

**PRUDENCE REVIEW OF COSTS
RELATED TO THE FUEL ADJUSTMENT
CLAUSE FOR THE ELECTRIC OPERATIONS
OF KCP&L GREATER MISSOURI
OPERATIONS COMPANY**

June 1, 2007 through May 31, 2008

**MISSOURI PUBLIC SERVICE COMMISSION
STAFF REPORT**

CASE NO. EO-2009-0115

*Jefferson City, Missouri
December 1, 2008*

**** Denotes Highly Confidential ****

NP

Table of Contents

I.	EXECUTIVE SUMMARY	1
II.	RECOMMENDATIONS	1
III.	INTRODUCTION	2
	A. GENERAL DESCRIPTION OF KCP&L-GMO’S FAC	2
	B. PRUDENCE	2
IV.	KNOWN ITEMS	4
	A. GENERATION CAPACITY	4
	B. C. W. MINING COAL COSTS	5
	C. FINANCIAL HEDGES	8
	D. SO2 ALLOWANCES	10
	E. BIOMASS TEST	12
	F. ENVIRONMENTAL WORK AT SIBLEY/JEFFREY	12
	G. AFFILIATE TRANSACTIONS/CROSSROADS.....	13
	I. STEAM/DIVISIONAL ALLOCATIONS	14
V.	OTHER ITEMS	15
	A. PLANT OUTAGES	15
	B. PURCHASE POWER CONTRACTS	16
VI.	ITEMS FOR FUTURE CONSIDERATION	17
	A. AFFILIATE TRANSACTION	17
	B. SO2 ALLOWANCES – REGULATORY UNCERTAINTY	17

Prudence Review of Costs Report

I. Executive Summary

The Missouri Public Service Commission (Commission) with its Report and Order in KCP&L Greater Missouri Operations Company's¹ (KCP&L-GMO's or Company's) last rate case (Case No. ER-2007-0004) authorized a Fuel Adjustment Clause (FAC) for KCP&L-GMO's then Aquila Networks-MPS (MPS) and Aquila Networks-L&P (L&P) divisions.

Missouri statute, Section 386.266.4.(4) RSMo Supp. 2007, requires prudence reviews of an electric utility's FAC no less frequently than at eighteen-month intervals. In the instant prudence review, Staff analyzed items affecting KCP&L-GMO's fuel and purchased power costs for the first two six-month accumulation periods of KCP&L-GMO's FAC. Thus, the period reviewed in this audit and documented in this report is from June 1, 2007 to May 31, 2008.

In evaluating decision-making prudence Staff reviews whether a reasonable person making the same decision would have found both the information the decision-maker relied on and the process the decision-maker employed reasonable based on the circumstances at the time when the decision was made, i.e., without the benefit of hindsight. Staff disregards the decision made. If the Staff determines the decision-making was imprudent, then Staff determines whether the imprudent decision caused any harm to ratepayers. If so, then, and only then, Staff will make a disallowance adjustment.

Staff analyzed a wide variety of items in examining whether KCP&L-GMO prudently incurred the costs associated with its FAC. Staff has found no evidence of financial impact due to imprudence of the items it examined. However, Staff noted several areas that will require analysis during the next prudence review since these areas were outside the June 1, 2007 to May 31, 2008 period covered by this report. Staff also recommends the Commission order KCP&L-GMO to provide additional information to assist in future reviews.

II. Recommendations

Staff recommends the Commission order KCP&L-GMO to submit the following additional information:

- All future settlement payments from C. W. Mining shall be reported in the monthly reports as additional information ordered by the Commission (4 CSR 240-3.161(5)(M));
- Applicable legal and collection fees and costs regarding C. W. Mining litigation in the monthly reports as of the date the Commission order regarding this prudence review is

¹ In Case No. EN-2009-0164 the Commission recognized, by order dated November 20, 2008 and made effective December 3, 2008, the name change of Aquila, Inc. d/b/a KCP&L Greater Missouri Operations Company to KCP&L Greater Missouri Operations Company. At different points in time the company now named KCP&L Greater Missouri Operation Company was known as or did business in Missouri as Aquila, Inc., Aquila Networks-MPS, Aquila Networks-L&P and KCP&L Greater Missouri Operations Company. For ease, in this report the company will be uniformly referred to as KCP&L-GMO or Company.

effective. The submitted information will show the fees and costs of outside counsel (e.g. Shook, Hardy & Bacon), outside collection agencies and any other fees and costs;

- Applicable legal and collection fees and costs regarding C. W. Mining litigation shall be included in the monthly reports as additional information ordered by the Commission (4 CSR 240-3.161(5)(M)). The submitted information will show the fees and costs of outside counsel (e.g. Shook, Hardy & Bacon), outside collection agencies and any other fees and costs; and
- Monthly amount and cost of emission allowances that are purchased, sold or used by KCP&L-GMO.

III. Introduction

A. General Description of KCP&L-GMO's FAC

The FAC mechanisms approved by the Commission for KCP&L-GMO allow it to recover from its ratepayers 95% of its prudently incurred variable fuel costs above a base amount. KCP&L-GMO accumulates costs during six-month accumulation periods. Each six-month accumulation period is followed by a 12-month recovery period where the over- or under-recovery during the six-month accumulation period relative to the base amount is flowed through to ratepayers by an increase or decrease in rates through the Cost Adjustment Factor (CAF). The CAF is designed to offset that over- or under-recovery by the end of the 12-month recovery period. KCP&L-GMO's first six-month accumulation period began on June 1, 2007. The Company's fuel costs were higher than the base cost in the FAC tariff so the CAF was adjusted to collect more revenue effective September 1, 2007. The second accumulation period began December 1, 2007, and ended May 31, 2008. The Staff reviewed the areas listed below for these first two accumulation periods.

B. Prudence

1. Definition

The Commission has previously cited with approval a New York Public Service Commission statement regarding prudence:

. . . the 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.²

² *Union Electric*, at 194, quoting *Consolidated Edison Company of New York, Inc.*, 45 P.U.R. 4th 331 (1982). <taken from GR-2003-0330 Report and Order>

2. Burden(s) of Convincing the Commission on the Issue of Prudence

In a Report and Order for Case No. GR-2003-0330, the Commission wrote:

The Commission established a standard for prudence in a 1985 case involving costs incurred by Union Electric Company incurred when constructing its Callaway nuclear plant. In determining how much of those costs were to be included in Union Electric's rate base, the Commission adopted a standard for determining the prudence of costs that had been established by the United States Court of Appeals, District of Columbia, in a 1981 case. The standard adopted by the Commission recognizes that a utility's costs are presumed to be prudently incurred, and that a utility need not demonstrate in its case-in-chief that all expenditures are prudent. "However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling those doubts and proving the questioned expenditures to have been prudent." (footnotes omitted)

3. Basis for Disallowance

Imprudence alone is not treated as a basis for a disallowance. However, when imprudence is coupled with harm to a utility's ratepayers, Staff has previously recommended disallowances based on the following standard, as enunciated by the Commission in its adoption of the standard in the area of natural gas local distribution company regulation:

ANG is not alone in suggesting that, in order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that (1) the utility acted imprudently (2) such imprudence resulted in harm to the utility's ratepayers.

State ex rel. Associated Natural Gas Co. v. Public Service Com'n of State of Mo., 954 S.W.2d 520, 530 (Mo.App. W.D., 1997)

4. Quantification of Financial Impact

The Commission has required a quantification of the financial impact to ratepayers caused by an imprudent action. This standard has also been enunciated in the context of a natural gas local distribution company, and is given below:

A prudence review of this type must focus primarily on the cause(s) of the *allegedly excessive gas costs*. Put another way, the proponent of a gas cost adjustment must raise a serious doubt with the Commission as to the prudence of the decision (or failure to make a decision) that caused what the proponent views as *excessive gas costs*. ... In addition, evidence about the particular controversial expenditures is needed for the Commission to determine the amount of the adjustment. ... In addition, it is helpful for the Commission to have evidence as to the *amount that the expenditures would have been if the local distribution company had acted in a prudent manner*. The critical matter of proof is the

prudence or imprudence of the decision from which expenses result. ... *The amount of the proposed adjustment must be based on excessive expenditures incurred during the particular ACA period involved.* (Emphasis added.)

Id.

IV. Known Items

A. Generation Capacity

1. Description

It has been the Staff's position in the previous two KCP&L-GMO general electric rate increase cases that, given the information from the resource planning process that was available at the time KCP&L-GMO made its decision regarding the replacement of power it was obtaining through the Aries capacity contract through May 2005, KCP&L-GMO should have added five 105 MW combustion turbines (CTs). When KCP&L-GMO's purchased power contract for Aries was concluding, KCP&L-GMO identified owning and operating five 105 MW CTs as the least cost way to meet its resource needs at that time. Even so, KCP&L-GMO chose to build only three 105 MW CTs at its South Harper site (which was designed for six 105 MW CTs) and entered into short-term purchased power agreements for its remaining capacity needs. In both of KCP&L-GMO's last two rate increase cases, the Staff modeled a site built for six 105 MW CTs, putting only five 105 MW CTs on it.

It is still Staff's position that KCP&L-GMO should be meeting its needs with its own resources, not short-term purchased power agreements. Over the short term, the costs of these short term contracts are less than the costs of owning generating assets. However, because utility-owned generation depreciates over time - lowering the costs of that generation - over the long term the cost of utility-owned generation is lower than the cost of a series of short-term purchased power agreements. Staff's view that KCP&L-GMO should own its generation assets is based on the proposition that owned assets will produce the lowest long-term revenue requirement and thus the lowest overall customer rates during the life of the generation asset.

2. Summary of Cost Implications

Staff reviewed hourly fuel and purchased power information and determined that because the energy received through the purchased power agreements was either purchased at market price or the cost of generating by natural gas fired CTs, the impact of KCP&L-GMO not having the two additional CTs did not materially affect KCP&L-GMO's fuel and purchased power costs. The difference in costs that materially affect rates at this time is the capital costs of the CTs that are included in rate base vs. the capacity costs of purchased power agreements that are expensed.

3. Conclusion

At this time, Staff intends to continue to include an additional two CTs in rate base in KCP&L-GMO rate cases. It will also continue to examine the fuel cost differential between the two CTs Staff believes that KCP&L-GMO should have built and its actual energy costs in both future rate cases and future FAC prudence audits.

4. Documents Reviewed

- a. Rebuttal testimony of Staff witness Lena M. Mantle in Case No. EF-2003-0465
- b. Direct testimony of Staff witness Lena M. Mantle in Case No. ER-2005-0436
- c. Surrebuttal testimony of Staff witness Lena M. Mantle in Case No. ER-2007-0004

B. C. W. Mining Coal Costs

1. Description

This issue involves any settlement payments for a breached coal contract between KCP&L-GMO and C.W. Mining, and the effect, or lack thereof, of any settlement payments on FAC related costs.

KCP&L-GMO entered into a coal supply contract with C. W. Mining in January 2004 to supply coal for KCP&L-GMO's Sibley and Lake Road power plants. In the early portion of the contract, C.W. Mining was unable to supply the quantity of coal indicated in the contract, and ultimately the contract was breached. This resulted in KCP&L-GMO having to burn higher cost coal at these two power plants. KCP&L-GMO is currently involved in litigation to recover the higher costs that it incurred as a result of the termination of the C. W. Mining coal contract.

The "Stipulation and Agreement as to Certain Issues" approved by the Commission in its Order Approving Stipulation and Agreement as to Certain Issues in ER-2007-0004 effective on April 22, 2007 (Stipulation And Agreement), stated, beginning on page 4, that settlement payments were to flow back to customers, net of certain KCP&L-GMO costs:

- a. IF A FUEL COST RECOVERY MECHANISM IS AUTHORIZED: The actual cost of fuel to serve native load will be included in the calculation of any fuel recovery mechanism that might be approved in this rate proceeding. As a result, any cash settlement or court ordered award, net of applicable legal and collection fees and costs, recovered by Aquila [(now KCP&L-GMO)] resulting from the pending C. W. Mining Company litigation will be flowed through fuel expense accounts and included in any fuel cost recovery mechanism approved in this rate proceeding. Applicable legal and collection costs shall be limited to incremental, non-payroll costs, including fees and costs of outside counsel (e.g. Shook, Hardy & Bacon) and outside collection agencies related exclusively to pending C. W. Mining litigation. If the Commission determines that fuel costs should be shared between customers and stakeholders, then the C. W. Mining

proceeds would flow through any fuel cost recovery mechanism at that same percentage. The Signatories agree that these conditions resolve all outstanding issues, including prudence, relative to Aquila's [(now KCP&L-GMO)] actions related to the C. W. Mining contract through March 28, 2007 in this and all future regulatory proceedings.

Since the Commission later approved a FAC for KCP&L-GMO in its Report and Order in the same case (ER-2007-0004), customers are to receive 95% of the C. W. Mining litigation proceeds, net of certain costs.

KCP&L-GMO's 2007 Annual Report filed with the Securities and Exchange Commission (KCP&L-GMO's 2007 SEC Annual Report)³, on page 119, also notes that 95% of settlement payments, net "applicable legal and collection fees and costs", is expected to flow back to customers:

Coal Supply Litigation

In the spring of 2005, one of our coal suppliers, C. W. Mining, terminated a long term, fixed price coal supply agreement allegedly because of a force majeure event. We incurred significant costs procuring replacement coal and disputed that the supplier was entitled to terminate the contract. We filed a lawsuit against the supplier in federal court in Salt Lake City and the trial was held in February 2007. On October 29, 2007, the United States District Court for the District of Utah, Central Division held that C.W. Mining's performance under the coal contract was not excused by a force majeure event and awarded us \$24.8 million in damages. In order to preserve and recover on our claim, on January 8, 2008, we participated in the filing of an involuntary Chapter 11 bankruptcy petition against C.W. Mining in the United States Bankruptcy Court in Salt Lake City, Utah. With the implementation of a fuel adjustment clause in our recent Missouri rate case, we expect that 95% of net damages collected as a result of this litigation will be for the benefit of our Missouri customers through lower rates.

As the Stipulation and Agreement and KCP&L-GMO's 2007 SEC Annual Report both stated that the FAC would be used to flow these refunds back to customers, net "applicable legal and collection fees and costs," Staff first reviewed the monthly and quarterly reports required to be submitted under 4 CSR 240-3.161(5) and (6) to see if any payments had been made from C. W. Mining to KCP&L-GMO. No information regarding any possible payments was included in any of the submissions under any of the report headings.

Staff subsequently submitted Data Request 0052 to see if KCP&L-GMO had received any settlement payments from C.W. Mining. The Data Request and response are below:

Question No. : 0052

Please provide the dollar values and dates of actual payments, awards and/or settlements of either cash or other compensation such as coal supply that have

³ Found online at <http://www.blackhillscorp.com/pdf/07KCP&L-GMOAnnualReport.pdf>

3. Conclusion

As any settlement payments will impact the FAC clause once net “applicable legal and collection fees and costs” are accounted for, Staff recommends the Commission order KCP&L-GMO to submit the following additional information:

- All future settlement payments from C. W. Mining shall be reported in the monthly reports as additional information ordered by the Commission (4 CSR 240-3.161(5)(M));
- Applicable legal and collection fees and costs regarding C. W. Mining litigation in the monthly reports as of the date the Commission order regarding this prudence review is effective. The submitted information will show the fees and costs of outside counsel (e.g. Shook, Hardy & Bacon), outside collection agencies and any other fees and costs; and
- Applicable legal and collection fees and costs regarding C. W. Mining litigation shall be included in the monthly reports as additional information ordered by the Commission (4 CSR 240-3.161(5)(M)). The submitted information will show the fees and costs of outside counsel (e.g. Shook, Hardy & Bacon), outside collection agencies and any other fees and costs.

Staff will continue to monitor this issue in future KCP&L-GMO FAC prudence audits.

4. Documents Reviewed

- a. 2007 SEC Annual Report of KCPL-GMO
- b. Direct Testimony of Staff witness Cary Featherstone in Case No. ER-2007-0004
- c. Stipulation and Agreement as to Certain Issues filed April 4, 2007 in Case No. ER-2007-0004
- d. Order Approving Stipulation and Agreement as to Certain Issues in Case No. ER-2007-0004 effective April 27, 2007
- e. KCP&L-GMO Monthly and Quarterly Reports submitted in compliance to 4 CSR 240-3.161(5) and (6)
- f. KCP&L-GMO responses to Staff Data Requests 0052 and 0055
- g. Workpapers submitted with KCP&L-GMO tariff filings to adjust its FAC Cost Adjustment Factor on December 28, 2007 (EO-2008-0216) and June 30, 2008 (EO-2008-0415)
- h. KCP&L-GMO’s 2007 Annual Report filed with the MO PSC

C. Financial Hedges

1. Description

According to the website www.investopedia.com, financial hedges can be described as:

Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract. An example of a hedge would be if you owned a stock, then sold a futures contract stating that you will sell your stock at a set price,

therefore avoiding market fluctuations. Investors use this strategy when they are unsure of what the market will do. A perfect hedge reduces your risk to nothing (except for the cost of the hedge).

In this case, the Company attempts to hedge against the fluctuations of natural gas, coal and diesel prices.

2. Summary of Cost Implications

a. Natural Gas

The treatment of natural gas hedging costs in KCP&L-GMO's FAC was addressed in paragraph 8 of the Stipulation and Agreement in Case No. ER-2007-0004:

Aquila [(now KCP&L-GMO)] agrees not to seek recovery of its 2006 hedge settlement losses of \$11.5 million in this or any future regulatory proceedings. The Signatories agree that ultimate settlement values of Aquila's [(now KCP&L-GMO)] hedge contracts in place on March 27, 2007 for the period June 1, 2007 through December 31, 2009 will be subject to the provisions of any fuel cost recovery mechanism approved by the Commission in this case. However, the ultimate settlement values will not be subject to challenge as to a prudence disallowance relative to Aquila's [(now KCP&L-GMO)] original decisions to enter into these hedge positions. The market values for these contracts as of March 27, 2007 are reflected in the attached Schedule 1. In the event that the Commission does not implement a fuel cost recovery mechanism for Aquila [(now KCP&L-GMO)], then the treatment for hedge costs shall be determined in a future proceeding. While Aquila [(now KCP&L-GMO)] believes that its current hedging practices are prudent, Aquila [(now KCP&L-GMO)] acknowledges that its continued use of its current hedging practices is subject to a prudence review and potential disallowances relative to hedge positions taken after March 27, 2007.

The Company had a net loss through its natural gas hedging program of approximately \$7 million for the June 1, 2007 to May 31, 2008 time period of this audit. The program had losses through the months of June 2007 through March 2008 – the first 10 months of the audit year. In the last two months of the audit year, the company's hedging program produced a gain of approximately \$1.5 million.

b. Diesel Fuel

In the twelve months reviewed, the Company purchased approximately \$388,000 of diesel fuel for its MPS Nevada plant. The Company purchased approximately \$1.3 million of diesel fuel for its L&P Lake Road units. This amounts to purchases of approximately \$1.7 million for diesel fuel for the entire company.

c. Coal

The Company purchased approximately \$95 million of coal of which \$65 million was purchased for use by its MPS Sibley unit and MPS's portion of the Jeffery coal units and \$30 million for its L&P Lake Road unit and L&P's portion of the Iatan coal unit.

3. Conclusion

For the time period reviewed, Staff concluded that ** _____ ** of hedging costs were associated with natural gas hedging contracts in place on March 27, 2007, and agrees that these dollars cannot be challenged according to the Stipulation and Agreement in Case No. ER-2007-0004. Staff concluded that ** _____ ** of costs was associated with natural gas hedging contracts in place after March 27, 2007, for the time period in this case. Staff found no indication of imprudence regarding costs associated with natural gas hedging contracts in place after March 27, 2007 for the time period in this case.

Staff found no indication of imprudence for the purchase of natural gas, diesel fuel or coal.

4. Documents Reviewed

- a. KCP&L-GMO responses to Staff data requests related to KCP&L-GMO's hedging of natural gas prices during June 1, 2007 to May 31, 2008
- b. Copies of invoices the company paid for natural gas as compared to the total cost of natural gas the Company is claiming it incurred during its first two accumulation periods
- c. KCP&L-GMO responses to Staff data requests related to diesel fuel purchased and the number of gallons received for the Company's Lake Road and Nevada units
- d. KCP&L-GMO fixed coal contracts in place for the delivery of coal to each of its units

D. SO₂ Allowances

1. Description

The U.S sulfur dioxide (SO₂) emission allowance trading program was established by Title IV of the 1990 Clean Air Act Amendments (CAAA). The program is intended to reduce environmental and human health impacts associated with the release of sulfur emissions from coal-fired electric power plants. It requires electric utilities to reduce their SO₂ emissions by about 50% from 1980 levels or purchase allowances to meet this standard.

Power plants are allocated a 30-year stream of tradable allowances, each worth one ton of SO₂ emission. The allocations are based on an average capacity factor from the period 1985 to 1987. Allowances are awarded by the Environmental Protection Agency (EPA) every year and

are designated by vintage year. The vintage year denotes the first year the allowances are usable for compliance. Unused allowances can be sold or banked for use in subsequent years.

Since this base period, the MPS Sibley and L&P Lake Road plant capacities have more than doubled; Iatan unit partially owned by L&P had a slight increase in capacity while the Jeffery Energy Center partially owned by MPS had a slight reduction in capacity. The net effect is that KCP&L-GMO is not allocated enough allowances to cover emissions from its power plants. In addition, KCP&L-GMO has a power purchase contract with Gerald Gentleman power plant that requires KCP&L-GMO to supply SO₂ allowances.

To meet its needs, KCP&L-GMO has established an SO₂ inventory. This inventory is tracked in Account 158100 Emission Allowance Inventory. At the beginning of each year, the EPA awards allowances to KCP&L-GMO, and it adds the new allowances to its inventory. To meet operational requirements, additional allowances are purchased throughout the year. At the beginning of each year, KCP&L-GMO Commodity Accounting calculates an average current year inventory price. This calculation can be found in KCP&L-GMO's Accounting Procedures Manual, Commodity Accounting.

Each month, KCP&L-GMO's power plant production report provides an estimate of SO₂ allowance requirements based on tons of coal and coal sulfur content. KCP&L-GMO's Commodity Accounting expenses an amount equal to this requirement times the average current year inventory price. This cost for SO₂ allowances is tracked in FERC account 509. A true-up of for account 509 coincides with the EPA yearly award of additional allowances.

The cost for SO₂ allowances, as provided in FERC account 509, is included as a recoverable cost in KCP&L-GMO's FAC. This allows KCP&L-GMO to recover 95% of its prudently incurred costs for SO₂ allowances above a base amount from its retail customers.

2. Summary of Cost Implications

The following table provides the cost of emission compliance for the two six-month accumulation periods beginning June 1, 2007 through May 31, 2008, and compares these costs with the annual baseline cost of emission compliance. 95% of the amounts above and below the baseline are recoverable expenses through the FAC.

Emission Allowance Costs			
June 1, 2007 - May 31, 2008			
Operating Territory	Recovery Period Costs	Base Line Costs ⁵	Amt Above/ (Below) Base
L&P	\$3,325,327	\$3,006,513	\$318,814
MPS	\$2,052,840	\$2,098,579	(\$45,739)

⁵ From Schedule 3 of the Report and Order from Case ER-2007-0002.

3. Conclusion

Based on the documents reviewed, Staff found no indication of imprudence, and the variations from the baseline appear to be caused by the changes in price per SO₂ allowance, and the number of allowances used during the accumulation periods. The numbers of allowances used are a function of the tons of coal burned during the accumulation periods and the sulfur content of the coal.

Staff does recommend that the Commission order KCP&L-GMO to submit as a part of its monthly reporting, monthly amount and cost of emission allowances that are purchased, sold or used by KCP&L-GMO.

4. Documents Reviewed

- a. KCP&L-GMO response to Staff Data Requests 0043, 0046, 0047, 0048 and 0049
- b. Direct Testimony of KCP&L-GMO's witness Susan Braun in Case No. ER-2007-0004
- c. Direct Testimony of Staff witness Graham Vessely in Case No. ER-2007-0004.

E. BioMass Test

1. Description

A test burn in Sibley Unit 2 using biofuel (pelletized waste) was conducted the week of May 5, 2008.

2. Summary of Cost Implications

The documents reviewed from the responses of DRs 0001, 0008 and 0054 show no indication that costs associated with the test burn were included in FAC expenses.

3. Conclusion

The available information indicates that the biomass test burn had no cost implications for the FAC during the two six-month accumulation periods from June 1, 2007 through May 31, 2008.

4. Documents Reviewed

- a. KCP&L-GMO responses to Staff Data Requests 0001, 0008 and 0054

F. Environmental Work at Sibley/Jeffrey

1. Description

Several regulatory driven air pollution control projects are in various phases of construction. These projects include:

Sibley Unit 3:	Selective Catalytic Reducer (SCR)
Sibley Unit 1 and 2:	Selective Non-Catalytic Reducer (SNCR) with Rich Reagent Injection (RRI)
Jeffrey Energy Center:	Replacing/rebuilding three scrubbers

During the two six-month accumulation periods from June 1, 2007 through May 31, 2008, these projects were in various phases of construction and were not operational. Therefore, no changes in operational expenses have been incurred due to these projects. Staff is monitoring the construction and start-up of these projects and will audit any operational costs that might be recovered through the FAC mechanism.

2. Summary of Cost Implications

There is no indication that any costs associated with the environmental projects at the Sibley Plant and the Jeffrey Energy Center were passed through the FAC during the two six-month accumulation periods from June 1, 2007 through May 31, 2008.

3. Conclusion

The air pollution control projects at Sibley and Jeffrey Energy Center had no cost implications for the FAC during the two six-month accumulation periods from June 1, 2007 through May 31, 2008.

4. Documents Reviewed

- a. KCP&L-GMO response to Staff Data Requests 0013, 0028, 0048 and 0049

G. Affiliate Transactions/Crossroads

1. Description

In the course of determining whether or not costs reflected in the FAC were prudent, Staff investigated the possibility of transactions between affiliates within the KCP&L-GMO corporate structure. Specifically, Staff looked for purchases of power from the Crossroads plant in Mississippi which was owned during the review period by a KCP&L-GMO affiliate, Aquila Merchant Services, and not included within the regulated rate base of either L&P or MPS divisions of KCP&L-GMO.

2. Summary of Cost Implications

None

3. Conclusion

In its review, Staff discovered no evidence of imprudence regarding affiliate transactions.

4. Documents Reviewed Costs

- a. KCP&L-GMO information submitted to meet the Monthly Reports 4 CSR 240-3.161(5)(J)
- b. KCP&L-GMO's 2007 MO PSC Annual Report
- c. KCP&L-GMO response to Staff Data Request 0021

H. Off-System Sales

1. Description

If there is opportunity to earn a profit through off-system sales, it is prudent for a utility to pursue such opportunities. Profit from off-system sales is a component of KCP&L-GMO's FAC, specifically FERC Account 555, or "P, the "actual cost of purchase energy", listed on KCP&L-GMO Tariff No. 1 Original Sheet No. 125.

Staff reviewed the off system sales quantity (MWh) and revenues over the review period. Staff compared the quantity and revenues to historical information regarding KCP&L-GMO's off-system sales.

2. Summary of Cost Implications

KCP&L-GMO pursuit of off-system sales at a profit results in lower total fuel and purchased power costs.

3. Conclusion

Staff found no evidence of KCP&L-GMO acting imprudently with regard to the issue of off-system sales.

4. Documents Reviewed

- a. Monthly reports submitted in compliance with 4 CSR 240-3.161(5)
- b. Workpapers filed with KCP&L-GMO's tariff filings adjusting its Cost Adjustment Factors
- c. KCP&L-GMO response to Staff Data Request 0021
- d. Monthly Outage data submitted by KCP&L-GMO in compliance with 4 CSR 240-3.190

I. Steam/Divisional Allocations

1. Description

- a. Divisional Allocation

An allocation of base fuel costs between the L&P and MPS was established on page 8 of the Stipulation and Agreement in Case No. ER-2007-0004. This allocation was 81% MPS and 19% L&P.

For the purposes of this review, the divisional allocation was used as a factor to allocate any further costs that were not directly attributable to either division.

b. Steam Allocation

KCP&L-GMO's calculation of Actual Fuel Costs for the former Aquila Networks- L&P division includes a monetary transfer entitled "Steam Transfer-Fuel", which includes the note, "Fuel-Variable (Transfer between electric and industrial steam)". This transfer is a negative number for the purposes of calculating costs, and is a credit against the accumulation of costs for fuel used to generate electricity for native load customers.

Staff compared the monthly fuel transfer amounts to the estimates of costs from Staff's fuel model run in ER-2007-0004.

2. Summary of Cost Implications

None

3. Conclusion

Staff's review uncovered no indication of imprudence with regard to allocation issues.

4. Documents Reviewed

a. Divisional Allocation

- (1). Stipulation and Agreement as to Certain Issues" in Case No. ER-2007-0004
- (2) Commission order approving "Stipulation and Agreement as to Certain Issues" in ER-2007-0004

b. Steam Allocation

- (1) KCP&L-GMO Response to Staff Data Request 0001
- (2) KCP&L-GMO workpapers included in tariff filings to adjust FAC
- (3) Staff workpapers from ER-2007-0004

V. Other Items

A. Plant outages

1. Description

KCP&L-GMO generates much of its own power at the following generating stations: Sibley Units 1, 2, and 3; Greenwood 1, 2, 3 and 4; Ralph Green 1; Lake Road 1, 2, 3, 4, 5, 6 and 7. In addition, it is also part owner of Iatan 1 and Jeffery 1, 2 and 3 from which it receives power. Outages taken at any of these generating units can have an impact on how much KCP&L-GMO will pay for fuel and purchase power and could result in the Company asking for more fuel cost than is necessary. Outages can be either planned or unplanned. Staff examined the outages and the timing of these outages to determine if these outages were prudently taken. An example of an imprudent outage would be planning an outage of a large coal unit during peak demand times.

2. Summary of Cost Implications

An imprudent outage could result in KCP&L-GMO purchasing expensive spot power or running its more expensive gas units to meet demand. Thus the Company would purchase natural gas than necessary and consequently result higher fuel costs.

3. Conclusion

Staff did not find any evidence of imprudent outages being taken during the time period examined in this review.

4. Documents Reviewed

- a. KCP&L-GMO responses to Staff Data Requests 0003, 0004, 0005 and 0006
- b. Monthly Outage data submitted by KCP&L-GMO in compliance with 4 CSR 240-3.190

B. Purchase Power Contracts

1. Description

As a smaller electric utility in the state of Missouri, KCP&L-GMO has met some of its capacity and energy needs through long term contracts. Staff did review these purchased power contracts held by KCP&L-GMO's during the review period.

In addition, any discussion of purchased power in this prudence review is intertwined with issue the Generation Capacity issue previously discussed. KCP&L-GMO chose to build only three 105 MW CTs at its South Harper site (which was designed for six 105 MW CTs) and entered into short-term purchased power agreements for its remaining capacity needs. As stated previously, it is Staff's position that KCP&L-GMO should be meeting its needs with its own resources, not short-term purchased power agreements.

2. Summary of Cost Implications

Even if it was found that KCP&L-GMO had been imprudent by purchasing additional power or capacity to meet its demand, evidence of imprudence regarding the resulting purchased energy would only be found if the cost of the purchased power agreement(s) energy was greater than the cost of generating the energy with additional generating capacity.

3. Conclusion

Staff found no evidence of imprudence related to KCP&L-GMO's long-term purchased power contracts.

Staff reviewed hourly fuel and purchased power information. Staff found that the energy received through the short-term purchased power agreements that KCP&L-GMO entered into instead of building generation was either purchased at market price or the cost of natural gas generation and therefore not materially different from the cost of energy generated by two additional CTs.

4. Documents Reviewed

- a. KCP&L-GMO Responses to Staff Data Requests 0020 and 0024
- b. Rebuttal testimony of Staff witness Lena M. Mantle in Case No. EF-2003-0465
- c. Direct testimony of Staff witness Lena M. Mantle in Case No. ER-2005-0436
- d. Surrebuttal testimony of Staff witness Lena M. Mantle in Case No. ER-2007-0004

VI. Items For Future Consideration

A. Affiliate Transaction

In the summer of 2008, KCP&L-GMO purchased power from the Crossroads plant. This affiliate transaction will need to be scrutinized in the next prudence review.

B. SO₂ Allowances – Regulatory Uncertainty

The US EPA's Clean Air Interstate Rule (CAIR) was developed to address the transport of pollutants from upwind to downwind states. States in the eastern half of the country were required over a six-year compliance period (2009-2015) to participate in a federal program intended to reduce emissions of SO₂ by 57 percent from 2003 levels and NO_x by 61 percent from 2003 levels.

The primary mechanism of the rule was a cap-and-trade program that will allow a major source of NO_x and/or SO₂ to trade excess allowances when its emissions of a specific pollutant fall below its cap for that pollutant. EPA issued a model cap-and-trade program for power plants, which could have been used by states as the primary control mechanism under CAIR.

However, a number of petitions for judicial review of CAIR were filed in the D.C. Circuit Court, and on July 11, 2008, the D.C. Circuit Court of Appeals vacated the Clean Air Interstate Rule. Immediate fallout from the court's decision was the drop in the price of SO₂ allowances from \$500 per ton at the beginning of the year to \$85 a ton on July 16, 2008. As of October 24, 2008, prices have increased to \$182 per ton. This uncertainty in the market for SO₂ allowances could translate into a wider variance in emission expenses that are accumulated through the FAC.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the First Prudence Review of	)	
Costs Subject to the Commission-Approved	)	
Fuel Adjustment Clause of Aquila, Inc., d/b/a	)	Case No. EO-2009-0115
KCP&L Greater Missouri Operations	)	
Company	)	

AFFIDAVIT OF LENA M. MANTLE

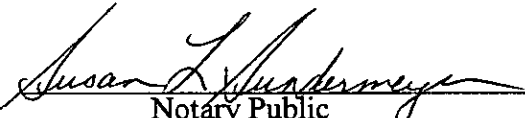
STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Lena M. Mantle, employee of the Staff of the Missouri Public Service Commission, being of lawful age and after being duly sworn, states that she has participated in the preparation of the accompanying Staff Report on pages 1-5, and the facts therein are true and correct to the best of her knowledge and belief..



Lena M. Mantle

Subscribed and sworn to before me this 15th day of December, 2008.



Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the First Prudence Review of)
Costs Subject to the Commission-Approved)
Fuel Adjustment Clause of Aquila, Inc., d/b/a)
KCP&L Greater Missouri Operations
Company

Case No. EO-2009-0115

AFFIDAVIT OF ADAM C. MCKINNIE

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Adam C. McKinnie, employee of the Staff of the Missouri Public Service Commission, being of lawful age and after being duly sworn, states that he has participated in the preparation of the accompanying Staff Report on pages 5-8, 13-15 & 17, and that the facts therein are true and correct to the best of his knowledge and belief.

AL MK

Adam C. McKinnie

Subscribed and sworn to before me this 15th day of December, 2008.



SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L. Sundermeyer
Notary Public


Notary Public


Notary Public