

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of the Application of Kansas ) City Power & Light Company for Approval ) to Make Certain Changes in its Charges for ) Electric Service to Continue the ) Implementation of its Regulatory Plan )	Case No. ER-2010-0355	<b>NP</b>
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In the Matter of the Application of KCP&L ) Greater Missouri Operations Company for ) Approval to Make Certain Changes in its ) Charges for Electric Service )	Case No. ER-2010-0356
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**INITIAL BRIEF OF THE MISSOURI RETAILERS ASSOCIATION**

**INTRODUCTION**

The Missouri Retailers Association (MRA) will address only the issue of the prudence of costs KCP&L incurred in the Iatan construction projects. MRA has identified approximately ten percent of project costs that resulted from KCP&L's imprudent management of the projects, and asks the Commission to hold KCP&L responsible for its management shortcomings. KCP&L asks the Commission to shift to ratepayers the risks that it knowingly and willingly accepted when it began the projects.

KCP&L is solely responsible for management of its affairs, to the exclusion of ratepayers, the Commission or the Commission's Staff. 393.130 RSMo<sup>1</sup> See, State ex rel. Laclede Gas Co. v. Public Service Commission, 600 S.W.2d 222 (Mo. App. 1980); State ex rel. City of St. Joseph v. Public Service Commission, 30 S.W.2d 8 (Mo. 1930). The management obligation includes providing all facilities necessary for safe, adequate and reasonable operation of its system. §393.130. After hearing, KCP&L is entitled to recover the reasonable costs to

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<sup>1</sup> All references are to the Revised Statutes of Missouri, 2000 unless otherwise noted.

provide service, including a reasonable return on the capital it provides. At all rate hearings, KCP&L bears the burden of proving proposed rates are reasonable. §393.150.2.

“Prudence” is the term used for the judgment whether or not a utility’s service and costs are reasonable. In *State ex rel. GS Technologies Operating Co., Inc. v. Public Serv. Comm’n*, 116 S.W.3d 680, 693-94 (Mo. App. 2003) the Court of Appeals, citing *State ex rel. Associated Natural Gas v. Public Serv. Comm’n*, 954 S.W.2d 520 (Mo. App. W.D. 1997), held that standard to be:

. . . In such a [rate] proceeding, the Commission reviews the reasonableness of the costs and, if it determines that the costs have been appropriately incurred, the Commission allows the utility to pass the costs on to its customers. *Id.* At 523. To determine whether the costs were appropriately incurred, the Commission uses a prudence standard. *Id.* Under the prudence standard, the Commission looks at whether the utility’s conduct was reasonable at the time, under all of the circumstances. *Id.* At 529. In applying this standard, the Commission presumes that the utility’s costs were prudently incurred. *Id.* at 528. Where, however, another participant in the proceeding before the Commission “ ‘creates a serious doubt as to the prudence of an expenditure, then the [utility] has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.’ ” *Id.* (citations omitted)....

...*Associated Natural Gas* was a ratemaking case initiated by the utility, seeking to pass on costs to its customers. *Id.* At 523. In such cases, the utility receives the benefit of the presumption of prudence with regard to its costs until a serious doubt is created with regard to the prudence of an expenditure. *Id.* at 528. When a serious doubt arises, the burden then shifts to the utility to prove prudence of the expenditure in order to succeed on its request to pass these costs on to its customers. *Id.*

The Commission assumes utilities act prudently until that assumption is challenged. In its *Report and Order in Re Union Electric Co.*, Case Nos. EO-85-17, et al., 27 Mo.P.S.C.(N.S.) 183, 192-93 (1985), the Commission cited *Anaheim, Riverside, Banning, et al. v. FERC*, 669 F.2d 799, 809 (D.C. Cir. 1981) to that effect:

The Federal Power Act imposes on the Company the “burden of proof to show that the increased rate of charge is just and reasonable.” 16 U.S.C. s 824d(e). Edison relies on Supreme Court precedent for the proposition that a utility’s costs are presumed to be prudently incurred. See *Missouri ex rel. Southwestern Bell Telephone Co. v. Missouri Pub. Serv. Comm.*, 262 U.S. 276, 289 n.1 (1923). However, the presumption does not survive “a showing of inefficiency or improvidence.” *West Ohio Gas Co. v. Public Utilities Comm.*, 294 U.S. 63, 55 S.Ct. 316, 79 L.Ed. 761 (1935); see 1 A.L.G. Priest, *Principles of Public Utility Regulation* 50-51 (1969). As the Commission has explained, “utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent.... However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.” Opinion No. 86, *Minnesota Power & Light Co. Opinion and Order on Rate Increase Filing*, Docket No. ER76-827, at 14, 20 Fed. Power Service 5-874, 5-887 (June 24, 1980) (footnotes omitted)....

Finally, the *Associated Natural Gas* Court held 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.” 954 S.W.2d at 529.

### **History of the Projects**

The Iatan 2 project was first proposed by KCP&L in a Project Definition Report (PDR) published in 2004. (Ex. 74). The PDR was developed at KCP&L’s direction by Burns and McDonnell (BMD). (Ex. 74). Pursuant to a Stipulation and Agreement among KCP&L and the parties to Commission Case EO-2005-0239, the Commission approved a Regulatory Plan for KCP&L that included among other things: the addition of Air Quality Control Systems to the Iatan1 generating station; the construction of the Iatan 2 generating station; the filing of rate cases by KCP&L during the construction period; and the provision of certain funding of the project by ratepayers through amortizations of cash flow sufficient to maintain KCP&L’s credit

rating at investment grade levels. The Regulatory Plan also called for KCP&L to provide the parties with a definitive cost estimate at the inception of the construction project. The Company provided that estimate in the form of a Control Budget Estimate (CBE) in early December, 2006. (Ex. 74, p. 2).

In late 2005 the Company decided to pursue the Iatan projects by obtaining an engineer, procure and construct (EPC) contract for the Iatan 1 AQCS and Iatan 2 boiler island; an EPC contract for the Iatan 2 generator; and by acting as general contractor on a multi-prime basis for the balance of plant (BOP) work for the projects. (Ex. 74, p. 1). Under the multi-prime approach, KCP&L not only entered into the various construction and materials contracts, but also assumed responsibility for administering the individual contracts and coordinating the contractors' performance into the project schedule.

KCP&L retained the services of consultants to assist in the management of the project, including Schiff Hardin, a Chicago law firm and construction management consultant (Ex. 74, p. 1); Schumacher Consulting LLC, a labor market consultant; and BMD, as owner's engineer for the project. (Ex. 74, p.1; Ex. 74, p. 2).

The preponderance of the evidence in this case establishes that in some respects KCP&L's management of the Iatan projects was not reasonable and resulted in excessive costs. This evidence provides a basis for the Commission to allocate the costs to KCP&L.

## ARGUMENT

### **1. MRA's Proposed Adjustments**

MRA, through its expert witness Walter Drabinski of Vantage Energy Consulting, LLC, recommends that the Commission reduce KCP&L's costs for the Iatan I project by \$13,938,000, and reduce KCP&L's costs for the Iatan II project by \$218,755,000. Because these adjustments

address the overall cost of the project, MRA is not recommending the Commission remove any of the costs of the common plant.

KCP&L has repeatedly claimed that the quantification of imprudent costs provided by MRA is not adequate for the Commission in this case. A review of the evidence shows this assertion to be completely erroneous. Mr. Drabinski provided a significant foundation related to disallowances in his direct testimony where he analyzes the problems that Alstom, Kiewit and other contractors encountered as a result of imprudent management on the part of KCP&L. His testimony provides details about BMD's failures that are described in KCP&L monthly reports, Schiff Hardin reports and independent audits. (Drabinski Direct, Ex. 2601, pp. 85-99). He addresses major contracts, amendments and settlements. In his analysis of purchase orders and change orders, he and his team started their review with almost 3,000 POs and COs. Ultimately they analyzed the detailed support for almost 300 separate POs and COs. This information was provided in Schedule 36 HC to his direct testimony (Ex. 2601). In addition to the written support Mr. Drabinski provides for his analysis, his testimony on cross examination by KCP&L provides significant additional support.

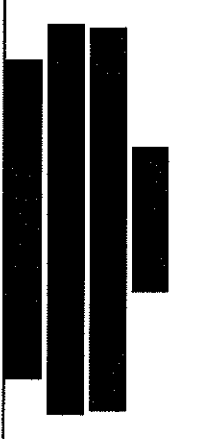
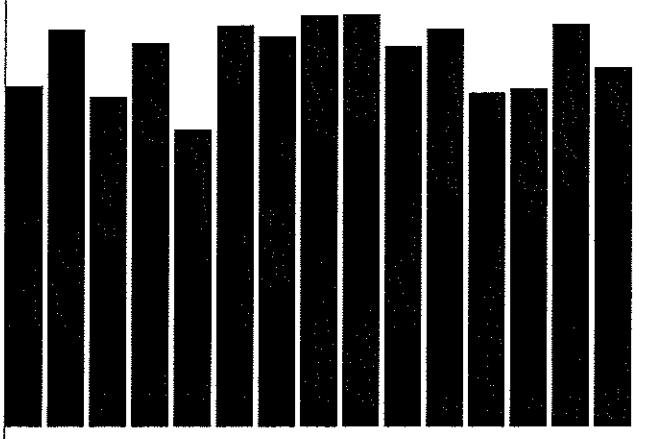
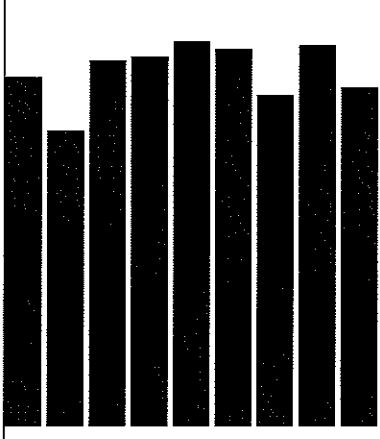

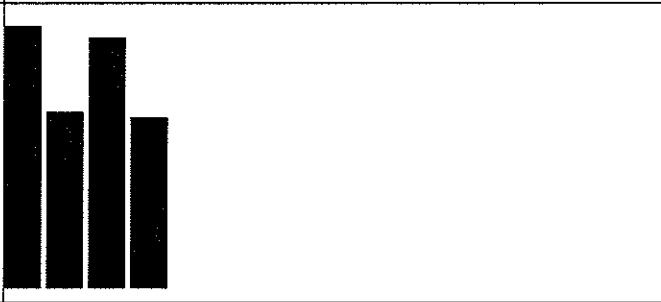
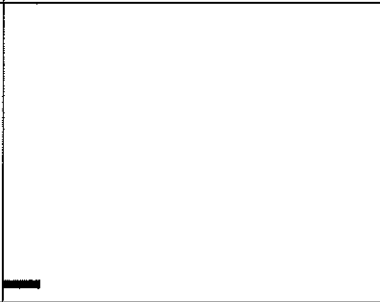

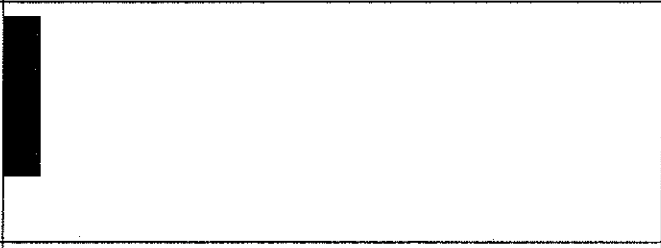
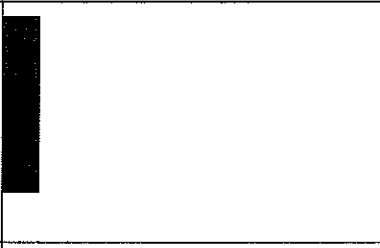

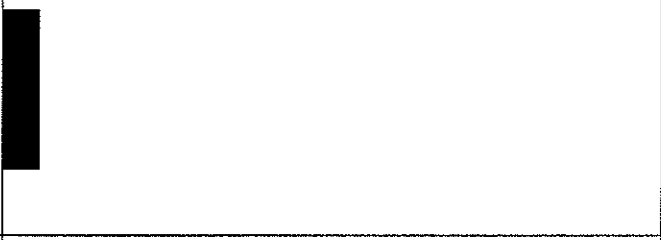
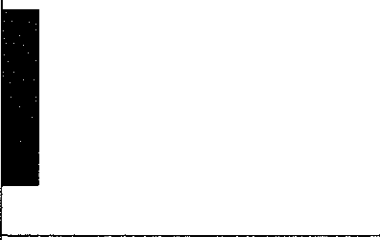
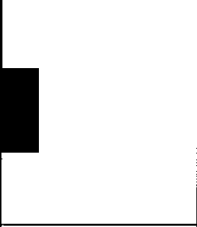


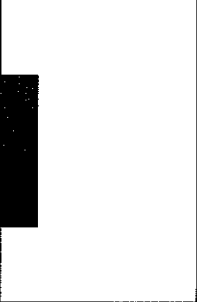
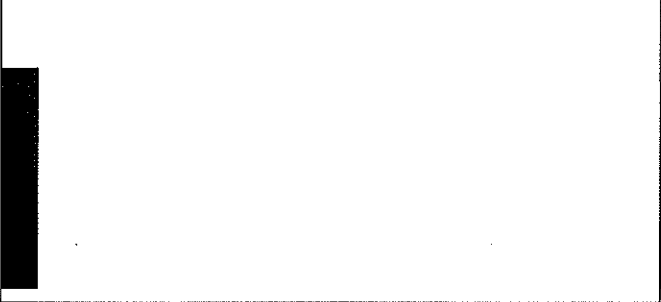

It is ironic that KCP&L complains about the level of support for Mr. Drabinski's analysis, when the support of their own witnesses (Meyer and Nielsen) pales in comparison. Careful examination reveals that Mr. Meyer provides no substantial support for his conclusion that every expenditure on the project is completely reasonable and prudently incurred. Mr. Nielsen provides support for two disallowances, but does not provide analysis as to why the balance of expenditures by KCP&L are prudent.

During the hearing, Mr. Drabinski was asked to review a number of purchase orders that KCP&L claimed were incorrectly deducted or should be deemed reasonable. A thorough

examination of all the purchase orders in his analysis resulted in two proposed changes to MRA's proposed disallowance. First, the \$1.6 million spent by Alstom for coal conveyor work was reasonable. This work had originally been awarded to another contractor but was transferred to Alstom since they were performing other work in the same area. Second, the adjustment of \$10.6 million for WSI Welding augmentation was included in both the Alstom settlement agreement and in Mr. Drabinski's analysis of Other POs, Indirects and Uncommitted. The net result of these changes is that the total amount now proposed for disallowance totals \$218.8 million.

A summary of the revised table from page 208 of Mr. Drabinski's testimony is provided below. It shows the changes discussed above. It also provides a reference to the support for each category of analysis.


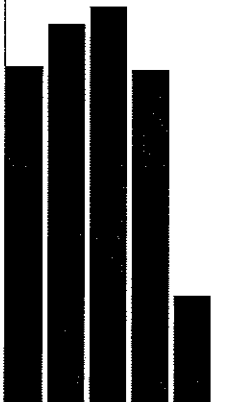








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## **2. KCP&L's Performance**

### **A. KCP&L's Project Management**

#### **1. General Signs of Trouble**

MRA believes that two examples during the project demonstrate generally the problems with KCP&L's project management.

The first example is the "turbine building bust." (Drabinski Direct, Ex. 2601, pp. 134-138). In the spring of 2006, KCP&L, through BMD, had prepared and distributed to potential vendors a request for proposals for construction of the turbine building. The estimates it received for materials were double the amounts anticipated. The documents released to vendors had provided for an appropriate amount of materials for the construction of the turbine building, but those quantities and anticipated prices had not been incorporated into budget estimates. The resulting surprise contributed to the delay from August to December in the final production of the control budget estimate, and entailed an intensive review of all project costs. In short, KCP&L's left hand did not know what KCP&L's right hand was doing.

The second example of management problems is KCP&L's failure to properly allocate costs to the common plant. From the outset of the Iatan project, KCP&L knew that Iatan 2 had different owners than Iatan 1, with different ownership interests. It also knew that the project for construction of a common plant which would be used by both Iatan 1 and Iatan 2. Project management should have recognized and accommodated this need from the outset of the projects. Yet, as late as 2009, KCP&L did not recognize this factor.

## **2. Specific Examples of KCP&L's Project Management Problems**

At the time that it decided to proceed with the projects by using UPC contracts for the Iatan 1 AQCS and Iatan 2 boiler island, and a multi-prime approach for the balance of the projects, the company knew that it was assuming responsibility for negotiating contracts for the balance plant and was responsible for the execution of those contracts by individual contractors, as well as the coordination of the contractors. (Drabinski Direct, Ex. 2601, Sch. WPD-13, Schiff Hardin September 29, 2005 Report, pp. 1-5).

The Company's consultants – Schiff Hardin, BMD and Shumaker Consulting, LLC, among others – by early 2006 had emphasized the need for strong, experienced project management to insure that individual contractors met their obligations, and that the individual contractor's performance meshed with the overall project's schedule. KCP&L was well aware that schedule compression and work site congestion could add substantially to the cost of the projects.

KCP&L recognized early on that it needed experienced construction management personnel to oversee the projects. KCP&L early on retained Messrs. Murphy, Price and Grimwade to manage the projects. Mr. Murphy served approximately five (5) months and Mr. Price and Mr. Grimwade served approximately thirteen (13) months. The Project Management turnover was substantial. (Drabinski Direct, ex. 2601, p. 60). It was not until the arrival of Mr. Churchman in May of 2008 that the projects had the stable, experienced oversight that they needed. (Ex. 2602, Drabinski Surrebuttal, pp. 32-34).

Specific problems with KCP&L's management of the projects is documented in Mr. Drabinski's Surrebuttal Testimony (Exhibit 2602, pages 6-43) by citation to 182 separate reports

from KCP&L management, consultants Schiff Hardin, Ernst & Young and Strategic Talent Solutions.<sup>2</sup>

It is the Reports of KCP&L staff and its consultants that demonstrate the management problems that caused the deviations from the December 2006 CBE. KCP&L has suggested that the Commission should not rely on these contemporaneous documents to form a picture of the project management problems that caused the balance of plant costs to jump from \$357 million to almost \$1 billion.

MRA relies on these contemporary chronicles of project management problems that had predictable and predicted impacts on the costs of the projects. KCP&L suggests otherwise.

### **3. KCP&L Explanations**

The company relies on its reforecasts and change orders to support the prudence of its project management. However, both the reforecasts and change orders merely acknowledge deviations from the project plan as planned, and correct those deviations from the plan. They are not justification of the day-to-day management problems that caused the deviations. Like Staff witness David Elliott's review, the reforecasts and change orders reflect the condition of the project at the time, and the plan to get the project back on track.

For instance, KCP&L repeatedly suggested in its testimony and evidence that reforecasts indicated reasonable costs because the December 2006 CBE was unreliable in that only 20% to 30% of the engineering was completed at the time. This assertion is not consistent with the other testimony in the record. Mr. Bell and Mr. Drabinski both agree that "fast track" construction processes in the construction of power plants was common place at the time of the Iatan projects. The evidence is clear that Burns & McDonnell had experience in the construction of power

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<sup>2</sup> Item No. 48 was attributed in error to the weekly leadership team meetings.

plants, and that hundreds of super-critical coal power plants had been built, providing a firm basis for estimating costs. KCP&L further ignores that the \$1.485 billion cost estimate in the December 2006 CBE was consistent with experience of other power plant construction projects. KCP&L's assertion also flies in the face of its own project execution plan published in July, 2007. The PEP indicated that it should be a project goal to bring the construction in at or below the CBE. Further, KCP&L also ignores the revised PDR published in June, 2007. That document supports CBE was reasonable. (Drabinski Direct, Ex. 2601, Sch. 2, PDR Supplement 2, pp. 5-10 to 5-12).

In support of the reasonableness of shifting the welding responsibilities from Alstom to WSI, KCP&L cites to the higher quality and productivity of the WSI performance. (Downey Rebuttal, Ex. 22). What KCP&L fails to note, however, is that for two (2) years prior to the 2008 WSI contract, KCP&L was paying Alstom for inefficient and poor quality performance.

Another instance casting doubt on KCP&L's view of the reasonableness of the project cost escalation is its treatment of the abandoned proposal to acquire railcars. The December 2006 CBE included almost \$50 million for the acquisition of railcars to service the Iatan generating station. KCP&L abandoned the proposed purchase, and instead plans to lease the railcars. However, KCP&L treated this decision as an increase in the contingency from \$220 to \$270 million, rather than reduction in the scope of the project from \$1.685 billion to \$1.635 billion.

KCP&L suggests that settlements and change orders that dramatically increase the cost of the projects were driven in substantial part by limitations of its contracts, and the costs, uncertainty and time of the dispute resolution provisions of the contract. However, the company does not acknowledge that as negotiator of those contracts, it is responsible for their



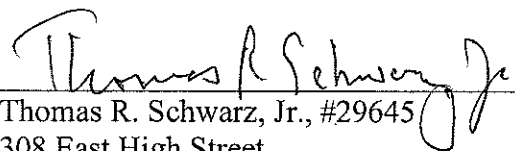
shortcomings. KCP&L never explains why an ECP contract for boiler island would not include boiler tube cleaning and railing necessary for operation of the plant.

**CONCLUSION**

The adjustments that the MRA proposes are fully explained in the extensive direct and surrebuttal testimony of Mr. Drabinski (Ex. 2601, 2602). The adjustments are based on numerous site visits to the construction site during the construction period, as well as review and analysis of the construction contracts, purchase orders and change orders authorized by KCP&L. Importantly, it relies on the contemporaneous documentation of KCP&L staff, KCP&L consultants and KCP&L auditors who were directly observing the day-to-day management problems encountered in the project. KCP&L's post hoc explanations for excessive settlement and change order costs do not provide sufficient basis for the Commission to include all such costs in KCP&L's rate base. The Commission should reduce the cost-basis of Iatan 1 by \$13,938,000.00 and reduce the cost-basis of the Iatan 2 generating station by \$218,755,000.00.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that true and accurate copies of the foregoing Initial Brief of the Missouri Retailers Association were sent by electronic transmission, this 10<sup>th</sup> day of March, 2011, to the following:

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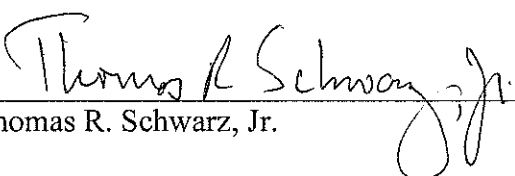
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