

APPENDIX B

PAGES 1-7 AND PAGES 20-24

HAVE BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

**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. )

**File No. ER-2010-0355**

In the Matter of the Application of KCP&L )  
Greater Missouri Operations Company for )  
Approval to Make Certain Changes in its )  
Charges for Electric Service. )

**File No. ER-2010-0356**

**REPORT AND ORDER DIRECTING KCPL AND GMO TO APPLY TO THE IRS  
TO REVISE THE MEMORANDUM OF UNDERSTANDING REGARDING  
THE ADVANCED COAL TAX CREDITS FOR IATAN**

Date Issued: March 16, 2011

Date Effective: March 26, 2011

This order directs Kansas City Power & Light Company (KCPL) and KCP&L Greater Missouri Operations Company (GMO) to apply to the Internal Revenue Service (IRS) for an amendment of the 2010 MOU that if agreed to by the IRS would allow GMO to obtain a share of Section 48A tax credits equal to its relative ownership share of Iatan 2 and a reallocation of credits in the amounts of \$80,725,000 for KCPL and \$26,562,500 for GMO.

**Procedural History**

On June 4, 2010, KCPL and GMO each filed tariffs and direct testimony in order to begin a general rate proceeding whereby their rates for electric service would increase. KCPL's tariff has an effective date of May 4, 2011. GMO's tariff has an effective date of June 4, 2011.

Interventions were allowed, and direct, rebuttal, and surrebuttal testimony was prefiled. Evidentiary hearings were held from January 18 - February 4, 2011, February 14 - 17, 2011, and March 3 - 4, 2011.

One of the issues raised during the course of the proceedings was whether a portion of the advanced coal tax credits received by KCPL should be allocated to GMO.<sup>1</sup> On February 24, 2011, the Commission directed the parties to fully brief this issue with their initial briefs filed on March 10, 2011 and to state any objection to the Commission hearing this issue separately from the rate issues in the case. The parties filed their briefs on March 10, 2011, as directed and no objections were filed. Thus, in this order the Commission takes up the limited issue of the allocation of the coal tax credit and no other issue.<sup>2</sup>

#### **Declassification of Evidence**

Schedule 1 of Paul R. Harrison's Surrebuttal Testimony<sup>3</sup> was designated as "highly confidential" in its entirety during these proceedings. This schedule is a copy of the Final Arbitration Award issued during a private arbitration of a dispute between The Empire District Electric Company (Empire), the Missouri Joint Municipal Electric Utility Commission (MJMEUC) and the Kansas Electric Power Cooperative, Inc. (KEPCo). In addition, Volume 37, Page 3947, was designated as "highly confidential" by the Regulatory Law Judge even though the conversation was not *in camera* at the time. It has since come to the Commission's attention that much of the arbitrator's award is

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<sup>1</sup> *Kansas City Power & Light Company's and KCP&L Greater Missouri Operations Company's List of Issues, Hearing Schedule and Order of Cross-Examination*, (filed January 1, 2011), p. 8; *List of Issues*, (filed January 7, 2011), p. 13.

<sup>2</sup> This includes the related issues of the prudence of the defense of the arbitration and the disallowance of the costs of arbitration. Those issues will be decided with the remaining rate case issues.

<sup>3</sup> Ex. KCPL-223 and GMO-222.

public information as shown by Missouri Lawyers Weekly articles published on March 30, 2010, and April 4, 2010.<sup>4</sup> Therefore, the Commission will designate as “public” the portions of Schedule 1 to Exhibits KCPL-223 and GMO-222 which are reported in the Missouri Lawyers Weekly articles and all of Volume 37 of the Transcript from February 14, 2011.

### **Findings of Fact**

1. KCPL is a Missouri corporation engaged in the generation, transmission, distribution, and sale of electricity in western Missouri and eastern Kansas, operating primarily in the Kansas City metropolitan area. KCPL is a subsidiary of Great Plains Energy, Incorporated (GPE).

2. GMO is a Missouri corporation engaged in the generation, transmission, distribution, and sale of electricity in western Missouri. GMO was formerly known as Aquila, Inc., and was purchased by GPE on July 14, 2008.

3. The Energy Policy Act of 2005 enacted a series of tax incentives including Section 48A of the Internal Revenue Code.<sup>5</sup> Section 48A provided for \$500 million of advanced coal project tax credits.

4. KCPL, GMO, Empire, MJMEUC, and KEPCo entered into a joint ownership agreement to build what is referred to as latan 2. Joint ownership is held as follows: KCPL 54.71%, GMO 18.00%, Empire 12%, MJMEUC 11.76%, and KEPCo 3.5%.<sup>6</sup>

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<sup>4</sup> *Power companies fight over \$125M tax credit*, Missouri Lawyers Weekly, March 30, 2010, and *Light fights Empire*, Missouri Lawyers Weekly, April 4, 2010.

<sup>5</sup> 26 U.S.C. § 48A.

<sup>6</sup> Exhibit KCPL-107, p. 12; Transcript p. 3941.

5. In August 2006 KCPL applied to the Department of Energy and the IRS for advanced coal tax credits for latan 2, but was denied.<sup>7</sup>

6. KCPL did not include any of the other latan 2 co-owners in its application for the coal tax credit<sup>8</sup> and did not inform any of the co-owners about the credit or its plans to apply.<sup>9</sup>

7. On October 30, 2007, KCPL again applied to the Department of Energy and the IRS for advanced coal tax credits for latan 2.<sup>10</sup>

8. In April 2008, the IRS accepted the application and allocated \$125 million of advanced coal tax credits for latan 2.

9. KCPL signed a Memorandum of Understanding (MOU) regarding the award of the credits with the IRS in the summer of 2008.<sup>11</sup>

10. None of the other co-owners of the latan 2 project (Aquila, Empire, MJMEUC, and KEPCo) applied for such credits in 2007.

11. On October 9, 2008, Empire notified KCPL of a controversy regarding the advanced coal tax credits.<sup>12</sup>

12. On October 31, 2008, both GMO and Empire filed applications with the IRS seeking advanced coal tax credits for latan 2. The IRS denied both applications indicating that the full \$125 million of credits available for latan 2 had already been awarded to KCPL.<sup>13</sup>

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<sup>7</sup> Ex. KCPL-223 and GMO-222, Harrison Surrebuttal.

<sup>8</sup> Tr. 3910.

<sup>9</sup> Ex. KCPL-223 and GMO-222, Sched. 1.

<sup>10</sup> Ex. KCPL-223 and GMO-222, Sched. 3-5.

<sup>11</sup> Ex. KCPL-223 and GMO-222, Sched. 3.

<sup>12</sup> Ex. KCPL-297.

<sup>13</sup> Ex. KCPL-223 and GMO-222, pp. 12-13 and Sched. 7-2; Tr. 3911.

13. Empire, MJMEUC, and KEPCo<sup>14</sup> initiated arbitration proceedings against KCPL, claiming that they were either entitled to their proportionate share of the tax credits according to their ownership shares in latan 2 or the monetary equivalent thereof.

14. GMO did not give notice to arbitrate its entitlement to a portion of the \$125 million advanced coal tax credits.<sup>15</sup>

15. On December 30, 2009, a private arbitration panel denied the claims of MJMEUC and KEPCo, but found in favor of Empire. The panel concluded that KCPL was in violation of the ownership agreement by failing to include the co-owners in the filing for the tax credit<sup>16</sup> or even telling the other co-owners about its application or its efforts to lobby Congress for an amendment to Section 48A.<sup>17</sup>

16. The panel directed KCPL and Empire to apply to the IRS for an amendment of the 2008 MOU to allow Empire to share in the Section 48A tax credits equal to \$17,712,500.<sup>18</sup>

17. The arbitration panel also directed KCPL to pay Empire the \$17.7 million in the event that the IRS did not agree to amend the MOU.<sup>19</sup>

18. MJMEUC and KEPCo are not tax-paying entities as MJMEUC is a political subdivision and KEPCo is a not-for-profit corporation.<sup>20</sup> Because MJMEUC and

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<sup>14</sup> On July 10, 2009, July 15, 2009, and July 17, 2009, respectively.

<sup>15</sup> Tr. 3920.

<sup>16</sup> EX-KCPL-223 and GMO-222, Sched. 1; Tr. 3913.

<sup>17</sup> Ex. KCPL-223 and GMO-222, Sched. 1.

<sup>18</sup> Ex. KCPL-223 and GMO-222, Sched. 1.

<sup>19</sup> Tr. 3914.

<sup>20</sup> Tr. 3927; Ex. KCPL-223 and GMO-222, Sched. 1-1.

KEPCo were not eligible for the tax credits, the arbitration panel denied their claims against KCPL.<sup>21</sup>

19. KCPL and Empire applied to the IRS for a reallocation of the Section 48A advanced coal project credits. A revised MOU between the IRS and KCPL was agreed to by the IRS on August 19, 2010 and delivered to KCPL on September 9, 2010.<sup>22</sup> The revised MOU reallocated the advanced coal project credits between KCPL and Empire according to their relative ownership shares in the amounts of \$107,287,500 and \$17,712,500, respectively.<sup>23</sup>

20. Section 9.1(a) of the Iatan 2 Agreement states that the co-owners did not intend to create a partnership, and Section 9.1(b) states that “to the extent possible” the co-owners “shall each separately report and pay for all real property, franchise, business, or other taxes and fees ... arising out of the acquisition, construction, operation, disposition and co-ownership of Iatan 2; ....”<sup>24</sup>

21. Great Plains Energy and its affiliates file joint tax returns.<sup>25</sup>

22. KCPL was obligated to share costs and benefits of Iatan 2 and to notify the other co-owners of significant events under the Iatan 2 ownership agreement.<sup>26</sup>

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<sup>21</sup> Ex. KCPL-223 and GMO-222, Sched. 1-1.

<sup>22</sup> Tr. 3928.

<sup>23</sup> Ex. KCPL-223 and GMO-222, Sched. 3, pp. 5-9.

<sup>24</sup> Ex. GMO-18, Hardesty Rebuttal at 10-11.

<sup>25</sup> Tr. 3922-3923.

<sup>26</sup> Ex. KCPL-223 and GMO-222, Sched. 1; Ex. KCPL-105; Tr. 3909.

23. KCPL charged GMO and the other co-owners a small portion of the costs of making the application for the tax credits. This amount has since been refunded.<sup>27</sup>

24. If the advanced coal tax credits are imputed to GMO, it will lower the cost of service for GMO and also lower rates.<sup>28</sup>

25. Any attempt by this Commission to reallocate tax credits or indirectly to accomplish a reallocation through adjustments to rate base may constitute a normalization violation.<sup>29</sup>

26. If a normalization violation occurs, it will affect not only the Section 48A advanced coal credits, but also all other investment tax credits on the books of KCPL.<sup>30</sup> Specifically, this would require KCPL to repay the IRS \$52,294,411, which consists of (a) \$29,151,153 in advanced coal credits that have been claimed, as well as (b) \$23,143,258 in other claimed investment tax credits. In addition, KCPL would lose the ability to offset future tax liabilities with \$77,957,534 of advanced coal credits that have not yet been claimed. The total penalty to KCPL for such a normalization violation would be \$130,251,945.<sup>31</sup>

27. Additionally, because GMO would purportedly receive reallocated tax credits from the Commission, not the IRS, GMO might also be subject to a normalization violation and lose all of its existing tax credits, which amount to

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<sup>27</sup> Tr. 3921.

<sup>28</sup> Ex. KCPL-223 and GMO-222, p. 24.

<sup>29</sup> Tr. 3936-37 and 3961-67.

<sup>30</sup> Ex. KCPL-30 and GMO-18, pp. 10-11.

<sup>31</sup> Ex. KCPL-30 and GMO-18, p. 11; Tr. 3936-37.



\$3,963,573 for its MPS Division and \$287,722 for its L&P Division, for a total of \$4,251,295.<sup>32</sup>

28. The parties agree that a reallocation may be accomplished without a normalization violation by an amendment to the 2010 MOU to which KCPL and the IRS are parties.

#### **Conclusions of Law**

1. KCPL is an “electrical corporation” and “public utility” as those terms are defined in Section 386.020, RSMo, and, as such, is subject to the jurisdiction of the Commission as provided by law.

2. GMO is an “electrical corporation” and “public utility” as those terms are defined in Section 386.020, RSMo, and, as such, is subject to the jurisdiction of the Commission as provided by law.

3. This Commission is not bound by the decision of a private arbitration panel formed under the terms of the Iatan 2 Agreement.<sup>33</sup>

4. Private Letter Ruling No. 200945006 (Nov. 6, 2009) states that: “If a normalization violation occurs, the results under [the tax laws] would be the disallowance or recapture of all of the unamortized investment tax credit of Taxpayer with respect to public utility property.”<sup>34</sup> Additionally, under Section 211(b) of the Tax Reform Act of 1986, “all credits for tax years open under the statute of limitations at the time a final determination is rendered [by a state utility regulatory commission]

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<sup>32</sup> Ex. GMO-18, pp. 10-11; Tr. 3936-37 and 3961-67.

<sup>33</sup> See *Jim Walter Resources, Inc. v. Federal Mine Safety and Health Review Comm'n*, 920 F.2d 738, 749-50 (11th Cir. 1990) (regulatory commission need not defer to an arbitrator's award).

<sup>34</sup> Ex. 106 at p. 3.

inconsistent with normalization requirements are recaptured.”<sup>35</sup> Therefore, a normalization violation may result if the Commission orders a reallocation of the tax credits between KCPL and GMO.<sup>36</sup>

5. Private letter rulings are entitled to evidentiary weight, are relied upon by courts as an instructive tool, and are helpful in ascertaining doctrines applied by the IRS.<sup>37</sup>

6. The latan owners are “tenants in common, each with an undivided ownership interest therein ....”<sup>38</sup> Since the parties to the latan 2 Agreement are tenants-in-common, and not partners or joint venturers, each party was responsible for its own tax matters and for submitting its own tax filings to the IRS.

7. As the operator of latan 2, under Section 6.5(d) of the latan 2 Agreement, KCPL owed a special duty to notify its co-owners of significant events related to latan 2.<sup>39</sup>

### **Decision**

Although the Commission is not bound by the decision of the arbitration panel, the Commission accepts the findings of the arbitration panel. Even though each party under the latan 2 Agreement was responsible for paying and filing its own taxes, as the operator of latan KCPL owed a special duty to its co-owners. KCPL should have

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<sup>35</sup> *Id.* at 7.

<sup>36</sup> See § 211(b), Tax Reform Act of 1986, Pub. L. No. 99-514, 99<sup>th</sup> Cong., 2d Sess. (1986); Treas. Reg. 1.46-6; Private Letter Ruling 200945006 (Nov. 6, 2009) (KCPL Exhibit 106). See generally R. Matheny, *Taxation of Public Utilities* (Matthew Bender, 2010), § 9.05, Investment Tax Credit Normalization Requirements (attached as Exhibit A).

<sup>37</sup> See *Hanover Bank v. Commissioner*, 369 U.S. 672, 686 (1962); *O’Shaughnessy v. Commissioner*, 332 F.3d 1125, 1131 (8th Cir. 2003); *Thom v. United States*, 283 F.3d 939, 934 (8th Cir. 2002); *Xerox Corp. v. United States*, 656 F.2d 659, 660 (Ct. Cl. 1981).

<sup>38</sup> See latan 2 Agreement, Exhibit 105, p. 1.

<sup>39</sup> Tr. 3909.

advised GMO and the other co-owners of its intent to request the availability of Section 48A credits and of its lobbying efforts to amend the law so that Iatan 2 qualified for the tax credits. The tax credits in the amount of \$125 million were certainly significant to the operation and construction of the facility, and were obviously part of KCPL's operations strategy.

In addition, once arbitration proceedings had begun, GMO should have been involved, in order to protect its own interest. It is clear that even though KCPL may not have realized it at the time, KCPL could not adequately represent the interest of GMO in the arbitration proceedings.

Because a normalization violation would eliminate the value of tax credits for both KCPL and GMO, causing harm to both of the companies and their customers, the Commission will not impute the tax credit to GMO unless the MOU cannot be amended. The Commission agrees with Staff that KCPL could have avoided the issue by alerting the other co-owners about the application, giving them an opportunity to join in its application for the coal tax credits.

If the normalization violation can be avoided, but GMO will receive its fair share of the tax allocations, that is the best course of action. Therefore, the Commission directs KCPL and GMO to apply to the IRS for an amendment of the 2010 MOU to reallocate the advanced coal project credits that KCPL now holds in revised amounts by a ratio that would reflect the proportionate ownership interests of KCPL at 54.71% and GMO at 18.00% (without regard to the ownership percentages of the non-taxpaying entities, MJMEUC and KEPCo), that is, \$80,725,000 and \$26,562,500, respectively.

Since Great Plains Energy and its affiliates file joint tax returns<sup>40</sup> it does not matter to the shareholders whether KCPL or GMO has the tax credits. But, which company has the tax credits can make a difference to the ratepayers<sup>41</sup> because it may affect the cost of service. If the advanced coal tax credits are imputed to GMO it will lower the cost of GMO to serve its customers and, therefore, lower GMO rates.

**THE COMMISSION ORDERS THAT:**

1. The Commission will change the designation from "highly confidential" to "public" portions of Schedule 1 to Exhibits KCPL-223 and GMO-222 which are reported in the Missouri Lawyers Weekly articles and all of Volume 37 of the Transcript from February 14, 2011. The Commission's Data Center shall change the designation of Volume 37 in the Commission's Electronic Filing and Information System (EFIS).

2. No later than April 5, 2011, GMO and KCPL shall apply, at the shareholders' expense, to the Internal Revenue Service for an amendment of the Memorandum of Understanding that would allow KCP&L Greater Missouri Operations Company to obtain a share of the Section 48A tax credits for Iatan 2, Section 48A tax credits equal to \$26,500,000.

3. If the application to amend the Memorandum of Understanding is denied, or if less than \$26,500,000 in Section 48A tax credits is allocated to KCP&L Greater Missouri Operations Company, then the Commission shall impute a proportionate amount of credits as a reduction to KCP&L Greater Missouri Operations Company's cost of service.

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<sup>40</sup> Tr. 3922-3923.

<sup>41</sup> Tr. 3928-3029.

4. This Report and Order shall be effective on March 26, 2011.

**BY THE COMMISSION**



Steven C. Reed  
Secretary

( S E A L )

Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur and certify  
compliance with the provisions of  
Section 536.080, RSMo 2000.

Dippell, Deputy Chief Regulatory Law Judge