

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

In the Matter of the Construction Audit and)
Prudence Review of Environmental Upgrades)
To Iatan 1 and Iatan Common Plant, Including All)
Additions Necessary for These Facilities to)
Operate.)

Case No. EO-2010-0259

**INITIAL BRIEF OF KANSAS CITY POWER & LIGHT COMPANY
AND KCP&L GREATER MISSOURI OPERATIONS COMPANY**

COME NOW Kansas City Power & Light Company (“KCP&L”) and KCP&L Greater Missouri Operations Company (“GMO”) (collectively the “Companies”), by and through counsel, and for their Initial Brief in this matter state as follows:

I. INTRODUCTION

KCP&L and GMO would like to thank the Commission for convening the hearing held on April 28-29, 2010, to allow the parties to address issues related to the continuing Staff audit of the Iatan 1 Air Quality Control System (AQCS) and the common plant associated with Iatan 1. The Companies particularly appreciate the opportunity to address Staff’s assertions that it has been the Companies’ actions—particularly related to discovery and the Companies’ cost tracking procedures—that have caused Staff to be unable to comply with the Commission’s directive to complete the Staff audit by December 31, 2009. The Companies also have serious concerns regarding Staff’s allegations that KCP&L personnel have violated the Company’s own Code of Ethical Business Conduct by failing to cooperate with the Staff in its audit.

As explained below, it is clear that these Staff assertions, or other Staff “justifications” for their failure to follow the Commission’s directive to complete the Iatan 1 audit by December 31, 2009, are unfounded. The apparent reason that Staff failed to complete its prudence review

and construction audit by December 31, 2009, as directed, is that the Staff failed to commence its prudence and construction audit in a timely manner. The Staff did not commence its prudence review and construction audit until after the Commission issued its April 15th Order directing Staff to file its audit by June 19, 2010. (Tr. 185-86; 509). In fact, Mr. Schallenberg, the Director of the entire Utility Services Division, initially commenced the audit by himself since no one else was “committed to the project.” (Tr. 512). Mr. Schallenberg candidly testified: “There are certain Staff members that aren’t comfortable doing something that we’ve never done before. I think there’s a certain reluctance to get involved in something like that.” (Tr. 512-13).

Mr. Chuck Hyneman and Mr. Keith Majors, the two Staff auditors who worked full-time on the project, did not commence their work on the project until June or July 2009. (Tr. 96, 186). The record also reflects that Hyneman and Majors had very few conversations (or attempts to discuss) the Iatan 1 prudence review and construction audit with the Operations Divisions engineers, including Mr. Dave Elliott, Shawn Lange, Michael Taylor. (Tr. 631, 687). Having finally commenced an audit, they have focused largely on mileage charges and expense reports. Any objective view of the evidence shows, as Commissioner Jarrett observed at the hearing, “at best they missed the forest for the trees.” (Tr. 259).

II. RELIEF REQUESTED

In this proceeding, the Companies are requesting the following from the Commission:

1. An order clarifying the status of the Staff’s audit. The Companies believe that the Staff should be precluded from proposing additional prudence disallowances in the next rate cases in addition to those eighteen (18) disallowances for KCP&L and twelve (12) disallowances for GMO that are already contained in its *Staff’s Report Regarding*

***Construction Audit and Prudence Review of Environmental Upgrades to Iatan 1 and Iatan Common Plant* filed in Case Nos. ER-2009-0089 and ER-2009-0090 on December 31, 2009 (“December 31 Reports”).**

The Commission has already directed that the Staff complete their prudence review and construction audit as of December 31, 2009, and the Staff’s Preliminary Report indicated that they were going to comply with the Commission’s Order. Indeed, Staff has filed its December 31 Reports that addressed its findings. The Staff has not sought any extension of the deadline for completing the prudence and construction review, or filed a request to now expand its recommendations. Therefore, it is reasonable and appropriate for the Commission to find that the Staff’s proposed disallowance contained in the December 31, 2009 Reports should be the basis for any prudence disallowances to be proposed by Staff in the upcoming KCP&L and GMO rate cases, as directed by the Commission.

2. The Companies believe that the Commission should make the following findings based upon the evidence in the record:

a) The Companies have not engaged in any dilatory or unreasonable practices in responding to discovery during the construction audit and prudence review.

b) The Companies’ cost control system adequately tracks the costs of the projects, and is consistent with accepted industry standards.

3. With regard to the upcoming Iatan 2 rate cases, the Staff should be required by the Commission to complete their prudence review of Iatan 2, and file their proposed prudence recommendations at the time that the Staff files its Direct Testimony in the rate

cases involving the inclusion of Iatan 2 in rate base that are expected to be filed by KCP&L and GMO in the near future.

Staff has chosen to take a different tact in this proceeding and appears to give the Commission the perception that it has only extreme options. As explained by Mr. Curtis Blanc, KCP&L's Senior Director of Regulatory Affairs, the Staff in this proceeding is giving the Commission a "false choice"—either let the audit go on indefinitely, or alternatively, "tell the Staff to put down its pencil, walk away and never look at another dollar." (Tr. 142-43). This is not the request of the Companies. (Tr. 144). The Companies are requesting that the Commission clarify that the prudence audit of the Staff has now ended, as of the filing of the December 31 Reports. Any prudence issues already contained in the December 31 Reports may be tried in the upcoming KCP&L and GMO rate cases. Other rate cases issues (e.g. AFUDC calculations, allocation issues between Iatan 1 and Iatan 2, and construction audit issues) may be continued to be reviewed. (Tr. 150-51). However, new prudence issues related to Iatan 1 and common plant may not be proposed by Staff in the upcoming rate cases.

According to the Companies' witness Dr. Kris Nielsen, there was a sufficient amount of information available to conclude a prudence review. (Tr. 190, 215-17). Certainly all of the decisions which were subject to a prudence review of the Iatan 1 construction had occurred months before the Staff's December 31, 2009 deadline for completing and filing its prudence review and construction audit since the Iatan 1 AQCS and common plant needed to operate Iatan 1 were fully operational and used for service more than one year ago. (Tr. 462). Moreover, by September 2009 over 90% of the costs had been incurred and were able to be audited by the end of 2009 (Ex. 1, p.41).

III. BACKGROUND OF THIS PROCEEDING

A. KCP&L AND GMO RATE CASES

On September 5, 2008, KCP&L and GMO submitted to the Commission proposed tariff sheets intended to implement a general rate increase for electrical service provided in the Missouri service areas. The proposed tariff sheets had an effective date of August 5, 2009. The Commission suspended the respective tariffs and established Case Nos. ER-2009-0089 and ER-2009-0090.

From the Companies' perspective, these cases were intended to reflect the costs of the Iatan 1 AQCS system and common plant needed to operate Iatan 1 in rates which were expected to become fully operational and used for service by the end of the proceedings. In these cases, there was an urgent need to have this investment reflected in permanent rates. Given the turmoil in the financial markets, the severe recession affecting the United States economy generally, the Companies' reliance on the anticipated cash flows from the rate relief in those rate cases, and the need to raise capital in the financial markets to complete Iatan 2, it was critically important that KCP&L and GMO be permitted to include their prudent investments in Iatan 1 in permanent rates in a timely manner.

The Staff and certain intervenors did not propose to reflect the full investment related to Iatan 1 in permanent rates, even though they did not include any specific allegations of imprudence or inefficiency in their testimony. Instead, the Staff proposed to put the rates into effect on an "interim subject to refund" basis because they had not completed the audit of Iatan 1 and the common plant, and they stated in their testimony that they did not intend to do

so before the case concluded.¹

The Commission had previously held in the Callaway and Wolf Creek rate case decisions that there is a presumption of prudence related to public utility expenditures.² The prudence standard adopted in the *Callaway I* and *Wolf Creek* cases has been recognized and approved by reviewing courts.³ The Commission and court decisions have held that when other parties raise a “serious doubt” as to the prudence of those expenditures, then the public utility has the obligation to come forward and rebut those allegations to meet its burden of proof.⁴

In the last KCP&L and GMO rate cases, none of the parties raised a “serious doubt” about the prudence of these expenditures. However, the Staff was unwilling or unable to provide the results of its prudence audit of Iatan 1 in the context of that case. Instead, the Staff wanted to defer trying any prudence issues to some future rate proceeding. We now understand why—because the Staff had not even started the prudence review and construction audit of Iatan 1 in that rate case. (Tr. 185-86; 509).

In the Direct Testimony of Mr. Cary Featherstone, the case coordinator in the last KCP&L and GMO rate cases, Mr. Featherstone testified that “Staff is reviewing the construction costs for plant additions for environmental equipment being installed at the Iatan 1 generation facility.” He testified that Staff was reviewing the Iatan 1 project as well as the Sibley and Jeffrey Energy Center projects. And he further testified that “Staff will not be

¹ See Ex. No. 8 , Direct Testimony of Cary E. Featherstone, p. 36 filed on February 11, 2009, in Case No. ER-2009-0089, and Ex. No. 112 , Direct Testimony of Cary E. Featherstone, p. 33 filed on February 13, 2009 in Case No. ER-2009-0090.

² See *In re Union Electric Company*, 27 Mo.P.S.C. (N.S.) 183, 193 (1985)(“*Callaway I*”); *In re Kansas City Power & Light Company*, 28 Mo.P.S.C. 228, 279-82 (1986)(“*Wolf Creek*”).

³ See *State ex. rel. Associated Natural Gas Co. v. PSC*, 954 S.W.2d 520, 529 (Mo. App. W.D. 1997).

⁴ *Id.*

able to complete and present the results of construction cost reviews for any of these projects in these rate cases either now or in the true-up. . . ”⁵

In the Surrebuttal Testimony of Robert E. Schallenberg in the KCP&L rate case, Staff attached a one-page “Coordination Procedure for Construction Audits” that explained the Staff procedure to have both the Utility Operations and Services Divisions involved in construction audits.⁶ During the depositions, the Companies learned for the first time that this Coordination Procedure for Construction Audits had been “cancelled” or suspended by the Staff at the time Mr. Schallenberg filed his Surrebuttal Testimony (Tr. 554-55), although he was apparently not aware of its suspension or cancellation.

Staff testimony of Mr. Featherstone and Mr. Schallenberg, and the actual observations of the apparent construction auditing activities at the Iatan construction site by the Utility Operations Division personnel, gave KCP&L and GMO the definite impression that a prudence review and construction audits of Iatan 1, Sibley and Jeffrey were well underway. However, this perception was grossly in error.

In virtually every other major electric rate case in which a public utility in Missouri has requested that new electric plant be included in rate base, the Commission Staff has conducted a prudence and construction audit, and made their recommendations regarding the appropriate level of investment that should be included in permanent rates within the context of that rate case.

⁵ See Staff Ex. No. 8 , Direct Testimony of Cary E. Featherstone, p. 36 filed on February 11, 2009, in Case No. ER-2009-0089, and Staff Ex. No. 112, Direct Testimony of Cary E. Featherstone, p. 33 filed on February 13, 2009 in Case No. ER-2009-0090.

⁶ See Schedule 2 attached to the Surrebuttal Testimony of Robert E. Schallenberg, Staff Ex No. 27 in Case No. ER-2009-0089.

For example, in the rate cases involving the Callaway, Wolf Creek and Grand Gulf nuclear power plants, the Staff conducted their prudence audits and made their recommendations to the Commission within the context of the rate case in which the plant was included in rates.⁷

More recently, in rate cases involving AmerenUE's Penon Creek plant⁸, Empire's rate cases involving the State Line Combined Cycle Plant⁹ and the Asbury Plant SCR project¹⁰, and Aquila's rate case involving the South Harper plant¹¹, the Commission Staff conducted its investigation and made its recommendations to the Commission in the context of those rate cases. And in those cases, the Commission made its determinations of prudence and determined the appropriate amount of investment that should be included in rate base within the context of those rate cases.

B. APRIL 15, 2009 ORDER REGARDING CONSTRUCTION AND PRUDENCE AUDITS OF THE ENVIRONMENTAL UPGRADES AT IATAN 1, JEFFREY ENERGY CENTER AND THE SIBLEY GENERATING FACILITY

During the course of the last KCP&L and GMO rate cases, the Commission held two motions hearings on April 6th, 2009, regarding the procedural schedule modifications to the True-Up Proceeding for both the KCP&L and GMO rate cases. At the hearings, the issue concerning Staff's ability to complete its construction and prudence audits of Iatan 1, Sibley and Jeffrey was again raised. Mr. Steven Dottheim, Chief Deputy Counsel for Staff, when asked

⁷ See *Callaway I and Wolf Creek, supra*; *In re Arkansas Power & Light Company*, 28 Mo.P.S.C. 435, 465-69 (May 4, 1986).

⁸ See *Re Union Electric Company d/b/a AmerenUE*, 257 P.U.R.4th 259, 2007 WL 1597782, *Report & Order*, Case No. ER-2007-0002, pp. 67-70 (Mo.P.S.C.)(May 22, 2007)

⁹ See *Re Empire District Electric Company*, 2001 WL 1861535 (Mo.P.S.C.), 10 Mo.P.S.C.3d 463, 474-75 *Report & Order*, Case No. ER-2001-299 (September 20, 2001)(State line combined cycle power plant issue was settled and capital costs were included in rate base.)

¹⁰ See *Re Empire District Electric Company*, 267 P.U.R.4th 396, 2008 WL 3833756 (Mo.P.S.C.), *Report & Order*, Case No. ER-2008-0093, pp. 61-64 (July 30, 2008).

¹¹ *In re Aquila, Inc., Order Approving Stipulation and Agreement*, 2006 WL 861195 (Mo.P.S.C.), Case No. ER-2005-0436 (February 23, 2006)(South Harper issue settled without inclusion in rate base).

how long it would take to complete an audit and prudence review in the KCP&L procedural hearing initially stated that he did not have an answer for that question, but it would take more than one or two or three months to complete.¹²

Later in the day at the companion hearing in the GMO case, Mr. Nathan Williams, Deputy General Counsel for the Staff, announced that the Staff auditors had informed him that it would take in the neighborhood of six months to perform a prudence review of the Iatan 1 improvements.¹³ (Tr. 20, ER-2009-0090).

Following these procedural hearings, the Commission issued separate orders in the KCP&L and GMO rate cases on April 15, 2009 both entitled “*Order Regarding Construction and Prudence Audits of the Environmental Upgrades at Iatan 1, Jeffrey Energy Center and the Sibley Generating Facility*” (“April 15th Order”). In the KCP&L version of the April 15th Order, the Commission stated:

Staff indicates that it does not plan to conduct a construction audit or prudence review until sometime next year, in the context of a future rate case. However, the Commission does not have the option to delay evaluating a relevant issue or factor in a case setting rates. Consequently, the Commission shall direct its Staff, based upon the information Staff has received from KCPL to-date, to complete a construction audit and prudence review of the environmental upgrades to Iatan 1. The construction audit and prudence review shall include all additions necessary for these facilities to operate. Staff shall identify and explain, with particularity, any disallowances of expenses that it believes are justified.¹⁴ (*Footnotes omitted*)

¹² Transcript of Proceedings, Oral Argument, Case No. ER-2009-0089, Volume 10, p. 116 (April 6, 2009). (*See also* Tr. 78-79).

¹³ Transcript of Proceedings, Oral Argument, Case No. ER-2009-0090, Volume 10, p. 39 (April 6, 2009). (*See also* Tr. 78-79).

¹⁴ *Order Regarding Construction and Prudence Audits of the Environmental Upgrades at Iatan 1, Jeffrey Energy Center and the Sibley Generating Facility*, Case No. ER-2009-0089, pp. 5-6 (April 15, 2009).

In footnote 11 of the KCP&L April 15th Order¹⁵, the Commission expressed its clear understanding that Staff was receiving the information it needed to complete its prudence review and construction audits of Iatan 1, Sibley and Jeffrey, when it stated:

The Commission notes that two-hundred and twenty-two (222) days (7 months and 10 days) have passed between the date KCPL filed its case and the date of this order, a time period in which the Commission has confirmed that Staff has been receiving information it needs to complete its audit. See Case No. ER-2009-0089, Transcript Volume 10 and Footnote 4.

The **ORDERED** section of this April 15th Order¹⁶ stated:

1. The Staff of the Missouri Public Service Commission shall complete and file the construction audit and prudence review of the environmental upgrades at Iatan 1, including all additions necessary for these facilities to operate, no later than June 19, 2009.
2. The Staff of the Missouri Public Service Commission is directed to provide a specific rationale for each and every disallowance recommended in the construction audits and prudence reviews.

C. SETTLEMENT OF THE KCP&L AND GMO RATE CASES

The parties eventually reached a settlement of the KCP&L and GMO rate cases (on April 24, and May 22, 2009, respectively)¹⁷ before the Staff's June 19th deadline for filing its construction audit and prudence review of Iatan 1.

As a part of the Non-Unanimous Stipulations and Agreement in these cases, the parties agreed that:

No Signatory Party to this 2009 Stipulation shall argue that anyone is prohibited from arguing or presenting evidence in the next KCP&L general rate case challenging the prudence of any Iatan 1 construction cost or that KCP&L should have had this unit operating at full generation capacity sooner than the actual date that Iatan 1 is found to be fully operational and used for service; provided

¹⁵ *Id.* at fn. 11, p. 5.

¹⁶ *Id.* at p.6.

¹⁷ See Non-Unanimous Stipulation and Agreement, Case Nos. ER-2009-0089 and ER-2009-0090 (filed on April 24, and May 22, 2009).

however, that any proposed disallowance of rate base for imprudence under this paragraph shall be limited to a maximum amount of Missouri jurisdictional rate base no greater than \$30 million inclusive of Iatan common costs.”¹⁸

A similar provision was included in the GMO Stipulation with a \$15 Million limitation on any prudence disallowances for GMO.¹⁹ There was also a statement in these Non-Unanimous Stipulations and Agreement²⁰ that stated:

The Non-Utility Signatories may continue their construction audits of Iatan 1 and Iatan 2 prior to KCP&L filing its Iatan 2 rate case.

In both the KCP&L and GMO stipulations, there were provisions which gave the Staff and other parties the opportunity to argue for higher Missouri jurisdictional disallowances than the \$30 Million for KCP&L and the \$15 Million for GMO under certain circumstances. These provisions included the following circumstances:

Should the Commission find that KCP&L, respecting any Non-Utility Signatory’s construction audit of these costs, (a) failed to provide material and relevant information which was in KCP&L’s control, custody, or possession, or which should have been available to KCP&L through reasonable investigation, (b) misrepresented facts relevant to charges to Iatan 1 or Iatan common costs, or (c) engaged in the obstruction of lawful discovery, said Non-Utility Signatory is not bound to proposing a disallowance to KCP&L’s Missouri jurisdictional rate base no greater than \$30 million inclusive of Iatan common costs in aggregate amount with regard to such construction audit.²¹

The Commission issued its *Order Approving Non-Unanimous Stipulations and Agreements and Authorizing Tariff Filings* on June 10, 2009 in both Case Nos. ER-2009-0089

¹⁸ See Non-Unanimous Stipulation and Agreement, Case No. ER-2009-0089, p. 3-4 (filed on April 24, 2009).

¹⁹ See Non-Unanimous Stipulation and Agreement, Case No. ER-2009-0090, p. 3 (filed on May 22, 2009).

²⁰ See Non-Unanimous Stipulation and Agreement, Case Nos. ER-2009-0089 and ER-2009-0090, p. 4.

²¹ *Id.*

and ER-2009-0090 which approved the Non-Unanimous Stipulation and Agreement “as a resolution of all factual issues encompassed within that Agreement.”²²

D. JUNE 10TH 2009 ORDER REGARDING JOINT MOTION TO EXTEND FILING DATE

Following the settlement of the rate cases, Staff and the Companies jointly filed on May 28, 2009, a motion requesting the Commission extend the deadline for filing the Staff audits until Staff filed its direct case in the next KCP&L and GMO rate cases.²³

On June 8, 2009, the Commission held on-the-record proceedings to consider the Non-Unanimous Stipulations and Agreement in Case Nos. ER-2009-0089 and ER-2009-0090. During that on-the-record proceeding, Mr. Robert E. Schallenberg, Director of the Utility Services Division of the Staff, was asked by Commissioner Davis the following question regarding the prudence audits of Iatan 1, Sibley and Jeffrey:

[Davis]: Q. Okay. So would you have any objection if the Commission ordered you to produce these audits by, say, December 31st, 2009, as opposed to what was said the time for Staff to file its direct testimony in the next round of rate cases?

[Schallenberg]: A. Obviously I won't object. It does change the priority of how the work is done, but if that's the Commission's desire, those audits will be moved up to make sure they meet that date and the other audits will be adjusted accordingly.²⁴

At the time of this on-the-record proceeding, Mr. Schallenberg clearly indicated to Commissioner Davis and the Commission that Staff had no objection to filing its completed Iatan 1 prudence review and construction audit by December 31, 2009.

²² *Order Approving Non-Unanimous Stipulations and Agreements and Authorizing Tariff Filings*, p. 15 in Case No. ER-2009-0089 and p. 14 in Case No. ER-2009-0090. (issued June 10, 2009)

²³ 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 and ER-2009-0090 (filed May 28, 2009).

²⁴ Transcripts of Stipulation Hearing, Case No. ER-2009-0090, Volume 12, Tr. 180. (June 8, 2009)

On June 10, 2009, the Commission issued its “*Order Regarding Joint Motion to Extend Filing Date*” in the KCP&L and GMO cases. The Commission did not approve the Joint Motion To Extend the Filing Dates, and instead clearly ordered the Staff to file a preliminary report of its construction audit and prudence review of the environmental upgrades at Iatan 1 no later than June 19, 2009. In addition, the Commission ordered the Staff to complete and file its final construction audit and prudence review of the environmental upgrades at Iatan 1, including all additions necessary for these facilities to operate, no later than December 31, 2009.²⁵

The Commission explained the reasons for its Order as follows:

In light of the parties’ settlement, the Commission finds it reasonable to extend the deadline for Staff to complete the construction audit and prudence review. However, the Commission recognizes that Staff, having operated under a deadline of June 19, should be able to file at least a preliminary report of its audits no later than the original deadline. The Commission further does not wish to delay completion of the audits beyond the end of this calendar year. By 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.²⁶ (*Emphasis added*)

In the Ordered Section of that June 10th Order, the Commission specifically stated as follows:

3. The Staff of the Missouri Public Service Commission shall file, no later than June 19, 2009, a preliminary report of its construction audit and prudence review of the environmental upgrades at Iatan 1.
4. The Staff of the Missouri Public Service Commission shall complete and file the construction audit and prudence review of the environmental upgrades at Iatan 1, including all additions necessary for these facilities to operate, no later than December 31, 2009.
5. The Staff of the Missouri Public Service Commission is directed to provide a specific rationale for each and every disallowance recommended

²⁵ Order Regarding Joint Motion to Extend Filing Date, Case No. ER-2009-0089, p. 2 (June 10, 2010).

²⁶ *Id.* at 1-2.

in the construction audits and prudence reviews.”²⁷ (June 10 Order, p. 2)(*Emphasis added*)

From KCP&L’s and GMO’s perspective, this Commission June 10th Order clearly set a deadline for the Preliminary Report by June 19, 2010, and the Staff was required by Order to complete and file the final construction audit and prudence review of the environmental upgrades at Iatan 1, no later than December 31, 2009. However, the Staff treated this directive as nothing more than a “special project” to be done for the Commissioners’ benefit. (Tr. 509). Apparently, it was never considered by Staff to be the real prudence audit and construction review that would be the basis for discussion in the upcoming rate cases.

E. PRELIMINARY REPORT OF THE STAFF

On June 19, 2009, the Staff filed its “Preliminary Report of the Staff Respecting Its Construction Audit/Prudence Review of Environmental Upgrades to Iatan 1 and Iatan Common Plant as Directed in the Missouri Public Service Commission’s April 15, 2009 Orders Regarding Construction Audits And Prudence Reviews and Modified in the June 10, 2009 Orders Regarding Joint Motion To Extend Filings Dates in Case Nos. ER-2009-0089, ER-2009-0090 and HR-2009-0092.” (“Preliminary Report”).

The Preliminary Report contained, among other things, sections addressing the Staff’s Preliminary Analysis, Audit Objectives, Definition of Prudence and Burden of Proof, Risk Assessment, Audit Scope and Approach, Audit Status and Status of Discovery with KCPL. The Preliminary Report also clearly acknowledged that Staff understood that it had a December 31, 2009 deadline for completing its construction audit and prudence review of the environmental upgrades at Iatan 1, including the common plant:

²⁷ Id. at 2.

As ordered by the Commission, the Staff's current deadline for filing its construction audit and prudence review of the environmental upgrades at Iatan 1, including related Iatan 1 and Iatan 2 common plant is December 31, 2009. The Staff has adjusted its audit / review scope to meet that deadline.²⁸

F. DECEMBER 31, 2009 REPORTS

On December 31, 2009, the Staff filed two reports in Case Nos. ER-2009-0089 and ER-2009-0090 entitled, "Staff Report of the Construction Audit/Prudence Review of Environmental Upgrades to Iatan 1 and Iatan Common Plant." ("December 31 Reports")

The December 31 Reports contained 18 specific disallowances for KCP&L,²⁹ and 12 proposed disallowances for GMO³⁰ related to the Iatan 1 AQCS and common plant. The December 31 Reports also clearly suggested that Staff expected to continue the prudence review and construction audits in contravention of the Commission's June 10th Order. For example, on page 3 of the December Reports, the Staff stated that the "Staff expects the remaining audits of the Iatan Project to be as follows:" and the Reports then listed in tabular form the following areas to be audited: "Iatan 1 AQCS Post May 31, 2009 Expenditures, Iatan 2 May 31, 2010 Expenditures, Iatan Project Common Plant not needed to operate Iatan 1 and in service by rate case cutoff date". The table also indicates that this portion of the Audit Report would be filed on the Staff Direct Filing Date in KCP&L's next rate case.³¹

The table also suggested that the Audit Report addressing the certain items would not be filed until the "Staff Direct Filing Date in KCPL's Rate Case following the inclusion of Iatan 2

²⁸ *Preliminary Report of the Staff Respecting Its Construction Audit/Prudence Review of Environmental Upgrades to Iatan 1 and Iatan Common Plant as Directed in the Missouri Public Service Commission's April 15, 2009 Orders. Regarding Construction Audits and Prudence Reviews and Modified in the June 10, 2009 Orders Regarding Joint Motion to Extend Filings Dates in Case Nos. ER-2009-0089, ER-2009-0090 and HR-2009-0092*, p. 14.

²⁹ December 31 Report for KCP&L, p. 6.

³⁰ December 31 Report for GMO, p. 6.

³¹ December 31 Reports, p. 3.

in rate base.” (*Emphasis added*). These items included: “Iatan 2 Post May 31, 2009 Expenditures and Iatan Project Common Plant not needed to operate Iatan 1 and in service after previous rate case cutoff date.”³²

On page 5 of the December 31 Reports, the Staff stated: “At this time Staff is proposing that approximately \$60 million of the cost overruns be examine (sic) in conjunction with Staff’s audit of Iatan 2 overruns.”³³

On page 7 of the December 31 Reports, however, there was an indication that Staff had concluded with at least a portion of its prudence review and construction audit:

While Staff has no intention to continue an audit in the areas contain (sic) in this Report, Staff will continue to inquire into portions of the Iatan Project to increase its understanding of the Project to provide in its future audit reports the best recommendation within its ability.³⁴

On February 16, 2010, KCP&L and GMO filed an Initial Response To Staff Report Of The Construction Audit/Prudence Review Of Environmental Upgrades To Iatan 1 and Iatan Common Plant seeking clarification of the Staff’s intent, and objecting to the Staff proposal to alter the June 10th Order by extending the Iatan 1 prudence review.

G. ESTABLISHMENT OF AN INVESTIGATORY DOCKET—CASE NO. EO-2010-0259.

On March 12, 2010, Staff filed its Staff Motion To Open Construction Audit And Prudence Review Investigation Case in which it made very clear that Staff intended to continue its prudence review and construction audit, in contravention of the Commission’s June 10th Order. In its motion, the Staff requested that the Commission “open a formal case for the Staff’s

³² *Id* at 3.

³³ *Id.* at 5.

³⁴ *Id* at 7.

construction audit and prudence review investigation of the Iatan 1 air quality control system (AQCS) environmental enhancements, Iatan common plant, and Iatan 2 generating plant construction projects established by the Kansas City Power & Light Company Experimental Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329, which has been occurring in Case/File Nos. ER-2009-0089 and ER-2009- 0090.”³⁵

On March 15, 2010, the Commission, *sua sponte*, issued its *Order Establishing Investigatory Docket and Setting On-the-Record Proceeding* which closed out the files in Case Nos. ER-2009-0089 and ER-2009-0090, created Case No. EO-2010-0259, and transferred certain orders from the rate cases into the new investigatory proceeding. This order also scheduled an on-the-record proceeding and stated that: “The parties shall be prepared to provide a complete explanation of every aspect of the on-going construction and prudence audit that was ordered to be completed on December 31, 2009.”³⁶

The Companies subsequently requested that the on-the-record proceeding be rescheduled to permit a more complete review of the matter.³⁷

Subsequent Staff pleadings, and the evidence adduced during the depositions and the hearings in this case have made it very clear that Staff now intends to continue the Iatan 1 audit until some unspecified time in the future. Given the clear and unequivocal directives of the Commission, Staff should not be permitted to ignore the Commission’s orders, and continue its

³⁵ Staff Motion To Open Construction Audit and Prudence Review Investigation Case, Case Nos. ER-2010-0089/ER-2010-0090 (March 12, 2010).

³⁶ *Order Establishing Investigatory Docket and Setting On-the-Record Proceeding*, Case No. EO-2010-0259 (issued March 15, 2010).

³⁷ Kansas City Power & Light Company’s and GMO’s Motion To Reschedule On-the-Record Proceeding, Case No. EO-2010-0259 (March 22, 2010).

prudence review and construction audit as if the Commission had never told them to complete their prudence review and construction audit by December 31, 2009.

IV. ARGUMENT

A. THE COMPANIES' ACTIONS HAVE NOT CAUSED STAFF'S FAILURE TO COMPLETE THE PRUDENCE REVIEW AND CONSTRUCTION AUDIT OF IATAN 1 AND COMMON PLANT BY DECEMBER 31, 2009.

As explained herein, the Staff's assertions that it has been unable to complete its prudence review and construction audit because of the Company's discovery practices and cost control system are simply unfounded, and should be rejected by the Commission. The testimony and evidence presented at the hearing clearly established that Staff's complaints about discovery and cost tracking are nothing more than attempts to cast aspersions on the Companies in order to mask Staff's failure to comply with the Commission's directive.

1. The Companies have not engaged in any dilatory or unreasonable practices in responding to discovery during the construction audit and prudence review.

The Companies asked the Commission for a hearing to address Staff's allegations regarding discovery because the Companies take those allegations very seriously. Staff alleged the Companies violated their own codes of conduct and engaged in unlawful obstruction of discovery. The language of Staff's allegations was quite inflammatory, but Staff presented no testimony to support those allegations. Indeed, all of the evidence demonstrated that the Companies have been diligent in providing discovery and have done nothing to impede Staff's audit. The only issues that arguably slowed discovery were the Companies lawful objections to Staff discovery requests. The number of those objections was only a handful and the

Companies' positions have been vindicated by Deputy Regulatory Law Judge Harold Stearley. (Tr. 63).

Mr. Tim Rush, KCP&L's Director of Regulatory Affairs, addressed the Staff's allegations regarding discovery issues. Mr. Rush explained the discovery process in general and the massive amount of information that has been requested of the Companies, and provided to the Staff, both the Services Division and the Operations Division, most often separately to accommodate their work practices.

Mr. Rush described the Companies' efforts to implement the CaseWorksEX system in 2006 to facilitate the discovery process for parties in the rate cases and related prudence and construction audits. (Tr. 361). This internet-based system allows the Staff and other parties to review any case discovery for which they have signed up, and access the data requests and responses using their own computers. (Tr. 362-63). He further described the informal data request process which includes KCP&L drafting the data requests needed by Staff following meetings with the Staff. (Tr. 364-65). He also described the recurring and supplemental data request processes where the Companies update information from previous data requests. (Tr. 365).

Mr. Rush testified that the Companies have "point persons" throughout KCP&L that distribute and coordinate the responses to the data requests. Approximately 200 people at the Companies are involved in answering the Staff's data requests, including four (4) persons in the Regulatory Department that are dedicated full-time to answering Staff's data requests and other requests for information. (Tr. 366-67). "Timeliness is critical, truthfulness is critical and completeness is critical," according to Mr. Rush as KCP&L processes Staff data requests. These

are KCP&L's minimum requirements, consistent with the Company's Code of Ethical Business Conduct, that are essential for handling the discovery requested by Staff and other parties. (Tr. 367).

Mr. Rush suggested that there were a handful of discovery concerns that were brought to KCP&L's attention by Staff during this case. KCP&L tried to resolve any concerns, and added full-time personnel to resolve Staff concerns, where necessary. (Tr. 369). Ex. No. 3 contains a summary of data requests served by Staff and meetings between Staff and Company personnel, as updated through March 24, 2010. According to Ex No. 3, there were 3,015 Missouri data requests, informal data requests, and supplemental data requests in the last rate cases. (Tr. 372-73).

Four hundred-thirty-nine (439) data requests were received subsequent to the June 10th Order which required a Preliminary Report be filed by June 19th and a Final Report by December 31, 2009. (Tr. 373). Recently, another forty-five (45) data requests have been received since Ex. No. 3 was updated. (Tr. 374). In responding to over 3,015 data requests, the Companies provided the requested data using CDs, DVDs, and two hard copies of that same information to the Kansas City auditors. (Tr. 374-75).

Mr. Rush testified that approximately 4.5 millions pages of data were provided to Staff in Missouri and Kansas. Nearly 4.0 million pages of information were provided to the Missouri Staff, in contrast to 528,000 pages of data provided to the KCC Staff. (Tr. 376-78).

Mr. Rush testified that KCP&L personnel met with the Missouri Staff engineers, including Dave Elliott and Shawn Lange, on 32 separate occasions. (Tr. 378). These meetings were typically held on the construction site, and addressed change orders and other construction

activities. (Tr. 378-79). One hundred-thirty-seven (137) separate meetings were held with the Missouri Staff during the discovery process in the rate cases. Since the December 31 Reports were filed by Staff, the Staff has submitted approximately 40 additional data requests. The Companies have continued to answer these data requests. (Tr. 380).

On page 6 of the December 31 Reports, the Staff alleged that discovery problems had “pestered” this audit from the beginning. Mr. Rush testified that he disagreed with this characterization. (Tr. 381). He testified that the Regulatory Department did not purposely delay providing answers to data requests from Staff, and had a dedicated group that was required to timely respond to the Staff data requests. (Tr. 381-82). He explained the extensive process that is used to accumulate, review and verify the data that is provided to Staff. (Tr. 382-83).

Mr. Rush also explained the process the Kansas Corporation Commission had used for discovery. Rush testified that the Companies have treated Missouri Staff just as they have treated Kansas Staff. (Tr. 390-91; 394). Rush testified that Kansas Staff was able to complete a prudence review of Iatan 1 and did not mention discovery as a basis for any difficulty or delay in completing their review.

Mr. Rush disagreed with Staff’s allegation that KCP&L treats Staff like a litigant in adverse litigation. (Tr. 383-85). He explained that KCP&L schedules meetings, and does everything that it can to facilitate the discovery process, including purchasing the CaseWorksEx system for reviewing the data request responses, scheduling numerous informal meetings, and moving “things through in a quick and timely manner and complete also.” (Tr. 386).

The Staff’s primary allegations in this case related to the discovery process related to the Companies’ assertion of attorney-client privileges, its failure to provide approximately 10,000

emails with 40,000 attachments from Mr. Dave Price within 20 days, and KCP&L's initial objection in the KCP&L rate case that Iatan 2 data was not relevant to the Iatan 1 rate case. (Tr. 173-74). In addition, the Staff seemed to be concerned about the Company's delay in locating and providing a dinner receipt from Mr. Downey. (Tr. 186). Finally, Staff seemed to be concerned that KCP&L should have provided to the Missouri Staff unredacted Schiff Hardin invoices that were inadvertently provided the KCC Staff. (Tr. 166). However, none of these instances should be objectively considered reasons from Staff's failure to complete its audit by December 31, 2009.

There were a few discovery requests that were taken by Staff to Judge Harold Stearley for resolution, including Staff's request for the inadvertently released invoices. Judge Stearley suggested in a few instances that more information should be provided by KCP&L, and KCP&L complied. (Tr. 31, 63, 134-35). In fact, Judge Stearley largely upheld the positions taken by KCP&L regarding attorney-client privileges and other objections, including KCP&L position that it should not be required to provide invoices that were inadvertently provided to the KCC Staff which were returned upon the discovery of the mistake.³⁸

With regard to the 10,000 Dave Price emails, Mr. Blanc noted that it was necessary for KCP&L to have outside counsel review all 10,000 emails to ascertain whether any of these emails were privileged documents, and this process took time. (Tr. 193-94). This is not an unreasonable discovery practice, and it is simply the result of Staff's overbroad request of all emails from the Company's former Vice-President of Construction.

³⁸ See *Order Regarding Staff Motion to Compel*, Case No. ER-2008-0089 (issued on December 9, 2010)(Tr. 63).

With regard to the dinner receipt, Mr. Giles testified in response to Commissioner Jarrett that the receipt was actually provided to Staff more than one year ago (Tr. 302)--before the Staff commenced its prudence review and construction audit. (Tr. 186-87). Similarly, KCP&L had resolved the issue of the relevance of the Iatan 2 data in the rate cases (Tr. 170-71), well before the construction audit and prudence review even commenced. As a result, it is difficult to understand how any delay in providing this dinner receipt or the Iatan 2 information could be legitimately used to explain Staff's failure to complete its prudence review and construction audit by December 31, 2009, as directed by the Commission. More specifically, it is particularly difficult to understand how a \$405 receipt for any expenditure would be considered essential to completing the prudence review and construction audit of a \$733 million project.

Finally, as mentioned above, Judge Stearley ruled that KCP&L did not have to provide to Staff unredacted copies of invoices that were inadvertently provided to the KCC Staff (and then returned to KCP&L upon discovery of the inadvertent release). *See Order Regarding Staff's Motion to Compel*, Case No. ER-2008-0089 (issued on December 9, 2010) in which the Commission stated at page 16:

KCPL's inadvertent disclosure to the KCC was not made knowingly, was not done voluntarily, and KCPL did not acquiesce. Instead, as soon as KCPL discovered the disclosure, it asserted its privileges, and withdrew and replaced the unredacted documents. KCPL's inadvertent disclosure to KCC did not waive its asserted privileges with respect to this Commission's audit.

With regard to other Staff complaints related to KCP&L's discovery practices and its assertions of the attorney-client privilege, the Commission stated at page 19 of the same Order:

Given the volume of materials requested and provided and the continuous communications ongoing between Staff and KCPL, as demonstrated in Mr. Rush's affidavit, the Commission believes KCPL's delay in responding to the data request was reasonable. KCPL's actions do not demonstrate bad faith, nor do they constitute actions being maintained for an improper purpose, to create

unnecessary delay, to gain an unfair tactical advantage or to increase the cost of litigation.

* * *

In making its decision, the Commission bears in mind the relevant purpose of the prudence audit, i.e., to determine the prudence of the expenditures outlined in the invoices. In that regard, it is noteworthy that Staff makes no allegations or demonstration that it lacks sufficient information to perform its audit, i.e. evaluate the prudence of KCPL's expenditures.

In addition to Mr. Rush, the Commission also heard from the current supervisor of regulatory affairs, Curtis Blanc, and the former supervisor, Chris Giles. Both testified that the Companies have complied with their own policies which require cooperation with investigations. All Company witnesses testified that they had not instructed any Company employee or agent to not cooperate with discovery requests nor were they aware of any Company employees who had done so.

Staff's testimony provided nothing to rebut the testimony of KCP&L witnesses. Staff witness Bob Schallenberg believed there may have been more objections than testified to by Mr. Rush, but did not directly contradict any of Rush's testimony. Staff witness Keith Majors said he personally had no difficulties where the Companies did not comply with requests he had authored. (Tr. 689). Staff witness Chuck Hyneman criticized the Companies' use of attorney-client privilege objections but otherwise offered no specific delays in discovery. (Tr. 675-76). Hyneman was clearly unhappy with the way information had been provided to him, but offered no testimony that discovery disputes had any effect on Staff's failure to complete the audit in compliance with the Commission's orders.

Based upon the competent and substantial evidence in the record, the Commission should find that KCP&L and GMO have acted lawfully with regard to discovery requests and have not

engaged in any dilatory or unreasonable practices in responding to discovery during the prudence and construction audit. None of the actions of the Company related to discovery practices caused Staff's failure to comply with the Commission's directive to complete and file the Staff's prudence review and construction audit by December 31, 2009.

2. The Companies' cost control system adequately tracks the costs of the projects, and is consistent with accepted industry standards.

Dr. Kris Nielsen of the Pegasus-Global management consulting firm has provided testimony in approximately thirty (30) regulatory proceedings (KCP&L Ex. No. 2) on behalf of both public service commission Staffs and public utilities. (Tr. 208). Approximately fifty percent of his engagements have been on behalf of regulatory agencies, and the other half of the engagements have been on the behalf of public utilities. (Tr. 208-09). During his extensive career, he has reviewed approximately 30-40 construction projects for various clients. (Tr. 209).

In this proceeding, Dr. Kris Nielsen, a trained mechanical and civil engineer, an attorney, and project management professional (Tr. 204), testified that he performed an independent and objective evaluation of the effectiveness of KCP&L management regarding the Iatan 1 project and the prudence of the decisions made by the Project Leadership Team. (Tr. 204-05).

Dr. Nielsen described the Companies' cost control system, including contingency logs, change orders, and purchase orders, that are a part of the cost tracking system. (Tr. 224-5). Based upon his independent review of KCP&L's cost tracking system, he testified: "I found that their tracking system was very consistent, maybe even best industry standards at today's juncture to other major capital projects." (Tr. 225).

Mr. Chris Giles, KCP&L's former Vice-President of Regulatory Affairs, also testified regarding the Company's cost control system. As explained by Mr. Giles, KCP&L agreed in the Regulatory Plan Stipulation in Case No. EO-2005-0329 that the Company would develop and implement a cost control system that allowed the Company to identify "cost over-runs" above the definitive estimates and explain any cost increases above that estimate. (Tr. 274-75; 280-81). This cost control system includes a number of source documents that allow the Staff or others to "drill down" from the summary page to identify and explain cost overruns as they are described in the regulatory plan. (Tr. 275). The same cost control system was utilized for tracking the costs of the LaCygne Unit 1 Selective Catalytic Reduction system project as was used for the Iatan 1 project. (Tr. 287-89).

The "definitive estimate" or Control Budget Estimate was prepared in December of 2006 when the project engineering was 20-25 percent complete. This estimate is frequently referred to as the control budget estimate or "CBE." Subsequently, a re-forecasted budget estimate was developed when the project was 75 percent engineered. (Tr. 275; 287). Mr. Giles explained that the Companies maintain cost tracking systems that would allow costs to be compared to either budget. Because the costs can be tracked back to the CBE in order to identify "over-runs" above the CBE, Giles testified the Companies are in compliance with promises made in the regulatory plan.

Mr. Giles addressed the specifics of Staff complaints about the cost tracking system. (Tr. 274-81; 284-91). He explained that, contrary to Staff's assertions, the Companies do track costs to the CBE. The Companies do not deny that there have been costs in excess of the CBE and that these costs may be considered over-runs when tracked to the CBE (although they are not over-runs when tracked to the more reliable reforecasted budget). Giles also explained that the

Kansas Corporation Commission Staff was able to use the Companies' cost tracking system. Kansas Staff sat down with Company personnel in order to fully understand the system. (Tr. 278). When they did so, Kansas Staff was able to complete their prudence audit for Iatan I. Finally, the Companies' cost tracking system, again contrary to Staff assertions, is the same for the Iatan project as for the LaCygne project. (Tr. 288-89). Giles testimony was that the cost tracking system posed no reason to delay the prudence audit beyond the date ordered by the Commission. (Tr. 290).

None of Staff's witnesses repeated the assertions made in Staff's pleadings. There was no evidence to rebut the testimony of Dr. Nielsen and Mr. Giles that the cost tracking systems were appropriate. There was no evidence to rebut the Companies' testimony that the cost tracking systems were no excuse for the Staff's failure to comply with the Commission's April 15th Order.

However, for purposes of cost control and cost tracking, KCP&L's cost control system tracks the changes in costs to the original Control Budget Estimate as well as the re-forecasted budget estimate. (Tr. 275-76). As explained by Mr. Giles, the Staff has been given access to all the cost control documents that show the costs associated with the Iatan 1 environmental upgrades. (Tr. 276). Staff has never been denied access to any of these documents, and they can access them through their own computer systems. (Tr. 277). Staff met with the cost control manager, Mr. Forrest Archibald, to discuss this cost control system. Similarly, the KCC Staff experts and Dr. Nielsen were given this same opportunity to discuss the details of the Company's cost control system and they have walked through numerous examples on how the cost control system tracks and explains the costs. (Tr. 277-78). As a part of KCP&L's effort to facilitate the prudence review and construction audit process, Staff was also invited to observe the actual

development of the re-forecasted budget estimate in an effort to be transparent, but Staff declined to participate with Company personnel in the re-forecast process. (Tr. 281-83).

Staff never raised the criticism that they could not track the project costs with KCP&L until the filing of the December 31 Reports. (Tr. 289). In fact, Staff did not raise this criticism in any of the sixteen (16) Comprehensive Energy Plan Quarterly Report Meetings held to discuss the costs and progress of the CEP projects. (Id.) Nor did Staff raise this criticism in any of the Staff testimony filed in the last KCP&L rate case or in the Staff's Preliminary Audit Report filed on June 19, 2009. (Tr. 289-90). If the criticism had been raised earlier, Mr. Giles testified that he would have "insisted that the Staff spend enough time with our cost control manager, Forrest Archibald, to walk through however many examples were required to give them the ability to track the costs. We did that with Dr. Nielsen and we did that with the Kansas Staff." (Tr. 290).

Based upon the competent and substantial evidence in the record, it is clear that KCP&L has developed a cost control system that adequately tracks the costs associated with Iatan 1 and 2, and is consistent with the best practices in the industry. Staff was provided the opportunity to review and understand this cost control system, and there is no evidence in the record that suggests that KCP&L's cost control system can be objectively blamed for Staff's failure to complete its prudence review and construction audit by December 31, 2009, as directed by the Commission.

3. The Companies have already provided Staff with access to all relevant personnel and information necessary to reach conclusions on the prudence of decisions made about Iatan 1 and Common Plant necessary for the operation of Iatan 1.

As discussed above, Mr. Tim Rush explained in great detail the efforts by KCP&L to provide the Staff with access to all relevant personnel and information to complete their

prudence review and construction audit. (Tr.359-87; 426-41). It is therefore unnecessary to re-iterate that extensive testimony in this section of the Initial Brief.

Dr. Kris Nielsen also testified that Staff has received all the information necessary to conduct a prudence review of Iatan 1. (Tr. 211-12). He and his firm, Pegasus Global, were provided with sufficient information from KCP&L to judge the decisional prudence related to the construction decisions at Iatan 1. (Tr. 211). He testified that he is also familiar with the fact that the Kansas Staff with the help of its outside consultant was able to complete its prudence audit of Iatan 1 last year using the same data that has been provided to the Missouri Staff, with no significant discovery disputes. In fact, based upon his thirty-five years of extensive construction management audit experience and his review of the Kansas consultants' experience with Iatan 1, Dr. Nielsen testified: "I saw no reason at that time that the Missouri Staff could not similarly reach decisional prudence." (Tr. 212).

Based upon the competent and substantial evidence in the record, it is clear that Staff was provided a massive amount of information and access to KCP&L personnel to answer their questions regarding the Iatan 1 construction project. Nothing in the record supports Staff's contention that the Companies' actions in any way could be the reason for Staff's failure to complete and file its prudence review and construction audit by December 31, 2009, as directed by the Commission.

4. The Staff's recent audit activities have largely focused on expense reports of officers of the Companies, and mileage charges reimbursements for employees working at the Iatan construction project.

Since Mr. Hyneman and Mr. Majors have joined the audit team in June or July, 2009, (Tr. 146) their audit focus has been largely on expense reports of officers of the Companies, and

mileage charge reimbursements for employees working at the Iatan construction project. In fact, of the most recent 400 data requests issued by Staff in this “construction audit”, more than 100 (or in excess of 25%) have dealt with expense reports of KCP&L employees. More than 50 data requests pertain to how KCP&L employees are reimbursed for mileage to the construction site. Only a dozen or so of those 400 data requests (or only 3%) pertain to expenditures by Alstom, Kiewit or Burns & McDonnell, the principal vendors responsible for the construction of Iatan 1, Iatan 2 and the Common Plant necessary to operate those units.³⁹

The Companies believe that the evidence demonstrates that Staff is largely focusing now on minutia related to mileage charges and receipts for officer expense accounts⁴⁰, rather than prudence issues related to the construction projects. Unlike the KCC Staff’s consultant which completed his prudence review of Iatan 1 in the last KCP&L rate case (Tr. 222), and dealt with the prudence of the Company’s major decisions related to the Iatan 1 construction project, the Missouri auditors have been spending their audit time:

(1) Requesting the home addresses and business addresses of every Burns & McDonnell employee at Iatan, apparently so Staff can independently check their monthly mileage charges. (DR No. 782) Apparently Staff believes it needs to know this information on a monthly basis, so that if these employees changed home addresses during the project, they can check the accuracy of their mileage requests.

³⁹ See Attachment 2 to the Kansas City Power & Light Company’s and GMO’s (1) Response to Order Establishing Investigatory Docket and Setting On-the-Record Proceeding; And (2) Response to Staff Motion to Open Construction Audit and Prudence Review Investigation Case (filed March 22, 2010).

⁴⁰ In the weeks since the hearing in this case, Staff continues to submit data requests that focus on mileage and expense accounts. The Companies request that the Commission take administrative notice of DR 728.3 (question regarding reimbursement of cellular phone charges), DR 944 (request for a copy of all receipts from Company issued credit cards from 1/2007 to 3/2010), DR 945 (question regarding reimbursement of Burns & McDonnell mileage charges).

(2) Checking the entrance logs of the power plant to verify whether the president of the Company and other company personnel actually traveled to Iatan on specific days, including the day of the crane accident (DR No. 740; 766, 767) so they can cross-check that information with the expense accounts.

(3) Mr. Hyneman and Mr. Majors even made a special trip (one of only 2 trips made by Mr. Majors) (Tr. 686) to the Iatan site so that they could measure the distance between a remote parking lot used by Union employees to the entrance to the Iatan construction site itself (Tr. 638). Apparently, this exercise was designed to verify that there was a real need for the Company to utilize a bus to transport these Union workers the 1 ½ miles from the remote parking lot to the construction site and pay them 30 minutes per day for their travel time. Under the terms of the National Maintenance Agreement the Company was required to pay and provide transportation for distances in excess of ½ mile. (*Id.*)

(4) Requesting that the Company provide the specific business purposes for Mr. Downey's visits to the Iatan site (DR. No. 768).

(5) Requesting copies of expense reports from Mr. Downey and other officers with all receipts for each and every expense account reimbursement charged to Iatan during the last 4 year time period (DR No. 708).

(6) In one request, the Staff even questioned whether the trip of Mr. Churchman, KCP&L Vice-President of Construction, to the funeral of the gentlemen that died in the crane accident should be considered as a personal rather than a business-related trip. (DR No. 780);

(7) Mr. Hyneman also spent his time searching the internet for tee times of the Schiff Hardin lawyers and the Company's Vice-President of Construction. (Tr. 652-53).

These are just a few of the examples of the types of issues that have been causing the Company personnel to spend a great deal of time accumulating information (and other minutia) in direct response to Staff inquiries—and often on an expedited basis. Initially, when KCP&L requested that Staff relieve it of a 10-day turnaround on data request responses after the rate cases ended and after the Staff filed its December 31 Reports, Staff objected since they insisted that they needed such information on an expedited basis to complete their prudence review.

Such examples also cause the Companies to question the “Big Picture” focus of the current audit by the Staff auditors and whether they understand the purpose of a prudence audit at all. As explained below, the evidence strongly suggests that the Staff has not conducted a prudence review but rather a financial audit that is heavily based upon a review of invoices.

5. The Staff appears to now be conducting a financial audit of the Companies rather than a prudence review of the construction decisions made related to Iatan 1 and Common Plant.

Dr. Kris Nielsen also explained the differences between a prudence audit of a power plant construction project, and a financial audit which the Staff appears to be conducting. Prudence audits “judge the prudent decisions regarding a project, and those prudent decisions are made prospectively from what the decision-maker knew or reasonably should have known, whether he actually followed practices and procedures that were reasonable at the time, reached the conclusion and implement the decision until such time as that decision is re-reviewed, change or otherwise reevaluated.” (Tr. 212-13). Construction audits, on the other hand, are “purely a financial type of audit that looks with hindsight at the actual bookings of costs. . .” (Tr. 213).

In particular, he addressed the Government Auditing Standards in its “Governmental Auding Standards” Manual (a/k/a the “Yellow Book”) published by the GAO which prescribes the appropriate standards for such audits.⁴¹ (Tr. 213-14). The Yellow Book auditing standards are used by most government agencies, third parties, and outside vendors for conducting performance audits, including prudence reviews of construction projects, and financial audits. (Tr. 213-14). In fact, Dr. Nielsen and his Pegasus-Global consulting firm routinely have used the Yellow Book standards for performing every prudence review and construction audit for both regulatory agencies and public utilities since 1983. (Tr. 263). The KCC Staff consultant also took a similar approach in his prudence review in the Kansas rate case. (Tr. 222). Dr. Nielsen testified, however, that there was no evidence that the Missouri Staff had used the Yellow Book auditing standards in its review of the Iatan 1 construction project. (Tr. 264). In fact, he testified that there was no evidence that the Missouri Staff even had a finalized Audit Plan at all. (Tr. 264). Dr. Nielsen’s testimony is supported by Staff’s incomplete Iatan I Audit Scope (Ex. 4). The detailed steps of the audit scope were never finalized by Staff. Mr. Schallenberg claims that Staff’s Audit Plan is contained in Staff’s June 19, 2009 Preliminary Report but that document does not contain the elements that would normally be contained in an Audit Plan such as specific steps for completing of the audit, work schedules or personnel needed to complete the audit. The Staff’s December 31 Reports do not discuss issues related to decisional prudence. (Tr. 260). Instead they focus largely on financial audit issues, such as mileage charges, expense reimbursements, AFUDC issues, and allocations between Iatan 1 and Iatan 2.⁴² Dr. Nielsen testified in his thirty-five (35) years of conducting such audits, he had never seen a report similar to the December 31 Report filed by Staff. (Tr. 223). He indicated that the majority of the Staff’s

⁴¹ Government Auditing Standards, July 2007 Revision (published by the Comptroller General of the United States, United States Government Accountability Office—GAO-07-731G).

⁴² December 31 Reports, pp. 5-7.

proposed disallowances or questionable items are more typical of construction or financial audits, and not prudence reviews. (Tr. 223).

Contrary to the approach taken by the Missouri Staff in its audit, Dr. Nielsen testified that he would never have requested the information of the type contained in Attachment No. 2 of the Company's Reply which contained the Staff's recent 400 data requests. (Tr. 226). He also would not have checked the mileage charges for persons working on the construction site. (Tr. 226). Instead, he would have audited the process in place and the policies of the major vendors. (Tr. 226-27). Nor would he have focused in a prudence review on reviewing emails on a project "because management wouldn't see every detail of information." (Tr. 227).

Based upon the competent and substantial evidence in the record, it appears that Staff is now conducting a financial audit of the Companies rather than a prudence review of the construction decisions made related to Iatan 1 and Common Plant. The Commission should find that the prudence review of the Iatan 1 and Common Plant ended as of December 31, 2009, and no additional prudence disallowances should be permitted to be proposed by Staff in the upcoming KCP&L and GMO rate cases.

6. The Companies have done nothing that would justify the removal of the \$30 million and \$15 million disallowance cap contained in the Non-Unanimous Stipulations and Agreements in Case Nos. ER-2009-0089 and ER-2009-0090.

In the Non-Unanimous Stipulation and Agreement filed on April 24 in Case Nos. ER-2009-0089 at pages 5-6, the Signatory Parties agreed to the following:

No Signatory Party to this 2009 Stipulation shall argue that anyone is prohibited from arguing or presenting evidence in the next KCP&L general rate case challenging the prudence of any Iatan 1 construction cost or that KCP&L should have had this unit operating at full generation capacity sooner than the actual date that Iatan 1 is found to be fully operational and used for service, provided however, that any proposed disallowance of rate base for imprudence under this

paragraph shall be limited to a maximum amount of Missouri jurisdictional rate base no greater than \$30 million inclusive of Iatan common costs.

A similar provision was contained in the Non-Unanimous Stipulation and Agreement filed on May 22, 2009 in Case No. ER-2009-0090 with a Missouri jurisdictional rate base disallowance of no more than \$15 million for GMO. (Tr. 26-28).

In both the KCP&L and GMO stipulations, there was a provision which gave the Staff and other parties the opportunity to argue for higher disallowances than the \$30 Million for KCP&L and the \$15 Million for GMO under certain circumstances. These circumstances included the following:

Should the Commission find that KCP&L, respecting any Non-Utility Signatory's construction audit of these costs, (a) failed to provide material and relevant information which was in KCP&L's control, custody, or possession, or which should have been available to KCP&L through reasonable investigation, (b) misrepresented facts relevant to charges to Iatan 1 or Iatan common costs, or (c) engaged in the obstruction of lawful discovery, said Non-Utility Signatory is not bound to proposing a disallowance to KCP&L's Missouri jurisdictional rate base no greater than \$30 million inclusive of Iatan common costs in aggregate amount with regard to such construction audit.⁴³

At the hearing, for the first time in any pleading or proceeding before this Commission, Staff raised the issue of whether the non-unanimous stipulations referenced above had been violated. Staff witness Chuck Hyneman went so far as to testify that he was "aghast" when he heard the Commissioners suggesting that Staff should complete its audit by December 31, 2009. (Tr. 635). None of Staff's witnesses were able to explain why they now take the position that an order on June 10, 2009 affected the stipulations yet they said nothing to the Commission until the hearing in April 2010. Staff's position on this issue is simply not credible.

⁴³ Non-Unanimous Stipulation and Agreement, Case No. ER-2009-0089, p. 4.

The only Company witness to directly address this issue, which is largely a legal issue, was Curtis Blanc. Blanc testified that he was involved in the negotiation of the stipulations. He advised the Commission that the Company had no intent to impact the Commission's ability to direct its own Staff. (Tr. 148). Blanc pointed out that the stipulation contains a clause specifically reserving any and all powers of the Commission regardless of the agreement of the parties. (Tr. 148-149).

At the end of the analysis, the stipulation is a red-herring when it comes to these proceedings. Staff never mentioned this issue in any of its pleadings leading up to the hearing (Tr. 147), but apparently pounced upon this new theory at the last minute in an attempt to inject risk and uncertainty. A careful review of the stipulations reveals that here has been no altering or breach of the plain language of the stipulations. If any party wishes to raise that issue in the future, the Commission can take the matter up at that time. But for now, it has nothing to do with whether Staff followed the Commission's directive to complete its prudence review by December 31, 2009.

Based upon the competent and substantial evidence discussed above, the Companies believe there is absolutely no evidence to support an assertion that they have (a) failed to provide material and relevant information which was in KCP&L's control, custody, or possession, or which should have been available to KCP&L through reasonable investigation, (b) misrepresented facts relevant to charges to Iatan 1 or Iatan common costs, or (c) engaged in the obstruction of lawful discovery. As a result, the Commission should find in this proceeding that the \$30 million and \$15 million cap on Missouri jurisdictional rate base disallowances in the next KCP&L and GMO cases, respectively, remain in place and are valid based upon the discovery practices followed by the Companies to this point in time.

B. STAFF'S DISCOVERY AND COST TRACKING ASSERTIONS ARE NOTHING MORE THAN A MASK TO DEFLECT THEIR APPARENT MISUNDERSTANDING OF THE PURPOSES OF A PRUDENCE REVIEW AND THEIR OWN FAILURE TO COMMENCE THE PRUDENCE REVIEW AND CONSTRUCTION AUDIT IN A TIMELY MANNER.

1. The Bucket Excuse

Although Staff pleadings leading up to the hearing focused on discovery and cost tracking, Staff elaborated on another excuse during the on the record proceeding. Staff witness Schallenberg explained that he approached the prudence review as having different “buckets” and that a proper review would wait until all of the buckets were complete so that the Commission could see costs moving from bucket to bucket. (Tr. 482) Schallenberg did not explain why he did not bring this matter to the attention of the Commission any sooner. Nor did Schallenberg explain why he did not accept the offer of the Companies’ Senior Directory of Regulation, Curtis Blanc, to make additional invoices available for Iatan I prior to the December 31 deadline.

The fundamental flaw in Schallenberg’s “bucket” analysis is that it has nothing to do with whether a prudence audit can be completed. A particular expense – whether it be a settlement with major contractor Alstom or a charge for a meal – can be analyzed for prudence and reasonableness regardless of the “bucket” in which it is ultimately placed. Staff was ordered to conduct a prudence review of the expenses for Iatan I. Staff specifically acknowledges in their audit that they did not review certain costs the Companies had designated as Iatan I costs because Staff wishes to review them during the Iatan II case.⁴⁴ What Staff does not explain is why they did not reach conclusions on the expenses that were in front of them. Staff had invoices and information about the expenses. Whether those expenses ended up in the Iatan I bucket or the

⁴⁴ December 31 Report, pp. 4-5.

Iatan II bucket was not relevant to the analysis that was due on December 31. The proper allocation or bucketing of costs can and should be dealt with in the main hearing of the Iatan II case and if necessary in the true-up phase of the Iatan II case.

2. The May Invoices Excuse

Staff also claims that they did not complete a prudence review of Iatan I because the Commission's April 15th Order required Staff to use information that was then available to Staff. Staff's position appears to be that the June 10th Order gave Staff until December 31 to complete an audit of the invoices that had already been turned in. Mr. Schallenberg's testimony discussed at length that the deadline for his audit (originally June 19) was moved to December 31 but that he believed he was to conduct the audit using only invoices that were available in May. But what Mr. Schallenberg failed to discuss was that the Commission's June 10th Order cancelled ALL deadlines and ordered a construction audit and prudence review of Iatan I and related common plant by December 31, 2009. No matter what Staff's current interpretation of that order is, the intent at the time was clear. ALL deadlines, including the Companies' deadline for submitting responses to the audits, were cancelled. Staff was ordered to COMPLETE and file its audit and prudence review of Iatan I. This review should have included all costs at Iatan I, not just those within an arbitrary cut off date at which Staff unilaterally arrived.

V. THE COMMISSION SHOULD REQUIRE THE STAFF TO COMPLETE THEIR PRUDENCE REVIEW OF IATAN 2 AND FILE ANY PROPOSED PRUDENCE DISALLOWANCES AT THE TIME THAT THE STAFF FILES ITS DIRECT TESTIMONY IN THE UPCOMING KCP&L AND GMO RATE CASES

With the recent history of Case Nos. ER-2009-0089 and ER-2009-0090, discussed above, the Staff's statements of intention to delay the completion of the Iatan 2 audit contained in the

December 31 Reports,⁴⁵ and the plethora of evidence of a “systemic breakdown”, as Commissioner Gunn characterized it (Tr. 517), the Companies have a very significant concern that history may repeat itself with the upcoming Iatan 2 rate case. It is not clear from the evidence in the record that the Staff intends to complete its prudence review and construction audit of Iatan 2 in the context of the Companies’ next rate cases. Unfortunately, the record strongly suggests that the Staff has no present intention to complete the Iatan 2 audit before the conclusion of the next rate cases.⁴⁶

Mr. Michael Cline, KCP&L’s Vice-President of Investor Relations and Treasurer, testified about the expected adverse reactions of investors to the uncertainty surrounding a failure to resolve the Iatan 1 and common plant prudence issues, and investors’ ability to rely upon Commission Orders. (Tr. 442-48). He explained that the uncertainty around such prudence issues can be expected to put downward pressure on bond ratings and the price of stock. (Tr. 445-48). More importantly, he testified that the stakes are far higher in the upcoming Iatan 2 rate case, and “delays in dealing with prudency similar to what we’ve experienced in this case would clearly harm the company in terms of its needs to raise capital.” (Tr. 447).

As a result, the Companies are very concerned that the Commission may see a repeat of the systemic problems that occurred in the last rate cases when Staff failed to complete its prudence review and construction audits in the Iatan 1 rate case. With the amount of money that is involved with the construction of Iatan 2, a repeat performance by Staff could jeopardize recovery of the huge investment in Iatan 2 or result in needless litigation.

⁴⁵ See December 31 Reports at 3.

⁴⁶ *Id.*

The evidence in the record also reflects that there is no longer a “coordination procedure” that requires the Operations Division engineers participate in the prudence review and construction audit.⁴⁷ This seems unfortunate since the engineers in the Operations Division appear to be devoting a substantial amount of time and resources to reviewing the mountains of construction data, and otherwise monitoring the developments at the Iatan construction site. Yet, the evidence reflects that there were very few conversations between the auditors with the Utility Services Division and the Utility Operations Divisions engineers, including Mr. Dave Elliott, Shawn Lange, Michael Taylor. (Tr. 631, 687). Even by the time of the hearings in this proceeding, the Audit Plans for reviewing Iatan 1 and Iatan 2, Sibley or Jeffrey (and Taum Sauk, Plum Point or Sioux) were not yet finalized. (See Ex. No. 4; Tr. 522-25; 468).

KCP&L and GMO are about to file major rate cases involving the Iatan 2 power plant which was built pursuant to the Experimental Regulatory Plan approved by the Commission in Case No. EO-2005-0329. This new coal-fired plant involves approximately \$1.9 billion of investment. It would be horribly unfortunate if the problems that occurred in Case Nos. ER-2009-0089 and ER-2009-0090 repeat themselves because proactive action was not taken at this juncture to avoid them.

Based upon the experiences of the recent rate cases, and the evidence that has been developed in this proceeding, the Companies must respectfully request that the Staff be ordered to complete its prudence review of Iatan 2 by the time that the Staff files its Direct Testimony in the upcoming KCP&L and GMO rate cases. Prudence issues should be ordered to be addressed in the main hearing of KCP&L and GMO’s next rate case. The Commission should further order

⁴⁷ See Schedule 2 attached to the Surrebuttal Testimony of Robert E. Schallenberg, Staff Ex. No. 27 in Case No. ER-2009-0089.

that the cut-off date for the construction (financial audit) of invoices should be four months prior to the true-up date of KCP&L and GMO's next rate case (in-service date of Iatan 2). Any additional invoices after that date would be subject to review in the next rate case. It is apparent from this record that Staff did not commence the prudence review and construction audit of Iatan 1 until the Commission ordered it to do so. Unless the Commission acts to correct the systemic problems that Commissioners Gunn and Jarrett have pointed out, it is likely to happen again. (Tr. 512-523).

VI. CONCLUSION

In conclusion, the Companies respectfully request that the Commission adopt the recommendations of the Companies contained herein. In particular, the Companies request that the Commission issue an order in this proceeding:

(1) clarifying the status of the Staff's audit and confirm that the Staff's prudence review of Iatan 1 and the common plant needed to operate Iatan 1 ended with the filing of the Staff's Reports on December 31, 2009;

(2) precluding Staff from proposing additional prudence disallowances in the next rate cases in addition to those eighteen (18) disallowances for KCP&L and twelve (12) disallowances for GMO that are already contained in its *Staff's Report Regarding Construction Audit and Prudence Review of Environmental Upgrades to Iatan 1 and Iatan Common Plant* filed in Case Nos. ER-2009-0089 and ER-2009-0090 on December 31, 2009 ("December 31, 2009 Reports"); and

(3) issue an order that finds:

(a) The Companies have not engaged in any dilatory or unreasonable practices in responding to discovery during the construction audit and prudence review;

(b) The Companies' cost control system adequately tracks the costs of the projects, and is consistent with accepted industry standards;

(c) And perhaps most importantly, the Staff should be required by the Commission to complete their prudence review of Iatan 2, and file their proposed recommendations at the time that the Staff files its Direct Testimony in the rate cases involving the inclusion of Iatan 2 in rate base that are expected to be filed by KCP&L and GMO in the near future.

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 20th day of May 2010 to counsel for all parties of record.

/s/ James M. Fischer

James M. Fischer