his off-system sales model. Staff finds that difficult to believe given the puny level of sales forecast by Mr. Schnitzer.

7. Merger Transition Costs:

What is the appropriate amount of merger transition costs to include in rates in this case?

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[516] *Id.*

[517] *Id.*

[518] Maloney, *supra.*

[519] *Id.,* pp. 1-2.

[520] Crawford, *Direct Testimony* (Case No. ER-2010-0356), p. 4.

[521] Maloney, *supra,* p. 2.

Staff's Position: No. KCPL and GMO should not include acquisition transition costs in the cost of service. KCPL and GMO have already recovered these costs through retained synergies by means of regulatory lag.

Staff presented substantial and competent evidence that the acquisition transition costs have been more than fully recovered by KCPL and GMO. On April 4, 2007, GPE, KCPL and Aquila filed an application with the Commission seeking authority for a series of transactions whereby Aquila would become a direct, wholly-owned subsidiary of GPE. On July 1, 2008, in Case No. EM-2007-0374, the Commission approved the series of transactions authorizing GPE to acquire Aquila. On July 14, 2008, GPE closed the acquisition.

In its Order in that matter, the Commission stated that it "will give consideration to their [transition costs] recovery in future rate cases making an evaluation as to their reasonableness and prudence. At that time, the Commission will expect that KCPL and Aquila demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service in future rate cases".[522]

Transition costs are "…costs incurred to successfully coordinate and integrate the utility operations of KCP&L and GMO. These costs are necessary to achieve the synergy savings that are reflected in KCP&L's test year cost of service that will be flowed-through to customers in rates effective as a result of this case. These costs include non-executive severance cost for employees terminated as a result of the merger, facilities integration costs, and incremental third-party and non-labor expenses incurred to support the integration of the companies."[523]

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[522] *Report and Order, Case No. EM-2007-0374, Footnote 930.*

[523] Ex No. KCP&L 35. *Direct testimony of Darrin Ives, page 4 lines 10-17.*

The Commission, in its Report and Order, specifically addressed the ratemaking value of the transition costs:

> 13. Nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.
>
> 14. The Commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.[524]

KCPL's argument for direct recovery through the cost of service hinges upon the language of Footnote 930 in the acquisition Report and Order. KCPL wants the Commission to believe that it is bound by a value for ratemaking; this has not been established in the Report and Order in the acquisition case.

KCPL and GMO utilized two approaches for looking at synergy savings. One is the annual level of savings, comparing baseline-adjusted 2006 Non-Fuel Operation & Maintenance (NFOM) costs with 2009 NFOM costs, which the company has interpreted is the way the Commission ordered in its Report and Order in Case No. EM-2007-0374. The other approach, the synergy project charter database method the company created, is more detailed.[525]

The Staff performed an analysis of both the Commission ordered synergy savings tracking model and KCPL-created synergy project charter database.[526] In examination of the latter, the excess regulated retained synergies over recoverable transition costs is ** [redacted] ** as of September 1, 2009, before any savings were passed on to customers.[527]

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[524] *Report and Order, Case No. EM-2007-0374, page 284.*

[525] (*Tr. 3492:24-25 and Tr. 3493:1-18 and Tr. 3494:23-25 and Tr.3495:1-3*)

[526] Ex. No. KCP&L 230, *Rebuttal testimony of Keith Majors, pages 7 line 14-page 8*

[527] *Ibid, page 12.*

KCPL asserts that it has yet to recover its transition costs through synergy savings.[528] KCPL wants the Commission to grant a double recovery of transition costs based on the fact that annual synergy savings exceed the amortized transition costs, a fact which Staff does not dispute.[529] However, to endorse this fact and ignore all other evidence that the transition costs have been recovered would be unjust, unreasonable, to the detriment of Missouri ratepayers.

KCPL agrees with Staff that it would be unreasonable to recover transition costs that were recovered through retained synergies by means of regulatory lag.[530] Staff has maintained that those costs have been recovered and provides uncontroverted evidence throughout its testimony to that effect. KCPL, GMO and GPE shareholders have received benefits from the acquisition of Aquila since July 2008. Because of regulatory lag, they will continue to enjoy this benefit for over 33 months until the full value of the synergies are reflected in rates on May 4, 2011, and June 4, 2011, for KCPL and GMO, respectively.[531] These synergies are reflected in Staff witness Majors' surrebuttal testimony, as set forth below[532]:

The following table is considered "<u>Highly Confidential</u>" in its entirety.

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[528] (*Tr. 3476: 6-23*)

[529] Ex. No. KCP&L 230, *Rebuttal testimony of Keith Majors, pages 7 line 19-page 8 line 4*

[530] (*Tr. 3471:4-9*)

[531] Ex. KCP&L 230, *Keith Majors Rebuttal testimony, ER-2010-0355, page 6.*

[532] Ex. KCP&L 231, *Keith Majors Surrebuttal testimony, ER-2010-0355, page 8.*

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In addition Mr. Majors shows that the balance of savings will be further skewed in the company's favor if the Commission were to authorize the company to reflect the amortization in the cost of service:[533]

The following table is considered "<u>Highly Confidential</u>" in its entirety.

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Regulatory lag benefits shareholders because they were receiving through the cost of service from July 14, 2008, costs which they were not incurring or paying out which is the very nature of synergies, and rates will not reflect the full value of those synergies until May of 2011. For 33 months, shareholders will have retained substantially all of the synergies related to the

[533] Ex. KCP&L 231, *Keith Majors Surrebuttal testimony, ER-2010-0355, page 13.*

acquisition of Aquila, above and beyond the transition costs to achieve those synergies. As those costs have been retained through regulatory lag it would be unreasonable for KCPL and GMO and GPE to recover transition costs again.[534]

Staff also performed an analysis of the Administrative & General (A&G) expenses for KCPL and GMO, and other electric utilities in the region.[535] The results of Staff's uncontroverted analysis shows that KCPL and GMO, on a combined company basis, have the highest A&G expenses per customer, per megawatt hour sold, and per dollar of operating revenue.[536] KCPL and GMO, while enjoying significant benefits through synergy savings, have not flowed a comparable amount of savings to its regulated electric utility operations.[537]

The question before the Commission is whether or not to allow KCP&L and GMO, and consequently GPE shareholders, a double recovery of the transition costs relating to the acquisition of Aquila. Substantial and competent evidence in the record as a whole supports the fact that those costs have already been recovered. KCPL and GMO have not denied that shareholders have overwhelmingly benefitted far greater than the ratepayers from the acquisition of Aquila. It is unreasonable to allow KCPL and GMO to recover these costs twice.

Therefore, the Staff believes that the Commission's Report and Order should contain the following finding of fact: KCPL and GMO are not entitled to include acquisition transition cost in their cost of service, because these cost have already been recovered.

10. <u>Rate Case Expense</u>:

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[534] (*see Tr3497:10-19*)

[535] Ex. KCP&L 231, *Surrebuttal testimony of Keith Majors, page 16 lines 7-11*

[536] *Ibid, page 16, line11 through page 17, line 10*

[537] *Ibid, lines 5-7*

What is the appropriate level of rate case expense to include in this proceeding?

12. <u>Advanced Coal Tax Credit</u>:

Should the Commission allocate a portion of KCP&L's advanced coal credit to GMO?

13. <u>Advanced Coal Tax Credit</u>:

Should fees incurred in the advanced coal credit arbitration case be recoverable?

<u>SUMMARY</u>

The primary issue concerning the advanced coal tax credits is the imprudence of GMO in not pursuing a portion of the $125 million of advanced coal tax credits the Internal Revenue Service awarded for Iatan 2. Had it done so, it is Staff's position that, like the outcome of The Empire District Electric Company's arbitration with KCPL where it was awarded a share of the credits in proportion to its ownership interest in Iatan 2, GMO would have received a $26.5 million share of those credits and, therefore, $26.5 million of credits should be imputed to it.

A secondary issue is the impropriety of including in the cost of service of KCPL the costs KCPL incurred in disputing the efforts of the other joint owners of Iatan 2, except GMO, to obtain a share of the $125 million advanced coal tax credits the Internal Revenue Service awarded for Iatan 2. Those efforts were successful only for the federal income taxpaying challenger, The Empire District Electric Company; however, GMO also pays federal income taxes.

<u>SHARING OF ADVANCED COAL TAX CREDITS WITH KCP&L GREATER MISSOURI OPERATIONS COMPANY</u>

In August 2006 KCPL applied to the Department of Energy and the Internal Revenue Service for advanced coal tax credits for Iatan 2, but was denied. On October 30, 2007, KCPL, after successfully lobbying for an amendment to make the Iatan 2 project eligible for the advanced coal tax credits, again applied to the Department of Energy and the Internal Revenue Service for advanced coal tax credits for Iatan 2. This time, on April 28, 2008, (before Great Plains Energy acquired Aquila on July 14, 2008) the Internal Revenue Service accepted the application and allocated $125 million of advance coal tax credits for Iatan 2. Subsequently, on August 26, 2008, (after Great Plains Energy acquired Aquila) the Internal Revenue Service and KCPL entered into a memorandum of understanding regarding the $125 million of advanced coal tax credits, and on February 6, 2009, the Internal Revenue Service certified KCPL's advanced coal tax credit application.[538]

On October 31, 2008, after Great Plains Energy had acquired Aquila, Inc. (which it subsequently renamed KCP&L Greater Missouri Operations Company) on July 14, 2008, both GMO and The Empire District Electric Company filed applications with the Internal Revenue Service seeking advanced coal tax credits for Iatan 2.[539] The Internal Revenue Service denied both applications indicating that the full $125 million of credits available for the Iatan 2 plant project had already been awarded to KCPL.[540]

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[538] Ex. KCP&L—210, Staff Cost of Service Report, p. 178; Ex. KCP&L—223, Harrison surrebuttal testimony, Sch. 1-3; Ex. GMO—222, Harrison surrebuttal testimony, Sch. 1-3; Ex. KCP&L—223, Harrison surrebuttal testimony, Sch. 3-5 to 3-6; Ex. GMO—222, Harrison surrebuttal testimony, Sch. 3-5 to 3-6.

[539] Ex. KCP&L—223, Harrison surrebuttal testimony, p. 10; Ex. GMO—222, Harrison surrebuttal testimony, p. 11.

[540] Ex. KCP&L—223, Harrison surrebuttal testimony, p. 11; Ex. GMO—222, Harrison surrebuttal testimony, pp. 12-13.

On October 9, 2008, The Empire District Electric Company notified KCPL of a controversy regarding the advanced coal tax credits.[541] On November 21, 2008, KCPL, by a letter signed by William H. Downey, President and Chief Operating Officer, responded to The Empire District Electric Company's notice of controversy stating KCPL's opinion that it had no obligations toward The Empire District Electric Company regarding the advanced coal tax credits.[542] On July 10, 2009, The Empire District Electric Company provided KCPL written notice to arbitrate its entitlement to a portion of the $125 million advanced coal tax credits the Internal Revenue Service had awarded to KCPL.[543] On July 15, 2009, the Missouri Joint Municipal Electric Utility Commission ("MJMEUC") gave a similar notice.[544] And on July 17, 2009, Kansas Electric Power Cooperative, Inc. ("KEPCO") gave its written notice to arbitrate.[545] GMO, newly acquired by the parent of KCPL and run by KCPL employees, the only other joint owner of Iatan 2, gave no similar notice to arbitrate.

In the final arbitration award, issued December 30, 2009, the three arbitrators unanimously stated the following:

[541]Ex. KCP&L—297, pp. 1-2, October 9, 2008 letter from Anderson & Byrd to Kansas City Power & Light Company.

[542] Ex. KCP&L—297, pp. 6-8, November 21, 2008 letter from Downey to Gipson.

[543] Ex. KCP&L—210, Staff Cost of Service Report, p. 178; Ex. GMO—210, Staff Cost of Service Report, p. 189; Ex. KCP&L—297, pp. 9-11.

[544] Ex. KCP&L—210, Staff Cost of Service Report, p. 178; Ex. GMO—210, Staff Cost of Service Report, p. 189; Ex. KCP&L—295.

[545] Ex. KCP&L—210, Staff Cost of Service Report, p. 178; Ex. GMO—210, Staff Cost of Service Report, p. 189; Ex. KCP&L—296.

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Iatan 2 is jointly owned as follows: KCPL (54.71%), GMO (18%), The Empire District Electric Company (12%), Kansas Electric Power Cooperative, Inc. ("KEPCO") (3.53%), and Missouri Joint Municipal Electric Utility Commission ("MJMEUC") (11.76%).[547] The $17,712,500 awarded to The Empire District Electric Company is based on its ownership share

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[546] Ex. KCP&L—223, Harrison surrebuttal testimony Sch. 1-3 TO 1-5; Ex. GMO—222, Harrison surrebuttal testimony Sch. 1-3 TO 1-5; Ex. KCP&L—210, Staff Cost of Service Report, p. 179; Ex. GMO—210, Staff Cost of Service Report, p. 189-90.

[547] Ex. KCP&L—223, Harrison surrebuttal testimony p. 5 and Sch. 1-1; Ex. GMO—222, Harrison surrebuttal testimony p. 5 and Sch. 1-1.

of Iatan 2 among the federal taxpaying entities as follows: $125 million x 12% / (54.71% + 18% + 12%). Therefore, it is reasonable to impute to GMO a share of the $125 million advanced coal tax credits on the basis of its ownership share for purposes of establishing just and reasonable rates for the retail customers of GMO. When that adjustment is made for the cost of service of GMO a matching adjustment must be made to the cost of service of KCPL. The appropriate adjustment for GMO is a tax credit of $125 million x 18% / (54.71% + 18% + 12%), which equals $26.5 million.[548]

In compliance with the arbitration award, KCPL and The Empire District Electric Company sought and obtained approval from the Internal Revenue Service to a sharing of the $125 million advanced coal tax credits based on their respective ownership shares so that KCPL gets credits of $107,287,500 and The Empire District Electric Company gets credits of $17,712,500.[549] When further adjusted for sharing $26.5 million of the credits with GMO, KCPL is left with advanced coal tax credits of $80,787,500. Since Great Plains Energy and its affiliates, including GMO and KCPL, file consolidated federal income tax returns, there was no benefit or detriment to the shareholders of Great Plains Energy if GMO obtained a share of the $125 million in advanced coal tax credits; however, how those tax credits are shared by GMO and KCPL affects their respective costs of service and, therefore, the rates that will be charged to their respective Missouri retail customers.

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[548] Ex. KCP&L—223, Harrison surrebuttal testimony p. 13; Ex. GMO—222, Harrison surrebuttal testimony p. 15; Ex. KCP&L—210, Staff Cost of Service Report, p. 179; Ex. GMO—210, Staff Cost of Service Report, p. 190.

[549] Ex. KCP&L—223, Harrison surrebuttal testimony Sch. 3-1 to 3-11; Ex. GMO—222, Harrison surrebuttal testimony Sch. 3-1 to 3-11; Ex. KCP&L—30, Hardesty rebuttal testimony, pp. 8-9; GMO—18, Hardesty rebuttal testimony, pp. 8-9.

To qualify for the advanced coal tax credits, the owners of Iatan 2 had to build a state of the art generating facility with currently available technology for clean emissions. The pollution control equipment to attain these clean emissions is very costly. Each owner is responsible for paying its share of all of the costs to construct, maintain and operate this power plant, and, as the arbitrators recognized, each is entitled to the benefits that go with those costs.

Like The Empire District Electric Company and its retail customers, the retail customers of GMO will pay for GMO's share of the costs of Iatan 2 through rates. KCPL, through the actions and inactions of its employees is, as it did with The Empire District Electric Company, attempting to deprive the retail customers of GMO of any benefit from the advanced coal tax credits. As stated earlier, based on its ownership share, GMO's cost of service should reflect $26.5 million in advanced coal federal income tax credits and KCPL's cost of service should reflect advanced coal tax credits of $80,787,500. Staff has made the appropriate adjustments in both cases.

KCPL is amortizing the advanced coal tax credits over an estimated 50-year life of Iatan 2.[550] Through the testimony of KCPL's Senior Director of Taxes, Melissa Hardesty, both KCPL and GMO argue that if the Commission imputes advanced coal tax credits to GMO by shifting them from KCPL it will violate IRS investment tax credit normalization rules that would subject both companies to the risk of having to repay past investment tax credits.[551] That risk is real, but not as foregone as the companies make it seem. Since the IRS did not approve the advanced coal tax credit attributable to Iatan 2 until April 28, 2008, the earliest calendar tax year consolidated

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[550] Ex. KCP&L—63, Weisensee direct testimony, pp. 33-34.

[551] Ex. KCP&L—30, Hardesty rebuttal testimony, pp. 9-12; Ex. GMO—18, Hardesty rebuttal testimony, pp. 9-13.

federal income tax return that included both KCPL and GMO where any of that credit could have been taken is 2007. Federal income tax returns for 2007 and subsequent years where advanced coal tax credits were claimed still may be amended. Therefore the straits in which KCPL has put itself with regard to advanced coal tax credits are not as dire as it paints them.

Regardless of the severity of their risk of losing or repaying investment tax credits, this Commission should not determine retail customer rates on the basis of adverse consequences that flow from imprudent decisions. However, to the extent it helps KCPL to extricate itself from the situation it has put itself into regarding advanced coal tax credits and to the extent it has the authority to do so, Staff suggests the Commission order KCPL and GMO to apply to the IRS for an amendment of its latest MOU to allow GMO to obtain a share of the Section 48A tax credits equal to $26,500,000.

Additionally, KCPL incurred $456,647 in legal fees in the test year to arbitrate the advanced coal tax credit. Staff has proposed an adjustment to remove that amount from the test year. KCPL has incurred additional legal fees to appeal the arbitrators' decision. The evidence will show that none of the legal fees incurred in the failed attempt to deny The Empire District Electric Company its share of the tax credit have benefitted or will benefit ratepayers.

COSTS OF DISPUTING THE RIGHTS OF OTHER IATAN 2 JOINT OWNERS TO ADVANCED COAL TAX CREDITS

As stated above, in the unanimous arbitration award where the panel ordered KCPL and The Empire District Electric Company to apply to the IRS for an amendment of the MOU between the IRS and KCPL that would allow The Empire District Electric Company to obtain a share of the $125 million of advanced coal tax credits equal to $17,712,500, the panel stated the following:

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KCPL's Missouri retail electric customers should not bear the imprudent costs KCPL incurred in defending itself for conduct as egregious as that of Aquila when Aquila proceeded to build South Harper despite a Court Order that to do so violated Cass County's zoning ordinance. Staff requests this Commission disallow these costs from the cost of service of KCPL so that its retail customers do not pay in their rates these imprudent legal expenses KCPL has incurred in defending its actions regarding the Internal Revenue Code Section 48A Qualifying Advanced Coal Project Tax Credits that led to arbitration and filing of one or more lawsuits. When Staff

filed surrebuttal testimony in File No. ER-2010-0355 on January 5, 2011, those legal expenses totaled $617,240.[552]

LOW INCOME WEATHERIZATION

Should KCPL and GMO continue to fund their low income weatherization programs at the current levels of funding?

Staff's position: Yes

If so, should the funds continue to be administered under current procedures or should the Commission order they be deposited into an account with the Environmental Improvement and Energy Resources Authority (EIERA) to be administered by EIERA and MDNR?

Staff's position: The funds should be deposited into an account with the EIERA to be administered by EIERA and MDNR.

[Low Income Weatherization] programs [are] designed to help low income customers with energy conservation. The Low Income Weatherization Program is administered by the Missouri Department of Natural Resources (MDNR) using federal, state and utility funding. The Weatherization Program is administered locally by Community Action Agencies or other local agencies (Weatherization Agencies).[553]

In the Stipulation and Agreement in Case No. EO-2005-0329, KCPL agreed to contribute ** [redacted] ** to weatherization agencies. The funding as budgeted by GMO has been underutilized.[554] The Missouri State Environmental Improvement and Energy Resources

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[552] Ex. KCPL—210, Staff's Cost of Service Report, pp. 122-23; Ex. KCPL—231, Majors surrebuttal testimony, pp. 18-19.

[553] Direct Testimony of Henry Warren, Staff Cost of Service Report, ER-2010-0355 page 142

[554] Direct testimony of Henry Warren, Staff Cost of Service Report, ER-2010-0356 page 155

Authority, (EIERA) was established to manage and disburse federal and other weatherization funds for MDNR to Weatherization Agencies according to MDNR guidelines.[555]

KCPL and GMO, [Aquila] admit that they have participated in Low Income Weatherization for approximately 15 years. The desire is that the Companies continue to participate.[556]

KCPL and GMO acknowledged their participation in the Low Income Weatherization Programs is contingent upon a demand-side regulatory recovery mechanism.[557] However, neither KCPL nor GMO has filed an appropriate cost recovery mechanism in for in this rate case.[558]

KCPL and GMO agree that they should continue to be advised regarding the low-income weatherization programs by the KCPL Customer Program Advisory Group (CPAG) and GMO Advisory Group as provided in the respective resource plans, providing other issues could be worked out.[559] Staff recommends that:

KCPL continue its current level of funding and recommends that GMO provide ** [redacted] ** to the Low Income Weatherization Program.

KCPL and GMO continue the Low Income Weatherization programs under the advice of the KCPL Customer Program Advisory Group (CPAG) and the GMO Advisory Group as provided in the respective resource plans.

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[555] Id. p. 143

[556] (Tr. Page 3560:18-25)

[557] (Tr. 4192: 24-25 and 4193:1-6)

[558] Surrebuttal testimony of Staff witness John A. Rogers ER-2010-0355, page 4 line 22 through page 5 line 6 and surrebuttal testimony of John A Rogers, ER-2010-0356 page 4 lines 4-10

[559] (Tr. 3563:3-6)

KCPL and GMO deposit into an EIERA account any budgeted money that has not been disbursed at the end of each fiscal year and that has been specifically targeted for the Low Income Weatherization Program to be utilized by the Community Action agencies or other local agencies. Additionally, any funds that have not been spent as included in KCPL's regulatory plan and GMO's 2007 through 2010 budget should be put in an EIERA account.

Staff also recommends that funds expended will be placed in the DSM regulatory asset account at the time it is provided to the weatherization agency or when sent to EIERA.

Therefore, Staff believes that the Commission's Report and Order should contain the aforementioned recommendations as a finding of fact.

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

In its February 24, 2011, *Order Regarding Briefing of the Advanced Coal Credit Issue* the Commission ordered the parties in these cases to "include in their initial briefs to be filed on March 10, 2011, the entirety of their legal arguments, proposed findings of fact and conclusions of law, and any other proposed order language or arguments involving the advanced coal credit issue. " Appended to this brief are the Staff's proposed findings of fact and conclusions of law on the advanced coal tax credits issues.

CONCLUSION

WHEREFORE, for the reasons set forth above, the Staff requests the Commission to adopt the Staff's position on each and every issue exclusive to File No. ER-2010-0355 or in both File Nos. ER-2010-355 and ER-2010-0356 that was presented in these cases; the issues exclusive to File No. ER-2010-0356 being briefed later.

Respectfully submitted,

/s/ Nathan Williams

Nathan Williams
Deputy Counsel
Missouri Bar No. 35512

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-8702 (Telephone)
(573) 751-9285 (Fax)
nathan.williams@psc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronic mail to all counsel of record this 7th day of March 2011.

/s/ Nathan Williams

STAFF'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW ON THE ADVANCED COAL TAX CREDITS ISSUES.

FINDINGS OF FACT

1. In August 2006 Kansas City Power & Light Company applied to the Department of Energy and the Internal Revenue Service for advanced coal tax credits for Iatan 2, but was denied.

2. After Kansas City Power & Light Company's August 2006 application was denied, Kansas City Power & Light Company successfully lobbied for a statutory amendment to make the Iatan 2 project eligible for advanced coal tax credits.

3. On October 30, 2007, Kansas City Power & Light Company again applied to the Department of Energy and the Internal Revenue Service for advanced coal tax credits for Iatan 2. On April 28, 2008, the Internal Revenue Service accepted the application and allocated $125 million of advanced coal tax credits for Iatan 2.

4. Great Plains Energy acquired Aquila on July 14, 2008.

5. On August 26, 2008, the Internal Revenue Service and Kansas City Power & Light Company entered into a memorandum of understanding regarding the $125 million of advanced coal tax credits.

6. On February 6, 2009, the Internal Revenue Service certified Kansas City Power & Light Company's October 30, 2007, advanced coal tax credits application.

7. On October 31, 2008, both KCP&L Greater Missouri Operations Company and The Empire District Electric Company filed applications with the Internal Revenue Service seeking advanced coal tax credits for Iatan 2. The Internal Revenue Service denied both applications indicating that the full $125 million of credits available for the Iatan 2 plant project had already been awarded to Kansas City Power & Light Company.

8. On October 9, 2008, The Empire District Electric Company notified Kansas City Power & Light Company of a controversy regarding the advanced coal tax credits.

9. On November 21, 2008, Kansas City Power & Light Company, by a letter signed by William H. Downey, President and Chief Operating Officer, responded to The Empire District Electric Company's notice of controversy stating Kansas City Power & Light Company's opinion that it had no obligations toward The Empire District Electric Company regarding the advanced coal tax credits.

10. On July 10, 2009, The Empire District Electric Company provided Kansas City Power & Light Company written notice to arbitrate its entitlement to a portion of the $125 million advanced coal tax credits the Internal Revenue Service had awarded to Kansas City Power & Light Company.

11. On July 15, 2009, the Missouri Joint Municipal Electric Utility Commission gave Kansas City Power & Light Company written notice to arbitrate its entitlement to a portion of the $125 million advanced coal tax credits the Internal Revenue Service had awarded to Kansas City Power & Light Company.

12. On July 17, 2009, Kansas Electric Power Cooperative, Inc. gave Kansas City Power & Light Company written notice to arbitrate its entitlement to a portion of the $125 million advanced coal tax credits the Internal Revenue Service had awarded to Kansas City Power & Light Company.

13. KCP&L Greater Missouri Operations Company did not give Kansas City Power & Light Company written notice to arbitrate its entitlement to a portion of the $125 million advanced coal tax credits the Internal Revenue Service had awarded to Kansas City Power & Light Company.

14. On December 30, 2009, the three arbitrators unanimously ordered in part that ** Kansas City Power & Light Company and The Empire District Electric Company apply to the IRS for an amendment of Kansas City Power & Light Company's memorandum of understanding with the IRS that would allow The Empire District Electric Company to obtain a share of the Section 48A tax credits equal to $17,712,500. **

15. In their December 30, 2009, final arbitration award, the three arbitrators opined Kansas City Power & Light Company ** breached provisions of the Iatan 2 ownership agreement and the implied duty of good faith and fair dealing by evaluating the project's eligibility for, and by applying for, advanced coal tax credits for Iatan 2 without informing the other owners of Iatan 2. **

16. Kansas City Power & Light Company and The Empire District Electric Company applied to the IRS for and obtained an amendment of Kansas City Power & Light Company's memorandum of understanding with the IRS that allows The Empire District Electric Company to obtain a share of the Section 48A tax credits equal to $17,712,500.

17. The $17,712,500 awarded to The Empire District Electric Company is based on its ownership share of Iatan 2 among the federal taxpaying entities as follows: $125 million x 12% / (54.71% + 18% + 12%).

18. KCP&L Greater Missouri Operations Company has never sought to obtain a share of the $125 million of Section 48A tax credits for Iatan 2.

19. Based on KCP&L Greater Missouri Operations Company's ownership share of Iatan 2, the appropriate advanced coal tax credits to impute to KCP&L Greater Missouri Operations Company is $125 million x 18% / (54.71% + 18% + 12%), which equals $26.5 million.

20. It would prejudice the retail customers of KCP&L Greater Missouri Operations Company if advanced coal tax credits are not imputed to KCP&L Greater Missouri Operations Company since the imputed credits would lower the cost of KCP&L Greater Missouri Operations Company to serve them and, therefore, their rates.

21. The appropriate advanced coal tax credits to impute to Kansas City Power & Light Company is $80.8 million.

22. As of when the parties filed surrebuttal testimony on January 5, 2011, Kansas City Power & Light Company legal expenses in defending itself totaled $617,240.

23. The consolidated group that includes Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company may file amended federal income tax returns for tax years 2007, 2008, 2009 and 2010 where advanced coal tax credits for Iatan 2 may have been claimed for either or both of them.

CONCLUSIONS OF LAW

1. It was imprudent of KCP&L Greater Missouri Operations Company not to seek a share of the $125 million of Section 48A tax credits for Iatan 2 based on its ownership interest in Iatan 2.

2. It was imprudent of Kansas City Power & Light Company to ** breach provisions of the Iatan 2 ownership agreement and the implied duty of good faith and fair dealing by evaluating the Iatan 2 project's eligibility for, and by applying for, advanced coal tax credits for Iatan 2 without informing the other owners of Iatan 2. **

PROPOSED ORDERED PARAGRAPHS

1. For purposes of setting rates in these cases the $107.3 million of advanced coal tax credits on the books of Kansas City Power & Light Company are imputed to KCP&L Greater Missouri Operations Company and Kansas City Power & Light Company as follows: $26.5 million to KCP&L Greater Missouri Operations Company and $80.8 million to Kansas City Power & Light Company.

2. To the extent this Commission has the authority to order them to do so, KCP&L Greater Missouri Operations Company and Kansas City Power & Light Company are ordered to file amended income tax returns for prior tax years to reflect these imputed amounts and to apply to the IRS for an amendment of Kansas City Power & Light Company's memorandum of understanding with the IRS that would allow KCP&L Greater Missouri Operations Company to obtain from Kansas City Power & Light Company's share of Section 48A tax credits for Iatan 2, Section 48A tax credits equal to $26,500,000.

3. The legal expenses Kansas City Power & Light Company has incurred in defending itself for its imprudent acts of ** evaluating the Iatan 2 project's eligibility for, and by applying for, advanced coal tax credits for Iatan 2 without informing the other owners of Iatan 2 **, expenses totaling $617,240 on or about January 5, 2011, are disallowed from Kansas City Power & Light Company's cost of service for setting rates in File No. ER-2010-0355.