BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc. with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief	))))))	Case No. EM-2007-0374

CITY OF KANSAS CITY'S UPDATED PREHEARING BRIEF

Comes now the City of Kansas City, Missouri ("City") and submits its prehearing brief on the issues submitted by the parties in this case on April 16, 2008. The City has limited its brief to the issues on which it has taken some position or on which it has filed testimony.[1] With respect to the remaining issues identified by the parties on April 16, 2008, the City takes no separate position, without impairment of its right to brief and argue these issues to the Commission as the evidence unfolds at hearing.

At the outset, the City states that it is generally in favor of the merger proposed in the application. Nonetheless, while the City does not oppose the merger, it must emphasize that to avoid any detriment to the public interest a Commission order approving the merger should include the conditions described below.

[1] The City previously briefed the issue of whether Commission approval of the merger should be conditioned upon requiring KCPL/Aquila to fund a comprehensive energy audit by a third party to evaluate the City's opportunities for lower costs, increased efficiency and other benefits. Through written correspondence to the Honorable Colleen M. Dale on April 8, 2008, the City withdrew this issue and the pre-filed testimony of Mr. Stan Harris. With the withdrawal of Mr. Harris' testimony, the City redacts that issue from its prehearing brief.

Issue VIII – Municipal Franchise

1. Should Commission approval of the Joint Application be conditioned upon the negotiation of a single, unitary franchise between KCPL/Aquila and the City of Kansas City within nine (9) months of the Commission's approval of the merger?

To date, Kansas City Power & Light ("KCPL") and Aquila, Inc. ("Aquila") have provided service to the City under separate electric franchise agreements. Because the proposed merger between Aquila and Great Plains Energy, Inc. ("GPE") will effectively unite KCPL and Aquila as affiliated entities, with significant integration of operations between the two, simple logic necessitates the conclusion that the City should be able to deal with the affiliated entities under a single franchise agreement.

By way of background, the City's electric franchise agreement with Aquila expired on December 31, 2006. Although the City recently commenced negotiations for a new franchise with Aquila, these negotiations were delayed once the transaction between Aquila and Great Plains Energy was announced. As a result, the City and Aquila continue to operate under the terms and obligations of the expired agreement.

The City's electric franchise agreement with KCPL was granted in 1881 and does not contain a term limit. The KCPL agreement, which is less than two pages in length, contains almost no information on how the parties intend to operate and is truly antiquated. While the City and KCPL negotiated an ordinance in 1996 that would have served as an operational agreement between the parties, KCPL failed to execute that agreement. Accordingly, the original franchise agreement still controls the relationship between the parties. This arrangement stands in stark contrast with municipal-utility relations under modern franchise agreements. Modern franchise agreements, which are no longer executed for indefinite periods of time, include terms and conditions that assure the quality and reliability of electrical service, as well as the provision of customer service through simplified billing and prompt outage restoration. Modern franchise agreements provide clear definitions, timeframes and procedures that reduce the potential for confusion or disagreement, and promote efficient and timely service, thereby reducing costs to consumers. Finally, modern franchise agreements typically establish basic commitments to community development, and include other related provisions that reflect issues important to utilities, local governments, and consumers alike.

The existence of two utilities acting under separate franchise agreements forces the City to expend additional resources and taxpayer money in order to manage its rights-of-way. City departments and personnel must work to meet two separate sets of differing obligations and responsibilities, and must duplicate efforts to monitor and manage two entities providing the exact same type of service to customers. The cost of monitoring and coordination - not to mention confusion - is likely to increase if there are two "separate" legal entities with significantly integrated operations. Thus, a unitary franchise is a common sense solution that will ameliorate these issues for the City *and* the utility.

As KCPL witness John Marshall has explained, "from a community and communication perspective, since the majority of [KCPL] customers live in the same metropolitan area, the merger enables more effective interaction with them, and a more coordinated role in supporting the needs of our community."[2] These observations should apply with equal force to the utility's relationship with the City as well. Nevertheless, KCPL has argued that the Commission cannot impair KCPL's contractual rights under its existing franchise agreement with the City,[3] or, in the alternative, that consideration of a consolidated franchise in this proceeding would be premature

[2] Supplemental Direct Testimony of John R. Marshall at 4, Lines 13-16.
[3] Surrebuttal Testimony of John R. Marshall at 14, Lines 2-6.

because Great Plains Energy intends to maintain two separate legal entities for the foreseeable future.[4] Neither argument is persuasive.

As an initial matter, to the extent that this Commission imposes a "unitary franchise" condition on the merger, opting into such a condition would be strictly voluntary on the part of the merging entities. The City is asking for the Commission to condition the merger on the negotiation of a franchise before the merger is found to be in the public interest. This condition would neither abrogate existing contracts, nor would it order the utilities into a new one; rather, it gives the merging utilities the choice to honor the precondition. Irrespective of this observation, it is well-established under Missouri law that the Commission possesses broad authority to "[override] all contracts, privileges, franchises, charters or city ordinances" in order to preserve and maintain the public welfare. *See May Dep't Stores Co. v. Union Elec. Light & Power Co.*, 107 S.W.2d 41, 48 (Mo. 1937). Moreover, since a franchise "is not truly a contract but merely a license for a term of years," contractual impairment of a franchise agreement by the Commission under similar circumstances is not even a legally cognizable claim. *See Missouri ex rel. Union Elec. Co. v. Pub. Serv. Comm. of Missouri*, 770 S.W.2d 283, 286 (Mo. Ct. App. 1989).

In light of the proposed transaction, the appropriate time for the Commission to consider this merger condition is now. Despite its projections of hundreds of millions of dollars in synergies resulting from the integration and consolidation of KCPL and Aquila operations,[5]

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[4] *Id.* at 16, Lines 22-23.

[5] *See, e.g.*, Supplemental Direct Testimony of Terry Basham at 1, Lines 15-16 ("The customers of Aquila and KCPL will benefit from the significant synergy savings that the combination of these two companies will produce); *Id.* at 2, Lines 8-10 ("Individual customers, and the community as a whole, will benefit from a larger, stronger regional utility that can be a better corporate citizen and provide low-cost reliable service."); Direct Testimony of William Downey at 4, Lines 13-15 (explaining that "significant savings opportunities are available soon after the close of the Merger through synergy savings related to combined operations of many functions within KCPL and Aquila."); Surrebuttal Testimony of Chris B. Giles at 3, Lines 9-10 ("It is true that much of the benefit to KCPL and Aquila customers from this transaction comes from integrating various KCPL and Aquila functions and activities."); Supplemental Direct Testimony of John R. Marshall at 3, Lines 7-11 ("[U]nderstanding the logic of this deal is as

KCPL is asking the Commission to ignore the practical effect of the transaction on the City's management of its rights-of-way. KCPL cannot have it both ways. If KCPL and Aquila can take advantage of synergies from more unitary operations, so should their customers. Accordingly, to avoid detriment to the City, and to promote the very synergies touted by the Joint Applicants, the Commission should condition its approval of this merger on KCPL/Aquila negotiating a unified franchise with the City within nine months of Commission approval.

<u>Issue IX – Quality of Service Plan and Earnings Sharing Mechanism</u>

1. Should Commission approval of the Joint Application be conditioned upon requiring KCPL/Aquila to file an application for a Quality of Service Plan within 90 days of the Commission's final decision in this proceeding?

The Joint Applicants' proposal currently lacks specificity regarding rate integration, system integration, customer service integration, and a meaningful commitment to compensate customers if certain service quality standards aren't maintained or improved as a result of the merger.

When regulated monopolies propose mergers that allege significant synergies and cost savings, it is incumbent on the Commission to ensure that service quality to captive customers does not deteriorate. The Joint Application fails to establish obligatory service quality standards that would put some teeth into requirements that the utility meet minimum service quality targets post-merger. Customers should be provided with safeguards to guarantee service quality, and in the event that these standards are not met, the utility should be obligated to provide compensation for the diminution of utility services.

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simple as looking at the map of service territories for the two companies," since "[c]onsolidating adjacent operations will enable the two companies to more efficiently cover the same area.").

Notably, the Joint Applicants' recent settlement agreement in the State of Kansas includes a quality of service plan whereby KCPL agreed to adopt and comply with a series of performance metrics for both its customer operations and distribution operations, with the assessment of "penalties" if KCPL fails to satisfy those metrics.[6] Under the agreement, any "penalty" assessed against KCPL will be refunded equally to its retail customers through a bill credit.[7]

In a similar vein, the Commission here should require the company to initiate a docket and file an application for a Quality of Service Plan, with the appropriate standards and customer remedies, within ninety days of its final decision in this proceeding. While the City is not suggesting that the Joint Applicants are doing anything wrong at this time, this measure is being proposed to avoid potential problems in the future. Regulatory guidelines with defined awards and penalties are best established when a utility has additional motivation for compliance, such as during a merger case that the utilities are strongly pursuing here.

2. Should Commission approval of the Joint Application be conditioned upon establishment of an Earnings Sharing Mechanism that returns to customers excess earnings of KCPL/Aquila above an authorized level.

In its application for merger approval, Great Plains asserts substantial benefits to itself, its shareholders, KCPL's customers and Aquila's customers. Included in this filing are requests for special regulatory treatment of certain costs and revenues. In this instance, a better approach is

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[6] *See* Kansas Corporation Commission, *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company and Aquila, Inc. for Approval of the Acquisition of Aquila, Inc. by Great Plains Energy Incorporated*, Joint Motion and Settlement Agreement Attachments 1-3, Docket No. 07-KCPE-1064-ACQ (Feb. 26, 2008). *See also* Colorado Public Utilities Commission, *In the Matter of the Application of Aquila, Inc. d/b/a Aquila Networks – WPC and Aquila Networks – PNG, Black Hills Corporation, Aquila Colorado, LLC, Black Hills/Colorado Utility Company, Inc. and Black Hills/Colorado Utility Company, LLC for an Order Approving the Transfer of Control and Ownership of Aquila's Public Utility Assets and Businesses in the State of Colorado*, Order Granting Application, Subject to Conditions at 24, Docket No. 07A-108EG, Decision No. C08-0204 (Feb. 14, 2008) (where Black Hills agreed to comply with Aquila's existing Quality of Service Plan).

[7] *See* Joint Motion and Settlement Agreement, *supra* n. 6, at Attachment 1.

for customers to share in the improved cost structure of the merged entity through a mechanism that annually evaluates the earnings picture of the company, and if earnings are realized in excess of the Commission's authorized rate of return, then customers receive a portion of that excess. The Commission should therefore require KCPL/Aquila to commit to an "Earnings Sharing Mechanism" that timely returns excess earnings above an authorized level to customers.

An Earnings Sharing Mechanism would work as follows. On an annual basis, KCPL/Aquila would file financial data with the Commission, and Commission Staff and other interested parties would have an opportunity to review and validate the figures supplied. The procedure could be litigated, but the more likely outcome is that the parties to the proceeding would come to an understanding of appropriate costs and revenues and establish the amounts subject to distribution to customers and the utility. The Commission would then issue a decision ordering the merged entity to return the proper portion of excess earnings to customers.

The most successful Earnings Sharing Mechanism would include a "reverse taper" in determining rewards for customers and the utility. This methodology utilizes the authorized return on equity (ROE) as the threshold above which excess earnings are either retained by the utility or returned to customers. In light of the fact that the easiest earnings to achieve are the next several dollars above the authorized level, the reverse taper returns to customers a greater share of those dollars. After greater excess earnings are achieved, more is retained by the utility. By way of example, if KCPL's authorized ROE is 11.25%, any earnings above 11.25% and up to 12.25% receive a distribution of 65% to customers and 35% to KCPL. Excess earnings above 12.25% up to 14.25% are split 50% each to customers and KCPL. The next 1% of excess ROE is allocated 35% to customers and 65% to KCPL. Finally, all excess earnings over 15.25% are retained 100% by KCPL.

If the utility does not experience a period of excess earnings during a particular year, this should not imply that the Earnings Sharing Mechanism has no value as a regulatory tool. While excess earnings may occur and would be distributed in other years, the opportunity for Staff and other parties to validate the utility's costs and revenues following the annual filing provides an additional regulatory benefit.

Issue X – Future Rate Case

1. Should Commission approval of the Joint Application be conditioned upon requiring KCPL/Aquila to file a comprehensive rate case with respect to the merged operations within three (3) years of the Commission's approval of the merger?

While Great Plains has briefly alluded to the topic of rate integration in its testimony and responses to discovery, its proposal lacks details and discussions of timing, improved rate designs and improved collection of customer data. The company should be dealing now with notions of how this significant transformation can be achieved with the optimum result for the company and its customers.

Rate integration can be an important step toward a total company effort to improve electric system operations and enhanced utilization of generation and transmission resources. Great Plains has stated that it will file cases for the separate operations of its KCPL and Aquila affiliates following the merger, but the savings associated with rate integration should not be deferred to another day. The Commission should therefore order the company to file a proposal to integrate financial operations and electric system operations into a cost structure that can be comprehensively evaluated for efficiencies and improved operations. Following a brief period to track and evaluate data, the company should be obligated to file a comprehensive rate case for its merged operations within three years of the Commission's approval of the merger. The analysis of the new cost structure should lead to more equitable assignment or allocations of costs to the appropriate service territories and customer classes of the new entity. The Commission needn't mandate a uniform rate structure or design throughout the territories, as rationally justified differentials due to geographic or other system differences should be allowed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

A true and correct copy of the foregoing was served via email upon the parties identified on the attached service list on this 15th day of April, 2008.

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