

**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) Case No. ER-2009-0089
to Continue the Implementation of Its Regulatory)
Plan.)

In the Matter of the Application of KCP&L)
Greater Missouri Operations Company for)
Approval to Make Certain Changes in Its Charges) Case No. ER-2009-0090
for Electric Service.)

**KCP&L'S AND GMO'S INITIAL RESPONSE TO STAFF REPORT OF THE
CONSTRUCTION AUDIT/PRUDENCE REVIEW OF ENVIRONMENTAL UPGRADES
TO IATAN 1 AND IATAN COMMON PLANT**

On December 31, 2009, Staff filed a "Staff Report of the Construction Audit/Prudence Review of Environmental Upgrades to Iatan 1 and Iatan Common Plant" ("Construction Audit Report"¹) in Case Nos. ER-2009-0089 and ER-2009-0090. Pursuant to this Commission's order of June 10, 2009, Staff was to have completed and filed "the construction audit and prudence review of the environmental upgrades at Iatan 1, including all additions necessary for these facilities to operate." The June 10 order allows Kansas City Power & Light Company ("KCP&L") and KCP&L Greater Missouri Operations Company ("GMO") (collectively, the "Companies") to file responses or rebuttal testimony to the Construction Audit Report in the Companies' next general rate cases.

If Staff chooses to file the Construction Audit Report as part of its testimony in those cases, the Companies will file rebuttal testimony addressing the specific issues raised in Staff's

¹ There are, of course, two separate audit reports. Because they are substantially similar, the singular "Construction Audit Report" is used here to refer to both collectively.

report.² The Companies file this initial response to address the over-arching issue of Staff's apparent attempt to modify the Commission's order concerning the audit. Rather than comply with the Commission's order to complete its construction audit and prudence review by December 31, 2009, Staff's filing appears to seek to extend the time to complete its construction review beyond 2009 – a proposal this Commission considered and rejected in its June 10, 2009 order.

PROCEDURAL BACKGROUND

In KCP&L's and GMO's last rate cases, Case Nos. ER-2009-0089 and ER-2009-0090, respectively, Staff engaged in extensive discovery and had the opportunity to conduct a construction audit and prudence review of Iatan 1 and related facilities. Staff did not complete an audit during those cases. *See surrebuttal testimony of Robert Schallenberg, April 19, 2009 in ER-2009-0090* ("Staff did not complete a prudence or construction audit of the environmental upgrades at Iatan I, Jeffrey Energy Center Units 1 and 3, and the Sibley Generating Facility, Unit 3") and *surrebuttal testimony of Robert Schallenberg, April 7, 2009 in ER-2009-0089, p. 6* ("The correct statement would be that Staff does not have anyone in its employ that will testify on its behalf that the expenditures being sought for recovery from ratepayers are prudent and reasonable because an audit has not been completed.")

On April 24, 2009 and May 22, 2009, Staff and other parties entered into a settlement with KCP&L and GMO in Case Nos. ER-2009-0089 and ER-2009-0090, respectively ("Unit 1 Settlements"). In the Unit 1 Settlements, the Companies agreed to allow Staff to continue the

² Some of the issues addressed in the Construction Audit Report are not prudence issues. They are instead typical ratemaking issues that will be addressed in KCP&L's and GMO's next rate cases, e.g. allocations of expenses between Iatan 1 and Iatan 2; changes to KCP&L's cost of debt; and the equity rate used in the calculation of AFUDC. The Commission expressly authorized KCP&L to respond to the true prudence issues as part of the rate case and KCP&L does not waive its right to do so by filing this response.

construction and prudence audit for Iatan 1 and Iatan common plant costs, but capped any potential disallowances at \$30 million for KCP&L and \$15 million for GMO. The Companies were willing to allow the Staff to complete its audit as late as the filing of direct testimony in the next rate cases and filed a joint motion with the Staff to extend time for completion of the audit.³

On June 10, 2009, the Commission granted the joint motion in part. But, in apparent acknowledgment that further delay was unfair to the Companies and the Commission itself, the Commission ordered Staff to provide a preliminary report of its construction audit and prudence review by June 19, 2009, which Staff did. Staff was also ordered to complete and file its full construction audit and prudence review by December 31, 2009 because the Commission did "not wish to delay completion of the audits beyond the end of this calendar year." The Commission also advised the Staff that "[b]y setting a final deadline of December 31, 2009, the Commission will have more time to adequately review Staff's audits, and the parties will have sufficient time to resolve any discovery disputes and file position statements with regard to Staff's reports." Finally, Staff was ordered to provide specific rationale for all disallowances. Staff filed the Construction Audit Report on December 31, 2009, at approximately 11:45 p.m.

The Staff has never sought relief from the Commission's June 10 order setting a December 31, 2009 deadline. Rather, Staff has proceeded with its audit and filed a report on the deadline imposed by the Commission. However, the Construction Audit Report is inconsistent with the order of the Commission, as it appears to attempt to leave open certain questions of prudence until the Companies' next rate cases.

³ See Joint Motion Of Staff, KCP&L And GMO To Extend The Filing Date Of Staff's Construction Audit And Prudence Review Reports And The Filing Date Of Responses Or Rebuttal Testimony To Staff's Construction Audit And Prudence Review Reports To KCP&L's And GMO's Next General Rate Cases, Case Nos. ER-2009-0089, ER-2009-0090, and HR-2009-0092 (filed May 28, 2009).

As a result of the lengthy discovery process discussed herein, Staff had all the information it needed in advance of December 31, 2009 to produce a conclusive and final "construction audit and prudence review" in conformance with the Commission's order. That portion of Staff's review should be complete, as ordered by the Commission. The Companies recognize, however, that Staff should have an opportunity to review invoices that were not available at the time it conducted its construction audit and prudence review, as well as expenses that were not yet incurred. Such a review is distinguishable from a "construction audit and prudence review" concerning data that was available to Staff in advance of December 31, 2009.

I. THE COMMISSION SHOULD HOLD THE STAFF TO ITS PREVIOUS ORDER

It came as a great surprise to the Companies that Staff's Construction Audit Report appears to suggest that Staff intends to continue an audit that the Commission instructed Staff to complete and file by December 31, 2009. Specifically, on page 3 of the Construction Audit Report, Staff states that it "expects the remaining audits of the Iatan Project" to include another filing in Staff's direct case which will audit "Iatan AQCS Post May 31, 2009 Expenditures." If Staff's proposal is to review invoices that were unavailable and expenses that had not yet been incurred in time for consideration in its December 31, 2009 Construction Audit Report, that is appropriate. If, on the other hand, Staff's proposal is to continue the "construction audit and prudence review" ordered by the Commission, it is not.

The Commission directed Staff to complete that portion of its review by December 31, 2009. By rejecting the request made in the May 28 joint motion to permit Staff to have until its direct case in the Companies' next rate cases to complete its review, the Commission expressly held that Staff's construction audit and prudence review was to be completed by December 31, 2009. It is also worth noting that Staff's decision only to review expenditures through May 31,

2009 was its own. Invoices paid after that date were available to Staff in ample time for inclusion in a report not due until December 31 of that year—seven months later.

Of similar concern, on page 5 of the Construction Audit Report, Staff unilaterally "proposes" that "approximately \$60 million [of Iatan 1 AQCS costs] be examine (sic) in conjunction with Staff's audit of Iatan 2..." Neither the Unit 1 Settlements nor the Commission's June 10 order allow the Staff to arbitrarily hold back Iatan 1 expenditures for audit at a later date. It would appear that Staff intends to disregard the Commission's order and conduct audit activities related to Iatan 1 during a separate rate case in 2010 and perhaps beyond.⁴ That is *inappropriate and inconsistent with the Commission's June 10 order*. Moreover, Staff offers no compelling grounds for extending its construction audit and prudence review in such a manner.

A. Staff's Position is Prejudicial to KCP&L and Unfair to This Commission.

Staff's proposal to continue its audit of Iatan 1 and common plant is highly prejudicial to the Companies. The Companies relied on this Commission's order and Staff's presumed compliance with that order to plan for its upcoming KCP&L and GMO rate cases. The Commission directed that the Staff identify all issues related to the Companies' prudence and construction on Iatan 1 by this time. The Companies and this Commission could then focus attention on the issues identified in the audit as well as the next rate cases.

The record reflects that Staff had a similar understanding of the Commission's order. In Staff's preliminary report of June 19, 2009, Staff specifically states that "The fact that the Staff does not propose an adjustment related to costs not specifically addressed in the Staff's

⁴ Curiously, after announcing on pages 3 and 5 that it intends to continue auditing certain items, Staff says on page 7 that "Staff has no intention to continue an audit in the areas contain (sic) in this Report." But later on that same page Staff writes, "[t]his report does not indicate that Staff will not address any area of costs in its report to be filed in the rate case when KCP&L/GMO seeks recovery of these costs in rates raised by other parties, including KCP&L (sic)." This latter sentence appears to signal that Staff will file a different Construction Audit Report in the upcoming rate cases.

construction audit and prudence review report to be filed no later than December 31, 2009 indicates that Staff did not find any or sufficient evidence to justify an adjustment, given resources and time constraints." *Prelim report at 4.* Furthermore, Staff's preliminary report never indicates that Staff will defer portions of the audit beyond December 31, 2009, nor, as previously established, did Staff at any time seek relief from the Commission to do so. Instead, the Staff assured this Commission and the Companies that Staff would comply with the Commission's order and complete the audit by December 31, 2009.

Staff has now had three formal opportunities to conduct a prudence audit of Iatan 1: (i) as part of KCP&L's last rate case (ER-2009-0089), as contemplated in the Regulatory Plan; (ii) in June 2009 in compliance with the first deadline or as part of its preliminary report; and (iii) as part of its December 31, 2009 report. Simple fairness requires this Commission prohibit Staff from continuing to chew on this apple.

II. STAFF'S REQUEST TO DELAY COMPLETING ITS CONSTRUCTION AUDIT AND PRUDENCE REVIEW IS NOT WARRANTED

Staff's Construction Audit Report contains essentially two purported justifications for Staff's attempt to avoid completion of its construction audit and prudence review: (i) Staff claims that it has not been able to complete discovery; (ii) Staff claims that KCP&L does not have a cost control system that complies with KCP&L's 2005 Regulatory Plan. Both assertions are flat wrong.

A. KCP&L has Complied with all Lawful and Reasonable Discovery Requests.

In several places, Staff's Construction Audit Report discusses discovery disputes. Staff's complaints about discovery are simply wrong and do not create a reasonable justification for delaying an audit past the date ordered by the Commission. Certainly KCP&L has objected to

miniscule amounts of Staff discovery requests, as is the Company's right. Those objections have been sustained by the Commission in the rare instances when Staff has utilized the Commission's process for seeking relief from discovery disputes.⁵

The Commission's June 2009 order acknowledged that discovery disputes might arise during the audit process. The Commission extended the original June deadline for the audit so that the parties "will have sufficient time to resolve any discovery disputes." This Commission acted wisely in June and gave the Staff sufficient time to resolve disputes. If discovery disputes remain, it is because the Staff did not avail itself of that opportunity.

The Staff's preliminary report (June 19, 2009) also recognized that a December 31, 2009 completion date would give it sufficient time to conduct and complete discovery. In that report, Staff indicated that it believed there were "significant discovery problems" associated with the audit (p. 4).⁶ Staff also told this Commission and KCP&L that it would move expeditiously to bring those disputes to formal adjudication in the future. ("With resolution of new rate cases in Case Nos. ER-2009-0089, ER-2009-0090 and HR-2009-0092, and based on Staff's [discovery dispute] experiences related above, the Staff intends to spend less time attempting to informally resolve discovery disputes with KCP&L before bringing the disputes before the presiding officer and the Commission.") *Prelim Audit at 19*. KCP&L accepted this promise from Staff and assumed Staff would seek guidance from the RLJ or Commission when it believed a discovery dispute existed.⁷

⁵ See Order Regarding Staff's Motion To Compel, Case No. ER-2009-0089 (issued December 9, 2009).

⁶ KCP&L disagrees that discovery disputes were "significant" in June of 2009 or at any other time, but Staff's assessment in June is certainly relevant to its claim that the additional six months were insufficient to complete discovery.

⁷ Rather than conduct discovery in a way that acknowledges that some information is protected from discovery, Staff continually submits DRs to KCP&L with apparent disregard for whether those DRs might be objectionable. An example is DR 0865 issued in December, 2009 in case ER-2009-0089 which states: "**Description:** Please provide a copy of all communications (including email communications) between Schiff Hardin LLP and/or any

Staff is well aware of the rules that allow formal resolution of discovery disputes. By way of example, of the more than 1,000 DRs KCP&L received in Case No. ER-2009-0089, Staff has taken several to the RLJ and only a couple to the Commission in the form of a Motion to Compel. Those disputes have largely involved KCP&L's invocation of the attorney-client privilege. The Commission's order of December 9, 2009 provides an excellent discussion of KCP&L's cooperation, the validity of its objections and the improper manner in which Staff has handled discovery.⁸ During the discovery process, litigants must make decisions about whether to pursue resolution of discovery issues. Staff had ample opportunity to air any discovery disputes, and those it pursued were rejected by the RLJ and the Commission. It is no longer timely for Staff to seek relief from the Commission for its alleged, though previously unheard, complaints regarding the discovery process. The Commission gave Staff ample time to pursue any discovery disputes that it believed impeded its audit. Staff chose not to do so.

Moreover, unlike a normal rate case where a utility files and Staff has only several months to complete an audit, Staff has had several years to gather information for this audit. Under the Regulatory Plan, since the beginning of the Iatan 1 project, KCP&L has been providing construction updates to Staff on a quarterly basis, both in writing and with follow-up meetings to address any questions Staff might have. The written Strategic Infrastructure Investment Status Reports are voluminous and include, among other details, KCP&L's description of the Project's status, schedule, cost and associated risks recognized at that time. The quarterly meetings follow an open agenda in which Staff and the other interested parties can

other consultant or law firm and KCP&L that references, either directly or indirectly, the Qualifying Advanced Coal Project Investment Tax Credits Under IRC Section 48A." (emphasis supplied).

⁸ See Order Regarding Staff's Motion To Compel, Case No. ER-2009-0089, pp. 19-20 (issued December 9, 2009).

ask KCP&L any question and request any information required. KCP&L recently provided its 16th such quarterly Status Report to Staff and other parties.

Under the Regulatory Plan, Staff was supposed to conduct its prudence audit of Iatan 1 in the last rate cases. Instead, Staff did not do so and the Commission set the December 31, 2009 deadline for filing of Staff's Construction Audit Report. The Commission should not entertain further complaints from Staff that KCP&L has somehow hindered Staff's access to information required for Staff to complete its prudence audit, or that untimely or unfair discovery requests justify a continuation of the audit work. *The time for those complaints has come and gone.*

B. Cost Tracking

The Staff Construction Audit Report asserts that KCP&L's method of tracking costs on the Iatan 1 Project is somehow not in conformance with the Regulatory Plan. Apparently, Staff now believes that KCP&L's cost tracking should be in a different format. This is merely an attempt by Staff to further justify reasons for its inability to comply with the Commission's order. *See Construction Audit Report, page 62 et seq.* The Commission should reject this attempted excuse as well. Staff has long been familiar with KCP&L's cost tracking system, which is in full compliance with KCP&L's commitments under the Regulatory Plan and is also in accordance with standards in the construction industry.

Staff has been aware of KCP&L's cost tracking system since at least June 2006, but nonetheless appears to have waited until it filed its Construction Audit Report on December 31, 2009 to voice its concerns about the adequacy of the system to this Commission. In that time, Staff has had the benefit of viewing twelve separate Strategic Infrastructure Investment Status Reports that included reports from the Iatan 1 and 2 Project's cost portfolio, using KCP&L's cost tracking system. It is noteworthy that Staff's Preliminary Report (which was filed at a time when

Staff should have originally completed its audit) makes no mention of difficulty in tracking costs or of any concerns about Staff's ability to do so.

In addition to the lateness of Staff's attempt to raise concerns about the adequacy of KCP&L's cost tracking system, Staff's assertions are simply not true. KCP&L's cost tracking system is both in conformance with its obligations under the Regulatory Plan and best practices in the construction industry. As explained to Staff in response to DR 859 in the 0089 case:

In accordance with the Regulatory Plan and KCP&L's Cost Control System, which was provided to Staff in June 2006, KCP&L has been tracking costs and variances on the Iatan 1 Project on a budgetary basis. In December 2006, KCP&L finalized the Control Budget Estimate ("CBE") for the Iatan 1 project. In the second quarter of 2008, KCP&L completed a reforecast of the Iatan 1 project budget that resulted in revisions to the CBE. KCP&L has maintained in its cost portfolio, which is the project cost reporting system, reference to the original CBE line items and has tracked variances, or "differences," including those from the 2008 Cost Reforecast, against the CBE.

* * *

In addition, KCP&L tracks its actual costs spent through its accounts payable system/general ledger. As discussed above, the actual cost, including accruals, are detailed in the Iatan 1 Cost Portfolio, which identifies any variances in actual cost against the CBE. KCP&L has provided its Iatan 1 and 2 Cost Portfolios as well as the accounts payable/general ledger information to Staff.

In short, Staff's complaint is both untimely and completely without merit. Staff's last minute attempt to raise this issue as an excuse for not completing the audit should be disregarded.

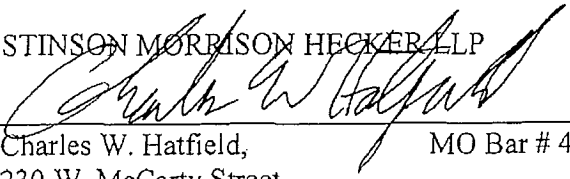
CONCLUSION

Staff's Construction Audit Report has been filed with the Commission. That filing was staff's last opportunity to present findings on prudence and reasonableness with regard to Iatan 1 and common plant expenditures. Although the Companies strongly disagree with the substantive findings of the Construction Audit Report, those findings will be addressed through testimony in

the Companies' next rate cases. This response was necessitated by language in Staff's Construction Audit Report which attempts to alter an order from this Commission upon which the Companies relied. The Companies object to the Construction Audit Report to the extent it attempts to alter the Commission's June 10 order. The construction audit and prudence review concerning Iatan 1 and common plant has been completed and should not be permitted to continue.

Respectfully submitted,

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ATTORNEYS FOR KCP&L AND GMO

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served either by electronic mail or by first class mail, postage prepaid, on this 16th day of February 2010 to counsel for all parties of record.

/s/ James M. Fischer

James M. Fischer