BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges For Electric Service	))))	Case No. ER-2010-0356

REPLY POSTHEARING BRIEF OF

INDUSTRIAL INTERVENORS

AS TO THE GMO [CROSSROADS] ISSUE

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COME NOW Ag Processing, Inc. a cooperative, and the Sedalia Industrial Energy Users' Association (collectively referred to herein as "Industrial Intervenors") by and through undersigned counsel, pursuant to the Commission's March 7, 2011 Order Granting Extension of Time to File Briefs, and submit their Initial Posthearing Brief on the following issues:

1. Crossroads

    a. Should Crossroads be included in rate base at depreciated net book value in this proceeding? If not, what is the appropriate valuation of Crossroads?

    b. If Crossroads is included in rate base, what should the amount of accumulated deferred taxes associated with Crossroads be used as an offset to rate base?

I. INTRODUCTION

In considering this issue, it is important that the Commission keep certain facts in mind. The Crossroads unit is the last remaining vestige of Aquila's ill-conceived entrance into the deregulated electric market. While Aquila was subsequently able to sell off its other deregulated assets (Aries, Raccoon Creek, Goose Creek and other combustion turbines), Aquila was **never** able to find a single bidder interested in the Crossroads Energy Center. This is not surprising given that Crossroads is located 500 miles away in Mississippi and is hampered by transmission constraints.

When Great Plains Energy, Inc. (Great Plains) purchased Aquila in 2007, it was saddled with the problem of disposing of Crossroads. Again, despite an acknowledged preference to sell Crossroads, Great Plains also was unsuccessful and, in fact, could not find a single entity interested in even bidding on Crossroads. Ultimately, given the lack of market interest and obvious diminution in value, Great Plains was required to write down the value of the Crossroads asset by $65 million. As such, like so many other combustion turbines, the only value of Crossroads was its salvage value - disclosed to be $51.6 million.

Today, Great Plains seeks to fix its problem of what to do with Crossroads by foisting it upon the regulated ratepayers. Despite previous acknowledgments that Crossroads has minimal market value, Great Plains ask that Crossroads be included in rate base at its net book value based upon the cost paid by Aquila Merchant in 2001. As was pointed out in the Industrials' Initial Brief,[1] GMO's request not only runs afoul of the

[1] Industrials' Initial Brief at pages 2-5.

Commission's affiliate transaction rule, it also is contrary to the dictates of the Supreme Court decision in *Smyth v. Ames*.[2]

GMO claims that Crossroads fair market value is not established by its previous filings and certifications to the SEC. Rather, GMO claims that the fair market value can be established by a self-serving analysis. Based upon a Request for Proposal (RFP) issued prior to the acquisition by Great Plains, GMO asserts that the fair market value is comparable to net book value. GMO's theory is flawed in that if the unit's market value does in fact equal its net book value, then GMO should be required to explain why no one would even bid on the unit. Truly the pieces to this argument do not connect. Ultimately, the evidence shows that GMO's assessment of the RFP is mistaken. In the end, this Commission can simply fix this problem. If GMO truly believes that the Crossroads unit is worth net book value, then the Commission should tell GMO to sell the unit in the market and keep the proceeds. Ratepayers should not be required to pay such exorbitant rates for what is truly a "hand me down" unit that is located over 500 miles away.

This brief will address a number of misstatements and oversights contained in the Crossroads section of the GMO brief. In this regard, GMO raises inapplicable concerns regarding the Commission's jurisdiction; the applicability of the Commission's affiliate transaction rule; the applicability of the Crossroads valuation disclosed at the same time with the Securities Exchange Commission; the relevance of the RFP; and the need to account for deferred taxes in any quantification of net book value.

[2] 169 U.S. 466, 546-547 (1898).

II. ARGUMENT

First, speaking in legal platitudes, GMO cites several court cases designed to raise superficial concerns regarding the Commission's jurisdiction in this matter.[3] As it pertains to the valuation of Crossroads, however, there can be no question that the Commission has absolute jurisdiction. As noted in the Initial Brief, a long-standing Supreme Court holding imposes this responsibility on the Commission.

> The corporation may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it. . . . We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation . . . must be the ***fair value of the property being used by it for the convenience of the public***. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be extracted from it than the services rendered by it are reasonably worth.[4]

Therefore, the Commission is required to determine the fair value of Crossroads property devoted to the public convenience. This authority has also been codified in the Commission's statutory authority. Section 393.230 provides

> ***The commission shall have the power to ascertain the value of the property of every . . . electrical corporation . . . in this state and every fact which in its judgment may or does have any bearing on such value***. The commission shall have power to make revaluations from time to time and to ascertain all new construction, extensions and additions to the property of every . . . electrical corporation. (emphasis added).

Therefore, contrary to GMO's immediate claims to the contrary, the Commission has the authority to quantify the "fair value"[5] of Crossroads.

Second, GMO proposes a self-serving interpretation of the Commission's affiliate transaction rule.[6] GMO notes that "Crossroads was initially held by Aquila's unregulated

[3] GMO Brief at pages 6-8.
[4] *Smyth v. Ames*, 169 U.S. 466, 546-547 (1898) (emphasis added).
[5] *Smyth* at pages 546-547.

merchant subsidiary. Aquila, Inc. later transferred Crossroads to the regulated utility, Missouri Public Service."[7] Based upon its belief that two transfers took place involving an intermediary (Aquila, Inc.), GMO asserts that the Commission's affiliate transaction rule was not applicable.

GMO's failure to understand the application of the affiliate transaction rule is caused by its failure to understand its own corporate structure. Unlike Great Plains Energy, which is an unregulated holding company, ***Aquila, Inc. was the regulated utility***. Within that regulated utility, Aquila, Inc. had a number of separate utility divisions including Missouri Public Service and Light & Power.[8] Furthermore, Aquila-Merchant was a wholly-owned unregulated merchant energy subsidiary. Therefore, when Crossroads was transferred from Aquila-Merchant (unregulated) to Aquila, Inc. (Missouri regulated) in August 2008, the Commission's affiliate transaction rule was implicated.

Third, GMO claims that, if the affiliate transaction rule is deemed to be applicable, then the fair market value of the Crossroads units should be established based upon its 2007 RFP.[9] As this brief demonstrates, however, that RFP was not only self-serving and of a scope that was not comparable to the current issue, it also ignores previous certificated statements made by Great Plains to the Securities Exchange Commission.

In August 2008, the Crossroads units were transferred from the unregulated business unit to the regulated GMO operations.[10] Therefore, the appropriate time to

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[6] GMO Brief at pages 9-10.
[7] *Id.* at page 9.
[8] In fact, the Commission has recognized this fact in its previous Report and Orders. "On July 3, 2006, Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P ("Aquila") filed proposed tariff sheets." *Report and Order*, Case No. ER-2007-0004, issued May 17, 2007, at page 3.
[9] GMO Brief at page 10. See also, GMO Brief at pages 14-15.
[10] Ex. 216, page 5.

ascertain fair market value is as of that date. The most proximate valuation of Crossroads was that conducted by Great Plains Energy a few months prior when it was closing the acquisition of Aquila. On at least three separate occasions during that time, Great Plains made filings with the Securities Exchange Commission stating that the "fair value" of Crossroads was $51.6 million.[11] Given the net book value at that time of $117.9 million, Great Plains was required to make a write-off of $66.3 million.

> ***The preliminary internal analysis indicated a fair value estimate of Aquila's non-regulated Crossroads power generating facility of approximately $51.6 million.*** This analysis is significantly affected by assumptions regarding the current market for sales of units of similar capacity. The $66.3 million adjustment reflects the difference between ***the fair value of the combustion turbines at $51.6 million*** and the $117.9 million book value of the facility at March 31, 2007. Great Plains Energy ***management believes this to be an appropriate estimate of the fair value of the facility***.[12]

Ignoring these certified statements to the Securities Exchange Commission, GMO now asks that Crossroads' fair market value be established based upon a self-serving RFP conducted several months earlier. Based upon that RFP, GMO claims that the net book value of Crossroads "is not greater than the fair market value of other available options."[13] GMO's assertions are pure fiction.

Clearly, given that the RFP had been completed at the time that it made its filings with the SEC, it is apparent that Great Plains itself had disregarded the purported conclusions of the request for proposal. Contrary to the alleged conclusions of the RFP, Great Plains made filings with the Securities Exchange Commission finding that "fair value" was $51.6 million and therefore required a write-off of $66.3 million. Inevitably

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[11] *Id.*
[12] *Id.* at page 12 (citing to Great Plains Energy & Aquila Joint Proxy Statement / Prospectus, filed with the SEC on May 8, 2007, at page 175) (emphasis added).
[13] GMO Brief at page 10.

the question arises, If Great Plains truly believed that fair value was established based upon this request for proposal, then why did it categorically reject that valuation when it made its filings with the SEC? Then answer is apparent, the RFP methodology was self-serving and, in the context of SEC filings which carry the implication of prosecution for false statements, none of the Great Plains Energy senior managers was willing to certify the accuracy of the RFP or its results. Those same managers, however, apparently do not feel similarly constrained by Commission proceedings, and now those same RFP results are apparently deemed trustworthy. In the end, however, it is obvious that the true valuation of fair market value was made in the context of the Securities Exchange Commission filings. Those filings clearly indicate that the fair value of the Crossroads Energy units was only $51.6 million.

Fourth, GMO attempts to rebuke its previous filings with the Securities Exchange Commission. Without any citation to record or SEC regulations, GMO simply claims that the $51.6 million valuation provided in those SEC filings was "a conservative, worst case scenario estimate of dismantling and selling the plant."[14] For some unexplained reason, GMO implies that the SEC filings were wrong and that the value of Crossroads can't be equal to the value of "dismantling and selling the plant."

It is unlikely that Great Plains would have willingly accepted the write-offs associated with the valuation of Crossroads if other valuation alternatives were truly viable. In fact, Great Plains has spent a great deal of time within this case pointing out the financial impacts of such write-offs and the need that such write-offs be a last resort.[15]

[14] GMO Brief at pages 15-16.
[15] See, KCPL / GMO Initial Brief on Common Issues at pages 134-137. See, "Such an impact on the Companies' results of operations and financial position jeopardizes the Companies' financial integrity. The Companies business and financial risk profiles could be weakened which could negatively affect Great

Despite the detrimental impacts of such write-offs, Great Plains now claims that the filing with the SEC and the associated write-off was simply a matter of being "conservative." Great Plains asserts that, given the presence of the RFP study, the true market value was actually much higher than that contained in the SEC filings. In fact, Great Plains would now assert that, recognizing that the RFP study shows that fair market value and net book value are comparable, the previous SEC write-off was actually unnecessary.

Clearly, Great Plains has demonstrated a ready willingness to tell the Securities Exchange Commission one thing while telling this Commission something entirely different! As detailed in the Industrials' Initial Brief, it is not surprising that the value of Crossroads equated to salvage value. At the time that Great Plains Energy purchased Aquila, a tremendous amount of effort had been made to sell all the deregulated assets. Ultimately, Aquila succeeded in selling its ownership interest in Aries, Raccoon Creek, Goose Creek and other combustion turbines at "distressed" prices.[16] Despite its willingness to sell at such a distressed price, Aquila was unable to find a single bidder for Crossroads.[17] Given the lack of an interested purchaser, and the transmission constrains that hinder the sale of energy from the unit,[18] it is not surprising that Crossroads fair value equated to its salvage value. Furthermore, one cannot find one plausible explanation why the units described above (Raccoon Creek and Goose Creek) which were much closer to Aquila's service territory had to be sold at distressed prices to Ameren, yet the Crossroads unit could still demand a higher price when located more than 500 miles away. Again the pieces do not connect. The reason is that as explained

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Plains Energy's corporate credit rating and, by extension, the senior unsecured debt ratings of KCP&L and GMO." KCPL / GMO Common Brief at page 136.

[16] Ex. 217, page 15.

[17] Ex. 216, page 13.

[18] Ex. 217, page 15.

earlier, the Crossroads unit was not worthy of a bid at net book value and truly was only worth its salvage value.

Fifth, GMO continues to refuse to recognize that, even if the Commission should establish the value of Crossroads based upon net book value,[19] it should also reflect the accumulated deferred taxes that are included in any book valuation. As Industrial witness Meyer points out,

> These taxes were generated due to the fact that the Internal Revenue Service ("IRS") allows an investment to be amortized or depreciated over a shorter time than GMO's expenses on its books. Therefore, the IRS allows for a higher depreciation rate. This creates a timing difference between the tax basis and book basis of the property. These differences create deferred taxes which are used to offset rate base.

As Mr. Meyer continues to note, the reflection of deferred taxes in the net book value determination is not only good policy, it is also mandated by the Commission's affiliate transaction rule.

> Deferred taxes should follow the sale of the asset. In transactions with which I am familiar, the deferred taxes accompany the asset sale or transfer. The Missouri Commission Staff usually requires that the deferred taxes follow the ownership of the asset.
>
> There is also the issue concerning the Commission's affiliate transaction rules. In transactions involving purchases from affiliates, utilities are required to buy from affiliates at the ***lesser*** of market value or cost. Deferred taxes are part and parcel of the "cost" of the transaction with the affiliate. Therefore, merely recording the asset at its net book cost without the consideration of deferred taxes does not comply with the affiliate transaction rules.[20]

III. CONCLUSION

As can be seen GMO's analysis is erroneous. As demonstrated by reference to Supreme Court holdings as well as Missouri statutes, the Commission has absolute

[19] GMO Brief at page 15.
[20] Ex. 1401, pages 12-13.

jurisdiction to determine the value of the Crossroads unit. Moreover, given the transfer of the Crossroads unit from Aquila merchant (deregulated) to Aquila, Inc. (regulated), the transfer of this asset invokes the protections of the Commission's affiliate transaction rule.

Given the application of the affiliate transaction rule, it is critical that the Commission make a determination of the fair market value of the Crossroads unit. In certified filings with the Securities Exchange Commission, Great Plains concluded that the "fair value" of the Crossroads was $51.6 million, well below the actual net book value. This "fair value" is consistent with the fact that, despite numerous previous attempts, Aquila and Great Plains were not able to find a single bidder for the Crossroads unit.

For all these reasons, the Industrial Intervenors ask that the Commission set the value of the Crossroads Energy Center at $51.6 million.

Respectfully submitted,

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ATTORNEYS FOR THE INDUSTRIAL INTERVENORS

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.

David L. Woodsmall

Dated: April 4, 2011