BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan.	)))))	**Case No. ER-2010-0355**
In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service.	))))	**Case No. ER-2010-0356**

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW OF KANSAS CITY POWER & LIGHT COMPANY AND KCP&L GREATER MISSOURI OPERATIONS COMPANY

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BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan.	)))))	Case No. ER-2010-0355
In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service	))))	Case No. ER-2010-0356

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW OF KANSAS CITY POWER & LIGHT COMPANY AND KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City Power & Light Company ("KCP&L") and KCP&L Greater Missouri Operations Company ("GMO") (collectively the "Companies") submits its Proposed Findings of Fact and Conclusions of Law as requested by the Public Service Commission of the State of Missouri ("Commission" or "MPSC") in the above-captioned dockets.

I. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. *Overview of Current Case*

1. On June 4, 2010, KCP&L filed tariff sheets designed to implement a general rate increase for electric service. The tariff would have increased KCP&L's annual electric revenues by approximately of $92.1 million. Since that time, the parties have settled several issues and KCP&L has adjusted its request to an increase of $66.2 million to be reflected in rates effective May 4, 2011. Staff of the Public Service Commission of the State of Missouri ("Staff") has recommended an annual increase in revenue of $3.9 million, based on the midpoint of its return on equity ("ROE") range. GMO has requested an $89.1 million annual increase, to be split

between its rate districts (L&P rate district: $23.1 million, MPS rate district: $66.0 million). Staff has recommended for GMO an annual increase in revenue requirement of $29.1 million ($27.1 million for L&P and $2.0 million for MPS), based on the midpoint of its ROE range.

2. The current docket is last of four rate cases contemplated by the Stipulation and Agreement ("Stipulation" or "Regulatory Plan") that was approved by the Public Service Commission of the State of Missouri in Case No. EO-2005-0329 (the "329 Docket").

3. The Stipulation established in the 329 Docket created a transparent, long-term process requiring KCP&L, Staff, the Office of Public Counsel ("OPC"), Missouri Department of Natural Resources ("MDNR"), Praxair, Inc. ("Praxair"), Missouri Industrial Energy Consumers ("MIEC"), and other parties to this proceeding to work collaboratively over a five-year period to strengthen the energy infrastructure needed to reliably serve KCP&L's Missouri consumers.

4. The primary purpose of the current rate case is to address the recovery of KCP&L's share of Iatan Unit 2, a new 850 megawatt coal-fired generation facility, which is also referred to herein as the "Iatan Unit 2 Project" or "Project." This case also includes recovery of KCP&L's remaining investment in the environmental upgrades to Iatan Unit 1, which went into service on April 19, 2009, as well as the remaining common plant investment which went into service with Iatan Unit 2 on August 26, 2010. Also included are continued investments in system reliability focused transmission and distribution ("T&D") projects, which are also provided for in the Regulatory Plan. This case also includes increased freight costs for the transportation of coal to several of the Company's coal-fired generating units, as well as non-Regulatory Plan investments in plant along with increasing operating costs.

B. ***Partial Settlement***

5. **Proposed Finding**: The Commission accepts the Stipulations and Agreements filed by KCP&L, GMO, Staff and various other parties resolving the following issues:

Depreciation and Regulatory Amortizations; Economic Relief Pilot Program (ERPP), Severance Expenses, Supplemental Executive Retirement Pension (SERP), Advertising, including the Connections Program issue, Bad Debts, Cash Working Capital–Gross Receipts Taxes and Injuries and Damages (KCP&L issue only), Cash Working Capital—Imputed Accounts Receivable Program (GMO issue only), Production Maintenance, Allocation of Off-System Sales Margins, Talent Assessment Program, Proposition C, Call Center Reports, Tracker for Iatan 2 and Iatan Common Operations and Maintenance Expenses, Transmission Expense and Revenue Tracker, SO_2 emission allowance regulatory liability. *See* Non-Unanimous Stipulation and Agreement Regarding Depreciation and Accumulated Additional Amortization (filed February 2, 2011); Non-Unanimous Stipulation and Agreement as to Miscellaneous Issues (filed February 3, 2011); Settlements have also been filed among some of the parties resolving the Class Cost of Service and Rate Design Issues, Residential Space Heating Rates (MGE issue), Wagner and Outdoor Lighting issues. *See* Non-Unanimous Stipulation And Agreement As To Class Cost Of Service /Rate Design (filed February 4, 2011); Non-Unanimous Stipulation And Agreement As To Rate Design Issue (filed February 4, 2011); Non-Unanimous Stipulation And Agreement As To Outdoor Lighting Issue (filed February 3, 2011).

C. *Procedural Background*

6. On April 28 and 29, 2010, the Commission held an on-the-record proceeding in Case No. EO-2010-0259 (the "0259 Docket"). By order of the Commission, the 0259 Docket has been consolidated with Case Nos. EO-2010-355 and 356.

7. The purpose of the 0259 Docket was to address issues related to the Staff audit of the Iatan Unit 1 Air Quality Control system ("AQCS") and the Common Plant upgrades. In particular, evidence was presented regarding KCP&L's discovery practices and whether it was cooperating with Staff in discovery matters.

8. On July 7, 2010 the Commission issued its Order Regarding Construction and Prudence Audits, as well as it Order Making Findings (filed only in the 0259 Docket) in which it issued the following findings and orders:

- KCP&L and GMO "have not engaged in any dilatory or unreasonable practices in responding to discovery during the construction audit and prudence review of the environmental upgrades to the Iatan 1 generating facility."
- All auditing activity shall be conducted in accordance with generally accepted auditing standards issued by the American Institute of Certified Public Accountants Standards. All Commission staff members conducting audit activity of any type in these matter shall attest by affidavit that all of their auditing activity and reports comply with these standards.
- Monthly status hearings will be set by separate order. At the status hearings the Commission's Staff shall update the Commission on the status of all audit activity of any type involved with these actions. Any discovery disputes shall be taken up immediately at these hearings. Any discovery dispute not timely raised at the status hearings shall be deemed waived.
- All audit activity, of any type, associated with the environmental upgrades to Iatan 1, if not already filed, shall be completed and filed no later than August 6, 2010.
- The deadline for final completion for all audit activity, of any type, involved with the Iatan II generating facility, including any common plant shared between Iatan I and II is January 30, 2011.
- The deadline for final completion for all audit activity, of any type, associated specifically with the rate increase request shall be no later than the date set for Staff to file its direct True-Up testimony.
- The Commission's Executive Director, Wess Henderson, is assigned primary audit oversight and completion. Mr. Henderson shall file monthly status reports with the Commission.

9. On July 29, 2010, the Staff, KCP&L, Praxair, and Missouri Energy Users' Association filed a Non-Unanimous Stipulation and Agreement/Proposed Procedural Schedule that sought clarification of the July 7, 2010 Order. On August 18, 2010, the Commission issued its Order Approving Nonunanimous Stipulation and Agreement, Setting Procedural Schedule,

and Clarifying Order Regarding Construction and Prudence Audit clarifying the following points:

- Setting a test period of the 12 months ending December 31, 2009, to be updated though June 30, 2010 with a true-up of the 12 months ending December 31, 2010.
- The Staff may audit the Iatan 1 AQCS costs for an appropriate period beyond August 6, 2010.
- Setting a true-up period of the 12 months ending December 31, 2010, and Iatan 2 and Iatan Common Plant cutoff period of October 31, 2010.
- The staff may audit Iatan 2 and Iatan Common Plant costs for an appropriate period beyond January 30, 2011.

10. KCP&L and Staff agree that KCP&L will incur “actual costs” on Iatan Unit 1 and Iatan Unit 2 beyond the original audit cut-off dates of August 6, 2010 for Unit 1 and January 30, 2011 for Unit 2. However, as referenced in the Order, Staff’s audit is limited to an “appropriate period” beyond the original audit cut-off dates and only those expenditures incurred by KCP&L after the cut-off dates. Staff is not permitted beyond January 30, 2011 to continue to audit expenditures or committed costs that it knew or should have known about prior to the originally imposed audit cut-off dates. Similarly, the scope of the True-up case is limited to issues that arose after October 30, 2011. Staff is also precluded from introducing new issues in True-up case that should have been brought forth in its November 2010 Report and the associated pre-filed and Evidentiary Hearing testimony.

11. On November 1, 2010, Staff requested the appointment of a Special Master to make a determination as to whether KCP&L had properly withheld documents as immune from discovery due to privilege or work product immunity. The Staff’s request was granted by the Commission on November 23, 2010 and appointed Senior Regulatory law Judge Harold Stearley as the Special Master. *See* Order Appointing Special Master and Clarifying July 7, 2010 Order.

12. On January 26, 2011, the Special Master issued an order indicating that he had reviewed approximately 60,000 pages of documents from KCP&L's data request responses that dated back to January 2009. Based on that review, the Special Master ordered that KCP&L make supplementary disclosures to Staff, which were provided by KCP&L to Staff prior to the start of the evidentiary hearings in this matter. Staff has not made any showing that any of the documents ordered to be produced by the Special Master has impacted or caused a delay to Staff's audit of the costs of Iatan Unit 1, Unit 2 or the Common Facilities.

13. On January 31, 2011, the Special Master held a discovery conference with Staff and the Companies. At that conference, Staff confirmed that it had received all of the documents subject to the Special Master's review. *See* Order and Notice Regarding Discovery Disputes dated February 4, 2011. Staff and the Companies further confirmed that with the exception of Data Request 580,[1] there were no other pending discovery disputes involving claims of privilege or other failure to adequately respond as of that date.

14. On January 26, 2011, after reviewing the 18,278 pages of disputed emails related to DR 580, the Special Master directed that certain emails be disclosed to Staff. Of the 18,278 pages reviewed, the Special Master directed that less than 1% (or approximately 93 pages) should be disclosed to Staff.

15. On February 8, 2010, KCP&L confirmed that it had provided all required pages of emails to Staff on January 31, 2010.

D. *Legal Principles*

16. Matters concerning public utilities are highly complex and the Commission is recognized to have vast experience and broad discretion in carrying out its ratemaking function.

[1] Data Request 580 relates to certain emails of Chris Giles, former Director of Regulatory Affairs for KCP&L.

17. The Commission's order must be both "lawful" and "reasonable." *See* R.S.Mo. §386.510.

18. Lawfulness is determined by whether or not the Missouri Public Commission ("MPSC") had the statutory authority to act as it did. *See State ex rel. Mo. Gas Energy v. Pub. Serv. Comm'n,* 186 S.W.3d 376, 382 (Mo.App.W.D.2005). Because the PSC "is purely a creature of statute, [its] powers are limited to those conferred by [statute] either expressly, or by clear implication as necessary to carry out the powers specifically granted." *State ex rel. Util. Consumers' Council of Mo., Inc. v. Pub. Serv. Comm'n,* 585 S.W.2d 41, 49 (Mo. banc 1979). While the Commission's statutory authority should be liberally construed in order to effectuate its purpose, however, "neither convenience, expediency or necessity are proper matters for consideration in the determination of' whether or not an act of the [PSC] is authorized by the statute." *Id.* (quoting *State ex rel. Kansas City v. Pub. Serv. Comm'n,* 257 S.W. 462 (Mo. banc 1923)).

19. The reasonableness of the order setting new rates is dependent upon whether or not "(i) the order is supported by substantial and competent evidence on the whole record, (ii) the decision is arbitrary, capricious or unreasonable, or (iii) the [PSC] abused its discretion." *Mo. Gas Energy*, 186 S.W.3d at 382.

20. The Missouri Supreme Court has previously enunciated a "substantial competent evidence" standard that the Commission must meet for its decisions to be lawful and valid. "Substantial evidence" has been defined by the Missouri Supreme Court as competent evidence which, if true, has a probative force on the issues. *See State ex rel. Rice v. Public Serv. Comm'n,* 359 Mo. 109, 220 S.W.2d 61 (1949).

21. In issuing its order, the Commission must make complete findings of fact as required by R.S.Mo. § 386.420; and *State ex rel. Fischer v. Public Service Commission*, 645 S.W.2d 39 (Mo. App. 1982) *cert. denied* 464 U.S. 819, 104 S.Ct. 81, 78 L.Ed.2d 91 (1983).

22. R.S.Mo. §386.420 as interpreted by this Court in *Rice* and followed in *Fischer* requires the MPSC to make a written report stating the conclusions of the Commission along with its decisions, orders, and requirements. The Commission must include findings of fact in its written report. 220 S.W.2d at 65; 645 S.W.2d at 42. Findings of fact that are completely conclusory, providing no insights into how controlling issues were resolved are inadequate. *See Fischer*, 645 S.W.2d at 42.

23. When addressing the issue of "substantial competent evidence" from an "expert," the qualification of a witness as an expert rests within the fact finder's discretion. *See State ex rel. Missouri Gas Energy v. Public Service Comm'n*, 186 S.W.3d 376, 382 (Mo. App. 2005); *Emerson Elec. Co. v. Crawford & Co.*, 963 S.W.2d 268, 271 (Mo. App. 1997). Pursuant to R.S.Mo. §490.065 a witness qualifies as an expert if he or she is able to assist the finder of fact with any scientific, technical or other specialized knowledge. Specific fact or opinion testimony offered by any expert is evaluated for its weight and credibility. *In re Interest of C.L.M.*, 625 S.E.2d 613, 615 (Mo. banc 1981). An expert's competence hinges on his or her knowledge being superior to that of the fact finder, and his or her opinion must aid the fact finder in deciding an issue in the case. *Duerbusch v. Karas*, 267 S.W.3d 700, 710 (Mo. App. 2008). Witness credibility is a matter for the fact finder, "which is free to believe none, part, or all of the testimony." *In re C.W.*, 211 S.W.3d 93, 99 (Mo. banc 2007).

E. *Issues Requiring Commission Determination in the Current Case*

1. Iatan Prudence

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

25. Staff's disallowance recommendations can be divided into two categories: (1) specific enumerated adjustments in the amount of $51,092,048 for Unit 1 ($19,133,972 KCP&L Missouri Jurisdictional share and $9,196,569 GMO share) and $81,103,094 for Unit 2 ($23,738,754 Missouri Jurisdictional share and $14,598,557 GMO share; and (2) a bucket of "unidentified/unexplained" cost overruns in the amount of $22,163,066 for Iatan 1 ($8,300,068 KCP&L Missouri Jurisdictional share and $3,989,352 GMO share) and $105,451,705 for Iatan 2 ($30,865,556 Missouri Jurisdictional share and $18,981,307 GMO share).

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

(a) Prudence Standard

27. The applicable "prudence" standard to determine whether KCP&L's and GMO's costs were prudent and should be included in rate base has been consistently applied by the

Commission. If a utility's costs satisfy the prudence standard, the utility is entitled to recover those costs from its customers.

28. The Commission as well as the Missouri courts have defined the applicable prudence standard as follows:

> [A] utility's costs are presumed to be prudently incurred.... However, the presumption does not survive "a showing of inefficiency or improvidence."
>
> ...[W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. (Citations omitted).
>
> In the [Union Electric] case, the PSC noted that this test of prudence should not be based upon hindsight, but upon a reasonableness standard:
>
> [T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.

See KCP&L/GMO's Initial Brief at ¶42 (citing *State ex. Re. Associated Natural Gas v. Public Serv. Comm'n*, 954 S.W.2d 520, 528-529 (Mo. App. W.D. 1997) (quoting *In Re Union Electric*, 27 Mo. PSC (N.S.) 183, 194 (1985)).

29. Furthermore, in order for the Commission to disallow a utility's recovery of costs from its ratepayers, the Commission must apply the following two pronged test: (1) evaluate whether the utility acted imprudently (that is, did not act reasonably at the time under the applicable circumstances); and 2) evaluate whether such imprudence was the cause of the harm (increased costs) to the utility's ratepayers. *See* KCP&L/GMO's Initial Brief at ¶¶43-44; Hearing Exhibit KCP&L-205, Staff November 2010 Report at p. 10, ln. 1-4; s*ee also Associated Natural Gas*, 945 S.W.2d at 529.

30. A construction estimate, particularly an early estimate, may not contain every single design element or project scope because as the design of a project progresses and matures, it is not unreasonable or imprudent for costs to increase based on additional scope added as the project's design becomes more defined. The industry terminology for this concept is known as "betterment" also known as "added first benefit rule" and "added value." *See* KCP&L/GMO's Initial Brief at ¶¶44-46; Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 23, ln. 6-14.

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

32. The concept of betterment is particularly well-suited for a prudence analysis. Simply because the costs of the Iatan Project exceeded the Definitive Estimate, does not, by

itself, mean that KCP&L acted imprudently. Under the theory of betterment, the Definitive Estimate, which was developed at 20-25% engineering, did not include the full scope or design of the completed project. As a result, additional costs were incurred for items necessary to complete the design. Mistakes or omissions in an estimate are not "avoidable" costs. These costs would have been incurred even if there had been no mistakes or omissions in the Definitive Estimate and as a result were not incurred unnecessarily due to KCP&L's imprudent actions.

33. In the *Union Electric* case, the Commission stated that in determining prudence on a large construction project there were two central questions: 1) Did the utility properly manage this complex project?; and 2) Did the utility properly manage matters within its control?" *See In Re Union Electric* 27 Mo. PSC at 213. This question of control is a particularly important one, because in some instances KCP&L had limited ability to influence the performance of the contractors on site. Therefore, as long as KCP&L did everything in its power to prudently manage the contractors and encourage performance under the contracts, KCP&L should not be penalized for the contractor's failure to perform despite KCP&L's active management of the project.

34. In addition to proposing that costs be disallowed due to the imprudence of KCP&L, Staff has proposed disallowances based upon terms such as "unreasonable," "inappropriate" or "not a benefit to the rate payers," while admitting that it has not performed a prudence analysis or formed an opinion as to the prudence of an expenditure. However, unless staff has performed a prudence analysis in accordance with Missouri law and has raised a "serious doubt" as to the prudence of a specific expenditure, it has failed to shift the presumption of prudence from KCP&L, and KCP&L is entitled to recover those costs from its customers. *See* KCP&L/GMO's Initial Brief at ¶48; *Associated Natural Gas*, 954S.W.2d at 528.

(b) Burden of Proof

35. As stated above, under the prudence standard, the Commission presumes that the utility's costs were prudently incurred. *See State ex. Re. Associated Natural Gas v. Public Serv. Comm'n,* 954 S.W.2d 520, 528 (Mo. App. W.D. 1997); *State ex rel. GS Technologies Operating Co. Inc. v. Public Serv. Comm'n,* 116 S.W.3d 680 (Mo. App. W.D. 2003) (citations omitted); *see also* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 9, ln. 26-29. This means that utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent. *See Union Electric Co*., 66 P.U.R.4th at 212. Staff or any other party can challenge the presumption of prudence by creating "a serious doubt" as to the prudence of an expenditure. Once a serious doubt has been raised, then the burden shifts to KCP&L to "dispel those doubts" and prove that the questioned expenditure was prudent. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 9, ln. 6-11.

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

to be higher, without more, is not sufficient to raise a serious doubt of imprudence on the part of KCP&L.

37. Staff and MRA therefore have the burden of creating a serious doubt before the burden would shift to KCP&L to establish that the expenditures were in fact prudent. *See* KCP&L/GMO's Initial Brief at ¶¶52-54; *Associated Natural Gas*, 945 S.W.2d at 528. Staff has not met this burden with respect to its "unidentified/unexplained" cost overrun adjustment as well as its specific disallowances. Similarly, MRA, who hired an independent consultant, Walter Drabinski, has failed to meet this burden in its "holistic" approach to evaluating prudence and the disallowance amount. Mr. Drabinski's proposed disallowances are based on a hindsight analysis, which is prohibited by Missouri Law. Mr. Drabinski has also failed to provide causation or nexus between any alleged imprudence by KCP&L and the recommended costs which they are advocating the Commission to disallow. In essence, Mr. Drabinski is proposing that KCP&L's shareholders should be responsible for costs that have not been proved to be caused by KCP&L's imprudent actions. Neither Staff's nor MRA's proposed prudence disallowances are not based on the type of analysis and findings that supported prior Commission findings concerning prudence disallowances, as discussed at length in the Commission's orders concerning the Wolf Creek Nuclear Generating Facility (*In Re Kansas City Power and light Company et al.,* 75 P.U.R. 4th 1 (1986)) and the Callaway Nuclear Generating Facility (*In Re Union Electric Company et al.*, 66 P.U.R. 4th 202 (1985)).

38. KCP&L has presented in its pre-filed testimony abundant evidence of its prudent management and decision-making throughout the entirety of the Iatan Unit 2 Project that was not rebutted by Staff or the MRA. *See* KCP&L/GMO's Initial Brief at ¶¶55-66. Much of the testimony was ignored, and in its place, Staff and MRA have engaged in a hindsight review,

claiming that the fact that cost overruns occurred are proof in and of themselves of imprudent management by KCP&L. KCP&L's witnesses were more credible than either Staff's witnesses or Mr. Drabinski.

39. Staff and MRA have failed to demonstrate that the prudence disallowance for the Iatan Project should equal or exceed the disallowances assessed in either Callaway and Wolf Creek. *See* KCP&L/GMO's Initial Brief at ¶¶40-41. Staff and MRA's proposed prudence disallowances are also unreasonable when compared to the Commission's findings in the Wolf Creek and Callaway cases. In both Callaway and Wolf Creek, the original control budget/definitive estimates for each project were approximately $1 billion. Ultimately each plant cost nearly $3 billion. Applying Staff's approach in this case to disallow all cots over the definitive estimate, the Commission would have disallowed nearly $2 billion in cost overruns on both Wolf Creek and Callaway. However, in Wolf Creek, for example, Staff recommended a prudence disallowance of approximately $200 million – about 7% of the total project costs and only about 11% of the excess costs above the definitive estimate. Here, where the Project is only three months late and at a cost only 16% greater than the Definitive Estimate, Staff proposes to disallow 100% of the cost increases above the Definitive Estimate. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at pp. 16-18. Staff's recommendation is unreasonable and not supported by substantial competent evidence.

(c) KCP&L's Obligations Under the Stipulation

40. **Proposed Finding**: KCP&L met its obligation under the Stipulation with respect to its reporting requirements and development of a cost control system that adequately tracks the costs of the projects. *See* KCP&L/GMO's Initial Brief at ¶¶19-30.

41. On August 5, 2005, the Commission approved the Stipulation and Agreement in Case No. EO-2005-0329 ("Stipulation"). Under the Stipulation, KCP&L has embarked upon a

series of infrastructure and customer enhancement projects valued at over $2.64 billion. Section III.B.4. of the Stipulation which identifies the required level of KCP&L's reporting of the CEP Projects states:

> KCPL shall provide status updates on these infrastructure commitments to the Staff, Public Counsel, MDNR and all other interested Signatory Parties on a quarterly basis. Such reports will explain why these investment decisions are in the public interest. In addition, KCPL will continue to work with the Staff, Public Counsel and all other interested Signatory Parties in its long-term resource planning efforts to ensure that its current plans and commitments are consistent with the future needs of its customers and the energy needs of the State of Missouri. *See* Stipulation and Agreement at III.B.4, p. 46.

42. KCP&L complied with this requirement by providing nineteen (19) written Quarterly Reports to Staff, OPC, and any other interested party, starting with the first quarter of 2006 through the third quarter of 2010. *See* KCP&L/GMO's Initial Brief at ¶¶17-22; Hearing Tr. at 1160-64; Evidentiary Hearing Exhibits: KCP&L-69; KCP&L-70; and KCP&L-71; KCP&L-24, Giles Direct Testimony at p. 19, ln. 20, to p. 24, ln. 5; KCP&L-25, Giles Rebuttal Testimony at p. 2, ln. 18-19; p. 4, ln. 4-7; p. 8, ln. 15-20; p. 38, ln. 1 to p. 39, ln. 19. KCP&L recently submitted the 20th Quarterly Report on February 15, 2011. Those Quarterly Reports discuss the status of the Regulatory Plan infrastructure investments, and other specific significant issues existing during the reporting period. KCP&L also met regularly with Staff, OPC, and representatives of the Signatory Parties to discuss the contents of the Quarterly Reports, as well as provide more current information if available at the time of the meeting. *See* Hearing Tr. at 1160-64. Several witnesses discussed KCP&L's transparent reporting of the CEP's costs and schedule status. *See* Hearing Tr. at 1022 ln. 3-10 (Giles); p. 1111, ln. 17 to p. 1113, ln. 1 (Giles); p. 1165, ln. 5-17 (Giles); *see also* Hearing Exhibits: KCP&L-4, Archibald Rebuttal Testimony at pp. 41-46; KCP&L-24, Giles Direct Testimony at pp. 18-24; KCP&L-25, Giles Rebuttal Testimony at pp. 8-9; 20-27; 38-39; KCP&L-43, Meyer Direct Testimony at pp. 36-38; *see also*

Hearing Exhibit KCP&L-66. KCP&L also provided Staff with ongoing access to its project management team, and provided Staff with private facilities on-site and at its corporate offices. This transparency was an integral part of KCP&L's agreement in the Stipulation, as it permitted all Signatory Parties the opportunity to monitor the progress of the Resource Plan.

43. With respect to cost control information, Section III.B.1.q. of the Stipulation requires that KCP&L do the following:

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

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

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

45. KCP&L has complied with these requirements. *See* KCP&L/GMO's Initial Brief at ¶¶25-30. KCP&L developed a comprehensive Cost Control System which provides key guidance to each of the CEP Projects governed by the Stipulation. *See* Hearing Exhibit KCP&L-38, Jones Direct Testimony at Schedule SJ2010-1. KCP&L's Cost Control System, which was transmitted to the Staff and the other parties' representatives on July 10, 2006, "describes the governance considerations, management procedures, and cost control protocols for the CEP Projects" including the Iatan Project. *See* Hearing Exhibits: KCP&L-25, Giles Rebuttal Testimony at p. 21, ln. 9-11; KCP&L-38, Jones Direct Testimony at Schedule SJ2010-1, p. 3. Further, the Cost Control System states that the Iatan Project's cost performance would be

measured against the Project's Control Budget (also known as the "Definitive Estimate"), and to do so, the Iatan Project's Control Budget "will identify the original budget amount (whether contracted or estimated) for each line item of the Project's costs and will track those budget line items against the following:

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

See Hearing Exhibit KCP&L-38, Jones Direct Testimony at Schedule SJ2010-1, at p. 17.

46. The Cost Control System also identified that costs for the Iatan Project would be tracked through a comparison to Iatan Unit 1 Project's and Iatan Unit 2 Project's "Definitive Estimates." The Cost Control System states that:

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

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

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

48. Staff admits that KCP&L's cost control system has the ability to track cost overruns. *See* Hearing Exhibit KCP&L-205, Staff's November 3, 2010 Report at p. 37, ln. 10-12. KCP&L's witnesses Mr. Archibald, Mr. Meyer and Mr. Nielsen, as well as the Missouri Retailer's Association witness Mr. Walter Drabinski and Staff's Mr. Elliott each showed that the Cost Control System that KCP&L developed for the Iatan Project allowed for any interested party to fully examine the costs incurred on the Iatan Project. *See* KCP&L/GMO's Initial Brief at ¶¶27-30.

49. Mr. Archibald, Mr. Meyer, and Mr. Nielsen testified that KCP&L's Cost Control System provided the guidance needed to establish the Iatan Project's Cost Portfolio, which it uses for day-to-day tracking and management of Iatan Project's costs. *See* KCP&L/GMO's Initial Brief at ¶28; Hearing Exhibit KCP&L-205, Archibald Rebuttal Testimony at p. 10, ln. 10-16; *see also* Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 3, ln. 14-19, p. 10, ln. 1-10; pp. 11-12, p. 30, ln. 10-17 and Schedules DFM2010-17 to DFM2010-24; KCP&L-46, Nielsen Rebuttal Testimony at p. 26, ln. 16-20. Mr. Archibald describes in detail how the Cost Control System contains all the information needed to both identify and explain each of the overruns to the Control Budget Estimate that occurred on the Iatan Project. *See* Hearing Exhibit KCP&L-205, Archibald Rebuttal Testimony at pp. 11-13. Mr. Meyer placed KCP&L's Cost Control System in the top quartile of those he has seen, and believes this system has allowed for the effective cost management of the Iatan Projects. *See* Hearing Exhibit KCP&L-44, Meyer Rebuttal Testimony at p. 3, ln. 6-10, pp. 7-8. KCP&L's expert witnesses, Dr. Kris Nielsen of Pegasus-Global and Mr. Daniel Meyer, a sub-consultant to Schiff Hardin, each testify that KCP&L's cost control system is consistent with industry best practices. *See* Hearing Exhibits

KCP&L-43, Meyer Direct Testimony at p. 5, ln. 10; KCP&L-46, Nielsen Rebuttal Testimony at pp. 249-250.

50. In fact, Forrest Archibald testified that KCP&L's cost control system is so robust that it allows any interested party to this matter to track every dollar that KCP&L spent on the Iatan Project, regardless of whether the costs were anticipated in the Control Budget Estimate or constitute a cost overrun to the Control Budget Estimate: "Our system allows you to track through every dollar that's spent from cradle to grave and understand where it was spent and wherever the overrun occurred." *See* Hearing Tr. at 2176-77.

51. Therefore, the Commission finds that KCP&L has complied with its reporting requirements and the development of a cost control system as required under the Stipulation. *See* KCP&L/GMO's Initial Brief at ¶¶23-30.

(d) After Applying the Prudence Test to Iatan Units 1 and 2, the Commission Finds KCP&L's Actions and Decisions in the Construction of the Iatan Project Were Prudent.

52. As demonstrated by KCP&L's Direct Testimony, Rebuttal Testimony, Surrebuttal Testimony and testimony during the evidentiary hearing, and based on the applicable standard for prudence under Missouri law, previous court and Commission decisions, KCP&L has made reasonable and prudent decisions in the development and management of Iatan Units 1 and 2.

53. KCP&L has presented substantive and competent evidence showing that its actions and decisions regarding the management of the Iatan Project were transparent and consistently just, reasonable, and prudent including the following:

54. Creation of the Executive Oversight Committee ("EOC") comprised of members of KCP&L's senior management. *See* KCP&L/GMO's Initial Brief at ¶57; Hearing Exhibit KCP&L-21, Downey Direct Testimony at pp. 2-8.

55. Utilization of independent oversight of Schiff Hardin, LLP. *See* KCP&L/GMO's Initial Brief at ¶58; Hearing Exhibit KCP&L-21, Downey Direct Testimony at pp. 8-10.

56. Utilization of industry standard project management tools including a cost control system; control budget estimate, earned value system, cost reforecasts. *See* KCP&L/GMO's Initial Brief at ¶59; Hearing Exhibits: KCP&L-38, Jones Direct Testimony at pp. 3-12 and Schedule SJ2010-2; KCP&L-43, Meyer Direct Testimony at p. 15, ln. 8-14; KCP&L-4, Archibald Rebuttal Testimony at pp. 6-7; KCP&L-50, Roberts Direct Testimony at pp. 6-9; KCP&L-21, Downey Direct Testimony at pp. 2-10.

57. Employing a prudent contracting strategy. *See* KCP&L/GMO's Initial Brief at ¶60; Hearing Exhibits: KCP&L-21, Downey Direct Testimony at pp. 11-12; KCP&L-22, Downey Rebuttal Testimony at pp. 55-61; KCP&L-46, Nielsen Rebuttal Testimony at pp. 102-64.

58. Staffing the project team with experienced and qualified individuals. *See* KCP&L/GMO's Initial Brief at ¶61; Hearing Exhibits KCP&L-19, Davis Rebuttal Testimony at pp. 22-30, 104-107.

59. Utilizing rigorous controls, processes and procedures to ensure the proper schedule and cost control including cost reforecasts. *See* KCP&L/GMO's Initial Brief at ¶¶62, 63-66; Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at pp. 76-80; KCP&L-38, Jones Direct Testimony at pp. 3-12, and Schedule SJ2010-1; KCP&L-50, Roberts Direct Testimony at pp. 17-22; KCP&L-19, Davis Rebuttal Testimony at pp. 25, 74, 80, 103-107; KCP&L-43, Meyer Direct Testimony at pp. 15, 24, 36-38; KCP&L-4, Archibald Rebuttal Testimony at pp. 21-23.

60. Considering the record as a whole, KCP&L's presentation of evidence with respect to its prudent management, including the credibility of its witnesses weighed greater than did Staff and MRA's.

(e) Staff Has Failed to Meet Its Burden to Prove Imprudent Actions and Staff's Proposed Iatan Unit 1 and 2 Adjustments Should Be Rejected.

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

62. **Proposed Finding**: Staff's recommended prudence disallowance is not supported by facts or competent analysis, and it is contrary to the Commission's prior decision decisions concerning prudence.

1. Staff is Not Qualified to Opine on Several of the Issues Raised in Staff's Testimony and November 2010 Report.

63. Under R.S. Mo. § 490.065.3 the evaluation of the underlying facts or data on which an expert's opinion is based requires a two-part test. First, there must be a finding that the facts or data are of the type reasonably relied on in the relevant field. Second, the court, or in

this case, the Commission, must itself accept the facts or data as otherwise reasonably reliable. As a result, the relevant scientific community must be defined in every case. In all cases, the underlying facts or data "must be … reasonably relied upon" by the appropriate "field," and even if a court finds that those in the appropriate field rely on the facts or data, the court itself must make the final determination that the testimony offered is "otherwise reasonably reliable." *State Board of Registration for Healing Arts v. McDonagh*, 123 S.W.3d 146 (Mo. *banc* 2003).

64. The Commission gives little weight to Staff's proposed disallowances because the witnesses sponsoring adjustments are unqualified to provide the required expert opinion consistent with Missouri law. *See* KCP&L/GMO's Initial Brief at ¶¶72-77. Additionally, Staff has failed to perform its prudence audit in accordance with generally accepted auditing standards ("GAAS") because in order to do so, it would have utilized individuals specifically trained to plan, execute and report on complex construction issues. *See id.*

65. Staff, in the absence of hiring a consultant, does not have the type of experience needed for rendering an expert opinion without input from the Utility Operations Division engineers ("Engineering Staff"). *See* KCP&L/GMO's Initial Brief at ¶¶ 73-77. Engineering conclusions have guided all of Staff's prior audit reports and associated disallowance recommendations. The evidence demonstrated in this case that the Audit Staff did not consult the Engineering Staff in developing its recommended disallowances. *See* Hearing Tr. at 2633-34, 2636-37, 2654-55, 2659; *see also* Hearing Tr. at 2400, ln. 12-20, p. 2412 ln. 3-18, p. 2421, ln. 2-21, p. 2633, ln. 24 to p. 2634, ln. 8, p. 2636, ln. 23 to p. 2637 ln. 2, p. 263, ln. 20 to p. 2654, ln. 3, p. 2661, ln. 2-11. Part of the basis for the lack of engineering participation in the audit was because Staff abandoned its coordination procedure for conducting construction audits and prudence reviews. *See* KCP&L/GMO's Initial Brief at ¶¶82-87.

66. Additionally, Staff did not comply with the GAAS requirements as ordered by the Commission. *See* KCP&L/GMO's Initial Brief at ¶¶78-81. As a result, Staff's opinions fail the *McDonagh* two-part test and Staff has not been able to provide credible evidence on many of the issues presented in this case.

2. Unidentified/Unexplained Cost Overrun Adjustment

67. **Proposed Finding**: The Commission rejects Staff's proposed adjustment for "unidentified/unexplained cost overruns." In making this finding, the Commission relied on the following:

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

69. The burden of proof does not shift to KCP&L to explain cost increases simply because the actual costs increased over the Definitive Estimate. *See* KCP&L/GMO's Initial Brief at ¶¶88-94. Similarly, the mere fact that costs increased above the Definitive Estimate does not "raise a serious doubt" as to the prudence of specific expenditures. Staff provides no testimony as to any imprudent action with respect to these cost overruns, or that imprudence was cause of the increased costs. In other words, Staff failed to meet its burden to "raise a serious doubt" as to the prudence of these "unexplained" expenditures.

70. KCP&L has explained all cost overruns by provided Staff with all documents necessary for Staff to perform a prudence audit of the Iatan Units 1 and 2 Projects. *See* KCP&L/GMO's Initial Brief at ¶94. The evidence presented by KCP&L shows that its Cost

Control System, KCP&L has provided Staff with a system that tracks how every dollar on the Iatan Project was spent. *See* Hearing Tr. at 2176-77.

71. Moreover, Staff has failed to articulate any deficiencies in KCP&L's Cost Control System that prevented Staff from performing a prudence audit of the Iatan Project. KCP&L's witnesses Mr. Archibald, Mr. Meyer and Dr. Nielsen, as well as MRA's witness Mr. Walter Drabinski and Staff's Mr. Elliott each showed that the Cost Control System that KCP&L developed for the Iatan Project allowed for any interested party to fully examine the costs incurred on the Iatan Project. *See* KCP&L/GMO's Initial Brief at ¶¶95-105.

72. Staff's testimony does not establish any imprudence with respect to "Unidentified/Unexplained Cost Overruns." *See* KCP&L/GMO's Initial Brief at ¶106. As a result, the Staff has failed to "raise a serious doubt" and these costs shall be included in KCP&L's rate base.

3. ALSTOM Unit 1 Settlement Agreement Adjustment

73. **Proposed Finding**: The ALSTOM Unit 1 Settlement Agreement was prudent. In making this finding, the Commission relied on the following:

74. Staff has proposed two disallowances based upon the ALSTOM Unit 1 Settlement Agreement. *See* KCP&L/GMO's Initial Brief at ¶108. The proposed adjustments are based upon two separate items: 1) the actual amount paid to ALSTOM under the Settlement Agreement; and 2) Staff's calculation of alleged "foregone" liquidated damages.

75. With respect to both proposed disallowances, Staff has failed to "raise a serious doubt" that would override the presumption of prudence. At the Hearing, Mr. Hyneman testified that Staff's reasoning for disallowing the costs of the Unit 1 Settlement Agreement was not because the decision to enter into the Settlement Agreement by KCP&L was imprudent, but

because it was "inappropriate" to charge the cost of the Settlement to rate payers. *See* Hearing Tr. at 2768, ln. 4-25; KCP&L/GMO's Initial Brief at ¶110..

76. By making no determination on prudence, Staff has not overcome the presumption of prudence afforded to KCP&L with respect to this expenditure, as it has failed to raise a serious doubt as to the prudence of the cost of the ALSTOM Settlement Agreement.

77. KCP&L has presented substantial competent evidence, as well as credible witness testimony proving that KCP&L's decision to enter into the Settlement Agreement and pay ALSTOM a settlement amount was prudent based upon the circumstances known by KCP&L at the time. *See* KCP&L/GMO's Initial Brief at ¶¶109-22.

78. With respect to the liquidated damages, the evidence establishes that at the time of the Settlement Agreement, no liquidated damages had accrued against ALSTOM, and as a result, KCP&L did not have a right to collect such damages under its Contract with ALSTOM. *See* KCP&L/GMO's Initial Brief at ¶¶123-29. Therefore, KCP&L did not "forego" its rights to any owed amounts by ALSTOM, and any argument that KCP&L would have been able to collect such damages is purely speculative.

(a) ALSTOM Unit 1 Settlement Amount

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

80. As an initial matter, Staff has failed to raise a serious doubt which would defeat the presumption of prudence afforded to KCP&L. In its pre-filed testimony and November 2010 Report, Staff's reasoning for its proposed disallowance, that "Staff is not convinced that ALSTOM's claims against KCPL were not the fault of KCPL's project management, raising the

question of KCPL's prudence and whether KCPL's ratepayers should be responsible for these costs." *See* KCP&L/GMO's Initial Brief at ¶¶110-14; Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 56, ln. 19-22. However, Staff has admitted that it currently does not have an opinion about the prudence of KCP&L's decision to enter into the this settlement. *See* KCP&L/GMO's Initial Brief at ¶110; Hearing Tr. at 2768, ln. 4-25.

81. Furthermore, neither in Staff's November 2010 Report, nor in its pre-filed or hearing testimony does Staff provide any substantive, competent evidence that the amounts paid by KCP&L were due to the fault of KCPL's project management. In fact, Staff's only evidence is simply a complaint that "KCP&L made no attempt to quantify the costs that may have been caused by its own project management team or the owner-engineering firm it hired, Burns & McDonnell ("B&McD"), or any other Iatan 1 contractor or subcontractor." *See* KCP&L/GMO's Initial Brief at ¶111; Hearing Exhibit KCP&L-205, Staff November 2010 Report at p. 57, ln. 11-14. Staff has not provided any evidence that the amounts paid to ALSTOM under the settlement were caused by B&McD or any other Iatan 1 contractor or subcontractor. *See* KCP&L/GMO's Initial Brief at ¶112.

82. KCP&L's pre-filed testimony of several of its Company witnesses discuss KCP&L's active management of its contractors and ALSTOM in particular. *See* KCP&L/GMO's Initial Brief at ¶¶115-22; Hearing Exhibit KCP&L-21, Downey Direct Testimony, p. 13-14; Hearing Exhibits: KCP&L-50, Roberts Direct Testimony, pp. 47-51, p. 110, ln. 9-15; and KCP&L-18, Davis Direct Testimony, pp. 20-21; *see also* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony, pp. 25-28; KCP&L-51, Roberts Rebuttal Testimony, pp. 7-9; KCP&L-19, Davis Rebuttal Testimony, pp. 15-16; and KCP&L-46, Kris Nielsen Rebuttal Testimony, pp. 127-32. Using the management tools available to it, such as the

schedule, KCP&L could see when the contractors were not performing as expected. KCP&L would then met with the contractors on a weekly and when necessary, daily basis in order to resolve any coordination issues and discuss ways in which the contractor's productivity could be improved and the schedule dates met. *See* Hearing Exhibit KCP&L-18, Davis Direct Testimony at p. 20, ln. 15-21. Additionally, KCP&L set up a very sophisticated and robust dispute resolution process with ALSTOM so that it could ensure that it received the best deal possible for itself and its customers. *See* KCP&L/GMO's Initial Brief at ¶115. KCP&L organized and participated in several facilitation sessions with a nationally-renowned mediator in order to help find solutions and remediation plans to help get the project back on track. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at pp. 40-41; KCP&L-51, Roberts Rebuttal Testimony at p. 8, ln. 12-14.

83. Mr. Hyneman, the Staff sponsor of this disallowance, provides no evidence that he is qualified to provide an opinion as to the prudence of this expenditure. *See* KCP&L/GMO's Initial Brief at ¶74. Mr. Hyneman is not a construction management professional, he has never managed a project, developed or analyzed a schedule, nor has he ever conducted a prudence audit prior to this case. *See* Hearing Tr. at 2566-67. From his testimony, the sum and substance of Mr. Hyneman's construction experience is a two-day training course he attended just prior to finalizing his portion of Staff's November 2010 Report. *See* Hearing Tr. at 2567-68. KCP&L has put forth the testimony of industry experts such as Dr. Nielsen and Mr. Roberts who have testified that the ALSTOM Unit 1 Settlement was a prudent expenditure on the part of KCP&L. *See* KCP&L/GMO's Initial Brief at ¶118; Hearing Exhibits: KCP&L-46, Nielsen Rebuttal Testimony at pp. 263-75; KCP&L-51, Roberts Rebuttal Testimony at pp. 7-12.

84. KCP&L's witnesses provided substantive, competent evidence which meet KCP&L's burden of establishing the prudence of the Iatan Unit 1 Settlement Agreement. KCP&L's decision to settle with ALSTOM was prudent in light of all of the circumstances and information known to KCP&L's senior management at the time.

(b) Unit 1 Liquidated Damages

85. In Staff's November 2010 Report, Staff is arguing that an additional adjustment based on KCP&L's alleged choice to forego liquidated damages for ALSTOM's Guaranteed Unit 1 Provisional Acceptance. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 59, ln. 15-16. However, Staff is mistaken in its belief that KCP&L ever had a right to collect such liquidated damages under the Contract. *See* KCP&L/GMO's Initial Brief at ¶¶123-29.

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

87. Testimony from KCP&L witnesses establish that once KCP&L and ALSTOM entered into the Settlement Agreement and agreed to modify the Provisional Acceptance date, any discussion about what KCP&L "could have" potentially collected under the original December 2008 contractual date is highly speculative, and completely unrealistic. *See* KCP&L/GMO's Initial Brief at ¶¶125-28. A contractor is not going to attempt to meet (much less spend additional money to meet) a contractual date that is no longer valid. *See* Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at pp. 36-38; KCP&L-19, Davis Rebuttal Testimony at pp. 59-60; KCP&L-51, Roberts Rebuttal Testimony at p. 11-12; and KCP&L-46, Nielsen Rebuttal Testimony at pp. 266-68.

88. KCP&L Company witnesses Mr. Davis and Mr. Downey discussed two issues that occurred during the Unit 1 outage that most likely would have been deemed to be "concurrent delays," meaning that even if ALSTOM had been late in completing its Unit 1 work, KCP&L would not have been able to collect liquidated damages. *See* KCP&L/GMO's Initial Brief at ¶¶126-28. These events were the economizer casing repair and the turbine rotor repair. During the Unit 1 Outage, the construction team discovered a latent defect in the economizer casing. This defect and the necessary repairs impacted the duration of the Unit 1 Outage by thirty-two (32) days. *See* Hearing Exhibits: KCP&L-19, Davis Rebuttal Testimony at p. 59, ln. 20-23; KCP&L-71, 4Q 2008 Strategic Infrastructure Investment Status Report.

89. Additionally, during the start-up after the Unit 1 Outage, a vibration event with the turbine caused an additional delay to start-up of the Unit. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony, at pp. 60. The effect of the economizer incident and the turbine would have made it impossible for ALSTOM to achieve its contractual dates (and even pushed out the revised dates under the Settlement Agreement). These two events added additional time

to the schedule, for which ALSTOM was not responsible. *See* Hearing Exhibit KCP&L-19, Davis Testimony Rebuttal Testimony at pp. 59-60. As a result, ALSTOM would have been entitled to an adjustment of its contractual Provisional Acceptance Date and KCP&L would not have been able to impose liquidated damages on ALSTOM. Accordingly, the evidence in KCP&L's prefiled testimony and at the evidentiary hearing demonstrate that ALSTOM achieved the contractually modified Guaranteed Unit 1 Provisional Acceptance Date and liquidated damages did not apply.

4. ALSTOM Unit 2 Settlement Agreement Adjustment

(a) Incentive Payments

90. **Proposed Finding**: The decision to enter into the ALSTOM Unit 2 Settlement Agreement was prudent based on the circumstances at the time. In making this finding, the Commission relied on the following:

91. Staff argues that KCP&L should not be entitled to recover any amounts it paid to ALSTOM under the Unit 2 Settlement Agreement. Staff revised the amount of its disallowance from the November 2010 Report to the total amount KCP&L paid ALSTOM under the terms of the Settlement Agreement. KCP&L's witnesses provided extensive detail regarding the circumstances surrounding the ALSTOM Unit 2 Settlement Agreement, including Mr. Downey, Mr. Roberts and Dr. Nielsen. *See* KCP&L/GMO's Initial Brief at ¶¶130-35; Hearing Exhibits: KCP&L-22, Downey Rebuttal Testimony at pp. 39-47; KCP&L-51, Roberts Rebuttal Testimony at pp. 12-18; and KCP&L-46, Nielsen Rebuttal Testimony at pp. 275-85. There were two main reasons KCP&L decided to enter into a Settlement Agreement with ALSTOM. First, ALSTOM had presented KCP&L with a significant delay claim based primarily on weather delays that needed to be resolved. Regardless of whether ALSTOM's claim had merit, defending against the claim would be both expensive and time consuming. *See* KCP&L/GMO's Initial Brief at

¶132; Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 15, ln. 14-17. Additionally, it would mire the KCP&L and ALSTOM project teams in a commercial dispute at a time when it was important for the focus to be on cooperatively completing the project. Second, Kiewit had told KCP&L that it would cost an a substantial amount for Kiewit to be able to support the dates in ALSTOM's schedule. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 41, ln. 10-16.

92. The Commission finds that the value for the benefits KCP&L received far exceeded the amount of incentive payments. *See* KCP&L/GMO's Initial Brief at ¶134; KCP&L's Post Hearing Exhibit filed on February 22, 2011. KCP&L considered and balanced both cost and schedule in creating a revised schedule and fostering cooperation between the main contractors. *See* KCP&L/GMO's Initial Brief at ¶135; Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 40, ln. 7-8. Based upon a prudence analysis, KCP&L's decision to enter into the ALSTOM Unit 2 Settlement Agreement was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

(b) Unit 2 Liquidated Damages

93. **Proposed Finding**: Staff's recommended adjustment of for allegedly "foregone" liquidate damages is rejected. In making this finding, the Commission relied on the following:

94. In his true-up testimony, Mr. Hyneman alleges, "Since Alstom's performance compared to contractual requirements were [sic] likely the cause of some if not most of these incremental costs, KCPL should have assessed and collected these costs from Alstom under the liquidated damages provision of the Alstom-KCPL contract. KCPL decided not to make such an assessment. If Alstom's performance did not meet its contract requirements and KCPL failed to protect itself from such performance by taking advantage of its rights under its contract with

Alstom, KCPL was unreasonable / inappropriate in its conduct and should bear the costs incurred." *See* Hearing Exhibit KCP&L-308, Hyneman True-up Direct Testimony at p. 3.

95. Mr. Hyneman's testimony is transparently based on speculation and hindsight and reveals that Staff has not performed any analysis of KCP&L's prudence regarding its decision to engage in the Settlement Agreement with ALSTOM. Mr. Hyneman also states, "If some or all of the delay in project completion was not the fault of Alstom, KCPL should determine who was at fault and hold that entity (including itself) responsible for these incremental Iatan Project costs." Hyneman True-up Direct Testimony, p. 3, ln. 17-23. Mr. Hyneman clearly admits that he does not know the basis of this agreement, or whether ALSTOM, KCP&L or anyone else for that matter was "at fault."

96. As stated, the circumstances surrounding the ALSTOM Unit 2 Settlement Agreement and KCP&L's analysis of the agreement are discussed in detail by several KCP&L Company witnesses, including Mr. Downey, Mr. Roberts and Dr. Nielsen. *See* Hearing Exhibits :KCP&L-22, Downey Rebuttal Testimony at pp. 39-47; KCP&L-51, Roberts Rebuttal Testimony at pp. 12-18; and KCP&L-46, Nielsen Rebuttal Testimony at pp. 275-285.

97. It is mere hindsight to imply that KCP&L could have but did not assess liquidated damages. KCP&L's witnesses provided competent evidence that the Unit 2 Provisional Acceptance date was subsequently revised from the original contract date. *See* Hearing Exhibit KCP&L-112, Giles True-Up Rebuttal Testimony at pp. 10-11; Data Request 658. Because Staff's proposed disallowance is a calculation regarding what KCP&L "could have" potentially collected had the original contractual date of June 1, 2010 remained in effect, the disallowance is not only highly speculative but factually irrelevant. *See* Hearing Exhibit KCP&L-112, Giles True-Up Rebuttal Testimony at p. 6; Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony

at p. 36-38; Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 58-60; Hearing Exhibit KCP&L-51, Roberts Rebuttal Testimony at p. 11-12; and Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 266, ln. 11 to p. 268 ln. 16. At the time of the Unit 2 Settlement Agreement, no liquidated damages had accrued, and as a result, KCP&L had no contractual right to collect such damages. Based on a prudence analysis of the evidence presented, KCP&L demonstrated that ALSTOM met the contractually required Guaranteed Unit 2 Provisional Acceptance date and, as a result, liquidated damages did not apply.

5. Schiff Hardin LLP Adjustments - Iatan

98. **Proposed Finding**: The use of services provided by Schiff Hardin LLP on the Iatan Project was prudent and the fees charged for such services were reasonable in the context of the facts and circumstances of their work in support of the Iatan Project. In making this finding, the Commission relied on the following:

99. KCP&L's witnesses testify to the value that Schiff Hardin brought to the Iatan Project, from the initial set-up of the commercial strategy and strategic schedule, the negotiation of the Iatan Project's contracts through the Project itself, all the while providing KCP&L's senior management team information it needed to oversee the Iatan Project's management. *See* KCP&L/GMO's Initial Brief at ¶136; Hearing Exhibits: KCP&L-8, Blanc Rebuttal Testimony at pp. 22-23; KCP&L-22, Downey Rebuttal Testimony at p. 6, ln. 15-17; KCP&L-25, Giles Rebuttal Testimony at p. 16, ln. 2-6; KCP&L-19, Davis Rebuttal Testimony at p. 5, ln. 12-19; KCP&L-6, Bell Rebuttal Testimony at p. 2, ln. 12-16.

100. Staff's recommended disallowance of nearly 40% of Schiff Hardin's fees for the Iatan Project is not supported by competent evidence or expert opinion. *See* KCP&L/GMO's Initial Brief at ¶139. Mr. Hyneman has none of the qualifications needed to opine relative to the market rates for attorneys. *See* KCP&L/GMO's Initial Brief at ¶¶140-45. He is not an attorney

himself, and has not presented any evidence that he has ever contracted for legal services at any point in his career. *See* KCP&L/GMO's Initial Brief at ¶142; Hearing Tr. at 2589, ln. 17-22. Mr. Hyneman admits that he is not an expert at evaluating the quality of legal work and he is not offering an opinion as to the quality of Schiff's work on the Iatan Project. *See* Hearing Tr. at 2649-50; KCP&L/GMO's Initial Brief at ¶¶143-45.

101. KCP&L's processes do not require that all services are subjected to a competitive bidding process. *See* KCP&L/GMO's Initial Brief at ¶¶147-48; Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at pp. 20-21. Moreover, there was considerable vetting of Schiff Hardin and their fees, not just at the outset of the Project but also as the Project progressed. *See* Hearing Tr. at 1436-37. KCP&L's decision to utilize Schiff Hardin was well considered on the basis of a vetting of both the needs for a firm of this type and the Schiff Hardin's unique set of qualifications, and KCP&L's day-to-day management of Schiff Hardin's work was robust. *See* Hearing Tr. at 1439-41.

102. KCP&L appropriately and prudently management Schiff's work on the Iatan Project. *See* KCP&L/GMO's Initial Brief at ¶¶146-54. Schiff Hardin only performed the work that KCP&L requested it perform, and the quality of their work and their advice is not being questioned by Staff.

103. Staff's disallowance does not raise a serious doubt because Mr. Hyneman's opinions regarding Schiff Hardin's services and the amount their fees have no clear basis in fact. *See* KCP&L/GMO's Initial Brief at ¶¶155-57. Mr. Hyneman testifies that it is Staff's belief that "80 percent of the work performed by Schiff Hardin employees were [sic] related to construction project management, including project controls." *See* Hearing Exhibit KCP&L-226, Hyneman Surrebuttal Testimony at pp. 22-24. However, Mr. Downey testified that he considered

approximately 65-70% Schiff Hardin's work was, in fact, legal in nature. *See* Hearing Tr. at 1343, ln. 12. Mr. Blanc testifies that if only hours incurred by Schiff Hardin personnel were considered, then the statistics would reflect Iatan Oversight (32%), Iatan Project Control (10%), Contracts (10%), Contract Administration (46%) and other (2%). *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 31, ln. 5-7. Even if Mr. Hyneman were competent to opine regarding the reasonableness of Schiff Hardin's fees, the comparisons Staff does to support its proposed disallowance, specifically the Laffey Matrix and the hourly rates of Kansas City law firms, are not a reasonable benchmark against which to measure Schiff Hardin's fees. Based upon a prudence analysis, KCP&L's decision to enter engage Schiff Hardin LLP for services on the Iatan Project was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

6. Schiff Hardin LLP Adjustments – Spearville 2 Wind Project

104. **Proposed Finding**: The Schiff Hardin LLP fees associated with the Spearville 2 Wind Project were prudent. In making this finding, the Commission relied on the following:

105. Staff has proposed disallowance of all of Schiff Hardin's legal fees arising from the Spearville 2 Wind Project. Mr. Hyneman's testimony supporting this proposed disallowance is improper and is not based upon any review of the services provided by Schiff Hardin on this Project. *See* Hearing Exhibit KCP&L-308, Hyneman True Up Direct Testimony at pp. 14-16. Mr. Hyneman provides no evidence at all, let alone evidence that raises a serious doubt regarding KCP&L's prudence in utilizing Schiff Hardin's services for the Spearville 2 Wind Project. *See* KCP&L-Exhibit 112, Giles True Up Rebuttal Testimony at pp. 13-15.

106. The Commission finds that the Staff did not offer substantial competent evidence in support of its proposed exclusion of Schiff Hardin's fees for the Spearville 2 Wind Project.

See Hearing Exhibit KCP&L-308, Hyneman True Up Direct Testimony at pp. 14-16. First, Mr. Hyneman provides no analysis or rationale for the necessity or appropriateness of the legal services for any of the firms who provided legal services to KCP&L in association with the Spearville 2 Wind Project. Schiff Hardin provided many of the same legal services on the Spearville 1 Project that was successfully completed on time and budget, and Staff proposed no disallowance for Schiff's fees as part of the Rate Case that addressed Spearville 1. Second, Staff offers no evidence for its opinion regarding the alleged excessiveness of legal fees associated with a project that completed on time and on budget. Similarly, Staff offers no testimony regarding the typical range of legal fees associated with conducting a mediation. Finally, Staff relies solely on its allegations regarding the impropriety of sole sourcing legal services for the Iatan Project as its basis to support a disallowance for services performed by an entirely different project. *See* Hearing Exhibit KCP&L-308, Hyneman True Up Direct Testimony at pp. 14-16.

107. Staff's proposal to disallow *every dollar* of legal fees charged by Schiff Hardin to the Spearville 2 Wind Project is overly broad and ignores legitimate legal services. The lack of evidentiary support provided by Staff fails to raise a serious doubt regarding the proposed disallowance for legal fees for the Spearville Wind Project, as a result, the proposed disallowance is arbitrary, capricious and without any evidentiary foundation. Based upon a prudence analysis, KCP&L's decision to engage Schiff Hardin LLP for services on the Spearville wind project was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

7. Campus Relocation Adjustment

108. **Proposed Finding**: The costs associated with the Campus Relocation were prudent. In making this finding, the Commission relied on the following:

109. The "Campus Relocation" issue was the move of construction trailers in response to a request from Kiewit, the Balance of Plant Contractor, for additional laydown space close to the turbine building to streamline its assembly and installation of the steam turbine generator. *See* KCP&L/GMO's Initial Brief at ¶¶158-62; Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 55, ln. 14-16.

110. Additionally, KCP&L discovered as contractors submitted their crane plans showing the location of the cranes they would use to complete their work, that the contractors were planning to put cranes and conduct material lifts very close to some of the construction management trailers. If KCP&L had rejected Kiewit's proposal, it would have made Kiewit's assembly and installation of the turbine more time consuming, risky, costly, and complicated, as well as increasing the risk of delays, damage, and other issues. *See* KCP&L/GMO's Initial Brief at ¶163; Hearing Exhibit KCP&L-8, Davis Rebuttal Testimony pp. 55-58. Based upon a prudence analysis, KCP&L's decision to enter relocate the construction campus to facilitate construction of the Project was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

8. JLG Accident Adjustment

111. **Proposed Finding**: The costs associated with the JLG accident were prudent. In making this finding, the Commission relied on the following:

112. Staff believes that KCP&L was unreasonable for executing the JLG Settlement Agreement. *See* KCP&L/GMO's Initial Brief at ¶¶165-66; Hearing Exhibit KCP&L-205, Staff November Report at p. 46, ln. 29-32. Mr. Davis testifies that KCP&L and ALSTOM chose to escalate this issue for resolution as part of a broader commercial strategy, and that this issue was one of several that KCP&L and ALSTOM ultimately resolved in this manner. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 54, ln. 17 to p. 55, ln. 11.

113. In its November 2010 Report, Staff has failed to raise a serious doubt as to the prudence of KCP&L's settlement of the JLG accident costs. Based upon a prudence analysis, KCP&L's decision to settle ALSTOM's JLG claim was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

9. Construction Resurfacing Project Adjustment

114. **Proposed Finding**: The costs associated with the Construction Resurfacing Project were prudent. In making this finding, the Commission relied on the following:

115. Staff is recommending the disallowance of the amount paid to ALSTOM as a result of a claim of delay and disruption made by ALSTOM due KCP&L's "Construction Resurfacing Project." KCP&L's witness testimony established that it engaged in the resurfacing project in support of its commitment to project safety, to improve the contractors' confidence regarding the safe operation of equipment on the Iatan site, and to minimize disruption to the construction. *See* KCP&L/GMO's Initial Brief at ¶168; Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 52, ln. 4-16.

116. Staff has failed to raise a serious doubt as to the prudence of these expenditures. *See* KCP&L/GMO's Initial Brief at ¶¶169-70. Based upon a prudence analysis, KCP&L's decision to resurface the areas used by heavy equipment on the Iatan Site was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

10. May 23, 2008 Crane Accident Adjustment

117. **Proposed Finding**: The costs arising from the Crane Accident were prudent. In making this finding, the Commission relied on the following:

118. The circumstances surrounding crane accident are described in detail in Company witness William Downey's Rebuttal Testimony at pp. 14-24. *See also* KCP&L/GMO's Initial Brief at ¶¶171-75. In summary, on May 23, 2008, one of the largest mobile cranes in the world,

a Manitowoc 18000 crane, collapsed while performing an unloaded test lift on the Iatan project (the "Crane Incident"). As a result of the collapse, one person was killed and others were injured. *See id.* at p. 14, ln. 20-22. KCP&L's EPC Contractor, ALSTOM, was responsible for the operation of the crane at the time of the incident. *See id.* at ln. 23.

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

120. The Commission finds that the costs incurred by KCP&L due to the Crane Incident were prudently incurred. *See* Hearing Exhibit KCP&L-22, Downey Rebuttal Testimony at p. 23, ln. 6 to p. 24, ln. 8. Despite the fact that KCP&L and ALSTOM have yet been unable to determine the costs that each party will bear as a result of the Crane Incident, the Commission can make a determination with respect to prudence on this issue, as KCP&L has proven that it has done everything within its control to effectively manage the contractor to mitigate these costs as well as recoup the costs to the extent possible from the responsible contractor.

121. Staff has failed to raise a serious doubt as to the prudence of these expenditures. Based upon a prudence analysis, KCP&L's decision to take swift action immediately after the Crane Incident on the Iatan Site was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

11. Cushman Project Management Rate Adjustment

122. **Proposed Finding**: The services provided by Cushman Project Management were prudent. In making this finding, the Commission relied on the following:

123. Staff's proposed disallowance for a rate adjustment relating to Mr. Cushman's fees was based on an assessment that Mr. Cushman's fees were unreasonable. *See* KCP&L/GMO's Initial Brief at ¶176; Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 98, ln. 4-20. Cushman was hired to develop processes and procedures for the Iatan Project including the Project Execution Plan ("PEP"). Mr. Cushman is highly respected in the industry and had a proven track record with KCP&L from Hawthorn. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 66, ln. 14-19. KCP&L evaluated the costs for Cushman's specialized services and determined that the costs were reasonable. *See id*. It does not appear that Mr. Hyneman has the expertise necessary to make a judgment as to whether Mr. Cushman's fees were reasonable, and as a result, he has failed to crate a serious doubt as to the prudence of this expenditure. Furthermore, Staff has not indicated that either KCP&L's decision to hire Mr. Cushman, nor KCP&L's management of his services were imprudent. Based upon a prudence analysis, KCP&L's use of services from Mr. Cushman was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

12. Pullman Adjustments

124. **Proposed Finding**: The costs paid to Pullman for work on the Iatan Project were prudent. In making this finding, the Commission relied on the following:

125. Although Staff includes in Schedule 1-1 of its November 2010 Report two proposed disallowances related to Pullman, the Chimney contractor, there is no explanation anywhere in Staff's November 2010 Report as to Staff's evaluation of these costs or why they have been deemed to be imprudent. *See* KCP&L/GMO's Initial Brief at ¶177. In its Initial Brief, Staff argues that a statement in the Kiewit Recommendation to Award Letter that "Pullman's Performance on the Project was well below expectations" does not explain why Staff is disallowing the costs to put a performance bond in place, nor is there any analysis that

identifies 1) how KCP&L had Pullman's performance within its control; or 2) how KCP&L acted imprudently that led to the disallowed costs. By its silence, Staff has not created a "serious doubt" as to these expenditures. As a result, Staff has not created a "serious doubt" as to these expenditures and base upon a prudence analysis, KCP&L's payments to Pullman are deemed to be prudent.

13. Reduction in Common Plant Costs

126. **Proposed Finding**: The Commission rejects the Staff's proposed reduction in Common Plant. In making this finding, the Commission relied on the following:

127. Staff's proposed disallowance of $19,646,346 of Common Plant Costs due to alleged inadequate documentation is without basis. *See* Hearing Exhibit KCP&L-308, Hyneman True Up Direct Testimony at pp. 8-12. The "Jones Book" established a means to estimate the Common cost component of KCP&L's budgeted cost. *See* Hearing Exhibit KCP&L-308, Hyneman True Up Direct Testimony at pp. 9-12; Jones Rebuttal Testimony (0089 Docket) at pp. 23-25 and Schedule SJ-4. KCP&L informed Staff repeatedly that the total Common costs would be above what had been identified and estimated in the "Jones Book." *See* Hearing Exhibit KCP&L-112, Giles True-Up Rebuttal Testimony at pp. 12-13. The first affirmative declaration to Staff that there would be additional Common Costs was in the Jones Book itself, which stated that there were additional Common Costs that would be identified later. *See also* Schedule SJ-4 (0089 Docket) at p. 5; Hearing Exhibit KCP&L-112, Giles True-Up Rebuttal Testimony at p. 13, ln 5-9. After issuance of the Jones book, KCP&L tracked all additional Common Plant costs through individual accounting codes. KCP&L has made all the supporting documentation supporting this additional amount of Common costs above the Jones book available to Staff. *See* Hearing Exhibit KCP&L-112, Giles True-Up Rebuttal Testimony at p. 13, ln. 9-16. Based upon

a prudence analysis, the Common Costs were prudently incurred when looking at the circumstances known by KCP&L at the time the decision was made.

14. Adjustment from KCC Staff Audits

128. **Proposed Finding**: The Staff's proposed adjustments from the Kansas Corporation Commission Staff audits are rejected. In making this finding, the Commission relied on the following:

129. Staff proposes adjustments in the amount of almost $2 million based on a KCC Staff audit. The KCC Staff audit is not before this Commission and is non-credible hearsay. Staff does not purport to have reached any independent determination about the prudence of the items listed in KCC's audit nor does staff offer any evidence other than the KCC audit to support Staff's recommendations. *See* KCP&L/GMO's Initial Brief at ¶178. The fact that KCP&L decided not to challenge those adjustments in its Kansas case does not create a serious doubt as to the imprudence of those expenditures, especially in light of the fact that KCP&L has not admitted that those expenditures were imprudent. KCP&L's witness testimony demonstrates the costs were prudent spends on the Project. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 71-72.

130. Accordingly, based upon a prudence analysis, the costs of R&O 330 and R&O 139 were prudent when looking at the circumstances known by KCP&L at the time the decision was made.

15. Affiliate Transactions Adjustments

131. **Proposed Finding**: The transaction with GPP was prudent. In making this finding, the Commission relied on the following:

132. Staff has proposed a disallowance for costs incurred by KCP&L's affiliate, Great Plains Power ("GPP") for work performed that was ultimately used as a part of the development

of the Iatan Unit 2 project. As cited by Staff in its November 2010 Report, KCP&L identified the work performed as pertaining to "environmental permitting and engineering which defined the project scope and plant design." *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 51, ln. 10-12. Staff's simply states that it "was not convinced that the costs incurred by GPP in its nonregulated activities were necessary for the construction of Iatan 2." However, Staff's November 2010 Report does not identify the reasons for this belief, nor does it provide any sort of prudence analysis of the costs incurred. *See* KCP&L/GMO's Initial Brief at ¶179. As a result, Staff has not raised a serious doubt as to the prudence of these costs that can overcome the presumption of prudence afforded to KCP&L. Based upon a prudence analysis, the affiliate transactions were prudent when looking at the circumstances known by KCP&L at the time the decision was made.

16. Welding Services Incorporated ("WSI") Change Order Adjustment

133. **Proposed Finding**: The costs paid to ALSTOM for WSI's welding services on the Iatan Unit 2 boiler was prudent. In making this finding, the Commission relied on the following:

134. Staff and one of KCP&L's experts, Dr. Kris Nielsen have proposed a disallowance for the additional costs associated with KCP&L's use of a specialty welding contractor, WSI, during the course of the Iatan Unit 2 Project. *See* KCP&L/GMO's Initial Brief at ¶¶180-82. Company witness Brent Davis discusses in his Rebuttal Testimony KCP&L's decision to direct ALSTOM to hire WSI at pages 66-68. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony. In general, Mr. Davis testifies that KCP&L decided to direct ALSTOM to hire WSI in order to improve ALSTOM's schedule performance and to increase the quality of the welds performed. *See id.* at p. 68, ln. 1-22. Additionally, KCP&L was ensured of higher

quality welds. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at p. 68, ln. 10-17. Under ALSTOM's Contract, directing ALSTOM to hire a specialty contractor had a higher price constitutes an "Owner Initiated Change" under Subsection 13.1 of ALSTOM's Contract. *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony, Schedule WPD-31. As a result, ALSTOM was entitled to additional compensation under its contract.

135. Staff did not make its own independent prudence evaluation of these costs, but simply relied on the recommendation of KCP&L's expert, Dr. Kris Nielsen. *See* Hearing Exhibit KCP&L-205, Staff's November 2010 Report at p. 101, ln. 2-11.

136. In determining that the WSI costs were imprudent, Dr. Nielsen analyzed the status of ALSTOM's work the Project including welding of the boiler, the construction schedule at the time, ALSTOM's contract terms, previous settlement agreements with ALSTOM, and the correspondence between KCP&L and ALSTOM regarding the status of the welding of boiler pressure parts. Dr. Nielsen concluded that because this issue was resolved outside of the normal dispute/settlement process utilized by KCP&L, KCP&L should not have provided additional compensation to ALSTOM. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at pp. 232-35. Although KCP&L agrees that Mr. Nielsen has conducted a proper prudence analysis, it disagrees with his conclusion. *See* KCP&L/GMO's Initial Brief at ¶¶180-82.

137. Based upon a prudence analysis, the WSI costs were prudent when evaluated based on the circumstances known by KCP&L at the time the decision was made.

17. Temporary Auxiliary Boiler Adjustment

138. **Proposed Finding**: The costs incurred for the temporary auxiliary boiler were prudent. In making this finding, the Commission relied on the following:

139. Staff's recommended disallowance for the temporary auxiliary boiler is based solely on Dr. Nielsen's testimony and related recommendation. *See* Hearing Exhibits: KCP&L-

46, Nielsen Rebuttal Testimony at p. 231, ln. 8-12, KCP&L-205, Staff November 2010 Report at pp. 101-102. In order to make his recommendation, Dr. Nielsen analyzed the project records including the evolution of the Project design and related correspondence regarding the need for auxiliary steam. Based on these records, Dr. Nielsen determined that KCP&L's decision to delete a permanent auxiliary boiler from the Project design in 2007 and later reincorporate this permanent equipment (and a temporary auxiliary boiler) was imprudent. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at pp. 235-38. Dr. Nielsen then evaluated the associated costs to identify any additional costs KCP&L incurred and recommended that a total of $ 5,346,049 (KCP&L Missouri jurisdictional share $1,564,781 and GMO share $962,289 million) be disallowed. *See id.* at p. 239, ln. 2.

140. KCP&L disagrees with Dr. Nielsen and Staff's recommendation to disallow costs for the temporary aux boiler. *See* KCP&L/GMO's Initial Brief at ¶¶183-86. Company witness Brent Davis provides KCP&L's rationale for the prudent expenditure of the temporary auxiliary boiler costs. *See* Hearing Exhibit KCP&L-19, Davis Rebuttal at pp. 68-71. Dr. Nielsen's proposed disallowance for the temporary auxiliary boiler costs is based on the fact that KCP&L could not provide Pegasus with documentation that established its decision for removing the aux boiler from the design of the Iatan Project. *See* Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony at p. 238, ln. 17-19. However, Brent Davis, in his pre-filed testimony, provides the circumstances which existed at the time KCP&L made the decision regarding the auxiliary boiler. See Hearing Exhibit KCP&L-19, Davis Rebuttal Testimony at pp. 69-71.

141. As a result, although Dr. Nielsen raised a serious doubt as to both the WSI and the temporary auxiliary boiler expenditures, but KCP&L has adequately addressed those doubts in its pre-filed and hearing testimony. Accordingly, based upon a prudence analysis, the temporary

auxiliary boiler costs were prudent when looking at the circumstances known by KCP&L at the time the decision was made.

18. Employee Mileage Charge Adjustment

142. **Proposed Finding**: The costs incurred for employee mileage were prudent. In making this finding, the Commission relied on the following:

143. Employees assigned to the Iatan Project were only going to be travelling to Iatan on a temporary basis. Therefore, it is prudent under these circumstances to agree to reimburse mileage costs for these temporary assignments rather than relocating the employees for a five-year period. *See* KCP&L/GMO's Initial Brief at ¶¶187-89. To require employees to work at the Iatan project site on a temporary, five-year project without compensation for mileage costs would not have been equitable and likely would have been viewed as a deterrent to working on the Iatan projects. *See* Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 39, ln. 4-11.

144. Staff's disallowance for 10% of all other employees' mileage reimbursements based upon Staff's perceived potential for errors or miscoding of mileage reimbursements is arbitrary and not based upon substantive, competent evidence. Based upon a prudence analysis, the employee mileage expenses were prudently incurred when looking at the circumstances known by KCP&L at the time the decision was made.

19. Inappropriate Charges Adjustment

145. **Proposed Finding**: Staff's proposed disallowance for inappropriate charges is arbitrary and not based upon substantive, competent evidence. In making this finding, the Commission relied on the following:

146. Staff has attached Schedules 4 and 5 that purport to support Staff's disallowances for the inappropriate charges. However, the Schedules identify only $18,351 of items charged to Unit 2 that Staff deemed as inappropriate. Staff's amount for the proposed disallowances are

only "estimates" which are wholly arbitrary. *See* KCP&L/GMO's Initial Brief at ¶¶190-91. Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 40, ln. 9-15. Staff has no basis for its estimates, and as a result, they will be disregarded by the Commission.

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

147. **Proposed Finding**: Staff's proposed adjustments for additional AFUDC due to the Iatan 1 turbine start up failure and the advanced coal tax credit are rejected. In making this finding, the Commission relied on the following:

148. Staff has not proposed an adjustment for the costs of the turbine trip. AFUDC costs are a component of the project's total costs and the turbine work was required to return Iatan Unit 1 and the AQCS environmental upgrades to service. *See* KCP&L/GMO's Initial Brief at ¶193. Based upon a prudence analysis, the AFUDC associated with the turbine failure should be allowed in rate base.

21. Severance Cost Adjustment

149. **Proposed Finding:** The Commission finds that the severance costs identified by Staff should be included in rate base. In making this finding, the Commission relied on the following:

150. The Company asserts that because the severance amounts at issue consist of amounts paid to employees formerly involved in the Iatan Project. Staff failed to raise a serious doubt regarding the prudence of these expenditures. These compensation costs are a legitimate capitalized cost.

(f) Missouri Retailers Association Has Failed to Meet Its Burden to Raise a Serious Doubt Regarding KCP&L's Actions and Its Proposed Iatan Unit 2 Adjustments Should Be Rejected.

151. MRA's consultant Mr. Drabinski proposes a disallowance of approximately $219 million (total plant) due to alleged imprudence by KCP&L. Mr. Drabinski's proposed disallowances are fatally flawed because his recommendations are: (1) not tied to even the general allegations of imprudence that exist in other, irrelevant portions of his testimony; (2) not substantiated with credible evidence, (3) based on hindsight, which is clearly prohibited by Missouri law, and Mr. Drabinski's substitution of his gut feel over facts; (4) riddled with errors, including double-counting of change orders and misunderstanding of the plain information that was available to him; (5) lacking in an audit trail that indicates why (to the limited extent he did) he selected certain change orders and purchase orders for disallowance; and (6) subjected to arbitrary percentage cuts, such as randomly choosing 50% of a cost, without any apparent or documented basis. *See* KCP&L/GMO's Initial Brief at ¶¶199-204. Therefore, the Commission is left with a recommendation for disallowance that by its nature fails to meet the applicable prudence standard.

152. MRA has not offered substantive, competent evidence of KCP&L's alleged imprudent acts nor does it attempt to establish how KCP&L's alleged imprudent actions were the cause of the proposed disallowance amounts, or how a different course of action could have avoided certain alleged imprudent costs. *See* KCP&L/GMO's Initial Brief at ¶¶205-223.

1. Mr. Drabinski's Analysis is Not Based on the Underlying Data in the Record or Proper Analysis as Required by Missouri Law.

153. **Proposed Finding**: After reviewing the arguments of the Parties on prudence, the Commission agrees with KCP&L that Mr. Drabinski's analysis is not supported by the underlying data or facts in the record or by the proper analysis required under Missouri law, and

therefore should be rejected, as the Commission may not rely on evidence that lacks a factual basis. In making this finding, the Commission relied on the following:

154. With respect to Mr. Drabinski's $219 million proposed disallowance, MRA has failed to provide any form of audit trail, work papers, calculations, or rationale for his calculations. Many of the disallowance amounts are simply all increased costs associated with a particular contract or straight-line percentages of the overall cost of a particular contract. *See* KCP&L/GMO's Initial Brief at ¶216. Mr. Drabinski has never identified any specific expenditures for which he provides any analysis as to how KCP&L's decisions or actions on each item led to the Project's increased costs or were imprudent under the standards described above.

155. Mr. Drabinski's proposed disallowance appears to be based primarily on Mr. Drabinski's "gut feel" with no data or support for his conclusions. Mr. Drabinski's imprecise methodology resulted in the inclusion of items in his recommended disallowance amounts that even he agrees were for scope that would always have been performed, such as Kiewit's insulation and heat trace work, and did not increase the cost of the Iatan Project. *See* KCP&L/GMO's Initial Brief at ¶¶237-244.

2. Mr. Drabinski Has Failed to Raise a Serious Doubt as to his proposed $219 million disallowance for Unit 2

156. There are significant portions of Mr. Drabinski's testimony on behalf of the MRA that are not only flawed from a factual and analytical standpoint, but at the core these arguments are what KCP&L has deemed to be "red herrings" because they do not factor in any way in Mr. Drabinski's actual recommendation for the disallowance of $219 million. Topically, these red herrings include Mr. Drabinski's allegations that:

- Mr. Drabinski's entire "Plant Comparison" analysis, "Comparison to Trimble County 2" and "Analysis of Budgets and Reforecasts", which he abandoned in exclusive favor of his single recommended $219 million disallowance. *See* Hearing Tr. at 1597, ln. 10-15;

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

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

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

- Mr. Drabinski's hindsight-based allegation that KCP&L's decision related to the Iatan Project's contracting methodology, i.e. to perform the Iatan Project on a multiple prime and not an EPC basis, increased the Project's cost (i.e. EPC vs. Multi-Prime) or was in an of itself imprudent; *See* Hearing Tr. at 1593, ln. 17-22. Drabinski testifies, "I never stated that the decision to use a Multi-Prime rather that an EPC approach was, in itself, imprudent." *See* Hearing Exhibit KCP&L-2602, Drabinski Surrebuttal Testimony at p. 24, ln. 8-10;

- KCP&L and Kiewit had some specious deal regarding an artificially low contract price. *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony at p. 159, ln. 4-15;

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

- The "turbine building bust" and "the cost of the unintended consequences of the decision to add a de-aerator to the project. Evidence shows that the cost of the enlarged turbine building was at least $106 million and perhaps over $200 million. This was part of the reason for the large increase in balance of plant costs." *See* Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony, p. 33, ln. 14-18. Company witness Mr. Meyer explains that while the Balance of Plant work increased due to design maturation, these were not in any way imprudent cost increases, as Mr. Drabinski obliquely asserts without examination of the facts. *See* Hearing Exhibit KCP&L-45, Meyer Supplemental Rebuttal Testimony, p. 48, ln. 14 to pg. 49, ln. 9;

- The cost of the Balance of Plant work increased from "$350 million to a billion dollars on this Project." *See* Hearing Tr. at 1615, ln. 4-5. Mr. Drabinski's statement is completely

unfounded and not supported by any facts. He apparently is attempting to measure the "growth" of the Balance of Plant by comparing early, irrelevant project estimates top the final cost, and doing so selectively. Fortunately, because Mr. Drabinski abandoned his meaningless comparison of estimates, the Commission will not have to ferret out the manner in which Mr. Drabinski twisted these facts;

- KCP&L could not manage a multi-prime project, a fact disputed by numerous KCP&L witnesses;

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

- KCP&L failed to timely implement expert advice, which Mr. Roberts thoroughly disputes; *See* Hearing Exhibit KCP&L-52, Roberts Supplemental Rebuttal, p. 2, ln. 17-21; and

- KCP&L's planned construction schedule was compressed and was made worse by KCP&L's failure to timely hire Burns & McDonnell as the Owner's Engineer.

See KCP&L/GMO's Initial Brief at ¶¶211-213.

157. Mr. Drabinski's proposed $219 million disallowance analysis is flawed, lacks substance, and does not establish a nexus between additional costs and the allegedly imprudent actions of KCP&L. *See* KCP&L/GMO's Initial Brief at ¶¶214-67. As a result, general allegations of imprudence, without a causal connection to a specific additional cost is not enough to "raise a serious doubt."

158. Instead, as can be plainly seen from his analysis, many of his disallowance amounts are just simply straight-line percentages or disallowances of any costs over an original contract amount. *See* KCP&L/GMO's Initial Brief at ¶¶214-67. Except for a few Kissick change orders and the 43 change orders identified in the "misc. PO" category, some of which Mr. Drabinski admits have been double-counted, Mr. Drabinski never identified any specific

purchase orders or change orders supporting his other recommended disallowance amounts, nor did he provide any analysis linking KCP&L's decisions or actions to the Project's increased costs or imprudence under the standards described above.

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

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

See KCP&L/GMO's Initial Brief at ¶¶214-23. Hearing Exhibit KCP&L-46, Nielsen Rebuttal Testimony, p. 227, ln. 9-18.

160. Under Missouri law, MRA has the burden not only to establish KCP&L's imprudent actions, but also to show that those imprudent actions caused KCP&L to spend additional amounts on the Iatan Unit 2 Project that were otherwise avoidable. MRA has failed to establish either of these two requirements, and as a result, the Commission has no basis to adopt Mr. Drabinski's proposed disallowance.

3. MRA's Iatan Unit 1 Recommended Disallowance

161. **Proposed Finding**: The Commission finds that Mr. Drabinski has not provided substantial, competent evidence regarding his proposed Unit 1 and Common disallowances. As a result, he has failed to raise a serious doubt as to these expenditures. The Commission finds that the Iatan Unit 1 costs were prudently incurred.

162. Mr. Drabinski has proposed a $13,938,795 disallowance for Iatan 1 (or $5,220,079 KCP&L Missouri Jurisdictional share and $2,508,983 GMO share) based upon an analysis he performed for the Kansas Commission almost two years ago. KCP&L and the Kansas Staff were able to come to a negotiated resolution in Docket No. 09-KCPE-246-RTS ("246 Stipulation"). *See* KCP&L/GMO's Initial Brief at ¶261.

163. The Commission finds that Mr. Drabinski has failed to provide the Commission with substantive and competent evidence to support those disallowances. MRA's recommended disallowance is based upon Mr. Drabinski's identification of five separate R&O packages related to the Iatan Unit 1 AQCS and Common plant projects that he believes reflect KCP&L's management's imprudence. *See* KCP&L/GMO's Initial Brief at ¶¶262-67; Hearing Exhibit KCP&L-2601, Drabinski Direct Testimony, Exhibit WPD-8. KCP&L's witnesses provided substantial evidence regarding the prudence of these expenditures. *See* KCP&L/GMO's Initial Brief at ¶¶263-66.

2. Iatan Regulatory Assets

(a) Iatan 1 AQCS and Iatan Common Regulatory Assets

1. Findings of Fact

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

165. The regulatory asset provision in the Stipulation allowed KCP&L to defer to this regulatory asset depreciation charges on these plant additions, also through the effective date of new rates in this case. The Stipulation included the following provision:

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

166. (*See Non-Unanimous Stipulation And Agreement*, Case No. ER-2009-0089, p. 5)(Hearing Exhibit KCP&L-64 (NP), p. 4-5, Weisensee Rebuttal).

167. The combined effect of these two provisions is essentially to treat plant additions not included in the 2009 Rate Case similar to construction work in progress, until new rates are established in this rate case. (Hearing Exhibit, KCP&L-65 p. 13 Weisensee Surrebuttal).

168. Although a majority of KCP&L's investment in the Iatan 1 AQCS equipment was included in rates as part of KCP&L's most recent rate case, ER-2009-0089, a portion remains to be included in rates as a part of this case. (Hearing Exhibit KCP&L-6 (NP), p. 4, Blanc Direct) This portion of the Iatan 1 costs is the basis of the Iatan 1 Regulatory Asset issue in this case. A similar, but more narrow, issue exists relating to the regulatory asset on Iatan Common plant added after April 2009.

169. This issue involves the question of whether KCP&L should be permitted to recover the carrying costs contained in the Iatan 1 Regulatory Asset, as contemplated by the Stipulation. KCP&L has included these carrying costs in the regulatory asset.

170. The Companies and Staff are in agreement that "If the Commission does not accept Staff's disallowances [regarding the prudence of Iatan 1, Iatan 2 and Common Plant] then it would be proper ratemaking treatment to include those costs in a regulatory asset." (Staff Br. at 68).

171. The Companies do not believe there is competent and substantial evidence in the record to support any of Staff's proposed disallowances related to Iatan Project. (Companies Br. at 16-134).

172. Staff is arguing that the costs in the Regulatory Asset should <u>not</u> be recovered since Staff has proposed to disallow all the Iatan I costs above its Control Budget Estimate. (Hearing Tr. pp. 3241-42)(*See also* Iatan Prudence Section of Brief).

173. In his Rebuttal Testimony at page 22, Staff witness Keith Majors stated:

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

175.

176. If Staff prevails on the "unexplained cost overrun" issue, then all of the expenditures made by KCP&L after April 30, 2009 would be disallowed. (Hearing Tr. p. 3242) Therefore, Staff believes it would be inappropriate to allow carrying cost similar to AFUDC on any of those costs because it believes all of these costs spent since April 30 should be disallowed. (Hearing Tr. pp. 3242-43).

177. KCP&L agrees that it should not be allowed recovery of carrying costs on expenditures, if any, that the Commission finds to be imprudent. But KCP&L is concerned that the Staff's approach to the Iatan 1 Regulatory Asset issue would effectively disallow carrying costs twice if the Commission found that some portion of the Iatan 1 costs expended after April 30, 2009 were somehow imprudent

178. KCP&L contends that the regulatory assets for Iatan 1 and Common and for Iatan 2, should be included in rate base at the amounts calculated by KCP&L until such time as a level of disallowance, if any, has been established. In a like manner, KCP&L argues that the amount of pre-in-service AFUDC that would be disallowed must also be synchronized with the level of expenditures disallowed, if any, and be recalculated if the Commission does not accept the full amount of disallowances proposed by Staff.

179. KCP&L has not included any carrying costs in plant-in-service accounts for Iatan 1 expenditures after April 30, 2009 which is the subject to Staff's prudence adjustments. Instead, KCP&L has included the carrying costs in the Regulatory Asset. (Hearing Exhibit KCP&L-63 (NP), p. 10 Weisensee Direct).

180. Staff is arguing that the Commission should not allow the recovery of the Iatan 1 Regulatory Asset which includes those AFUDC-like carrying costs since it does not believe the Commission should find those costs to be prudent. (Hearing Tr. pp. 3245-56).

181. The Staff's proposed prudence disallowances related to Iatan 1 and Common Plant have included in them an additional AFUDC adjustment to reflect the carrying costs associated with each adjustment. (Hearing Tr. p. 3245).

182. If Staff prevails on their proposed prudence disallowances, the disallowances would increase by an amount to reflect the carrying costs—the same type of carrying costs included in KCP&L's Regulatory Asset.

183. The treatment of the amounts disallowed, if any, including the associated AFUDC included prior to the applicable in-service date for each portion of the Iatan project, must be closely synchronized with the base amount of plant expenditures on which regulatory asset carrying costs are calculated for each portion of the Iatan project after the applicable in-service date.

184. If one level of disallowance is ordered as a reduction of the plant in service amounts but the amount of base costs in Staff's regulatory asset calculation, upon which the carrying costs after the in service date are calculated, is not adjusted to reflect a consistent level of disallowances, then Staff's calculation of the Iatan 2 and Iatan Common regulatory assets will be understated.

185. Staff did not allow an Iatan 1 regulatory asset for any amount of either deferred carrying costs or deferred depreciation, so if the Commission reduces Staff's proposed disallowances related to Iatan 1, then a regulatory asset must be created for Staff's case.

186. KCPL has also placed the depreciation expense on the post-April 30 expenditures into the Regulatory Asset. As a part of the underlying accounting entry, it has reflected the associated Accumulated Depreciation Reserve in rate base. In other words, the Accumulated Depreciation Reserve was not deferred, and was instead included as a rate base offset in the normal manner.

187. Although Staff adjusted the Plant-in-Service accounts, it made only a portion of the associated adjustment for the reserve for depreciation for those disallowances.

188. If the Commission adopts a prudence disallowance for Iatan 1, then Staff agrees that the accumulated reserve for depreciation related to those plant disallowances should be adjusted to remove the related reserve for depreciation. (Hearing Tr. p. 3246).

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

190. Although Staff included a regulatory asset for deferred depreciation and carrying costs on Iatan Common plant expenditures incurred subsequent to the April 2009 cut off date used in the 0089 case, it reduced the amount of carrying costs claimed by the Company by first reducing the expenditures by the amount of its proposed disallowances. Should the Commission determine that the level of Iatan Common disallowance, if any, is less than that proposed by Staff, then the Staff's calculation of Iatan Common regulatory asset would need to modified to reflect a consistent level.

2. Conclusions of Law

191. The Commission concludes that it would inappropriate and unreasonable for the Commission to exclude both KCP&L's Iatan 1 AQCS and Common Regulatory Asset costs which include carrying costs, and also adopt the Staff's Iatan 1 and Common Plant disallowances which includes an additional component for imputed AFUDC-like carrying costs, unless the amount of disallowances were synchronized between the regulatory asset and the plant components.

192. The Commission concludes that all of the Iatan 1 AQCS and Iatan Common costs should be included in rate base and amortized to cost of service prior to any decision as to possible prudence disallowance. The Commission will not exclude the carrying costs in the Iatan 1 AQCS and Common Regulatory Asset based on a level of disallowance that is different from the disallowed carrying costs associated with prudence adjustments recommended by the Staff.

193. The Commission concludes that the Reserve for Depreciation associated with the Iatan 1 disallowances should be adjusted to remove accumulated depreciation associated with the disallowed Plant.

194. Recognizing the technical nature of this issue, the Commission hereby directs the Companies and Staff to work together to properly synchronize the base amount of plant expenditures on which carrying costs are calculated for each portion of the Iatan Project after the applicable in-service date when finalizing the revenue requirement calculation for purposes of developing the tariffs consistent with the this Report & Order. The synchronization process should also include the development of an Iatan 1 Asset, if necessary, to be consistent with the findings contained in this Report & Order.

(b) Iatan 2 Regulatory Assets

1. Findings of Fact

195. KCP&L has included in this case deferral of costs under the construction accounting concept , including carrying costs, related to the time period after Iatan 2 was found to be in-service (i.e. August 26, 2010) and the December 31, 2010 True Up date. Costs deferred between December 31, 2010 and the effective date of new rates in

this case, pursuant to the terms of the Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329, will be included in the next rate case.

196. The Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329 (pages 43-44) authorized Iatan 2 construction accounting after Iatan 2 met its in-service criteria, and the resulting Iatan 2 regulatory asset.

197. KCP&L contends that this Regulatory Asset relate to Iatan 2 should be included in rate base in this case, with the annualized amortization expense included in cost of service.

198. The Regulatory Plan Stipulation And Agreement specifically stated:

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

199. During the True-Up hearings, Staff witness Majors agreed that the Iatan 2 Regulatory Asset balances, as determined by the Commission in this case, should be amortized over 47.7 years for both KCP&L and GMO. *See* Hearing Tr. pp. 4764-4765. KCP&L accepts this approach to this amortization.

2. Conclusions of Law

200. The Commission concludes that that it would be unreasonable and inappropriate to disallow from KCP&L's regulatory assets the carrying costs related to Staff's proposed disallowances that have been included as a part of its "Construction Accounting" for Iatan 2, and then also accept Staff's proposed prudence disallowances on Iatan 2 that include an additional component for AFUDC (Tr. 3252), unless the amount of disallowances were synchronized between the regulatory asset and the plant components.

201. The Commission would effectively be disallowing the carrying costs associated with Iatan 2 twice if the Commission accepted the approach recommended by Staff on the Iatan 2 Regulatory Assets, and also the prudence disallowances recommended by Staff related to the Iatan 2 plant itself unless the amount of disallowances were synchronized between the regulatory asset and the plant components.. Therefore, the Commission concludes that it will reject Staff's approach to this issue until the level of plant disallowances has been determined.

202. Recognizing the technical nature of this issue, the Commission hereby directs the Companies and Staff to work together to properly synchronize the base amount of plant expenditures on which carrying costs are calculated for each portion of the Iatan Project after the applicable in-service date when finalizing the revenue requirement calculation for purposes of developing the tariffs consistent with the this Report & Order. The synchronization process should also include the development of an Iatan 1 Asset, if necessary, to be consistent with the findings contained in this Report & Order.

3. Cost of Capital

(a) Capital Structure Findings of Fact:

203. The capital structure for both KCP&L and GMO, based upon the actual capital structure of GPE as of December 31, 2010, shall be the capital structure of the Company, as set forth below:

KCP&L and GMO Capital Structure

Debt	48.58%
Equity-Linked Convertible Debt	4.52%
Preferred Stock	0.61%
Common Equity	46.25%
Total	100.00%

204. The equity-lined convertible debt known as Equity Units are a part of the Companies' capital structure and are included at their actual cost of 13.59%.

205. There is no basis to adjust the cost of the Equity Units because a much larger utility, FPL Group, was able to issue its Equity Units at a lower cost. The FPL offering was significantly different from GPE's offering. FLP's Equity Units were more senior in the capital structure of that company, which had previously issued Equity Units in 2002 and had a track record investors could rely on. However, this was the first time GPE had ever issued Equity Units, which were subordinated to its other debt. Additionally, the Equity Units at FPL represented only 1.5% of its equity market capitalization, compared to GPE's offering which was 16.6% of its equity market capitalization.

206. GPE's offering price was the third best pricing of any offering of equity units in 2009. Equity Units are also a lower cost alternative to issuing common stock and, thus, cost ratepayers less.

(b) Return on Common Equity Findings of Fact

207. Dr. Samuel C. Hadaway testified on behalf of the Companies. Dr. Hadaway holds a Ph.D. in finance from the University of Texas, where he has served as an adjunct professor. He has also served as a professor of finance at the University of Alabama, Texas Tech University, and Texas State University at San Marcos. Before becoming a private consultant and professor, he served as director of the Economic Research Division at the Public Utility Commission of Texas.

208. David Murray testified on behalf of Staff. He holds a bachelor of science degree in business administration from the University of Missouri and a masters in business administration from Lincoln University. He is the Acting Utility Regulatory Manager of the Financial Analysis Department of the Commission.

209. Michael Gorman testified on behalf of the Industrials. Mr. Gorman holds a bachelor of science degree in electrical engineering from Southern Illinois University and a masters in business administration from the University of Illinois at Springfield. He is currently employed as a consultant at Brubaker & Associates, Inc.

210. Dr. Hadaway relied upon three Discounted Cash Flow (DCF) models, consisting of Constant Growth (Analysts' Rates), Long-Term Growth (GDP), and Multi-Stage Growth. He also conducted a Risk Premium analysis, as well. Based upon the results of his DCF analysis, Dr. Hadaway arrived at a range of 10.2% to 10.8%, with a mid-point return on equity (ROE) recommendation of 10.5%. His Risk Premium analysis produced a range of 10.05% to 10.24%. Dr. Hadaway's overall ROE recommendation was 10.50%.

211. Mr. Murray conducted a Constant Growth and Multi-Stage Growth DCF analysis, and recommended a cost of equity range from 8.7% to 9.7%. He did not conduct a Risk

Premium Analysis. His Capital Asset Pricing Model (CAPM) ranged from 6.69% to 7.72%. His overall ROE recommendation was 9.0%, based on a range of 8.5% to 9.5%.

212. Mr. Gorman conducted three DCF analyses, with a range of 9.33% to 10.33%, with a mid-point of 9.82%. His risk premium analysis produced a 9.58% figure, and his CAPM, a 9.20% figure. His overall ROE recommendation was 9.65%.

213. The average ROEs awarded to vertically-integrated utilities like KCP&L and GMO for the third and fourth quarters of 2010 was 10.32%, according to Regulatory Research Associates. The Commission finds that a zone of reasonableness extends 50 basis points in either direction from 10.32%, for a range of 9.82% to 10.82%.

214. The economic data contained in the record shows that interest rates on government and utility bonds declined to a 40-year trough in mid-2010, and that since that time the economy has begun to improve, with interest rates on government and utility bonds increasing. Federal government agencies such as the Congressional Budget Office and the Federal Reserve Board have increased near-term projected growth rates.

215. Dr. Hadaway used a 6.0% long-term GDP (gross domestic product) growth rate for his DCF analysis. It is based upon historical growth rates reported by the St. Louis Federal Reserve Bank for the period 1949 through 2009. The average growth rate for that period was 6.9%. However, Dr. Hadaway gave more weight to the growth rates of more recent years, calculating a growth rate of 6.0%, which is 90 basis points lower than the actual long-term growth average.

216. The nominal 4.75% growth rate used by Mr. Gorman is lower than any nominal GDP growth rate for any 10-year period reported by the St. Louis Federal Reserve Bank over the past 60 years. Mr. Murray's growth rates are even lower, and not based upon any published

statistics. Rather, they are based on Staff's subjective view of what it believes is a reasonable growth rate. The Commission accepts Dr. Hadaway's growth rate as a reasonable estimate of long-term growth which is reasonable given the improvement in the economy.

217. Dr. Hadaway used in his DCF analysis a proxy group of 31 comparable companies, which was accepted by Mr. Gorman. Mr. Murray only used ten companies which, with one exception, did not do business in either Missouri or its surrounding states. The Commission finds that Dr. Hadaway's proxy group is the appropriate proxy group for determining the Companies' cost of equity.

218. Of the three experts, Dr. Hadaway's credentials and experience are superior. His analysis of financial and economic data is comprehensive and sound. His DCF range of 10.2% to 10.8% is the most reasonable of the three recommendations, particularly given that vertically-integrated utilities have been awarded average ROEs of 10.32% during the past two quarters.

219. Dr. Hadaway's recommended ROE mid-point of 10.5% is fair and reasonable, and falls within the Commission's zone of reasonableness of 9.82% to 10.82%.

220. The Companies' request for an additional 25 basis points to be added to Dr. Hadaway's ROE recommendation of 10.5%, with which this Commission agrees, is reasonable. The Commission finds that this is appropriate given the Companies' overall excellent performance in the areas of reliability and customer service.

221. The Commission finds that 10.75% is the appropriate return on common equity for the Companies.

(c) Cost of Debt Findings of Fact

222. The Commission finds that KCP&L's cost of debt is 6.82%.

223. The Commission finds that GMO's cost of debt is 6.42%.

224. GMO's cost of debt is generally based upon GMO's actual debt cost, with the exception of one issue, the 11.875% Senior Notes of $500 million. These Senior Notes continue to use a hypothetical cost of 6.26% which was first assigned by GMO's predecessor Aquila. This hypothetical cost was part of Aquila's commitment to the Commission to hold its customers harmless from the effects of Aquila's unsuccessful non-regulated operations. Since Aquila's acquisition by Great Plains Energy in July 2008, both Great Plains Energy and GMO have continued this commitment which serves to benefit ratepayers.

225. Since the 11.875% Senior Notes mature in mid-2012, there is no reason to depart from the current cost of debt assigned to this issue or to GMO. As such, there is no need to adopt as a proxy for GMO's cost of debt the debt cost of a proxy which Staff proposed. Staff's recommendation that the Commission use the cost of debt of the Empire District Electric Company is not reasonable as Empire's debt does not reflect the debt of GMO.

226. The factors that dictate a utility's cost of debt include the maturity of the debt; the timing and amount of the debt; the terms and conditions of the debt; the credit profile of the company when the debt is issued; alternative sources of funding; the utility's market capitalization; and the financial market conditions existing when the debt is issued. Staff did not utilize any of these factors in arriving at its recommendation to use Empire's debt as a proxy for GMO.

227. The Commission finds that at this time the use of a consolidated debt structure, which was not specifically proposed by Staff, is not necessary.

(d) Cost of Capital Issues Conclusions of Law

228. In setting just and reasonable rates, the Commission must include revenue sufficient to cover operating expenses, to service debt, and to pay a dividend commensurate with the risks facing the Company. *Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591,

603 (1943); *Bluefield Water Works & Improv. Co. v. Public Service Comm'n*, 262 U.S. 679, 690 (1923).

229. The Commission properly considers the effects of current economic conditions, including periods of inflation as well as deflation in order to balance the interests of utility investors with ratepayers. *See State ex rel. Missouri Water Co. v. PSC*, 308 S.W.2d 704, 718 (Mo. 1957); *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (W.D. Mo. 1981).

230. The Commission's establishment of a zone of reasonableness is lawful and proper. *Mobil Oil Exploration and Producing Southeast, Inc. v. United Distribution Companies*, 498 U.S. 211, 216 (1991); *In re Permian Basis Area Rate Cases*, 390 U.S. 747, 822 (1968); *State ex rel. Missouri Gas Energy v. PSC*, 186 S.W.3d 376, 389-90 (Mo. App. W.D. 2005); *State ex rel. Associated Natural Gas Co. v. PSC*, 706 S.W.2d 870, 882 (Mo. App. W.D. 1995).

4. Off-System Sales Margins & Fuel Purchased Power

(a) Off-System Sales Margin Calculation for Rates Findings of Fact

231. Since 2006 the Commission has set rates for off-system sales margin at the 25th percentile level in consideration of the risks posed by the volatile natural gas market and the uncertainties in wholesale electricity prices in general. Any margins earned by KCP&L in excess of the 25th percentile level are flowed back to ratepayers with interest, as ordered by the Commission in the 2007 rate case. *See* Report & Order, Case No. ER-2007-091 at 39-40 (Dec. 6, 2007).

232. In the last two KCP&L rate cases, this Commission relied upon the probabilistic analysis conducted by Michael Schnitzer, a managing director of the NorthBridge Group in Concord, Massachusetts. Mr. Schnitzer's testimony described the risks that KCP&L faces in the

off-system sales market, noting that natural gas prices drive such electricity prices in KCP&L's service area, which is the Southwest Power Pool (SPP)-North region.

233. Exhibit 122 sets forth the SPP-North quarterly spot electricity prices from 2003 to 2010, and depicts the volatility of not only spot prices for electricity, but also spot prices for Henry Hub natural gas. Mr. Schnitzer confirmed that energy prices in SPP-North continue to be volatile. While prices have fallen from the levels that they saw in 2008, they have continued to fluctuate as a result of various economic, transmission system, and weather-related conditions.

234. The Industrials and Staff have argued that KCP&L either manages to the 25th percentile or otherwise fails to actively participate in these markets. They conclude that setting margin at the 25th percentile does not provide customers with a sufficient credit to rates. However, the evidence in the record shows that overall KCP&L has performed generally as expected, reaching levels somewhat about the 25th percentile. Given the decline in electricity prices and the generally poor economic conditions during this time, these results are neither surprising nor questionable.

235. The Industrials and Staff suggest that KCP&L needs a greater incentive to make off-system sales and that the level of margins in rates should be raised, possibly as high as 40%. However, the danger in setting off-system sales margin at that level is that it raises the risks that KCP&L faces of not achieving such increased levels of margin, while failing to offer any true incentive because there is no ability to share in such up-side risks. Mr. Schnitzer stated that as long as the treatment of off-system sales margin is asymmetric, fairness dictated that margins included in rates should be set around the 25th percentile. The current model is asymmetric because KCP&L loses if the 25th percentile is not reached, but receives no benefit because any margin in excess of the 25th percentile is returned to customers with interest.

236. The Industrials assert that the different methodologies in Missouri and Kansas regarding off-system sales margin allocation discourage KCP&L from making greater efforts to sell excess electricity into the wholesale markets. The different allocation methodologies between Kansas and Missouri create an imbalance where KCP&L loses roughly five cents for every dollar that it makes in sales.

237. While the allocation methodology must be solved in a future case, it does not provide a significant disincentive to the company making off-system sales because it only amounts to 5%. For example, if off-system sales exceed the benchmark by $10 million, KCP&L would face an incremental loss of only $500,000. If margins fell short of the benchmark by $10 million, by contrast, KCP&L would face an incremental loss of over $5 million. As a result, KCP&L would be ten times worse off if the Company missed the mark by $10 million than if it surpassed the mark by that amount. Therefore, the incentive is for KCP&L to exceed the off-system sales margin benchmark placed into rates, not simply to hit it or, worse, to miss it.

238. Off-system sales revenue, cost and margin are included in the ratemaking process, with any margins serving as a credit to rates. This is a requirement of the Regulatory Plan Stipulation and Agreement. *See* Section III(B)(1)(j) at p. 22, Stipulation and Agreement, *In re Proposed Experimental Reg. Plan of Kansas City Power & Light Co.*, Case No. EO-2005-0329 (filed Mar. 28, 2005). The Commission approved this Stipulation and Agreement in its July 28, 2005 Report & Order in that case, as amended in its Order of August 23, 2005.

239. Consequently, any changes to the current policy regarding off-system sales margin to make it symmetrical must occur in a future proceeding.

240. During the true-up hearing the Industrials raised several objections to the updated figures sponsored by Mr. Schnitzer and the NorthBridge Group. The difference in the

computation of retail load sponsored by the Company and by the Industrials is explained by the Industrials' failure to consider spinning reserve, as well as the fact that the NorthBridge Group data uses a figure of prospective or forecast load, rather than historical load. Additionally, the difference in outage schedules has a de minimis effect on off-system sales. Finally, the Industrials have improperly used "around-the-clock" wholesale prices in their analysis of sales to be made by the Company, instead of a price that reflects the fact that KCP&L's off-system sales are mainly off-peak.

241. Staff and the Industrials assert that the addition of Iatan 2 to KCP&L's generation fleet will provide greater opportunities for off-system sales. While it is true that off-system sales margin should increase, KCP&L's greater capacity is still subject to the price risks of the wholesale market. Mr. Schnitzer stated that the potential volatility in off-system sales margin actually increases with an increase in available capacity for sale, all other factors being equal.

242. It is for all these reasons that the Commission believes that off-system sales margin should continue to be set at the 25th percentile with any profit above that percentile returned to customers with interest, pursuant to the current method.

(b) Proposed Adjustments to the Off-System Sales Margin Calculation Findings of Fact

243. KCP&L has proposed three adjustments related to Purchases for Resale, SPP Line Loss charges, and SPP Revenue Neutrality Uplift charges. Staff only opposes the SPP Line Loss adjustment, whereas the Industrials oppose all three adjustments.

244. Purchases for Resale are a result of KCP&L's participation in the wholesale energy market, in particular the SPP Energy Imbalance Service (EIS) market. KCP&L earns revenue and incurs expense as a result of wholesale electricity transactions to ensure that adequate energy is available in real-time to reliably meet all of its energy obligations.

245. Staff does not oppose this adjustment. The Industrials do not dispute that KCP&L should be compensated for any losses, but oppose the adjustment. The Industrials' objection is based not on specific facts, but rather their view that a further study should be done to determine the cause of the losses. This is not a sufficient reason to oppose the adjustment which is reasonable.

246. SPP Line Losses reflect charges that SPP levies on wholesale energy transactions that exit the EIS market. These charges relate to transmission system energy losses. Such charges result in both payments that KCP&L makes on a portion of its off-system sales, as well as revenue that it receives on a share of the loss charges collected by SPP. The adjustment proposed by the Company reflects its net loss revenue.

247. Staff agrees that an adjustment should be made to reflect revenue associated with SPP compensating payments from other SPP members. However, it opposes an unspecified portion of the charges that it believes are not in the NorthBridge database. The Industrials also oppose this adjustment to the extent of sales that occur outside the SPP footprint. Neither Staff nor the Industrials oppose the SPP Line Losses as an item to be included and recovered in KCP&L's revenue requirement.

248. Whether the SPP Line Losses are included or excluded from the NorthBridge model, they are expenses of KCP&L's efforts to make off-system sales. Therefore, the adjustment proposed by the Company is reasonable.

249. Revenue Neutrality Uplift (RNU) charges reflect revenue and expenses incurred in the EIS market. Because total revenues collected by SPP do not always match the total amount of disbursements, imbalances in revenue and expense are shared by market participants as either a charge or a credit.

250. Staff does not oppose this adjustment. The Industrials oppose the adjustment, claiming that revenues flow back to shareholders while ratepayers pay the losses.

251. As stated earlier, all revenue and expenses from the Company's off-system sales are included in determining the margins, either as set in rates or if in excess of rates, as a credit with interest ratepayers.

252. The proposed adjustment for RNU charges is reasonable.

(c) Fuel & Purchased Power Expense Findings of Fact

253. Natural gas costs should be determined as proposed by KCP&L witnesses W. Edward Blunk and Burton L. Crawford, as trued-up at the conclusion of the case. There was no opposition to either Mr. Blunk or Mr. Crawford on this proposal.

254. KCP&L and Staff have agreed that the fuel oil expenses related to the Wolf Creek Nuclear Plant should be included in rates. Fuel oil prices have been updated through December 2010 and should be included in rates.

255. The parties agree and the Commission finds that the megawatts formerly associated with KCP&L's contract to sell power to the Missouri Joint Municipal Electric Utility Commission (MJMEUC) should be considered available for off-system sales. Mr. Schnitzer confirmed that his model assumed that there were no contractual obligations to MJMEUC and that the capacity related to that contract is now available for sale in the off-system wholesale market.

256. KCP&L proposes to determine spot market purchased power prices using the MIDAS™ model which forecasts spot market electricity prices. Staff proposes to use its 1996 model which uses only historical market prices and loads.

257. The MIDAS™ model contains historical information, including the experience of KCP&L, but is also based on a production simulation for the entire Eastern Interconnection.

This model includes a wide range of data including information supplied by electric utilities in their FERC Form 1 filings, as well as data submitted to the U.S. Department of Energy's Energy Information Administration and to the Continuous Emissions Monitoring System (CEMS) of the U.S. Environmental Protection Agency. The MIDAS™ model is designed to simulate the wholesale power markets in order to develop hourly prices of power for the wholesale market. This information is then used to determine the normalized level of fuel and purchased power for KCP&L.

258. Staff's model relies only upon historical data of KCP&L. It relies on no data from any other utility and does not use any projected data.

259. The Commission must set the level of fuel expense and purchased power expense for KCP&L in this case, and should use the greatest amount of information available to it with regard to spot market prices. Therefore, the Commission determines that a nationally recognized tool like the MIDAS™ model should be used to determine spot market prices in this case.

(d) Conclusions of Law for Off-System Sales Margin and Fuel & Purchased Power Issues.

260. The Commission's decisions regarding the use of methods to set rates regarding off-system sales, as well as fuel and purchased power are dedicated to the exercise of the sound judgment and discretion of the Commission acting within its area of expertise. *State ex rel. Missouri Gas Energy v. PCS*, 186 S.W.3d 376, 382 (Mo. App. W.D. 2005). In the past when the Commission used methods to project a utility's revenue using a forecasted peak times load factor and to allocate the costs of producing electricity, its decisions have been affirmed as lawful and reasonable in all respects. *State ex rel. Arkansas Power & Light Co. v. PSC*, 736 S.W.2d 457, 461-62 (Mo. App. W.D. 1987).

5. Transition Cost Recovery

(a) Findings of Fact

261. The Commission considered and addressed the proper treatment of transition cost recovery in its Report and Order in the joint application to merge the operations of Great Plains Energy, Inc. (*i.e.*, KCP&L) and Aquila, Inc. (Merger Order). Case No. EM-2007-0374 (Jul. 1, 2008). In that case, the Commission found that the Companies should be allowed to defer and amortize the merger transition costs over a five-year period so long as the transition costs were reasonable and prudent and the company could demonstrate that the synergy savings exceeded the level of the amortized transition costs. Merger Order at 241.

262. In the current rate cases, the Companies seek to recover the merger transition costs in rates over five years beginning with rates effective from this case.

263. The Companies argued that the transition costs were reasonable and prudent. The Companies, Staff and Office of the Public Counsel (OPC) are the only parties that testified on this issue. No party challenged or even questioned the reasonableness or prudence of the merger transition costs. At the evidentiary hearing, Staff stated that the transition costs incurred by the company were not unreasonable or imprudent. *See*, *e.g.*, Hearing Tr. at 3448, 3470, 3489. The parties waived cross examination of OPC's witness. Given the lack of opposition to the Companies' position, the Commission finds that the transition costs were reasonable and prudent.

264. The Companies argued that they demonstrated that the synergy savings exceed the level of the amortized costs. *See* Hearing Exhibit KCP&L-35, Ives Direct at 4, 7-10; Exhibit KCP&L-230 Majors Rebuttal at 7-8; Hearing Tr. at 3472. The Companies, Staff and OPC are the only parties that testified on this issue. There has been no testimony by any party which disputes that the companies have demonstrated that the synergy savings exceed the level of the amortized costs. Given the lack of opposition to the Companies' position, the Commission finds

that the Companies have demonstrated that the synergy savings exceed the level of amortized costs.

265. Despite the Companies' compliance with the Merger Order, Staff offered an alternative standard for determining the appropriate ratemaking treatment of the merger transition costs. Staff argues that the Companies should demonstrate that savings exist in excess of the transition costs and that they have not already recovered these costs through retained synergies by means of regulatory lag. Hearing Exhibit KCP&L-210, Staff Report at 191. Staff stated it would be unreasonable to recover transition costs that have already been recovered through regulatory lag. *See* Hearing Tr. at 3497.

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

267. Staff relied on boilerplate language which appears at the back of the Merger Order, and indeed every Commission order, as support that the Merger Order has no precedential value. Merger Order at 284.

268. Staff also relied on its analysis of the Companies' Administrative & General expenses and other electric utilities in the region. Hearing Exhibit KCP&L- 231, Majors Surrebuttal at 16. Staff's analysis indicates that on a combined company basis, KCP&L and GMO have the highest A&G expenses per customer, per megawatt hour sold and per dollar of operating revenue. *Id.* at 16-17. Staff links its finding in its A&G analysis to its proposal to net the transition costs against synergy savings retained by the Companies, stating that "KCP&L and GMO, while enjoying significant benefits through synergy savings, have not flowed a comparable amount of savings to its regulated electric utility operations." Staff's Initial Brief at 147, referencing Hearing Exhibit KCP&L- 231, Majors Surrebuttal at 16-17.

269. Staff claims that to allow the Companies to recover transition costs absent netting against retained synergy savings would constitute double recovery of the transition costs related to the acquisition of Aquila.

270. In response to Staff's proposal, the Companies argued that the Commission created an expectation in its Merger Order, that so long as the transition costs were deemed reasonable and prudent, and the Companies could demonstrate that synergy savings exceed the level of amortized transition costs, the Companies would be permitted to recovery the transition costs in rate. Merger Order at 241. The Companies stated that no party contests that they have fully complied with the Merger Order. Further, no party to this proceeding has either challenged the reasonableness and prudence of the claimed transition costs or challenged the calculated synergy savings. As a result, the Companies state that the record evidence in this case supports the Commission's original findings in the Merger Order that the Companies should be permitted to recover the merger transition costs in rates over five years beginning with rates effective from this case.

271. The Companies also argued that if Staff's position is adopted, the companies will have to write off millions of dollars of these accumulated costs -- costs that were incurred to achieve the undisputed synergy savings and accumulated based upon this Commission's support for deferral and amortization in the Merger Order. Specifically, the projected true-up value of Missouri jurisdictional transition costs is $41.8 million. Hearing Exhibit KCP&L-37, Ives Surrebuttal at 3.

272. The Commission finds that substantial and competent evidence exists in the record to maintain its position in the Merger Order, that the Companies should be permitted to recover the merger transition costs in rates over five years beginning with rates effective from this case. There is no dispute that the transition costs are reasonable and prudent. Further, there is no dispute that synergy savings exist at level that exceeds the transition costs.

273. First, the Commission finds it is hesitant to modify its prior order based on, in effect, boilerplate language that appears in all Commission orders. Absent more convincing evidence, the Commission will not avail itself of the ratemaking escape clauses highlighted by Staff.

274. Next, while the Commission recognizes that the Companies have enjoyed the benefit of regulatory lag to retain synergy savings over the last five years, the Commission finds that this outcome was specifically contemplated in its consideration of the appropriate treatment for synergy savings in the merger case and as set out in the Merger Order. The Commission also finds that it specifically contemplated that synergy savings would be higher than predicted. The Commission finds that this outcome does not constitute double recovery and thereby justify a departure from its prior order.

275. While Staff's analysis of the Companies' A&G expense interesting, the Commission finds that it has little relevance to the issue of whether the Commission should modify its Merger Order.

(b) Conclusions of Law

276. The Commission concludes that the Companies have complied with the Merger Order as it relates to recovery of transition costs. The Companies accumulated all transition costs consistent with the Merger Order. The Companies developed and maintained a Synergy Tracking Model which demonstrated that the merger synergy savings exceed the amortization of merger transition costs. The Companies stopped the deferral as of December 31, 2010. Therefore, the Commission further concludes that the Companies should be allowed to recover the merger transition costs in rates over five years beginning with rates effective from this case.

277. The Commission further concludes the Companies were permitted to retain synergy savings through regulatory lag as specifically set out in the Merger Order.

278. Finally, the Commission concludes that there no evidence in the record that would justify departure from the provision in the Merger Order.

6. Rate Case Expense

(a) Findings of Fact

279. The Company seeks to recover $4.1 million in rate case expenses incurred through the true-up of the KCP&L case and approximately $3 million collectively for GMO. Staff disputes the amount that the companies should be allowed to recover in this case.

280. Staff's main case for rate case expense appeared in the true-up portion of the proceeding. Staff claims it was required to make its case in the true-up because it did not receive adequate supporting documentation from the Company on a timely basis. *See* Majors True-Up

Direct Testimony at p. 2. The record provides Staff sent Data Request (DR) No. 141 on June 25, 2010. KCP&L responded on July 12, 2010. Staff didn't follow up on KCP&L's request for clarification until September 3, 2010, over six weeks after KCP&L's initial response was provided. KCP&L responded on September 23, 2010. Staff waited another five weeks before issuing another follow up DR on November 3, 2010, seeking full invoice detail for the first time. KCP&L responded on November 24, 2010. *Id*. at 104-105.

281. Although Staff acknowledged that the Company provided face sheets in its initial response to Staffs request for legal invoices, Staff still criticized the "lack of detail" provided. *See* Majors True-Up Direct Testimony at pp. 2-3. According to John Weisensee, a witness for the Company, face sheets were provided in prior cases and if additional detail was required, the company provided it. Further, Mr. Weisensee noted that face sheets were timely provided in response to Staffs request for legal invoices. When additional detail was requested, the detail was also provided in a timely manner with appropriate redactions made. *See* Hearing Tr. pp. 3640-42.

282. Staff next takes issue with certain vendors used by the companies for legal and other services necessary to prepare and defend the current rate cases. Regarding specific disallowances, Staff initially disallowed all legal expenses from vendors Stinson, Morrison & Hecker, Schiff Hardin, Pegasus Global and Morgan, Lewis, & Bockius, upon review of the invoices provided, Staff proposes to remove all legal expenses of Morgan, Lewis & Bockius. In addition, Staff proposes an adjustment to rate case expenses charged by Schiff Hardin and an adjustment for services relating to witness preparation. Finally, Staff maintains its disallowance of the NextSource consulting expenses of Chris Giles per its pre-filed testimony as duplicative. *See* Majors True-Up Direct Testimony at pp. 3-4 and 8.

283. With regard to Staff's proposed adjustment to remove all legal expenses of Morgan, Lewis & Bockius, Staff claims the attorneys' rates are excessive when compared to local attorneys, the expenses are not related to the current rate case and work is duplicative of other attorneys work. *Id.* at 2, 4. The Company responded by arguing it is unreasonable to apply Missouri law firm rates to the rates charged by attorneys practicing in other, possibly more expensive locations. In addition, the Company argues "Staffs 'standard' fails to take into account particular areas of expertise—including accounting, engineering, economics, large scale construction projects, financial markets, to name a few--needed by attorneys to assist utilities in rate case preparation and hearing."

284. The Company further argues that Morgan Lewis was employed in the 0259 docket which has been consolidated with the current rate case. The 0259 docket was an on-the-record proceeding to determine the status of Staff's Iatan 1 audit. This docket was central to the rate case in that the Staff was to explain every aspect of the Iatan 1 construction audit. That audit is part of this rate case and the data requests in that docket are linked to this rate case. *Id.*

285. With regard to the invoices related to Schiff Hardin, Staff proposes to disallow a portion of the expenses by, in effect, discounting the rate charged by Schiff Hardin attorneys to the hourly rate charged by Pegasus Global Holdings. *Id.* at 7. Staff claims this discount is reasonable because Staff "assumes" there was duplicative legal expenses charged to rate case expense. *Id.* Staff also claims it is appropriate to disallow excessive expenses. Staff provided no substantive evidence that the witnesses provided duplicative services.

286. Regarding NextSource, Staff initially removed "all dollars KCPL has included in rate case expense related to Mr. Giles' services as an independent contractor." *See* Hearing Exhibit KCP&L-9, Blanc Surrebuttal at 6, quoting Majors Rebuttal at 21. Staff argues that the

company should not be allowed to recover Mr. Giles' expenses as an independent contractor because it believes his salary was included in the rates that resulted from KCP&L's last rate case. Further, Staff argues that the Company should not be allowed to recover Mr. Giles' expenses as an independent contractor because Mr. Giles has the same job duties as Mr. Blanc, and therefore customers should not pay two people to perform one job. *See* Hearing Exhibit KCP&L-230, Majors Rebuttal Testimony at p. 12.

287. The Company argues that while it is correct that Mr. Blanc assumed the former duties of Mr. Giles, Staff has failed to demonstrate that Mr. Giles performed the same duties as an independent contractor as he did while a company employee. Notably, the Company argues Mr. Blanc specifically stated that Mr. Giles provided support to him "in the same manner as any contract employee or KCP&L employee in the Regulatory Affairs Department." *See* Hearing Exhibit KCP&L-9, Blanc Surrebuttal Testimony at p. 6.

288. Further, the Company argues that in making this adjustment, Staff seems to believe that the expenses of Mr. Giles and Mr. Blanc are duplicative. However, as testified to by KCP&L witness John Weisensee, only one full-time equivalent ("FTE") employee has ever been included in KCP&L's cost of service as the head of the Regulatory Affairs Department, because payroll is annualized. *See* Hearing Tr. p. 3644. Further, Mr. Giles never performed the same duties as Mr. Blanc once Mr. Giles left the company's employ. *Id.* at 3644.

289. As further explained by Mr. Blanc, employees may move around to different jobs within the company, or work as an outside consultant and take a job in-house, or conversely leave the employ of the company and work for the company as an outside consultant. In all of these cases, the company has only sought recovery of one FTE per employee function plus the

costs of outside consultants for purposes of rate case expense. According to Mr. Blanc, the company has not sought to recover overlapping or duplicative expenses. *Id.* at 3655-60.

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

291. Staff proposes removing the costs associated with CCA from rate case expense. Staff claims that the services provided by CCA related to witness development and coaching are typically performed by counsel. *Id.* at 8. The Company argues that contrary to Staff's "assumption," the true fact is that CCA was engaged to prepare the companies' Iatan prudence witnesses. In these preparation sessions, counsel for the companies did, in fact, prepare mock cross and redirect examination for the witnesses; however, CCA provided more expansive witness preparation, such as videography services, not routinely or typically provided by counsel.

(b) Conclusions of Law

292. Based upon the competent and substantial evidence in the record, the Commission concludes that KCP&L should recover $4.1 million and the collective GMO companies $3.1 million. These amounts represent the true-up amounts recorded as of December 31, 2010, not final rate case expenses. The difference will be recovered in the next rate case, subject to Staff review. *See* Majors True-Up Rebuttal Testimony.

293. The Commission concludes the legal expenses of Morgan, Lewis & Bockius should not be eliminated as the costs were not duplicative or excessive.

294. The Commission concludes the Schiff Hardin and Pegasus witnesses each provided testimony on separate, discrete issues related to the reasonableness of the expenditures related to the construction of Iatan. As a result, there was no duplication of effort and Staff assumed incorrectly. Thus, the Commission rejects Staff's proposed disallowance, including a reduction to Schiff Hardin's rate.

295. The Commission concludes there is no evidence to justify disallowing the inclusion of Mr. Giles expenses as an independent contractor.

7. Hawthorn 5 Settlement

(a) Findings of Fact

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

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

298. Staff proposed an adjustment to reflect the $2.8 million settlement proceeds "as an increase to the depreciation reserve and a decrease in depreciation expense, as if the plant cost had been adjusted for the total settlement proceeds received." See Hearing Exhibit KCP&L-8,

Blanc Rebuttal Testimony at p. 48. Staff's adjustment is based on its belief that "[a]ll the increased costs to KCPL were and are currently being paid by KCPL customers in utility rates." See Hearing Exhibit KCP&L-2 10, Staff Report at 109.

299. KCP&L states that customers never paid the outage-related fuel and purchased power costs. KCP&L believes customers should not be reimbursed for costs they did not pay.

300. KCP&L asserts that the settlement proceeds should not flow back to customers. First, the proceeds of this litigation are non-recurring revenue and are also outside the test year in this case. Unusual, non-recurring events (expenses or revenues) are excluded from the test year because they do not reflect the ongoing cost of service of the company. Further, the cost of replacement power and additional ammonia expense that resulted from the catalyst outage was never paid by customers. Customers did not pay for replacement power or additional ammonia expense because KCP&L did not have a fuel adjustment clause at the time of the outage and also KCP&L normalizes fuel and purchased power expenses in its rate cases so test year anomalies are disregarded. Additionally, there were no incremental costs to the company and, in turn, to its customers related to work assigned to KCP&L personnel as a result of the outage. See Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at pp. 49-50.

301. KCP&L witness Curtis Blanc testified that there is no way KCP&L's customers have paid for any increased costs because KCP&L didn't have a fuel adjustment clause at the time of the outages. See Hearing Exhibit KCP&L-8, Blanc Rebuttal at 49-50, 51-52.

302. Curtis Blanc indicated that although he does not have specific training in cost of service, fuel or accounting, Mr. Blanc has an undergraduate degree in business, including several accounting classes. Tr. at 3667. Blanc also testified that he participates in the ratemaking process and understands how it works. *Id.* at 3668. Mr. Blanc stated unequivocally that extra

costs associated with the outage were not passed on to ratepayers because of the normalization process which removes abnormal expenses. *Id*. at 3706.

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

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

305. Staff proposed an adjustment to reflect the $6.7 million settlement proceeds "as an increase to the depreciation reserve and a decrease in depreciation expense, as if the plant cost had been adjusted for the total settlement proceeds received." See Hearing Exhibit KCP&L-8, Blanc Rebuttal Testimony at p. 51. Staff's adjustment is based on its belief that "[a]ll the increased costs to KCPL of the operation of Hawthorne [sic] 5 resulting from the step-up transformer failure were paid by KCP&L customers in utility rates." See Hearing Exhibit KCP&L-2 10, Staff Report at 111.

306. KCP&L normalized fuel and purchased power expense in the years related to the Hawthorn 5 SCR and transformer outages. Further, the company did not have a fuel adjustment clause which would have permitted the pass through of those increased fuel and related costs. Therefore, customers did not pay any additional expenses associated with the outages.

(b) **Conclusions of Law**

307. The Commission concludes that Staff's attempts to include unusual, non-recurring, out-of-period Hawthorn 5 settlement proceeds in KCP&L's cost of service would constitute retroactive ratemaking and therefore rejects Staff's proposal to do so.

308. The Commission further concludes that for KCP&L customers to receive the benefit of reimbursement for costs they did not pay would unjustly enrich KCP&L's customers to KCP&L's detriment.

309. Finally, the Commission concludes that there no evidence in the record that would justify KCP&L not receiving reimbursement for the extra costs it absorbed during the outages.

8. **Fuel Switching**

(a) **Findings of Fact**

310. MGE has proposed that KCP&L be mandated to implement a fuel-switching program whereby KCP&L would be required to offer financial incentives to KCP&L customers to convert certain end use appliances from electricity to natural gas. Hearing Exhibit KCP&L-2201, Reed Direct at p.2.

311. MGE bases its proposal in part on a report from the National Research Council ("NRC") in response to a request from the Department of Energy ("DOE"), Office of Energy Efficiency and Renewable Energy {"EERE") to review the DOE's appliance standard program. *Id*. at 5; Hearing Tr. at 3101-02. The DOE is considering whether to adopt an alternative method for measuring energy consumption known as the Full-Fuel Cycle approach. Hearing Exhibit KCP&L-2201, Reed Direct at p. 5. The context of DOE's inquiry is whether to use the Full-Fuel

Cycle approach[2] in measuring energy consumption for inclusion on the yellow Energy Guide labels found on home appliances, or whether to continue using the site-based approach.[3] *See* Hearing Exhibit KCP&L-2209, Review of Site & Full-Cycle Measurement.

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

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

314. *Id*. at 38.

315. More significantly for the context of this rate case, Committee Member Ellen Berman indicated that switching from a site-based approach to appliance standards to the Full-Fuel Cycle approach is complex and won't benefit consumers, in part because consumers have

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

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

no control over the upstream costs included in the Full-Fuel Cycle methodology. Specifically, Ms. Berman stated:

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

317. Id. at 39-40.

318. MGE asserts that "the Full-Fuel Cycle approach is not a prerequisite to the adoption of this program." MGE's Initial Post-Hearing Brief at 4. However, MGE's proposal does not work in the absence of the Full-Fuel Cycle approach. Using a site-based approach will not favor natural gas appliances. Therefore, fuel switching can only be justified by the use of a Full-Fuel Cycle approach.

319. A primary tenet of the Full-Fuel Cycle is environmental impact. MGE asserts that environmental issues would lead the Commission to favor natural gas over electric production. *See*, *e.g.*, MGE's Initial Post-Hearing Brief at 5. However, the issues relating to environmental impacts have not been sufficiently fleshed out in this proceeding. MGE's testimony and brief do not address the release of methane, a potent greenhouse gas, caused by the extraction of natural gas. Hearing Tr. at 3130. Hydraulic fracturing of shale formations, the primary method currently used to procure new sources of natural gas, has been linked to fouling of municipal water supplies, release of cancer causing agents into water systems, and home explosions. Hearing Exhibit KCP&L-26, Goble rebuttal at 10-12; *see also*, Hearing Tr. at 3152.

320. MGE cites to Energy Star Performance Rating Methodology for Incorporating Source Energy Use (December 2007). Hearing Exhibit KCP&L-2201, Reed Direct at p. 8, fn. 6. This report, among other things, calculates the source-site ratio for various types of energy. Table 1 on page of 3 of the report shows that fuel oil (diesel, kerosene), propane and even wood have similar values to natural gas. The Energy Star Performance Methodology for Incorporating Source Energy Use also discusses the "potential for inefficiency in the conversion of primary fuels" and the "potential for loss when either primary or secondary fuels are transmitted/distributed to individual sites." *Id*. at 2.

321. MGE included its own tables which shows comparisons of electric and natural gas consumption under the Full-Fuel Cycle, whereby natural gas appears to be the more attractive fuel choice. Hearing Exhibit KCP&L-2201, Reed Direct at pp. 10-11. However, the data used by MGE is not specific to KCP&L, and MGE has not demonstrated that the general data it received from the American Gas Association ("AGA") is applicable to KCP&L. *See* Hearing Exhibit KCP&L-26, Goble Rebuttal at p. 20. The footnotes which accompany MGE's tables

state that the data is from a document entitled "A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances" prepared by the AGA. *Id*. This document indicates that the AGA's information was developed, in turn, by the Gas Technology Institute for Codes & Standards Research Consortium in a paper entitled "Source Energy and Emission Factors for Building Energy Consumption" (August 2009). *Id*. The original source of the information relied upon by MGE includes the following statement:

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

323. *Id*. at 20-21. Therefore, underlying data of MGE's analyses demonstrates that it is not reliable for the purposes intended by MGE.

324. In Table 3 prepared by MGE (Hearing Exhibit KCP&L-2201, Reed Direct at p. 13), MGE demonstrates the estimated annual cost savings when using water heating and space heating gas and electric appliances. However, MGE's calculations contain errors which must be corrected. Specifically, the prices used by MGE are not measured in the same units as the consumption. "[T]he consumption is measured in MMBtu, but the price is stated in terms of Dollars per hundred kWh." Hearing Exhibit KCP&L-26, Goble Rebuttal at p. 22. Correcting for errors shows customers who switch from electricity to natural gas for their water heating needs alone will experience no savings. In fact, their annual bill will increase by over $200 per year. *Id*. at 24. MGE estimated $200 in annual savings for switching from electricity to natural gas.

325. MGE did not provide the results of any Total Resource Cost ("TRC") test for its proposed water heating and space heating fuel substitution program. This Commission has routinely employed the TRC test in its economic analysis of potential energy efficiency

measures. Hearing Exhibit KCP&L-2201, Reed Direct at p. 39. For MGE's proposal to be considered a viable energy efficiency measure, the results of the benefit-cost tests would have to be evaluated. Although MGE did not provide sufficient information for any other party to perform this test, KCP&L's witness Goble estimated the required data in order to provide a rough analysis. Mr. Goble's analysis showed that "[t]he costs exceed the benefits in absolute as well as on a present worth basis. Even using very favorable assumptions, the Benefit-Cost ratio is only 0.5." Hearing Exhibit KCP&L-26, Goble Rebuttal at p. 26. Mr. Goble acknowledged that not all water heater fuel substitution programs are unacceptable. However, even with the suspect quality of data available for his analysis, Mr. Goble concluded "that it would be imprudent to implement the hastily designed electric to gas water heater substitution program recommended by MGE's witness … on the basis of economics." *Id.*

326. Goble also conducted a Ratepayer Impact Measure ("RIM") test and a Total Participant test. The results of the RIM test indicated that the costs exceed the benefits in every year as well as on a present worth basis, suggesting that implementation of MGE's proposed water heater fuel substitution program will result in higher rates for KCP&L's customers. *Id*. at 26-27. Similarly, customers' costs would exceed the benefits in every year as well as on a present worth basis under the Total Participant test. "Even using very favorable assumptions, the Benefit-Cost ratio is only 0.6." *Id*. at 27.

327. KCP&L also performed an analysis of MGE's proposed space heating electric to natural gas fuel substitution program. In general, the results of the TRC test for space heating were comparable to the results for water heating. *Id*. The results of the RIM and Total Participant tests revealed costs slightly in excess of the benefits. *Id*. Based on KCP&L's analysis, "neither the participant, the non-participants, nor society as a whole would benefit

economically from the substitution of electricity by natural gas for both the water and space heaters." *Id*. at 27-28.

328. MGE states that its proposed fuel switching program would help KCP&L reduce its peak load or defer future plans for new generation or transmission facilities and that "utility planning involves very long time horizons in order to meet future demand growth." Hearing Exhibit KCP&L-2201, Reed Direct at p. 34. However, KCP&L does not need capacity until the 2020-25 timeframe. Hearing Tr. p. 3129.

329. MGE recognizes that KCP&L previously considered fuel switching in Missouri as part of its 2008 Integrated Resource Plan ("IRP"). Hearing Exhibit KCP&L-2201, Reed Direct at p. 35. At that time, KCP&L acknowledged that "the impact of greenhouse gas restrictions could encourage large scale fuel switching." *Id.* The 2008 IRP was developed during a time of uncertainty surrounding federal mandates regarding emissions. To date, there have been no federally-mandated greenhouse gas emissions standards or restrictions implemented. Nor does Missouri have any such restrictions. Tr. at 3130.

(b) Conclusions of Law

330. The Commission concludes that adoption of MGE's proposal is not in the best interests of Missouri ratepayers at this time.

9. Demand-Side Management

(a) Findings of Fact

331. From the Companies' perspective, the primary goal related to Demand Side Management ("DSM") programs in this case is to establish a bridge or a temporary framework for going forward on the Companies' DSM programs until the Commission completely implements its rules related to the Missouri Energy Efficiency Investment Act ("MEEIA").

332. As recognized in the Staff Cost of Service Report, (Hearing Exhibit KCP&L-2010 (NP), p. 127, COS Report), "The Company's overall spending levels for demand-side programs have met and exceeded the expectations established in the Regulatory Plan. As reported by the Company, through June 30, 2010 the budget for all Company demand-side programs is $24,001,009 and the actual total expenditures through this period are $27,442,517, or 14% greater than budget." The Commission finds that the Companies have been aggressive participants in DSM programs in their respective service areas.

333. With the ending of the KCP&L Regulatory Plan in this case, however, the Commission finds that there is no established framework approved for addressing KCP&L's investments in DSM programs.

334. The Commission finds that KCP&L has complied with the requirements of the KCP&L Regulatory Plan, as well as the Integrated Resource Planning ("IRP") rule regarding DSM programs. In fact, KCP&L has been active with many of the parties, including the Staff, Public Counsel and MDNR, in addressing KCP&L's IRP as well as the Customer Program Advisory Group ("CPAG"), in addressing and planning the status of its DSM programs.

335. The Commission finds that the Companies are continuing their DSM programs contained in its tariffs. However, there needs to be a determination from the Commission regarding how the DSM programs will be treated following the conclusion of the KCP&L Regulatory Plan.

336. Staff has suggested that the existing levels of DSM investments should be mandated by the Commission to continue into the indefinite future, and the existing cost

recovery mechanism should be maintained. *See* Hearing Exhibit KCP&L-210 (NP) p. 126-30, COS Report; Hearing Exhibit KCP&L-239, Rogers Rebuttal at p. 2.

337. However, the current mechanism does not provide timely recovery or earnings opportunities, nor does it sufficiently encourage the implementation of energy efficiency programs by KCP&L. Therefore, the Staff's proposal should not be accepted by the Commission.

338. Under the existing cost recovery mechanism, KCP&L first funds the DSM programs, and the costs are placed into a regulatory asset for consideration for recovery in the next rate case without a carrying cost. Assuming the DSM costs are determined to be recoverable, then those costs are amortized over a ten-year period without the inclusion in rate base.

339. Until the new MEIAA rules are finally implemented, the Commission finds that it is important for the KCP&L to have a bridge that establishes the framework for the treatment of its DSM investments until the MEEIA rules can be implemented.

340. For the purposes of this case, KCP&L has proposed that the cost recovery mechanism should be consistent with the recent *Order Approving First Stipulation And Agreement* in the AmerenUE rate case, Case No. ER-2010-0036 (March 24, 2010). *See* Hearing Tr. pp. 3531-32. This would change KCP&L's current amortization period for the DSM regulatory assets from ten (10) years to six (6) years as described below, and include the unamortized balance in rate base for actual expenditures booked to the DSM regulatory asset up through the period of December 31, 2010. Hearing Tr. pp. 3501-03.

341. KCP&L has argued that KCP&L's cost recovery mechanism in this case should be consistent with the recent *Order Approving First Stipulation And Agreement* in

the AmerenUE rate case, Case No. ER-2010-0036 (March 24, 2010)(Tr. 3531-32). This would change the current amortization period for the DSM regulatory assets from ten (10) years to six (6) years, and include the unamortized balance in rate base for actual expenditures booked to the DSM regulatory asset up through the true-up period of December 31, 2010.

342. The six year amortization period would be applied to DSM program expenditures referred to by Staff as being incurred in "Vintage 4", that is, those subsequent to September 30, 2008. Prior expenditures would continue to be amortized over the originally authorized ten-year period.

343. Additionally, KCP&L would defer the costs of the DSM programs in Account 182 and, beginning with the December 31, 2010 True Up date in this case, calculate allowance for funds used during construction (AFUDC) monthly using the monthly value of the annual AFUDC rate. (Hearing Exhibit KCP&L-55 (NP), pp. 5-6, Rush Rebuttal)

344. The Commission finds that KCP&L's proposal is reasonable and should be adopted.

345. The Companies have argued that the Commission should reject Staff's and MDNR's recommendations to direct the Companies to invest in DSM programs without any assurance that the full costs and lost revenues associated with these programs will be recognized in rates. Instead, the Commission should move forward to implement the cost recovery issue expeditiously, including the recovery of lost revenues associated with the specific DSM programs. *See* Hearing Exhibit KCP&L-55 (NP), Rush Rebuttal at p. 8.

346. The Commission finds that the Companies have experienced customer load growth changes due to many factors including the downturn in the economy. The change in

load has necessitated some changes to the plant, which has been presented to the parties involved in the Companies' IRP processes.

347. The Commission finds that the Companies are continuing their DSM programs contained in their tariffs with the hope that the Commission will implement rules that provide for adequate cost recovery of DSM expenditures. In fact, as discussed above, KCP&L has expended more funds on DSM in total than was set out in the Regulatory Plan. Hearing Exhibit KCP&L-56 (NP), Rush Surrebuttal at p. 4.

348. The Commission finds that it is unnecessary for the Commission to require KCP&L and GMO to make a compliance filing with the Commission regarding MEEIA legislation as proposed by the Staff. *See id.* at p. 3.

349. The record reflects that Staff nets unrelated issues to be included with its adjustment for DSM program costs. *See* Hearing Exhibit KCP&L-210 (NP), COS Report at p. 131-37; Hearing Exhibit KCP&L-226 (NP), Hyneman Surrebuttal at p. 63. Staff includes negative costs against the unamortized balance of DSM program costs for purposes of computing an annual amortization and return. These negative costs are those that the Commission has previously ordered to be returned to ratepayers over ten years and include excess margins on off-system sales (OSS) and net reparations from the litigation of Montrose coal freight rates before the Surface Transportation Board (STB), but are unrelated to DSM Program costs.

350. As discussed in the Rebuttal Testimony of John P. Weisensee, KCP&L and GMO believe this netting to be inappropriate. Mr. Weisensee discusses at length the concerns raised by Staff's specific adjustments and its approach to lump together these unrelated adjustments. *See* Hearing Exhibit KCP&L-64 (NP), Weisensee Rebuttal at p. 6-18. The Commission finds

that DSM costs should be considered as a stand-alone cost for purposes of cost recovery and the Staff's "netting" method is hereby rejected.

351. As discussed in the Rebuttal Testimony of John P. Weisensee, the Commission finds that it ordered in prior cases that the carrying costs for the excess margins on OSS would be established at LIBOR plus 32 basis points and that this interest would be included in the unamortized balance of excess OSS margins for amortization over ten (10) years. It also finds that it prohibited rate base recognition for the unamortized balance of net reparations from the litigation of Montrose coal freight rates before the STB and did not otherwise order carrying costs.

352. As discussed in the Rebuttal Testimony of John P. Weisensee, the Commission finds that the value of excess margins on OSS should be calculated for the period applicable to the effective rates in each rate case, using the 25th percentile of OSS ordered in that case, rather than on a calendar year basis as was reflected by Staff in its True Up case. For partial years, the process ordered in the ER-2009-0089 case should be applied.

(b) Conclusions of Law

353. The Commission concludes that it should adopt KCP&L's proposal in this case. KCP&L's cost recovery mechanism should be consistent with the recent *Order Approving Stipulation And Agreement* in the AmerenUE rate case, Case No. ER-2010-0036 (March 24, 2010). The Commission concludes that it is reasonable and appropriate to change KCP&L's current amortization period for DSM regulatory assets from ten (10) years to six (6) years, and include the unamortized balance in rate base for actual expenditures booked to the DSM regulatory asset up through the period of December 31, 2010. The Commission concludes that KCP&L should be allowed to calculate carrying costs on all DSM expenditures incurred after December 31, 2010 based on the current AFUDC rate.

354. The Commission concludes that it is unnecessary for the Commission to require KCP&L and GMO to make a compliance filing with the Commission regarding the MEEIA legislation as proposed by Staff.

355. Based upon the competent and substantial evidence in the record, the Commission concludes that it is reasonable and appropriate that DSM costs should be considered as a stand-alone cost for purposes of Staff's calculation of the revenue requirement in this case. The Commission concludes that the "netting" approach proposed by the Commission Staff should be rejected in this case.

356. The Commission concludes that carrying costs on excess OSS margins should be calculated at LIBOR plus 32 basis points and that this interest should be included in the balance for amortization over ten (10) years. The Commission concludes that there should be no carrying costs on the unamortized balance of net reparations resulting from the litigation before the STB.

357. The commission concludes that the value of excess margins on OSS should be calculated for the period applicable to the effective rates in each rate case, using the 25th percentile of OSS ordered in that case, rather than on a calendar year basis as was reflected by Staff in its True Up case. For partial years, the process ordered in the ER-2009-0089 case should be applied.

10. Low-Income Weatherization Program Funding

(a) Findings of Fact

358. In the Staff's Cost of Service Reports (Hearing Exhibit KCP&L-210 (NP), Staff's COS Report, p. 143 and Hearing Exhibit GMO-210 (NP), p. 156), the Staff recommended that KCP&L and GMO be required to continue to provide annual funding of $573,888 and $150,000,

respectively. Staff also suggested that unspent weatherization funds should be placed into an account with EIERA. *See* Hearing Exhibit KCP&L-246 and Hearing Exhibit GMO-247, Warren Surrebuttal.

359. The Companies disagrees with both Staff proposals. The Companies contend that this rate case is not the proper forum for a decision to continue the current funding levels for low income weatherization.

360. From the Companies' perspective, such proposals should be first vetted with the Customer Program Advisory Group ("CPAG") which consists of various interested parties. Perhaps more importantly, the Companies argue that a Commission determination of the recovery mechanism for such programs should be made before a decision on the level of weatherization funding is made.

361. The Companies also argue that it would be unlawful for the Commission to mandate a specific funding level for low income weatherization without a mechanism in place for the Companies to recover these mandated-expenditures.

362. The Companies also have suggested that it would be inappropriate to require the unspent funds be deposited into an EIERA account. The record reflects that KCP&L anticipates spending ninety-six percent (96%) of the budgeted funds for its existing weatherization program. *See* Hearing Exhibit KCP&L-246, Warren Surrebuttal at p. 4.

363. The Commission finds that it is unreasonable to require that the remaining unspent funds (4%) should be deposited into an EIERA account for use by a program that has recently been able to spend a much lower percentage of its funds for weatherization purposes. *See* Hearing Tr. p. 3608.

364. MDNR witness Adam Bickford also testified that MDNR had not been approached by any party regarding Staff's proposal in this case. He indicated that EIERA would have to balance resources with other projects they are involved in, and consider whether there are significant design differences between the federal weatherization programs and KCP&L's program. *See* Hearing Exhibit KCP&L-605, Hearing Exhibit GMO-603, Bickford Surrebuttal at p. 3.

365. Additionally, Staff is recommending that the Companies modify their direct reimbursement payment method to the weatherization agencies from monthly to annual. This recommendation would also be harmful to the Companies' cash flow and place an undue burden on the Companies. *See* Hearing Exhibit KCP&L-55 at p. 3; Hearing Exhibit GMO-33, Rush Rebuttal at pp. 12-13.

(b) Conclusions of Law

366. Based upon the competent and substantial evidence in the record, the Commission concludes that it should reject Staff's proposals regarding mandating the funding of low income weatherization programs in this case.

367. The Commission also concludes that it is unreasonable to require that KCP&L deposit the remaining unspent funds (4%) into an EIERA account.

368. The Commission also concludes that it will not adopt Staff's recommendation that the Companies be required to modify their direct reimbursement payment method to the weatherization agencies from monthly to annual. The Commission concludes that this recommendation would be harmful to the Companies' cash flow and place an undue burden on the Companies.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 18th day of March, 2011, to all counsel of record.

/s/ James M. Fischer
James M. Fischer