

**THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS**

Before Commissioners:     Brian J. Moline, Chair  
                                       Robert E. Krehbiel  
                                       Michael C. Moffet

In the Matter of the Future Supply, ) Docket No. 04-KCPE-1025-GIE  
Delivery and Pricing of the Electric Service )  
Provided by Kansas City Power & Light )  
Company.

## ORDER APPROVING STIPULATION AND AGREEMENT

The above captioned matters come before the State Corporation Commission of the State of Kansas (Commission) for consideration and decision. Having examined its files and records, and being duly advised in the premises, the Commission makes the following findings:

1. On May 18, 2004, Kansas City Power & Light Company (KCPL) filed its Application to Establish Investigatory Docket and Informal Panel Discussion Process (Application). KCPL sought, among other things, a forum in which to discuss constructive regulatory responses to emerging issues that will affect the supply, delivery and pricing of the electric service it provides. Application, 1.

### *The Stipulation and Agreement*

2. On April 27, 2005, KCPL, the Staff of the Commission (Staff), Sprint, and the Kansas Hospital Association (KHS) (collectively, the Parties) filed their Joint Motion to Approve Stipulation and Agreement (Joint Motion) along with a copy of the Stipulation and Agreement (Agreement). Under the Agreement, the parties agreed to "certain premises, fundamental concepts, and factual conclusions." Agreement, 2. The

Parties asked that the Commission approve and adopt the Agreement. Agreement, 3; Motion, 1.

3. On May 3, 2005, the Commission issued its Order Setting Procedural Schedule (Procedural Order). In the Procedural Order, the Commission set forth deadlines for the filing of testimony in support of and opposition to the Agreement. Procedural Schedule, 2. The Commission scheduled an evidentiary hearing for June 17, 2005 (Tr. Vol. I). Procedural Order, 2.

4. At the hearing, the following attorneys entered their appearances: (1) Glenda Cafer, William Riggins, and Frank Caro on behalf of KCP&L; (2) Wendy Tatro and Dana Bradbury on behalf of Staff; (3) David Springe on behalf of CURB; (4) Constance Shidler on behalf of Sprint and the Kansas Hospital Association; (5) Charles Benjamin on behalf of Sierra Club; and (6) James Flaherty appeared on behalf of Empire and Aquila. Tr. Vol. I, 6-7.

5. At the hearing, KCP&L presented the prefiled testimony of Chris Giles, John Grimwade, Lori Wright, Wm. Edward Blunk, Michael Cline, Susan Nathan, and William Herdegen. Tr. Vol. I, 36, 125, 156-57. With the exception of Giles and Grimwade, the prefiled KCP&L testimony was admitted without cross-examination. Tr. Vol. I, 156. Staff presented the testimony of Larry Holloway, Jeffrey McClanahan, and Don Low. Tr. Vol. I., 157, 182, 206. Sierra Club admitted the prefiled testimony of William Griffith and Craig Volland. Tr. Vol. I, 229, 241.

#### *Collaborative Process*

6. KCP&L witness Giles described the collaborative approach used in this docket and explained why KCP&L chose the collaborative approach to address the issues involved. Direct Testimony of Chris B. Giles, filed May 10, 2005 (Giles), 3-6. Under the traditional approach to utility planning, the utility must first make decisions and investments and later seek regulatory approval, thereby running the risk that not all investments will be recovered. Giles, 5-6. However, under the collaborative approach used in this docket, KCP&L secured agreement with Staff, Sprint, and the KHS on additional generation, environmental concerns, transmission and distribution investments, and customer programs for managing electricity use. Giles, 6. Also, approval of a plan would help attract capital on favorable terms. Giles, 6. KCP&L conducted numerous informal meetings with interested groups and individuals. Giles, 3. KCP&L conducted workshops, public forums, and strategic planning seminars, involving employees, customers, energy experts, financial experts, the general public, consumer groups, manufacturers, industrial and trade groups, environmental organizations, and other utility companies, as well as government and community leaders. Giles, 4. KCP&L representatives also met with representatives from Staff, CURB, and other parties. Giles, 5.

7. Staff witness Low testified that KCP&L largely could have sought approval of its resource plan under the statutory provision of K.S.A. 66-1239, which permits an electric utility to request a determination by the Commission of the "rate-making principles and treatment, as proposed by the public utility, that will apply to recovery in

wholesale or retail rates of the cost to be incurred" for certain transmission lines and generating resources. Direct Testimony of Donald Low, filed May 10, 2005 (Low), 4.

*Proposed Major Capital Expenditures*

8. Under the Agreement, KCP&L agreed to undertake reasonable efforts to make the following investments: (1) the addition of 500 MW generation through the expansion of the Iatan site, near Weston, Missouri (Iatan 2); (2) the addition of 100 MW of new wind generation to be installed in 2006 and the potential addition of an additional 100 MW of wind generation to be added in 2008; (3) transmission and distribution additions; and (4) environmental improvements to existing generation. Agreement, Appendix A. The Parties agreed that those investments are elements of a reasonable and adequate resource plan. Agreement, 3.

9. The total company cost of the investment planned by KCP&L amounts to nearly \$1.2 billion, including \$734 million for KCP&L's 500 MW share of Iatan 2, \$131 million for the 100 MW of wind generation, \$272 million for environmental investments through 2010, and \$52.8 million for demand side management and energy efficiency pilot. Direct Testimony of John R. Grimwade, filed May 10, 2005 (Grimwade), 17; Staff Direct Testimony Prepared by Jeffrey D. McClanahan, filed May 10, 2005 (McClanahan), 3; Giles, 7-9.

*Iatan 2*

10. Staff witnesses Holloway and Low testified regarding the addition of the 500 MW of generation capacity. In explaining the need for additional generation capacity, Holloway explained that KCP&L will be required to make annual generation

capacity purchases in 2008 and 2009, and, when Iatan 2 comes on line in 2010, KCP&L will have a limited amount of generation capacity that will be almost gone by 2014. Staff Direct Testimony Prepared by Larry Holloway, filed May 10, 2005 (Holloway), 6.

Holloway testified that KCP&L's plan of adding 500 MW generation capacity in 2010 is reasonable. Holloway, 7. In further support, Holloway cited a study by the now defunct MOKAN power pool indicating that the ideal mix of generation capacity consists of 54% baseload, 21% intermediate, and 25% peaking. Holloway, 7-8. Based on the MOKAN study, in addition to projections of the need for increased generation capacity, Holloway concluded that KCP&L's decision to add baseload generation was reasonable. Holloway, 9-10.

11. Under the Agreement, KCP&L plans to build an 800 to 900 MW coal power plant in order to meet the need for additional generation capacity. Holloway, 3. KCP&L plans on owning 500 MW of the plant, with partners owning the remaining 300 to 400 MW. Holloway, 3. The cost of Iatan 2 is projected to be approximately \$733,666,000, amounting to \$1,467 per KW of installed capacity. Holloway, 10. Holloway testified that this projected cost is reasonable. Holloway, 10. Holloway specifically testified that the decision to construct Iatan 2 was reasonable and that the Agreement contains an adequate level of protection and safeguards for KCP&L's Kansas retail ratepayers. Holloway, 13.

12. Support for Iatan 2 was also provided by KCP&L witness Grimwade. Grimwade testified regarding KCP&L's Integrated Resource Planning (IRP) process and proposed Comprehensive Resource Plan. Grimwade, 2. KCP&L projected that it will

have a capacity shortfall in 2010 of 431 MW. Grimwade, 7. The most economical way to add the necessary generation capacity was to add a 500 MW share of a pulverized coal-fired generating unit to come on line between 2010 and 2012. Grimwade, 9.

13. Sierra Club witness Griffith testified that through energy efficiency programs and investment in windpower, there is no need for KCP&L's planned addition of coal fired generation. Direct Testimony in Opposition by William Griffith of the Sierra Club, filed May 31, 2005 (Griffith), 1. Griffith cited a study in Iowa showing that 40 to 50% of the nation's projected load growth over the next two decades can be displaced through energy efficiency, load management, and pricing reforms. Griffith, 1. The Commission notes that the full study cited by Griffith was not entered into the record. Tr. Vol. I, 233-34. Further, the Commission is concerned that the 40 to 50% figure could not be found in the actual study. Tr. Vol. I, 235-38.

14. Sierra Club witness Volland testified that the data provided by KCP&L did not support its conclusion that additions to baseload capacity are needed. Direct Testimony of Craig S. Volland, filed June 1, 2005 (Volland), 3. Volland also testified that even if additions to baseload were necessary, KCP&L has not supported the conclusion that such additions be in the form of coal fired generation rather than wind power. Volland, 3. Volland alleged that the purpose of the addition of Iatan 2 was to support KCP&L's planned wholesale operations. Volland, 5.

15. The Commission finds that the Agreement regarding the addition of 500 MW of coal fired generation is reasonable, and that the plan to build the additional generation capacity contains adequate safeguards for KCP&L's Kansas retail ratepayers.

The weight of the evidence presented supports the conclusion that KCP&L is required to add baseload generation capacity and that such capacity cannot be satisfied through wind power. While Sierra Club witnesses testified that KCP&L should rely on wind generated power rather than a coal fired plant, the Commission finds, as discussed below, that wind generation is not adequate to meet KCP&L's needs at this time. Consequently, the Commission finds the Agreement reasonable in this regard.

#### *Wind Generation*

16. Staff witness Holloway testified that KCP&L will install 100 MW of wind generation in 2006 and possibly another 100 MW in 2008. Holloway, 13. The additional 100 MW of wind generation in 2008 was not presently justified by KCP&L and would require further study. Holloway, 13-14. Holloway testified that the addition of the 100 MW of wind generation in 2006 will have little anticipated effect on generation capacity. Holloway, 6, 14. The low reliability of wind generation due to the unpredictability of the weather is a limitation of wind generation. Holloway, 14. Holloway said that the anticipated cost of \$130,838,000, or approximately \$1,308 per KW of installed capacity, was a reasonable estimate of the cost of construction of the wind generation facilities. Holloway, 14. Further, Holloway testified that the Agreement contains adequate safeguards to address Staff's concerns and to protect ratepayers. Holloway, 16.

#### *Transmission and Distribution Additions*

17. KCP&L witness Herdegen discussed the \$42.3 million of distribution and transmission investments needed as part of the Asset Management plan. Direct Testimony of William P. Herdegen, filed May 10, 2005 (Herdegen), 2. KCP&L will

conduct a system-side condition assessment and address areas experiencing high failure or areas nearing their useful life. Herdegen, 3-4.

18. Staff witness Holloway testified that Staff supports KCP&L's asset management plan. Holloway, 19-20. The improvements would increase KCP&L's retail quality of service and decrease maintenance and operating costs. Holloway, 20.

*Environmental Improvements to Existing Generation*

19. Regarding the environmental improvements to existing generation, Staff witness Holloway testified that there was a need for KCP&L to undertake the environmental upgrades, that the estimated costs of those upgrades was reasonable, and that the Agreement contains sufficient provisions to ensure that KCP&L's implementation of the upgrades is done in a prudent and efficient fashion. Holloway, 19.

*Demand Response, Efficiency, and Affordability Program*

20. Staff witness Holloway testified that based on the ratepayer impact measurement (RIM), KCP&L's proposed demand response program was reasonable. Holloway, 24. Holloway could not say the same for KCP&L's energy efficiency and affordability programs; however, because all particular demand response, energy efficiency, and affordability programs will be subject to Commission review and approval, Holloway testified that Staff believes the Agreement was reasonable. Holloway, 24-25.

*CIAC: Overview*

21. KCP&L witness Cline testified to (1) discuss the importance of the acceptance of the Regulatory Plan by the financial community; and (2) explain the



KCP&L's interaction with the rating agencies during the development of the Regulatory Plan. Direct Testimony of Michael W. Cline, filed May 10, 2005 (Cline), 2. Cline explained that it is important for the financial community to accept the Regulatory Plan for the following reasons: (1) KCP&L will have to rely on external financing to fund the Plan; (2) KCP&L will have to refinance significant amount of existing debt; and (3) the acceptance of the Plan will affect how the parent company's stock performs. Cline, 3. Cline testified that preserving KCP&L's credit rating is vital. Cline, 4.

22. In order to address the financial concerns posed by the plan to spend approximately \$1.2 billion in capital improvements, the Parties agreed to support the contributions in aid of construction (CIAC) amortization. Agreement, 5-9. The CIAC is designed to maintain certain financial ratios for the purpose of preserving KCP&L's investment grade credit rating through the construction period ending June 1, 2010. Giles, 12.

23. The CIAC amortization will be a part of a KCP&L rate case when the revenue requirement fails to satisfy certain S&P financial ratios. Giles, 12. In particular, the CIAC is designed to maintain the following two financial ratios at the lower end of the top third under the BBB columns: (1) Funds from operations interest coverage; and (2) Funds from operations as a percentage of average total debt. McClanahan, 10; Giles, 13. Another financial ratio, total debt to total capitalization, will be addressed in a soon to be filed financing application. Giles, 13.

24. After the expiration of the Regulatory Plan, the cumulative amount of the CIAC offsets the gross plant over the life of the plant assets. McClanahan, 8, 12; Low, 6.

This gross plant offset provides ratepayers a long-term benefit. McClanahan, 12. Staff witness Low testified regarding the limitations of the CIAC. Low, 6. The CIAC will exclude any negative cash flow impacts or consideration of amounts related to imprudent or unreasonable actions or costs, as determined by the Commission. Low, 6. The CIAC cannot be increased because of inadequate cash flows from Missouri operations, because of non-regulated operations, or because of risk associated with KCP&L's parent company. Low, 6. The CIAC is not required if KCP&L fails to prudently manage costs, continuously improve productivity, or maintain service quality during the five-year plan. Low, 6. Further, for purposes of calculating the cost of debt, the lower of the actual cost of debt or the cost of debt for an investment grade rating will be used. McClanahan, 26. For example, if the CIAC mechanism provides adequate revenue to KCP&L for it to meet the investment grade financial ratios, yet KCP&L fails to obtain an investment grade credit rating, the cost of debt used in the ratecase for ratemaking purposes will be that cost of debt that KCP&L would have incurred had KCP&L received an investment grade. McClanahan, 26.

25. Staff witness Low testified that the CIAC mechanism is an appropriate balance of interests. Low, 11-12. To the benefit of KCP&L, the CIAC assists KCP&L's financial health during the construction period, and the CIAC represents more risk for the ratepayers. Low, 11. However, the ratepayers benefit through the reduction in costs of the investments for ratepayers in future years. Low, 11. Further, the CIAC represents the lowest cost alternative to ratepayers due to the lower overall return "on" and return "of" the additional plant contemplated in the plan. McClanahan, 8, 12; McClanahan,

Supplemental Direct, 2-5; Low, 6. Additionally, the Agreement provides for a reduction in AFUDC for Iatan 2 during the construction period by 250 basis points. Low, 11. Further, KCP&L agreed not to request additional return on investments in its wind generation, which is authorized at K.S.A. 66-117(e). Low, 12. Low testified that considering the amount of money at stake for wind investment, KCP&L's concession regarding K.S.A. 66-117(e) is potentially significant. Low, 12.

*CIAC: Legal Considerations*

26. The Commission recognized that parties to the docket had legal concerns with the CIAC mechanism. Consequently, the Commission provided the parties an opportunity to file briefs raising those concerns. Tr. Vol. I, 260-62.

27. On June 28, 2005, the Citizens Ratepayer Board (CURB) filed its Brief (CURB Brief). In CURB's opening paragraph, CURB appeared to suggest that it may oppose the CIAC mechanism despite the fact that it will lower consumer rates. CURB Brief, 1. CURB pointed out that traditional ratemaking requires analysis of actual utility expenses. CURB Brief, 1-2. In contrast, CURB pointed out that the CIAC mechanism is not based on any actual costs. CURB Brief, 2. Broadly stated, CURB cited three concerns with the CIAC mechanism: (1) that the CIAC revenue is above and beyond an already determined just and reasonable rate; (2) that the CIAC impermissibly delegates rate making determinations to an outside third party; and (3) that the CIAC mechanism improperly makes ratepayers involuntary contributors of capital. CURB Brief, 3.

28. When addressing its concern that the CIAC amounts are impermissible because they are in addition to the determined just and reasonable rate, CURB

acknowledged Staff's and KCP&L's likely position that the Commission will be ruling on the totality of the rates. CURB Brief, 4. However, CURB pointed out that the Agreement itself belies that position with the following language: "The adjustment process to determine the Kansas jurisdictional CIAC amounts in each rate case will be based on the cash flow needs after consideration of the traditional revenue requirements determination and will be based on the major components of such determination." Agreement, 8; CURB Brief, 4. Consequently, CURB concluded that the CIAC amount represents additional revenue on top of the traditional rate determination, which is, traditionally, a determination of a just and reasonable rate. CURB Brief, 5. CURB cited *Gas Service Company v. State Corporation Commission*, 4 Kan. App. 2d 623, 609 P.2d 1157 (1980), for the proposition that only actual or reasonably projected expenses can be recovered by a utility. CURB Brief, 5. In contrast, maintained CURB, the CIAC creates an expense not related to money spent in the past or to be spent in the future, but rather a fictional expense for the purpose of creating cash flow. CURB Brief, 6. In attacking the anticipated position of Staff and KCP&L that it is the overall bottom-line result that must be just and reasonable, CURB linked this argument to its position that the role of the Commission is not to guarantee the financial integrity of the utility. CURB Brief, 7. CURB also maintained that any addition, apparently irrespective of how insignificant, to a just and reasonable determined rate will cause that rate to not be just and reasonable. CURB Brief, 8.

29. CURB also argued the Commission would be sub-delegating its legislative authority to an outside third-party through the determination of the CIAC. CURB Brief,

9. In support, CURB cited *United States Telecom Association v. Federal Communications Commission*, 359 F.3d 554 (D.C. Cir. 2004), *Gumbhir v. Kansas State Board of Pharmacy*, 228 Kan. 579, 618 P.2d 837 (1980), and *Sedlak v. Dick*, 256 Kan. 779, 887 P.2d 1119 (1995). CURB Brief, 9.

30. Last, CURB questioned whether the CIAC impermissibly makes KCP&L ratepayers involuntary contributors of capital to the utility. CURB Brief, 10. CURB recognized that contributions to capital may be permissible in cases of extraordinary customer specific expenditures, *e.g.* line extensions, yet distinguished those cases as voluntary rather than the involuntary contributions as in this present case. CURB Brief, 10.

31. On June 28, 2005, KCP&L filed its Post Hearing Brief (KCP&L Brief). KCP&L's brief was intended to provide the public policy and legal considerations that support approval of the Agreement. KCP&L Brief, 1. KCP&L said that its plan properly balances the interests of customers, creditors, and shareholders -- a basic holding of the seminal *Federal Power Commission v. Hope Natural Gas Co*, 320 U.S. 591, 603, 88 L. Ed. 333, 64 S.Ct. 281 (1944) ("the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests"). KCP&L Brief, 2. Regarding the CIAC, KCP&L stressed that the CIAC amount will require Commission approval in future rate cases. KCP&L Brief, 2. Further, KCP&L asserted that without the CIAC, KCP&L's credit rating would be downgraded upon taking on the plan to make the additional investment, ultimately causing higher rates for ratepayers. KCP&L Brief, 2. KCP&L pointed out that the amortized CIAC amounts are offset by corresponding

reductions in rate base. KCP&L Brief, 3. KCP&L also pointed out that the lower cost of capital is also a benefit to ratepayers that should be balanced against the CIAC. KCP&L Brief, 4. Further, KCP&L noted the 250 basis point reduction in the equity portion of the AFUDC rate applicable to Iatan 2. KCP&L Brief, 4.

32. Importantly, KCP&L pointed out that the Commission is not a party to the Agreement. KCP&L Brief, 5. KCP&L acknowledged that the Commission's approval of the Agreement would not require the Commission to make any specific determinations or grant any approvals in subsequent dockets. KCP&L Brief, 5. In support, KCP&L referenced the following language to this effect in the Agreement:

"Nothing in the Agreement is intended to impinge or restrict, in any manner, the exercise by the Commission of any statutory right, including the right of access to information, or of any statutory obligation, including the obligation to ensure that KCPL is providing efficient and sufficient service at just and reasonable rates." Agreement, 12.

KCP&L Brief, 5.

33. KCP&L also pointed out that, in the context of the CIAC, the signatory parties, including Staff, would retain the right to argue that KCP&L has failed to prudently manage its costs. KCP&L Brief, 6. KCP&L noted that the Agreement seeks the Commission's approval of the following accounting measures:

"(i) KCPL would be authorized to implement an Energy Cost Adjustment ("ECA") mechanism that reflects its total fuel costs on a monthly basis, to become effective concurrently with the new rates that will be determined in KCPL's next rate case at which time the details and mechanics of such ECA will also be determined, as provided in Appendix C at Section B;

"(ii) KCPL would be authorized to manage its SO<sub>2</sub> emission allowance sales, as detailed in Appendix C at Section D and Appendix C-1;

"(iii) KCPL would be authorized to establish a regulatory asset or liability on KCPL's books related to FAS 87 pension expense, as detailed in Appendix C at Section E;

"(iv) KCPL would be authorized to reduce its AFUDC rate in the equity portion of the rate applicable to Iatan 2 by 2.5% or 250 basis points, as detailed in Appendix C at Section G;

"(v) KCPL would be authorized to accumulate the Demand Response, Efficiency and Affordability Program costs in regulatory asset accounts as the costs are incurred and amortize those costs as detailed in Appendix C at Section F and Appendix B;

"(vi) KCPL would be authorized to use the depreciation and amortization rates set forth in Appendix c-2;

"(vii) KCPL would be authorized to accrue additional amortization expense referred to as a Contribution in Aid of Construction ("CIAC") as a cost of service for ratemaking purposes. Any CIAC amounts that are approved by the Commission in a separate rate case shall be treated as increases to depreciation reserve and shall be deducted from rate base in a future KCPL rate proceeding, beginning with the 2009 rate case contemplated by the Stipulation. The specific plant accounts to be reduced by the CIAC amounts shall be determined at a later time. Section III.A.5 at page 6-7." KCP&L Brief, 6-7.

34. KCP&L asserted that the purpose of the CIAC is to maintain KCP&L financial credit ratings, which in turn will reduce the overall costs of the plan. KCP&L Brief, 7. Regarding the calculation of the CIAC, KCP&L cited numerous safeguards contained within the Agreement designed to preserve the Commission's discretion and authority. KCP&L Brief, 8.

35. KCP&L cited to previous dockets in which the Commission has relied on an investment grade credit rating for measure the financial health of a utility. KCP&L Brief, 12-14. KCP&L also cited to *Kansas Gas & Electric Co. v. Kansas Corporation*

*Comm'n*, 239 Kan. 483, 489, 720 P.2d 1063 (1986), for the proposition that the end result is the critical question in the ratemaking process, not the particular method used.

KCP&L Brief, 16.

36. On June 28, 2005, The Kansas Chapter of Sierra Club filed its Legal Brief (Sierra Club Brief). Sierra Club raised a number of public policy arguments. The Commission notes that the briefs were ordered to be confined to legal matters. Tr. Vol. I, 252, 260-62. As to factual matters, the Commission notes that Sierra Club declined to give closing arguments regarding factual matters, but instead relied upon its opening statements. Tr. Vol. I, 253.

37. On July 8, 2005, Staff filed its Brief on the Legality of the CIAC Mechanism (Staff Reply). Regarding the argument by CURB that the CIAC amount is above and beyond the just and reasonable determined level and therefore results in an amount that is not just and reasonable, Staff had three responses: (1) that the Commission is not required to use a traditional ratemaking formula; (2) that just and reasonable is a more flexible concept than CURB allows; and (3) that CURB's approach is short sighted. Staff Response, 2. Staff cited to K.S.A. 66-128 for the proposition that the Commission is required to "determine the reasonable value of the 'used and required to be used' property in rate base 'whenever the commission deems the ascertainment of such value necessary in order to enable the commission to fix fair and reasonable rates.'" Staff Reply, 2-3. Staff cited *Southwestern Bell Telephone Co. v. State Corp.*, 192 Kan. 39, 386 P.2d 515 (1963), and *Kansas Gas and Elec. Co. v. State Corp. Com'n*, 239 Kan. 483, 720 P.2d 1063 (1986), for the proposition that the Commission has the discretion to



chose a methodology for reaching a just and reasonable result to all interested parties.

Staff Reply, 3. Staff cited *Sekan Electric Cooperative Association, Inc. v. State Corporation Commission*, 4 Kan. App. 2d 477, 609 P.2d 188 (1980), for the proposition that it is the end result that must be evaluated against the just and reasonable standard.

Staff Reply, 3. For further statutory support for the notion of Commission flexibility in approaching ratemaking, Staff cited to K.S.A. 66-117(e), which permits an increased rate of return for renewable, conservation, and efficiency improvements. Staff Reply, 4. In support of its position regarding the just and reasonable zone, Staff emphasized the need of the Commission to balance the needs of all parties. Staff Reply, 4-5. Staff emphasized the valid ratepayer interests in the plan, including (1) the reasonableness of the resource plan; (2) the need to maintain KCP&L's investment grade credit status; (3) the lower cost of financing; and (4) the overall lower cost of the plan to ratepayers. Staff Reply, 5. Staff continued its analysis and stressed that the Commission's broad consideration of interests must also include consideration of the interests of future ratepayers and the public interests throughout the life of the plant additions. Staff Reply, 6-8. Regarding CURB's position that the CIAC mechanically guarantees KCP&L financial integrity, Staff pointed out that the safeguards -- such as the limitation that the CIAC amount cannot exceed the overall expected cost savings -- keep the rates within the zone of reasonableness. Staff Reply, 6-7.

38. Staff also addressed the allegation of CURB that the CIAC is an impermissible delegation of the Commission's legislative authority. Staff Reply, 8. Staff stressed that the Commission will be making a decision in each rate case on whether to

approve or deny the CIAC. Staff Response, 8. Staff also stressed the bottom line requirement that the Commission approve only just and reasonable rates. Staff Reply, 9.

39. Staff rejected the argument by CURB that the CIAC mechanism impermissibly forces ratepayers to become involuntary investors. Staff Reply, 10. In support, Staff cited to construction work in progress (CWIP), K.S.A. 66-128, as statutory precedent for inclusion in rate base of assets not used and useful. Staff Reply, 10.

40. On July 8, 2005, KCP&L filed its Reply to Post Hearing Briefs Submitted by CURB and Sierra Club (KCP&L Reply). KCP&L pointed out that CURB does not overtly recommend Commission disapproval of the Agreement, but rather asks that the Commission give due consideration to some legal issues. KCP&L Reply, 2. KCP&L emphasized the relationship between return on equity (ROE) and the CIAC. KCP&L Reply, 4. In addressing CURB's concern that the CIAC is not based on actual expenses, KCP&L pointed out that the Commission is authorized to adopt hypothetical capital structures, which, not unlike the CIAC, forces ratepayers to pay for expenses that are not actually incurred. KCP&L Reply, 5. KCP&L pointed out that unlike the case of a hypothetical capital structure which may exaggerate the equity component, the CIAC is beneficial to ratepayers. KCP&L Reply, 6. Regarding the delegation issue, KCP&L emphasized that the Commission will at all times retain the discretion and authority over KCP&L's rates. KCP&L Reply, 7. Indeed, KCP&L pointed to its own witness' testimony who said at the evidentiary hearing that the Agreement only binds Staff and that the Commission is free to carry out its statutory duties unaffected by the Agreement. KCP&L Reply, 7; Tr. Vol. I, 56. Regarding CURB's argument that the CIAC mechanism

makes ratepayers involuntary investors in the utility, KCP&L noted the statutorily authorized construction work in progress (CWIP), K.S.A. 66-128, as an example of involuntary ratepayer investment. KCP&L Reply, 10. Regarding CURB's argument that the CIAC amount would push an already determined just and reasonable rate to the point of an unjust and unreasonable rate, KCP&L made two points: (1) the Commission will make the just and reasonable determination after consideration of the CIAC amount by looking at the overall picture; and (2) the just and reasonable rate is not any one specific, exact rate, but is rather a set of rates within a zone of reasonableness. KCP&L Reply, 11-12.

41. On July 8, 2005, CURB filed its Reply Brief (CURB Reply). While CURB appeared to criticize the "simple legal platitudes" cited by KCP&L, it said that its raising of the "difficult questions of law" was based on "a few simple points." CURB Reply, 1-2. CURB maintained its position that CIAC pushes a determined just and reasonable rate to an unjust and unreasonable rate. CURB Reply, 2-5. From the discussion provided by CURB, it is not clear how CURB would respond to a procedure used by the Commission what would require a just and reasonable determination after the CIAC amount is set. CURB also maintained its position regarding the delegation of its authority. CURB Reply, 5. While CURB emphasized how the Commission has no control over the S&P standards, CURB failed to respond to the fact that the Commission nevertheless retains complete control over the CIAC amount, the particular level of S&P standards notwithstanding. Further, CURB raised two hypotheticals. CURB Reply, 6. Under one hypothetical, CURB hypothesized that the CIAC would be mechanically increased,

presumably against the will of the Commission. CURB Reply, 6. Again, under the Agreement, the Commission retains final approval to set a just and reasonable rate. Contrary to CURB's understanding, the final decision on the amount of the CIAC is set forth by the Commission, not S&P. CURB questioned how the Commission will determine a just and reasonable rate. CURB Reply, 8. Rhetorically, one might ask how such determinations are presently made sans CIAC. CURB acknowledged that the CIAC amount is related to return on equity (ROE). CURB Reply, 8. Thus, in any given rate case with or without a CIAC, CURB, any other party, or a court can derive an equivalent ROE. Consequently, the determination of a just and reasonable rate is no more difficult or elusive than it already is under the traditional approach.

#### *Failure to Object*

42. KCP&L cited K.A.R. 2004 Supp. 82-1-230a(b) for the proposition that CURB and Sierra Club have waived their right to object to the Agreement. KCP&L Brief, 11; KCP&L Reply, 1. The Commission finds that the Commission's procedural schedule set forth in the Order Setting Procedural Schedule, issued May 3, 2005, made the requirement of a written objection to the Agreement unnecessary. The purpose of the regulation is to provide notice to the parties of objections to a settlement agreement. There was no question that there were objections and this is the purpose of the Commission having set forth a procedural schedule to specifically accommodate objecting testimony. Indeed, such testimony in opposition to the Agreement was filed by Sierra Club. Further, the Commission conducted an evidentiary hearing on the

Agreement on June 17, 2005, at which hearing Sierra Club presented testimony. KCP&L made no objection at that time to the right of Sierra Club to oppose the Agreement.

43. The Commission hereby finds that the Procedural Order, by giving the parties to the docket an opportunity file testimony in opposition to the Agreement, excused any party from the requirement of filing an objection pursuant to K.A.R. 2004 Supp. 82-1-230a(c). In other words, because of the Procedural Order, it was reasonable for CURB and Sierra Club to proceed with the understanding that it could file testimony in opposition to the Agreement and that the Commission would consider such testimony.

#### *CIAC: Conclusion*

44. The Commission is persuaded that the CIAC mechanism is not only legal, but is reasonable from a policy perspective. Staff witness Low testified that the CIAC will lower the overall long-term costs to ratepayers through the reduction in rate base. Low, 6. Staff witness McClanahan also testified that the CIAC provides the lowest cost alternative to ratepayers due to the lower overall return "on" and return "of" the additional plant contemplated in the plan. McClanahan, 8; McClanahan Supplemental Direct, 2-5. Further, CIAC will lower rates through reductions in the cost of financing to KCP&L. Low, 6.

45. The Commission also rejects the legal concerns raised by CURB. The Commission agrees with the analysis provided by Staff and KCP&L. CURB's citation to *Kansas Gas & Electric Co.*, 239 Kan. at 488, for the proposition that it is not the role of the Commission to guarantee the financial integrity of the utility misses the mark and represents a myopic view of the overall effects of the CIAC mechanism. *Kansas Gas &*

*Electric Co.*, in warning that rates are not required to guarantee the financial integrity of the utility, teaches that the interests of other parties, such as ratepayers and others must be considered. Clearly, there are benefits to the CIAC mechanism that benefit KCP&L. However, the evidence in this record of the benefit to ratepayers cannot be ignored. Staff's investigation and consideration of this matter has led it to conclude that the CIAC is also in the interests of ratepayers. This recommendation by Staff is largely unchallenged. As further support for the correctness of that conclusion, the Commission notes safeguards inherent in the CIAC such that the CIAC amounts recovered cannot exceed the expected benefit of the mechanism to the ratepayers. If there were no benefit to the ratepayers or if the ratepayers were to be greatly harmed by the CIAC, and the only benefit was to insure the financial integrity of the utility, CURB's concern may have some merit.

46. The Commission also rejects the argument by CURB, (CURB Brief, 8-9), regarding the narrowness of the just and reasonable determination. Rather, the setting of rates is a difficult process requiring the balancing of a multitude of interests from a perspective of various points in time. The Commission strives to reach a rate that is within a zone of reasonableness, *Kansas Gas & Electric Co. v. Kansas Corporation Comm'n*, 239 Kan. at 490, and to that end, the Commission with the approval of the CIAC mechanism is attempting to address a policy goal of helping KCP&L maintain a certain credit rating.

47. On an abstract level, CURB's position is that the Commission cannot consider the investment grade rating in its balancing analysis designed to reach a just and

reasonable rate. The Commission rejects this position and finds that the CIAC mechanism is uniquely designed to meet the Commission's policy objective of maintaining KCP&L's investment grade credit rating. The Commission determines that the policy benefits of such a decision benefit the ratepayers, in addition to KCP&L.

48. The Commission rejects the delegation issue raised by CURB. The Commission is required to set just and reasonable rates. K.S.A. 66-101b. The Agreement does not affect the Commission's ability to exercise its statutory rights. Agreement, 12. While the S&P ratios may affect the exact amount of CIAC in any given rate case, neither statutes nor the Agreement contemplate anything other than a just and reasonable rate. Should the calculation of the CIAC amount result in an overall rate that is unjust and unreasonable, the Commission will not approve it. Authorities cited by CURB establish legal principles regarding delegation of the Commission's authority. The question in this present docket is as follows: Is the Commission actually delegating its authority? As the Commission retains the final determination of the CIAC amounts and will set those CIAC amounts so that the overall rate falls within the statutory just and reasonable requirement, the Commission finds that it is not delegating its authority through the approval of the CIAC. Reference to the S&P ratios as a useful metric is not only not a delegation of Commission authority but is also consistent with past Commission action. The CIAC provision in the Agreement furthers Commission policy that public utilities should strive to maintain an investment grade credit rating in order to minimize the cost of necessary debt. The phrase, "investment grade credit rating," is a term of art having meaning only by reference to an outside entity such as S&P. The

CIAC provision of the Agreement relies on the S&P metric as a means of implementing the policy decision that KCP&L retain its investment grade credit rating. Viewed in this light, what the Commission hereby approves in this docket is consistent with Commission action in other dockets. See Docket No. 01-WSRE-949-GIE, *In the Matter of the Investigation of Actions of Western Resources, Inc. to Separate Its Jurisdictional Electric Public Utility Business From Its Unregulated Businesses*, Order, issued July 20, 2001, 36-37.

49. Last, the Commission rejects the argument that CIAC mechanism impermissibly makes ratepayers involuntary investors. The Commission agrees with the analysis of Staff and KCP&L on this matter. In particular, the Commission finds persuasive the citation to K.S.A. 66-128 for the proposition that there is statutory authority for placing assets not used and useful into rate base.

#### *Rate Plan*

50. Giles testified regarding the 4 rate case filings contemplated by the Agreement. Giles, 10. The Agreement calls for two mandatory rate filings on February 1, 2006, and August 15, 2009; and two optional rate filings on March 1, 2007, and March 1, 2008. Agreement, Appendix C, 1; Giles, 10.

#### *ECA*

51. The Agreement contemplates that KCP&L implement an energy adjustment clause (ECA) with its 2006 rate proceeding. Holloway, 26. Staff witness Holloway pointed out that a well-designed ECA could benefit ratepayers by decreasing the need for rate increases and passing through decreases in costs quickly. Holloway, 26. Holloway



testified that the Agreement's treatment of KCP&L's energy cost adjustment (ECA) clause as to the 2006 rate case was reasonable. Holloway, 25-26.

#### *Depreciation and Amortization Rates*

52. Staff witness Holloway testified regarding the depreciation and amortization rates contemplated in the Agreement. While Holloway expressed some concern that the rates were outdated, Holloway testified that given the existence of the CIAC mechanism, it made little sense to adjust the depreciation and amortization rates when the result would only be offset by the CIAC. Holloway, 26-27. However, KCP&L is required to file an updated depreciation study prior to August 1, 2010. Holloway, 28. Holloway testified that such a solution is reasonable. Holloway, 28.

#### *Off System Sales*

53. Staff witness McClanahan testified that off-system sales continue under the Agreement to be treated above-the-line for ratemaking purposes. McClanahan, 15.

#### *SO2 Allowances*

54. The Agreement sets forth KCP&L's SO2 Emission Allowance Management Policy (SEAMP). Blunk, 2-4. Under the Acid Rain Program, a part of the Clean Air Act Amendments of 1990 (CAAA), utilities are required to hold sufficient allowances to offset their SO2 emissions from the prior calendar year. Blunk, 3. The Acid Rain Program, which permits utilities to exchange allowances, is a market-based approach to reducing acid rain. Blunk, 3. Some utilities may find it economically advantageous to install environmental control equipment to reduce SO2 emissions, and other utilities may

find it economically advantageous to acquire allowances. Blunk, 3. KCP&L witness Blunk testified that KCP&L has an inventory of SO<sub>2</sub> allowances. Blunk, 3.

55. The goal of SEAMP is as follows: (1) Manage SO<sub>2</sub> emission allowances in such a way as to minimize the expected present value of long-run revenue requirements; (2) Provide structure and procedure for the review of so<sub>2</sub> emission allowance transactions; and (3) Provide structure and procedure for the authorization of so<sub>2</sub> emission allowance transactions. Blunk, 4.

56. Staff witness McClanahan testified that the sale of SO<sub>2</sub> allowances will provide cash flow for KCP&L during the Regulatory Plan period. McClanahan, 16. As the environmental upgrades are completed, KCP&L's need for allowances will decrease. McClanahan, 16. McClanahan testified that ratepayers receive a financial benefit through the SEAMP. McClanahan, 17.

#### *Pension Expense*

57. Staff witness McClanahan testified regarding the Agreement's treatment of pension expenses. McClanahan, 19-23. According to McClanahan, the Agreement in this regard has three purposes: (1) to conform ratemaking treatment of pension expense with a stipulated agreement arrived at in Missouri regarding an Empire District Electric rate case; (2) to provide a true-up mechanism for any differences between the pension expense collected through rates and the actual pension expense incurred; and (3) to avoid any reduction in KCP&L equity with the establishment of a deferred regulatory asset account. McClanahan, 19-20.

#### *Allowance for Funds Used During Construction (AFUDC)*

58. Staff witness McClanahan testified regarding the Agreement's treatment of the allowance for funds used during construction (AFUDC). McClanahan, 23-25. KCP&L agreed to a 250 basis point reduction in the equity portion of the AFUDC calculation as to Iatan 2. McClanahan, 24. McClanahan testified that Staff negotiated the 250 basis point reduction to provide a benefit to ratepayers as an offset to the costs associated with the CIAC mechanism. McClanahan, 25. The AFUDC will cease when the plant is considered to be in-service. McClanahan, 25.

#### *Cost-Control System*

59. Staff witness Holloway testified regarding the Agreement's provision of a cost control system. Holloway, 28. Under the Agreement, KCP&L must identify and explain any cost overruns for the proposed generation and environmental projects. Holloway, 28. Additionally, KCP&L has certain reporting requirements. Holloway, 28. According to Holloway, the cost control system will provide adequate documentation to verify the prudence of KCP&L's implementation of the large capital projects. Holloway, 28.

#### *Deregulation*

60. Staff witness Holloway testified that the Agreement provides reasonable protection from stranded costs to ratepayers should the electric industry be restructured in Kansas. Holloway, 28-29.

#### *Rate Plan: Conclusion*

61. The Agreement asks the Commission to approve the rate plan, including the treatment of the issues summarized above. Agreement, 4. The Commission finds that the

proposal for future rate proceedings is reasonable. The proposed treatment regarding the specific matters contained in the Agreement appears reasonable at this time, but is subject to future Commission review to ensure that they result in just and reasonable rates and reflect the provision of efficient and sufficient service. K.S.A. 66-101b.

*Public Hearing and Response to Comments Made Therein*

62. At the Commission scheduled public hearing on June 23, 2005 (Tr. Vol. II), over 15 witnesses from the public testified. As a consequence of the high quality of comments made at the public hearing, (Tr. Vol. II, 127), the Commission ordered that KCP&L submit a response by July 18, 2005, in writing to the comments made at the public hearing. Order Requiring KCP&L to File a Response to Comments Received at Public Hearing, issued June 29, 2005.

63. On July 18, 2005, KCP&L filed its Response to Comments Received at Public Hearing (KCP&L Response). KCP&L rebutted comments to the effect that it did not require new generation, referring to its witnesses Giles and Grimwade. KCP&L Response, 3. KCP&L asserted that comments made at the public hearing were incorrect because they were based on past events and failed to include weather normalization. KCP&L Response, 4. KCP&L stressed that wind generation cannot meet its increased demand needs because wind generation is intermittent. KCP&L Response, 4. In response to a comment that KCP&L could rely on purchased power agreements to make up for any power shortfall, KCP&L asserted that such an approach would be risky and would subject ratepayers to the risk of increased costs. KCP&L Response, 4-5. KCP&L dismissed the allegation that the purpose of KCP&L's plan for new generation plan is to

make off-system sales. KCP&L Response, 6. KCP&L defended its actions regarding its exploration demand side management (DSM) programs, saying it had obtained input from numerous entities. KCP&L Response, 7. KCP&L maintained that even with the DSM programs, it would still need to build additional generation capacity. KCP&L Response, 8. In response to comments that wind generation is a more cost effective method of generation, KCP&L disagreed. KCP&L Response, 9. In order to make for a fair comparison, KCP&L said that between 5,000 and 10,000 MW of wind generation would be equivalent of 500 MW of coal fired generation. KCP&L Response, 9-10. KCP&L pointed out that wind generation rather forms a component of a balanced approach to overall generation. KCP&L Response, 9. Regarding the allegation that KCP&L had not considered the environmental impacts of coal generation, KCP&L said that it had worked with relevant authorities for getting approval for environmental permits. KCP&L Response, 10. KCP&L asserted that there will be no significant impact on the regional air quality; rather, after considering the environmental upgrades, there will be net reductions of some emissions even after the addition of the 500 MW coal fired generation. KCP&L Response, 10-11. One witness testified regarding the health effects of particles smaller than 2.5 microns in size, known as 2.5 PM emissions. Tr. Vol. II, 54. KCP&L responded by saying it proposed to use a superior emissions control technology that would result in net reductions of 2.5 PM even after the addition of the new coal fired generation. KCP&L Response, 11. KCP&L addressed concerns that its regulation plan shifted all the risk from shareholders to ratepayers. KCP&L Response, 12. KCP&L said the prudence of the construction activities remains subject to Commission review.

KCP&L Response, 12. Also, the shareholders run the risk that the new generation capacity may be deemed no longer used and useful, thereby making it not properly included in ratebase. KCP&L Response, 12. Regarding the CIAC, KCP&L said this mechanism will not be used to recover costs imprudently incurred. KCP&L Response, 12. KCP&L addressed comments made at the public hearing regarding its plans to build a merchant power plant. KCP&L Response, 13. KCP&L explained that the lack of a deregulation progress in Kansas on Missouri prompted it to scrap its plans for a merchant power plant, yet the need for additional generation capacity persisted. KCP&L Response, 13-14. KCP&L also defended its environmental record, citing its efforts at reducing CO2 emissions. KCP&L Response, 14. KCP&L said Iatan 2 will be one of the most efficient coal generators in the country. KCP&L Response, 15.

64. On July 18, 2005, Sierra Club filed its document responding to the Commission's June 29, 2005 Order (Sierra Club Document). Sierra Club confirmed data cited by one of the witnesses who suggested a lower growth in the amount of electric power to be sold by KCP&L suggested that there is no urgent need for new generation capacity. Sierra Club Document, 1.

### *Conclusion*

65. The Commission is satisfied by the responses provided by KCP&L. The parties to this docket have struggled with striking the appropriate balance between efficiency, reliability, and environmental impact. Clearly, some with different priorities may disagree with the Regulatory Plan proposed by KCP&L; however, the Commission finds that concerns about the proposal do not warrant rejection of the Agreement. As

noted by various parties to the proceeding, approval of the Agreement does not mean that the Commission is making a final determination that the resource plan is reasonable and prudent. The provisions of the Agreement with regard to the resource plan would generally restrict the Staff and other signatory parties from arguing in future proceedings that the resources "should be excluded from KCPL's rate base on the grounds that projects were not necessary, or that alternative technologies or fuels should have been used." Agreement, Appendix C, 7. This does not restrict non-signatory parties from presenting evidence in future proceedings that the resources should not be included in rate base as unreasonable or imprudent. It should also be noted that the Agreement does not restrict Staff or any party from addressing the prudence of the costs expended for the projects or whether the resources are "used and required to be used" under K.S.A. 66-128. Agreement, Appendix C, 7-8. Although Sierra Club and some public witnesses question whether it is good public policy for the Commission to approve limitations on Staff's future activities, this policy question has already been answered by the legislature. Under K.S.A. 66-1239, the Commission is required to make a pre-determination of the future regulatory treatment of proposed transmission and generation resources. Although the exact parameters of the pre-determination are unclear, (Low, 4-5), it is apparent that the legislature envisioned some decisions that would limit future examination of issues by not only Commission Staff but also the Commission itself. In this proceeding the question is whether the Commission believes that its Staff should not be limited in future proceedings from exploring the reasonableness and prudence of the resource plan, despite its examination of the plan in this proceeding. Without prejudging whatever issues may

arise in future proceedings, the Commission does find that there is sufficient evidence about the reasonableness and prudence of the resource plan to approve the Agreement and the limitations on future Staff review. The Commission does note, however, that there are provisions in the Agreement that allow Staff to request re-assessment of the resource plan upon specified changes in circumstances, (Agreement, 10), and provide for termination of the Agreement upon a finding that material facts were not provided or misrepresented, (Agreement, 13-14).

**IT IS, THEREFORE, BY THE COMMISSION ORDERED THAT:**

- A. The Motion is granted. The Commission hereby approves the Agreement.
- B. The parties have fifteen days, plus three days if service of this Order is by mail, from the date of service of this Order in which to request rehearing on any matter decided herein.
- C. The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering such further order or orders as it may deem necessary.

**BY THE COMMISSION IT IS SO ORDERED.**

Moline, Chr.; Krehbiel, Comm.; Moffet, Comm.

Dated: AUG 05 2005

ORDER MAILED

AUG 05 2005

 Executive  
Director

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Susan K. Duffy  
Executive Director

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