

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

In the Matter of the Application of Kansas City)
Power & Light Company for Approval to Make)
Certain Changes in Its Charges for Electric Service) File No. ER-2009-0089
to Continue the Implementation of Its Regulatory)
Plan.)

In the Matter of the Application of KCP&L Greater)
Missouri Operations Company for Approval to) File No. ER-2009-0090
Make Certain Changes in its Charges for Electric)
Service.)

STAFF'S REPLY TO KCPL'S AND GMO'S FEBRUARY 16, 2010 INITIAL RESPONSE

COMES NOW the Staff of the Missouri Public Service Commission (Staff), by and through the Staff Counsel Office of the Missouri Public Service Commission, and for its reply to KCP&L's And GMO's Initial Response To Staff Report Of The Construction Audit/Prudence Review Of Environmental Upgrades To Iatan 1 And Iatan Common Plant (Initial Response), which was filed on February 16, 2010, the Staff states as follows:

1. The Commission in its February 23, 2010 Order Granting Request For An Extension Of Time With Modifications made Staff's reply discretionary. The Staff not replying to the February 16, 2010 Initial Response of KCPL/GMO is not a possible option for the Staff.

2. On February 16, 2010, Charles W. Hatfield, as signatory counsel, and Karl Zobrist and James M. Fischer, Attorneys for Kansas City Power & Light Company (KCPL) and KCP&L Greater Missouri Operations Company (GMO), caused to be filed KCP&L's And GMO's Initial Response To Staff Report Of The Construction Audit/Prudence Review Of Environmental Upgrades To Iatan 1 And Iatan Common Plant apparently seeking that the Commission issue an Order finding that the Staff's December 31, 2009 Report Of Staff

Respecting Its Construction Audit / Prudence Review Of Environmental Upgrades To Iatan 1 And Iatan Common Plant is its complete construction audit and prudence review concerning Iatan 1 and Iatan common plant for invoices that were available and expenses that had been incurred in time for consideration for its December 31, 2009 filing and Staff should not be permitted to continue any audit activities relative to Iatan 1 and Iatan common plant.

3. KCPL/GMO apparently seek that the Commission take a new approach as to how the Staff is to function in general, and in particular respecting construction projects. The Staff may not discover or become aware of imprudent, unreasonable, or inappropriate expenditures or conduct during the period of time covered by an initial Staff audit. KCPL/GMO evidently want the Commission to prevent the Staff from subsequently inquiring into and addressing: (a) matters that a party other than the Staff may raise before this Commission,¹ (b) matters that the public

¹ In Case No. ER-2009-0089, the Hospital Intervenors filed the testimony of James R. Dittmer which set forth the material amount the costs of KCPL on the Iatan 1 air quality control system (AQCS) exceeded the definitive estimate and the Industrial Intervenors took the position that the Commission must make a legal determination whether under applicable law it is required to include costs in rate base of KCPL that materially exceed the definitive estimate. The U.S. Department of Energy and the U.S. National Nuclear Security Administration, on behalf of themselves and all other affected Federal Executive Agencies, filed the testimony of Jatinder Kumar and took the positions that (a) KCPL had not carried its burden of demonstrating what the costs of Iatan 1 AQCS have been, indeed some significant portion of the cost of Iatan 1 AQCS work had still not even been expended, and (b) the costs of Iatan AQCS rate base additions that exceed KCPL's [REDACTED] "definitive estimate" should either be excluded from rate base or be included in rate base on an interim subject to refund basis. Statements Of Positions filed April 15, 2009 in Case No. ER-2009-0089.

Another example of a matter which an informant provided information to the Staff which resulted in a Staff adjustment adopted by the Commission involved securities fraud litigation against Union Electric Company (UE). Imprudence was found by the Commission respecting UE and the Harris litigation issue in *Re Union Electric Company*, Case Nos. EC-87-114 and EC-87-115, Report And Order, 29 Mo.P.S.C.(N.S.) 313, 327-28 (December 21, 1987). The Harris litigation itself involved a securities fraud action brought against UE by a class of bondholders resulting from UE attempting to call certain first mortgage bonds. It was alleged that UE had violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 of the Securities and Exchange Commission (SEC). A jury verdict of \$2.7 million was rendered in Federal District Court and was upheld on appeal to the Eighth Circuit Court of Appeals, *Harris v. Union Electric Co.*, 787 F.2d 355 (8th Cir. 1986). The Commission in its decision noted that the Eighth Circuit Court of Appeals, which affirmed the Federal District Court, held that:

... the evidence is sufficient for the jury to have found that UE's entire conduct from March, 1975 to April, 1978 concerning the Series 2005 Bonds constituted a course of business and scheme or artifice which operated as a fraud on the bondholders. *Harris v. Union Electric Co.*, 787 F.2d 355, 362 (8th Cir.1986)

service commission staff in an adjoining State might raise in a contemporaneous proceeding in that adjoining State to a Missouri Commission proceeding or in a subsequent proceeding to a Missouri Commission proceeding involving the same construction project, (c) matters that an informant may bring to the attention of the Staff of which the Staff was not previously aware,² (d) matters that may be raised by the media of which the Staff was not previously aware, (e) information not timely disclosed by KCPL or information disclosed by KCPL that is later found to be fraudulent, inaccurate, misleading, or incomplete,³ (f) matters that may originate as an inquiry by a member of the Legislature of which the Staff was not previously aware, (g) matters that the Staff may become aware of on its own, but too late in an audit to be entirely developed by a deadline in a particular case,⁴ and (h) matters that become an issue only after the

The Staff proposed to reduce UE's expenses by \$3.8 related to the judgment and plaintiffs' and UE's attorneys' fees. UE argued before the Commission that the litigation costs were a reasonable business expense and that its attempts to call the bonds was intended to reduce UE's cost of money which would benefit its ratepayers. A letter in opposition to the UE transaction was written to a UE executive by one of the members of the UE Board of Directors. The Commission stated that "[i]t is apparent that a serious doubt existed as to the legality of the redemption attempt." 29 Mo.P.S.C.(N.S.) at 328. The Commission held that UE had not shown that its action underlying the litigation was prudent, and, therefore, had not shown that inclusion of these litigation expenses in UE's cost of service was justified. The Commission adopted the Staff's adjustment.

² **

[REDACTED]

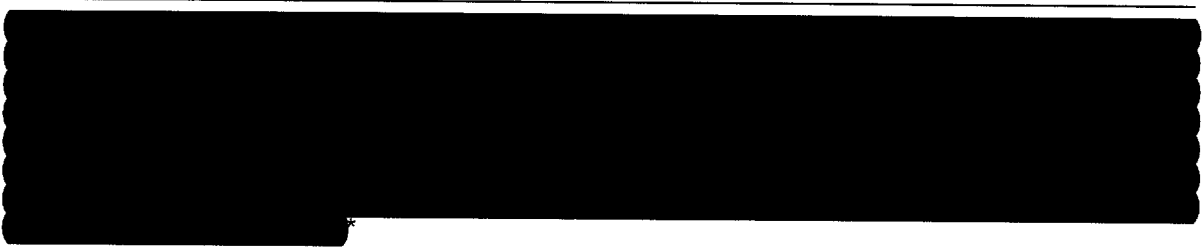
³ See footnote 2 *supra*.

⁴*

[REDACTED]

“completed” construction project operates for a period of time, such as a unit not meeting design specifications, having high maintenance costs, experiencing low availability, etc. Will KCPL/GMO respond that the preceding are exceptions to what it is seeking by its February 16, 2010 Initial Response, i.e., that the Staff can only submit a Data Request to KCPL/GMO on Iatan 1 and Iatan common plant post Month Day, 2009 if the inquiry falls under one of the preceding exceptions? Undersigned Staff counsel suggests to the Commission that it does not need to take KCPL’s/GMO’s offer of an “e-coli obfuscation” by circumscribing its Staff in conducting construction audits / prudence reviews.

4. Also based on the Commission’s Orders of April 15, 2009 and June 10, 2009, the Staff is seeking guidance from the Commission whether the Staff is to modify its practice such as that used for the Hawthorn 5 rebuild and other major construction projects of filing a “complete” audit after costs for the project are “finalized” and construction “completed” and instead file “interim audits” based upon a limited scope. Should the Staff in future rate cases, absent a Commission order to the contrary, perform a construction audit / prudence review based on best available information for presentation in upcoming rate cases even though the final costs of the construction project are not known and construction is not complete? The Staff has been working on this basis to address the Iatan Project costs, i.e., Iatan 1, Iatan 2, and Iatan common plant, in KCPL’s next rate cases. On April 15, 2009, the Commission ordered the Staff to perform what at that time could only be a limited audit of Iatan 1 air quality control system (AQCS) environmental enhancements and the related common plant. The Commission ordered



the Staff's audit to be performed based on the information Staff had under its control to-date and a review of True-Up invoices provided through June 8, 2009. The Staff was to complete this review; develop and support with a specific rationale any adjustments, to an unspecified cost baseline for Iatan 1 AQCS actual costs; and file the construction audit and prudence review by no later than June 19, 2009.⁵ The Staff wants to be very clear on this next point: Because the Iatan 1 ACQS is fully operational and used for service does not mean that all Iatan 1 costs have been incurred and Iatan common plant is complete. The Staff believes the Commission limited the Staff's December 31, 2009 construction audit / prudence review to the common plant needed to operate the Iatan 1 ACQS, but KCPL/GMO assert that the Staff was responsible on December 31, 2009 for a complete audit of Iatan common plant that the Staff believes was never ordered by the Commission. KCPL/GMO has sought to create the false and self-serving perception that the Staff has consciously operated outside the parameters of the Commission's Orders and that is not the case.

5. The Commission in its April 15, 2009 Order Regarding Construction And Prudence Audits Of The Environmental Upgrades At Iatan I, Jeffrey Energy Center And The Sibley Generating Facility in Case Nos. ER-2009-0089 and ER-2009-0090 stated that the audit it was directing was needed by the Commission to assist in the Commission's deliberations of the Iatan issues expected to be heard in the then current KCPL and GMO rate cases. The Commission stated at page 5, paragraph two, first sentence of its April 15 Order "Staff obviously has some data upon which to complete at least a partial audit, even if that data is incomplete until True-Up," and directed in "Ordered: 3." that "[a]ll true-up invoices shall be provided to the Commission's Staff for review no later than June 8, 2009." Of course a construction audit /

⁵ The Commission set the general True-Up cut-off date in Case Nos. ER-2009-0089 and ER-2009-0090 as April 30, 2009 in its April 18, 2009 Order Modifying Procedural Schedules For True-Up Proceedings And Formally Adopting Test Year And Update Period.

prudence review is much more than an audit of invoices. A Staff review of Iatan 1 AQCS invoices to June 8, 2009 would be inconclusive without a detailed understanding of the relationship of those charges to the Iatan 1 AQCS segment costs including the related contract and any commercial issues underlying the charges contained in the invoices. Normally invoices are requested in conjunction with these other materials. The invoices are never the exclusive focus of a construction audit / prudence review. The invoice is reviewed in conjunction with the related contract and purchase order. KCPL takes approximately forty-five (45) days to provide month-end cost summary information for the Iatan 1 AQCS segment. Thus, the Staff would not have the Iatan 1 AQCS month-end cost report for May 31, 2009 until approximately July 15, 2009. This cost report would be the only cost baseline to match adjustments based on invoices through June 8, 2009. On April 15, 2009, the Staff only had Iatan 1 AQCS segment information through February 28, 2009. The Staff was making arrangements to address the gap between examining June 8, 2009 invoices and the Iatan 1 AQCS month-end cost report that includes the costs reflected on these invoices. Once a Stipulation And Agreement was reached in the KCPL rate case, ER-2009-0089, which therefore indicated a stipulation and agreement was likely in the GMO rate case, ER-2009-0090, the Staff thought that the Commission ordered filing for June 19, 2009 might be addressed in the next KCPL and GMO rate cases. KCPL/GMO did not disagree with the Staff and a 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 KCP&L's And GMO's Next General Rate Cases was filed on May 28, 2009 in Case Nos. ER-2009-0089 and ER-2009-0090. In its June 10, 2009 Order, the Commission did not accept the Staff's and KCPL's/GMO's proposed approach, and instead directed the Staff to make a filing by December 31, 2009. The Commission's June 10, 2009

Order did not address the matter of an invoice cutoff date nor specifically modify the scope of the audit the Commission ordered on April 15, 2009.

6. A truly final Iatan 1 AQCS and related plant construction audit and prudence review could not be completed on December 31, 2009 because the construction, purchasing, and cost for this segment of the entire project is still ongoing and will not be completed until the end of 2010 at the earliest. The latest schedule of Iatan 1 expenditures received by signatory parties to the KCPL Experimental Regulatory Plan shows significant expenditures in 2010 over eight months after the Iatan 1 AQCS project was determined to be fully operational and used for service. The signatory parties were recently advised that a large expenditure for an auxiliary boiler will be constructed and charged against the Iatan 1 AQCS budget. The latest "Iatan Unit 1 Project Expenditure Summary" from the "Fourth Quarter 2009, KCP&L Strategic Infrastructure Initiatives – Quarterly Status Update – MPSC Case No. EO-2005-0329, page 41" shows the following schedule:

Iatan Unit 1 Project Expenditure Summary				
Month	Current Budget Estimate	Actual Projected	Variance	
2004 - 2005	\$ -	\$ -	\$ -	
2006	** [REDACTED] **	** [REDACTED] **	-	
2007	** [REDACTED] **	** [REDACTED] **	-	
2008	** [REDACTED] **	** [REDACTED] **	** [REDACTED] **	
2009	January 2009	** [REDACTED] **	** [REDACTED] **	
	February	** [REDACTED] **	** [REDACTED] **	
	March	** [REDACTED] **	** [REDACTED] **	
	April	** [REDACTED] **	** [REDACTED] **	
	May	** [REDACTED] **	** [REDACTED] **	
	June	** [REDACTED] **	** [REDACTED] **	
	July	** [REDACTED] **	** [REDACTED] **	
	August	** [REDACTED] **	** [REDACTED] **	
	September	** [REDACTED] **	** [REDACTED] **	
	October	** [REDACTED] **	** [REDACTED] **	
	November	** [REDACTED] **	** [REDACTED] **	
	December	** [REDACTED] **	** [REDACTED] **	
2010	** [REDACTED] **	** [REDACTED] **	** [REDACTED] **	
TOTAL	** [REDACTED] **	** [REDACTED] **	** [REDACTED] **	

Note: Above costs do not include AFUDC.
 All above project costs are 100% basis and include current allocation of common.

While the above schedule shows approximately **[REDACTED]** of the Iatan 1 AQCS current budget estimate, or **[REDACTED]**, of expenditures in 2010 for the Iatan 1 AQCS project segment, the Staff's continuing audit causes the Staff to believe that the above schedule provided on February 12, 2010 by KCPL is misleading. Other documentation indicates that KCPL expects that **[REDACTED]** of the expenditures indicated above for 2010 will not occur. Page 41 from Fourth Quarter 2009, KCP&L Strategic Infrastructure Initiatives – Quarterly Status Update – MPSC Case No. EO-2005-0329 illustrates the difficulty in auditing the Iatan 1 AQCS project as KCPL documents cannot be relied upon or taken at face value. Independent

documentation, when available and discoverable, is needed to verify the accuracy of KCPL information and assertions. KCPL/GMO appear to acknowledge in their February 16, 2010 Initial Response that Staff has not seen all the Iatan 1 AQCS and Iatan common costs and invoices, and that discontinuation of all Staff Iatan 1 AQCS and Iatan common plant audit activities may be unreasonable.

7. If the Commission desires the Staff to conclude all audit of Iatan 1 and Iatan common plant before it is complete, as KCPL and GMO pray the Commission direct its Staff to do, then the Commission can order the Staff to discontinue any of its audit activity that may be related to Iatan 1 and Iatan common plant before it is complete, and the Staff will comply with the Commission's Order. Staff would request that the Commission issue this directive as soon as possible so Staff can redirect its resources to address other demands. In the event the Commission wants the Staff's Iatan 1 and Iatan common plant audit activities discontinued, then Staff will need a clear delineation of the audit parameters Staff is to follow because despite any assertion by KCPL/GMO to the contrary, Iatan 1 and Iatan 2 costs are commingled between these two project segments.

8. The Commission in its April 15, 2009 Order Regarding Construction And Prudence Audits Of The Environmental Upgrades At Iatan I, Jeffrey Energy Center And The Sibley Generating Facility in Case Nos. ER-2009-0089 and ER-2009-0090 stated as follows in the body of the Order and presciently in footnote 13, which shows the Commission ordered its Staff to perform a limited audit in these cases. By attempting to "cut-off" the Staff's audit activities, KCPL is attempting, among other things, to prevent the Staff from pursuing KCPL's commingling of costs between Iatan 1 and Iatan 2:

. . . 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 I.¹³

¹³ Restricting the scope of this audit to Iatan I, and all equipment upgrades required for its operation, that should eliminate any issue with regard to any commingling of shared components between Iatan I and Iatan II. . . .

* * * *

3. . . . All True-Up invoices shall be provided to the Commission's Staff for review no later than June 8, 2009.

9. Obviously, the Staff does not agree with KCPL/GMO that the Commission should end the Staff's audit of the costs of Iatan 1 and Iatan common plant. Even though the Iatan 1 AQCS is fully operational and used for service, Iatan 1 construction costs have not stopped as shown in the above table. Iatan 1 invoicing has not stopped, and the commingling of Iatan I and Iatan 2 construction costs continues. KCPL has been using its legal rights to the fullest to withhold information from audit such as the support for the contingency reserve in the Iatan 1 AQCS control budget. (See Schedule 6 to the Staff's December 31, 2009 Report). KCPL/GMO seek to portray themselves in their February 16, 2010 Initial Response as merely rightfully exercising their legal rights while during part of the Staff's audit KCPL speciously objected to Staff Data Requests seeking Iatan 2 cost data and information arguing that such data and information was not relevant to the audit of Iatan 1 AQCS, stating as follows to multiple Staff Data Requests, for example Staff Data Request Nos. 336, 337, 341, 343, 362, 378, 382, 384, 387, 389, and 392:

. . . KCPL objects to this data request to the extent it calls for information pertaining to Iatan 2 and therefore seeks discovery of information which is irrelevant, immaterial and inadmissible and whose discovery is not reasonably calculated to lead to the production of relevant and admissible evidence. Subject to this objection, KCPL will provide responsive information concerning Iatan 1.

KCPL eventually dropped this objection, but not before time was lost by the Staff dealing with a patently meritless objection. The Staff believes that KCPL/GMO has acted contrary to page 9 of

the October 30, 2007 Great Plains Energy Incorporated (GPE) Code of Ethical Business Conduct which specifies full cooperation to requests for information in any external, as well as internal, investigation, not in a manner to frustrate any legitimate investigation such as that being performed by the Staff and directed by the Commission:

Accounting and Recordkeeping: Cooperation with Investigations

Consistent with applicable law, we are required to cooperate fully, promptly and truthfully in any internal or external investigation, including responding to requests for information relating to the subject matter of the investigation. We will not destroy or alter any Company record with the intent to obstruct any pending or threatened investigation.

(See pages 83-84, Schedule 14, and Schedule 15 in Staff's December 31, 2009 Report Of Staff Respecting Its Construction Audit / Prudence Review Of Environmental Upgrades To Iatan 1 And Iatan Common Plant filed in File Nos. ER-2009-0089 and ER-2009-0090, and footnote 4 *supra*).

10. The timeline of pertinent events is as follows:
 - (a) 04/21/09 Non-unanimous agreement in principle to settle Case No. ER-2009-0089 announced by certain parties
 - (b) 04/21/09 Notice And Order Suspending Evidentiary Hearing, Setting Deadlines For Filing, And Setting Deadlines For Requesting A Hearing issued by the Commission in Case No. ER-2009-0090
 - (c) 04/24/09 Non-Unanimous Stipulation And Agreement to settle Case No. ER-2009-0089 filed
 - (d) 05/11/09 Parties in Case No. ER-2009-0090 announced that a Stipulation And Agreement in principle had been reached
 - (e) 05/11/09 Notice And Order Suspending Evidentiary Hearing, Setting Deadlines For Filing, And Setting Deadline For Requesting A Hearing issued by the Commission in Case No. ER-2009-0090
 - (f) 05/13/09 Order Setting Stipulation Hearing for 6/8/09 issued by the Commission in Case Nos. ER-2009-0089 and ER-2009-0090

- (g) 05/22/09 Non-Unanimous Stipulation And Agreement to settle Case No. ER-2009-0090 filed
- (h) 05/28/09 In Case Nos. ER-2009-0089 and ER-2009-0090 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 KCP&L's And GMO's Next General Rate Cases – Joint Motion of Staff, KCPL, and GMO states, in part:
 - . . . given the stipulation and agreements that have been reached in Case Nos. ER-2009-0089, ER-2009-0090, and HR-2009-0092, the Staff, KCP&L, and GMO believe that extending these deadlines [to KCP&L's and GMO's next general rate cases] will not prejudice any party to these cases and will afford additional time for the Staff, KCP&L, and GMO to discuss and potentially resolve any issues that have arisen or might arise, including the Iatan common costs issues. (Emphasis supplied.)
- (i) 06/08/09 On the record Stipulation Hearing held in Case Nos. ER-2009-0089 and ER-2009-0090
- (j) 06/10/09 Order Regarding Joint Motion To Extend Filing Date issued by Commission in Case Nos. ER-2009-0089 and ER-2009-0090
- (k) 06/19/09 Staff files Preliminary Report Of Staff Respecting Its Construction Audit / Prudence Review Of Environmental Upgrades to Iatan 1 and Iatan Common Plant
- (l) 10/29/09 Empire files Empire Case No. ER-2010-0130 seeking recovery of Iatan 1 AQCS costs in Empire rates
- (m) 12/31/09 Staff files Report Of Staff Respecting Its Construction Audit / Prudence Review Of Environmental Upgrades To Iatan 1 And Iatan Common Plant
- (n) 01/25/10 KCPL files in Empire Case No. ER-2010-0130 Response Of Kansas City Power & Light Company To Staff's And Empire's Proposed Procedural Schedules, And To Staff's Motion To Delay The Adoption Of Procedural Schedule
- (o) 02/25/10 Non-Unanimous Stipulation And Agreement and Joint Proposal Regarding Certain Procedural Matters filed in Empire Case No. ER-2010-0130

11. As noted above, on January 25, 2010 in Empire's rate case, Case No. ER-2010-0130, KCPL filed the Response Of Kansas City Power & Light Company To Staff's And

Empire's Proposed Procedural Schedules, And To Staff's Motion To Delay The Adoption Of Procedural Schedule. KCPL's pleading states, in part, as follows at paragraph 4, on page 2:

. . . KCP&L has a different concern with the proposed schedules that pertains to the Iatan 1 AQCS and the Iatan common plant included in Empire's case. In particular, KCP&L is very concerned that the procedural schedule being proposed by Staff may result in any prudence issues related to the completion of the Iatan 1 AQCS and the Iatan common plant being litigated in the context of the pending Empire rate case rather than in the context of the next KCP&L rate case which is anticipated to be filed this Spring.¹ KCP&L strongly believes it would be preferable to wait to litigate such prudence issues until the next KCP&L rate case since KCP&L, rather than Empire, is the majority owner, constructor, and operator of the Iatan Generating Station. Litigating prudence first in the case of a minority owner will likely create both logistical and due process issues. KCP&L, however, also expects that the discussions among the parties may address and resolve this concern. . . .

¹ In Staff's Proposed Procedural Schedule And Other Proposed Procedures, Staff stated at page 3: "The Staff's direct case filing on February 26, 2010 will include the Staff's Iatan 1 AQCS and Iatan 1 common plant construction audit and prudence review filed by Staff on December 31, 2009, in Case No. ER-2009-0089 and Case No. ER-2009-0089, which is based on invoices booked and paid by KCPL through May 31, 2009." KCP&L, as opposed to Empire, is in a better position to substantively respond to the issues raised in those reports.

12. The Non-Unanimous Stipulation and Agreement filed on February 25, 2010 in Case No. ER-2010-0130 provides for prudence issues related to the completion of the Iatan 1 AQCS and the related Iatan common plant being litigated in the context of Empire's next succeeding rate case to Case No. ER-2010-0130. Thus, KCPL has no objection to the processing of Empire's initial rate case addressing its Iatan 1 AQCS investment without the benefit of an early partial construction audit or prudence review.

13. On January 13, 2010 GPE and KCPL, as well as Empire, filed 8-K Reports with the U.S. Securities and Exchange Commission (SEC) stating as follows:

. . . Due to construction delays and unusually cold weather, Great Plains Energy and KCP&L currently anticipate that the in-service date of Iatan No. 2 will shift approximately two months into the fall of 2010.

The shift in the expected in-service date will likely cause approximately the same movement in the effective dates of rates to be set in KCP&L's pending Kansas rate case and KCP&L's and GMO's anticipated Missouri rate cases, which had

been originally projected to be October 17, 2010 [in Kansas] and early first quarter 2011 [in Missouri], respectively.

14. Less than two weeks after its SEC filing KCPL stated in its January 25, 2010 Response in the Empire rate case, Case No. ER-2010-0130, that the next KCPL rate case “is anticipated to be filed this Spring.” Spring starts with the March equinox on March 20, 2010 and ends with the June solstice on June 20, 2010. On February 16, 2010, at its quarterly Iatan construction project update meeting with its KCPL Regulatory Plan Signatory Parties, KCPL clearly indicated that its rate case filing would be the latter part of Spring 2010. This development indicates that the expected February 1, 2010 filing date for the next KCPL rate case as Iatan 2 will be delayed to an unspecified date. The delay in KCPL’s filing its next rate case would have provided greater certainty that the final cost of the Iatan 1 AQCS project would be available for audit in KCPL’s next rate case, if it were not for the fact that the Iatan 1 AQCS work order continues to be charged for purchases, construction, and costs months after the Iatan 1 AQCS project has been completed. While there may be appropriate reasons for further Iatan 1 activity, KCPL’s/GMO’s attempt to stop or limit certain of the Staff’s audit activities is unreasonable as the Iatan expenditures represent cost overruns from the Iatan 1 AQCS control budget estimate (CBE), which is KCPL’s substitute for the Definitive Estimate required in KCPL’s Experimental Regulatory Plan.

15. The next KCPL and GMO rate cases are the rate cases in which KCPL / GMO now intend to litigate prudence issues related to Iatan 1, Iatan 2, and Iatan common plant. KCPL/GMO assert at page 6, first full paragraph, first sentence and at page 9, first full paragraph, first sentence of its February 16, 2010 Initial Response that “as contemplated in the Regulatory Plan” / “[u]nder the Regulatory Plan, Staff was supposed to conduct its prudence audit of Iatan 1 in the last rate cases.” The Case No. EO-2005-0329 KCPL Experimental

Regulatory Plan Stipulation And Agreement provides at page 29 in Section III.B.3. Expected Rate Cases During Regulatory Plan that of the four (4) rate filings addressed by the KCPL Regulatory Plan:

. . . KCPL is not required to file Rate Filing #2 and Rate Filing #3. However, KCPL agrees to file Rate Filing #1, and a rate case to include the investments related to the completion of Iatan 2. . . .

16. On page 41 of the KCPL Regulatory Plan Stipulation And Agreement, Rate Filing #4 is identified as KCPL's "2009 Rate Case." To further understand how far off schedule the completion of Iatan 2 is from what was anticipated in the KCPL Regulatory Plan Stipulation And Agreement, one need only review page 41, Section III.B.3.d. where the schedule for the Iatan 2 case is identified:

RATE FILING #4 (2009 RATE CASE)

(i) Schedule. Rate schedules with an effective date of September 1, 2010, will be filed with the Commission on October 1, 2009, or eight (8) months prior to the commercial in service operation date of Iatan 2. The test year will be based upon a historic test year ending December 31, 2009, (initially filed with nine (9) months actual and three (3) months budget data), with updates for known and measurable changes, as of March 31, 2010, and with a true-up through May 31, 2010. On or about July 1, 2010, KCPL will file in a true-up proceeding a reconciliation as of May 31, 2010. . . .

17. The KCPL Experimental Regulatory Plan does not restrict a party from a further review of expenditures once the expenditures have received any level of review. The Staff's statements in the Staff's Report filed December 31, 2009 regarding the Iatan 1 AQCS cost overruns were not intended to indicate that the Staff would continue to focus its construction audit / prudence review on the Iatan 1 AQCS project and related common plant. The Staff was merely indicating outstanding areas that existed which in Staff's thinking regarding the next KCPL and GMO rate cases would likely result in changes in the Staff's cases from the results (quantifications/values) in the Staff's December 31, 2009 filing respecting its audit of the Iatan 1

and Iatan 2 cost overruns and Iatan 2 charges. Just as the Staff found Iatan 1 charges which it believes should be charged to Iatan 2, the Staff suspects that it will conclude that certain Iatan 2 charges should be charged in part to Iatan 1.

18. Restriction of the Staff audit activities on cost overruns would likely result in the Staff recommending disallowance of the cost overruns in excess of the Iatan 1 AQCS control budget which are not identified and explained by KCPL's cost control system. The Staff is of the opinion that its audit work concentrated on Iatan 2 will identify areas where additional costs may be justified for Iatan 1 AQCS as many of the factors which impact Iatan 2 would also impact Iatan 1. But KCPL/GMO has opted to petition the Commission to authorize KCPL to perform no further work in response to Staff inquiry regarding Iatan 1 and Iatan common plant cost overruns, and then condemn Staff for seeking to continue to work on the construction audit / prudence review of Iatan 1 and Iatan common plant.

19. The Commission notes in its February 23, 2010 Order Granting Request For An Extension Of Time With Modifications that "timely resolution of pending matters is paramount to ensure the substantive due process rights of all the parties." The Staff again makes note of Messrs. Zobrist, Fischer, and signatory Hatfield, as attorneys for KCPL/GMO on the February 16, 2010 Initial Response because the Staff counsel principally dealing with discovery matters for months have been communicating with other attorneys for KCPL/GMO, other than on occasion with Mr. Fischer. This pleading will seek to clarify for the Commission that Staff counsel who have been addressing discovery matters on a regular basis have a very different recollection of discovery matters than that which is set out in the February 16, 2010 Initial Response of KCPL/GMO.

20. At page 4, in both the first paragraph, third sentence, and the second paragraph, third sentence of its February 16, 2010 Initial Response, KCPL/GMO assert that the Staff's remaining work regarding Iatan 1 and Iatan common plant should be limited by the Commission to:

. . . invoices that were not available at the time it [i.e., the Staff] conducted its construction audit and prudence review, as well as expenses that were not yet incurred.

* * * *

. . . invoices that were unavailable and expenses that had not yet been incurred in time for consideration in its December 31, 2009 Construction Audit Report . . .

However, the very last sentence of KCPL's/GMO's February 16, 2010 Initial Response states: "The construction audit and prudence review concerning Iatan 1 and common plant has been completed and should not be permitted to continue."

21. December 31, 2009 invoices were not made available to the Staff for review by KCPL until late January 2010. Iatan construction invoices have a lag up to several months between the time work is performed and the time the vendor issues an invoice to KCPL for the work that is covered by the invoice. There is a forty five (45) day delay respecting KCPL Iatan 1 AQCS costs reports before they are made available by KCPL for Staff review. For example, the December 2009 KCPL Iatan 1 AQCS costs report generally covering costs through November 30, 2009 was sent to the Staff by KCPL on February 5, 2010. In certain circumstances, KCPL retains payment for a portion of the charges for work performed at Iatan as a surety that KCPL receives satisfactory work. Thus, certain invoices are only paid, or finally paid in full, several months after the work which is covered by the invoice has been completed.

22. At page 5 of its February 16, 2010 Initial Response, the title for subsection "A." and the first sentence of the following paragraph KCPL/GMO state that for the Commission to not so limit the Staff's remaining audit of Iatan 1 and Iatan common plant is "highly prejudicial

to the Companies” and “unfair to this Commission.” KCPL/GMO in the next sentence assert that “[t]he Companies relied on this Commission’s order and Staff’s presumed compliance with the order to plan for its upcoming KCP&L and GMO rate cases.” KCPL/GMO entered into a Joint Motion with the Staff in which they agreed to extend the filing date of the Staff’s construction audit / prudence review report to the filing date of responses or rebuttal testimony to KCPL’s/GMO’s next general rate cases, and KCPL/GMO stated that they “believe that extending these deadlines [to KCP&L’s and GMO’s next general rate cases] will not prejudice any party to these cases.” (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 KCP&L’s And GMO’s Next General Rate Cases, p. 5, first paragraph, first full sentence, filed May 28, 2009).

23. In *Missouri Gas Energy v. Public Serv. Comm’n*, 978 S.W.2d 434 (Mo.App. 1998) (*MGE*), Missouri Gas Energy (MGE) made an equitable estoppel argument against the Commission when it sought judicial review of a decision of the Commission in a 1996 MGE rate increase case. In the MGE rate case, the Commission determined that the carrying cost rates for an AAO granted in 1994 should, for ratemaking purposes, be the weighted average short-term debt interest rate for allowance for funds used during construction (AFUDC) of 4% for 1994 and 6% for 1995 and 1996, instead of the 10.54% rate which had been requested by MGE in its Application for an AAO and as authorized by the Commission in the AAO the Commission issued in 1994. The Western District Court of Appeals, noting that equitable estoppel is not ordinarily applicable against the government, identified the elements of equitable estoppel as follows as it applies to a government entity:

- (1) a statement or act by the government entity inconsistent with the subsequent government act;

- (2) the citizen relied on the act;
- (3) injury to the citizen;
- (4) the governmental conduct complained of must amount to affirmative misconduct;
- (5) there must be exceptional circumstances and a manifest injustice will result;
- (6) equitable estoppel will not be invoked if it will interfere with the proper discharge of governmental duties, curtail the exercise of the State's police power or thwart public policy; and
- (7) equitable estoppel is limited to situations where public rights must yield because private parties have greater equitable rights.

978 S.W.2d at 439; *See State ex rel. Capital City Water Co. v. Public Serv. Comm'n*, 850 S.W.2d 903, 910-11 (Mo.App. W.D. 1993) (“The private rights of the Company must outweigh the public rights of the ratepayers in order to equitably estop the Commission. Such a situation does not exist. The Commission has broad discretion to set just and reasonable rates and it has not exceeded that discretion in the instant case. [Citation omitted]” 850 S.W.2d at 910-11); *Union Electric v Public Serv. Comm'n*, 136 S.W.3d 146, 161 (Mo.App. W.D. 2004) (“whether couched in legal or constitutional terms, UE’s claims fail because it was not wrongfully denied any contractual or property rights.” 136 S.W.3d at 161.) The party claiming equitable estoppel has the burden of proof and every fact creating the estoppel must be established by clear and satisfactory evidence. *Van Kampen v. Kauffman*, 685 S.W.2d 619, 625 (Mo.App. S.D. 1985). The Western District Court of Appeals also found *United States v. Winstar Corp.*, 518 U.S. 839, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996) to be inapplicable. The *Winstar* case involved the savings and loan industry crisis of the last decades of the Twentieth Century. In *Winstar*, a change in regulatory policy after entities (sound savings and loans and outside investors) had

acted in reliance on prior regulatory policy (had acquired failing savings and loans through “supervisory mergers”), which change in policy would render the relying entities immediately insolvent if the change in policy were upheld, caused the U.S. Supreme Court to hold that the regulatory agency was not permitted to change policy and penalize the entities that had acted in reliance on continuation of the prior policy.

24. At page 3, last paragraph, first sentence of its February 16, 2010 Initial Response, KCPL/GMO take the Staff to task on the basis that “[t]he Staff has never sought relief from the Commission’s June 10 Order setting a December 31, 2009 deadline.” KCPL/GMO failed to tell the Commission that counsel for the Staff inquired of counsel of KCPL/GMO in November 2009 if KCPL/GMO would be amenable to the Staff filing for an extension beyond December 31, 2009 on the basis that the Staff would provide to KCPL/GMO as a draft what the Staff would otherwise file on December 31, 2009, KCPL/GMO would have until February 15, 2010 to review the draft report and submit comments to the Staff regarding whatever KCPL/GMO took issue with, the Staff would have fifteen days until Tuesday, March 2, 2010 to make any changes to the report based on KCPL’s/GMO’s comments, and the Staff would file the report as revised by the Staff with KCPL’s/GMO’s comments on March 2, 2010. KCPL/GMO rejected the Staff’s proposal in late November 2009. As a consequence, the Staff did not pursue its proposal with the Commission seeking to avoid additional conflict with KCPL/GMO regarding a Staff proposal concerning an extension of the report filing date.

25. On the matter of discovery, KCPL/GMO want each side of any argument. Throughout its February 16, 2010 Initial Response, KCPL/GMO castigate the Staff for not bringing discovery disputes to the Commission for resolution seeking, to leave the impression that the Staff did nothing. Except in a few instances KCPL/GMO has sought that the Staff

continue to talk with KCPL/GMO on outstanding discovery disputes and be mindful of purported time and resource constraints respecting KCPL/GMO personnel. The Staff has attempted to proceed, mindful of Commission Rule 4 CSR 240-2.090, which sets a procedure parties are directed to follow to attempt to resolve discovery disputes before engaging the Commission. KCPL/GMO do not mention that in an attempt to facilitate discovery starting in September 2009, counsel for KCPL and counsel for Staff scheduled weekly calls with each other for the sole purpose of attempting to address discovery issues on a regular basis at the Staff's initial suggestion.

26. At page 8, first paragraph of its February 16 Initial Response, KCPL/GMO assert that the "several" discovery disputes that the Staff has taken to the RLJ and the "couple" discovery disputes that the Staff has taken to the Commission in the form of a Motion To Compel is not merely indicative of KCPL's compliance with the Staff's discovery efforts, but an indicia of KCPL's cooperation. While KCPL seeks to leave the impression that the more than 1,000 Staff Data requests that it received in Case No. ER-2009-0089 were related to the Staff's Iatan 1 AQCS and Iatan common plant construction audit / prudence review, the number of Staff Data Requests cited by KCPL relates to the entirety of the Staff's rate case audit. KCPL's rendition of its conduct does not address the number of Staff Data Request responses that KCPL did not provide in a timely manner, but ultimately provided just prior to the Staff going to the RLJ or the Commission thereby obviating the Staff taking such action.⁶ In part, the Staff utilized part of the Summer and Fall of 2009 addressing matters such as the provision of

⁶ KCPL fails to mention the times the RLJ ruled against KCPL in KCPL's lengthy delay in providing the details of a \$405 lunch at the Capital Grille in Kansas City charged to Iatan involving KCPL's President and an individual representing a principal vendor doing significant business with KCPL, which charge to Iatan was later signed off on by KCPL's Chairman. KCPL also fails to mention the RLJ's finding that KCPL had withheld what the Staff deemed to be a significant amount of important information regarding invoices, which was not protected by attorney-client privilege / attorney work product immunity respecting the vendor, whose representative was involved in the \$405 lunch.

privilege/immunity logs by KCPL, provision of copies of documents on the Commission's premises for the Staff's review rather than only at KCPL designated locations, redacting purported attorney-client / attorney work product material from documents rather than not providing documents with non-attorney-client / non-attorney work product material unredacted, and providing Iatan 2 materials.

27. On the matter of the Staff not going to the Commission to compel discovery, the Staff had a Motion To Compel relating to a Report prepared by Strategic Talent Solutions, Northfield, IL 60093, dated May 2007, entitled "Construction Project Effectiveness" (Staff Data Request No. 637.5) drafted and nearing completion for filing with the Commission when KCPL/GMO provided the document as part of other Staff construction audit / prudence review discovery, thereby obviating the need for the Staff filing the Motion To Compel.⁷

28. On page 7, in footnote 7 of its February 16, 2010 Initial Response, KCPL/GMO, evidently referring to the attorney-client privilege, charges that "[r]ather than conduct discovery in a way that acknowledges that some information is protected from discovery, Staff continually submits DRs to KCP&L with apparent disregard for whether those DRs might be objectionable." KCPL/GMO then quotes from Staff Data Request No. 865 which asked: "Please provide a copy of all communications (including email communications) between Schiff Hardin LLP and/or any other consultant or law firm and KCP&L that references directly or indirectly, the Qualifying Advanced Coal Project Investment Tax Credits Under IRC Section 48A." (Emphasis added by KCPL/GMO). The Staff appreciates KCPL/GMO raising the matter of the Staff's inquiry into Qualifying Advanced Coal Project Investment Tax Credits Under IRC Section 48A because of

⁷ Undersigned counsel saw no need to burden the record by attaching a copy of this draft pleading, which contains Highly Confidential information, but if the Commission desires to see this ten (10) page draft Motion To Compel, undersigned Staff counsel can file a Highly Confidential copy. The Staff did file on October 30, 2009 an entirely separate Motion To Compel Production Of Documents regarding other documents.

the very essence of the effort that KCPL/GMO are engaged in by the filing of their February 16, 2010 Initial Response against the Staff.

29. Staff Data Request No. 865 is dated January 5, 2010 and was submitted to KCPL by the Staff on that date. The Staff received the following written response from KCPL on February 1, 2010:

Non-privileged copies of communications between KCP&L and its consultants or law firms that reference, either directly or indirectly, the Qualifying Advanced Coal Project Investment Tax Credits under IRC Section 48A are provided. In addition, non-privileged e-mails that reference the agreed-to search terms "coal tax credit" or "section 48A" are also provided. Please note all responsive documents are Highly Confidential pursuant to 4 CSR 240-2.135 and should be treated as such. Because this DR explicitly requests all communications between KCP&L and its law firms, many of those communications are subject to the attorney-client and/or work product privilege are withheld subject to those privileges. A privilege log will be provided simultaneous with the submission of this response.

Please note: the attachments listed below will be included on CD as they are too voluminous to load electronically.

Thus, even KCPL was able to identify responsive information to Staff Data Request No. 865 that it provided and still made its legal objection regarding materials it believes are protected by the "attorney-client and/or work product privilege."

30. The Staff appreciates KCPL/GMO raising in its February 16, 2010 Initial Response the matter in Staff Data Request No. 865 of "Qualifying Advanced Coal Project Investment Tax Credits Under IRC Section 48A." *

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED]

31. GPE's and KCPL's public characterization of the arbitrators' unanimous decision in their February 25, 2010 filing of their Form 10-K Report to the SEC for the Period Ending December 31, 2009 is both enlightening and opaque. GPE and KCPL state at page 112 of that filing as follows regarding the arbitrators' unanimous decision:

KCP&L Advanced Coal Credit Arbitration

In 2009, KCP&L was served a notice to arbitrate by Empire District Electric Company (Empire), Kansas Electric Cooperative, Inc. (KEPCO) and Missouri Joint Municipal Electric Utility Commission (MJMEUC), joint owners of Iatan No. 2. The joint owners asserted that they are entitled to receive proportionate shares (or the monetary equivalent) of approximately \$125 million of qualifying advance coal project credit for Iatan No. 2. As independent entities, the joint owners are taxed separately and the joint owners do not dispute that they did not, in fact, apply for the credits themselves. Notwithstanding this, the joint owners contend that they should receive proportional shares of the credit. This matter was heard by an arbitration panel in November 2009. On December 30, 2009, the panel issued its order denying the KEPCO and MJMEUC claims but ordering KCP&L and Empire to jointly seek a reallocation of the tax credit from the IRS giving Empire its representative percentage of the total tax credit, worth approximately \$17.7 million. The order further specifies that if the IRS denies the parties' reallocation request or if Empire is allocated less than its proportionate share of the tax credits, KCP&L will be responsible for paying Empire the full value of its representative percentage of the tax credits (less the amount of tax credits, if any, Empire ultimately receives) in cash. KCP&L has recorded a \$17.7 million liability in other current liabilities for this matter. The parties have 90 days to appeal the arbitrators' decision.

32. Recall that KCPL/GMO raised in its February 16, 2010 Initial Response the propriety of the Staff's Data Request No. 865 in Case No. ER-2009-0089. First, regarding the very language in Staff Data Request No. 865 of which KCPL/GMO criticize the Staff in their February 16, 2010 Initial Response was agreed to by Staff counsel and KCPL/GMO counsel for purposes of an e-mail search requested by the Staff. Second, the Staff does not assume that all communications to or from a law firm is protected by the attorney-client privilege or attorney work product immunity. For example, KCPL filed in Case Nos. ER-2009-0089 the testimony of

Kenneth M. Roberts, who is an equity partner, co-chair of the Construction Law Group and a member of the executive committee of the general practice law firm Schiff Hardin LLP. In addition to Mr. Roberts of Schiff Hardin, Daniel F. Meyer of Meyer Construction Consulting, who identified himself as having been retained by Schiff Hardin, filed testimony on behalf of KCPL in this case.⁸ Although KCPL/GMO initially sought to avoid doing so, the Staff has taken the position that if a document is truly protected by the attorney-client privilege or the attorney work product immunity, KCPL/GMO must provide a privilege/immunity log. KCPL/GMO was initially not doing so. Only subsequently did KCPL/GMO agree to provide privilege/immunity logs.

33. As noted above, the Iatan 1 AQCS project costs have continued to be incurred and are expected to continue long after the June 8, 2009 invoice cut-off date the Commission set for audit in its April 15, 2009 Orders in Case Nos. ER-2009-0089 and ER-2009-0090. Additional equipment is being ordered, installed, and charged to the Iatan 1 AQCS project long after the April 19, 2009 fully operational and used for service date of the Iatan 1 AQCS. Currently, the Staff understands that the Iatan 1 AQCS project costs will not be closed and final until late 2010 at the earliest.

34. The KCPL Experimental Regulatory Plan Stipulation And Agreement, Case No. EO-2005-0329, states at III.1.q., page 28, as follows:

Cost Control Process for Construction Expenditures

⁸ Although Schiff Hardin, LLP is a general practice law firm, it has been assisting KCPL in KCPL's project management duties at Iatan 1. Mr. Roberts states at page 1, lines 6-12 of his Direct Testimony in Case No. ER-2009-0089 that KCPL "engaged Schiff: (i) to help the Company develop project control procedures to monitor the cost and schedule ("Project Controls") for the infrastructure projects contained in the Company's Comprehensive Energy Plan ("CEP"); (ii) to monitor the CEP's progress and costs, including the review and management of change order requests; (iii) to negotiate contracts with vendors; and (iv) to resolve disputes with vendors that might arise." Mr. Meyer in his Rebuttal Testimony in Case No. ER-2009-0089 at page 1, lines 9-10, identifies the work that he has performed for Schiff Hardin since the early 1990s as "[p]rimarily cost and cost analysis work, project oversight, some scheduling work, some litigation support, all in the construction industry and primarily in the power industry."

KCPL must develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate during the construction period of the Iatan 2 project, the wind generation projects and the environmental investments

The Staff inquired of KCPL at a quarterly status update Comprehensive Energy Plan (CEP) meeting if the “control budget estimate (CBE)” was the same as the “definitive estimate” required in the KCPL Experimental Regulatory Plan Stipulation And Agreement. KCPL indicated that the answer to this question was “yes.” In the rebuttal testimony of KCPL Staff witness Steven Jones in Case No. ER-2009-0089 is Schedule SJ-1, Comprehensive Energy Plan [CEP] Construction Projects Cost Control System. Mr. Jones was an independent contractor, then working for KCPL as Senior Procurement Director of KCPL. He states at page 4, lines 15-16 of his rebuttal testimony that “[t]he CEP Cost Control System is a document that outlines the governance considerations, management procedures and cost control protocols that govern the CEP projects.” He further said at page 5, lines 13-14 of his rebuttal testimony that “[b]ased upon my experience, the cost control measures in the Cost Control System provided all of the measures necessary to run a project of this size.” At page 8 of Schedule SJ-1, in the section **[REDACTED]** **[REDACTED]** under the heading **[REDACTED]** appear the following two paragraphs:

[REDACTED]

[REDACTED]

Mr. Jones' rebuttal testimony verified the CEP Construction Projects Cost Control System, i.e., the CBE, was to be based on the definitive estimate.

35. On February 21, 2008, the Staff, on behalf of the non-utility signatory parties to the KCPL Experimental Regulatory Plan Stipulation And Agreement, requested a meeting with KCPL to discuss several topics including the status of Iatan 1 and 2 costs and schedule controls. On March 12, 2008, the meeting was held. At the meeting, a representative of KCPL Regulatory indicated that KCPL would still be able to track change orders back to the CBE consistent with the KCPL Experimental Regulatory Plan Stipulation And Agreement requirement even if the CBE was no longer the current budget for the Iatan 1 AQCS project segment. The Staff asked if the reforecast effort then underway would result in an increase in the budget to levels such that KCPL would assert, after the reforecast, that it did not have cost overruns, and since it did not have cost overruns, it was not required to identify and explain changes in project costs. KCPL indicated that this concern would not materialize. Attachment 2 to the instant Staff Reply are pages from two of KCPL's Quarterly Status Update Reports showing KCPL's tracking of the variance between actual costs and "control budget estimate" for Iatan 1 AQCS for the fourth quarter 2006 and third quarter 2007. (Staff emphasis). The pages from these reports show that this earlier Iatan 1 AQCS cost tracking compared actual costs to the CBE consistent with the KCPL Experimental Regulatory Plan cost control system, but a new cost control tracking protocol, shown above in the instant Staff Reply, on KCPL's Quarterly Status Update Report for fourth quarter 2009 was substituted. The Attachment 2 Quarterly Status Update Reports when compared to the Iatan 1 AQCS Expenditure Summary for fourth quarter 2009 contained, in the instant Staff Reply above, indicates that the anticipated issue did materialize, as one sees the tracking by KCPL of actual costs to higher "current budget" amounts after KCPL adopted the

higher “current budget estimate” for comparison purposes rather than continue with the “control budget estimate” for analysis purposes. (Staff emphasis). In actuality what is occurring, is KCPL increases its “current budget” and uses it for tracking purposes to prevent the very recognition of, and the requirement to explain, cost overruns. (Staff emphasis).

36. As part of the Staff’s effort to address the Staff’s concern regarding KCPL’s compliance with the KCPL Experimental Regulatory Plan Stipulation And Agreement, the Staff on January 14, 2009 submitted Staff Data Request No. 445 to KCPL asking for the documentation consistent with the KCPL Experimental Regulatory Plan Stipulation And Agreement requirements explaining cost overruns for the Iatan 1 AQCS segment of the Iatan Project. The Staff received the following response to Staff Data Request No. 445 on February 3, 2009:

Question No. 445

Please provide all Iatan 1 reporting documentation that states that the Iatan 1 cost overruns are related to labor productivity and availability, availability of qualified personnel, rapid increases in commodity prices, and scarcity of materials and qualified vendors.

Response:

The Iatan 1 environmental upgrade project has not incurred cost overruns. The current Control Budget Estimate of [REDACTED] has not been exceeded and management does not believe it will be exceeded.

37. At page 10, first full paragraph of its February 16, 2010 Initial Response, KCPL/GMO quote from the KCPL response to Staff Data Request No. 859 in Case No. ER-2009-0089 maintaining that “KCP&L’s cost tracking system is both in conformance with its obligations under the regulatory plan and best practices in the construction industry.” Excerpted below is part of KCPL’s response to Staff Data Request No. 859 in Case No. ER-2009-0089 that is shown on page 10 of KCPL’s/GMO’s February 16, 2010 Initial Response:

. . . **In the second quarter of 2008, KCP&L completed a reforecast of the Iatan 1 project budget that resulted in revisions to the CBE.** KCP&L has maintained the in its cost portfolio, which is the project cost reporting system, reference to the original CBE line items and has tracked variances, or “differences,” including those from 2008 Cost Reforecast, against the CBE.

* * *

. . . As discussed above, the actual cost, including accruals, are detailed in the **Iatan 1 Cost Portfolio, which identifies any variances in actual cost against the CBE.** . . .

38. While KCPL/GMO in its February 16, 2010 Initial Response asserts that it tracks variances of actual costs against the CBE, KCPL indicates in its response above to Staff Data Request No. 859 that in the second quarter of 2008, KCPL completed a reforecast of the Iatan 1 project budget that resulted in revisions to the CBE. KCPL indicates in its response to Staff Data Request No. 445 quoted above that KCPL does not rely on CBE variances for the purpose of identifying and explaining cost overruns, despite the fact that KCPL’s actual costs have exceeded the Iatan 1 AQCS CBE. KCPL has not provided any documents identifying or explaining any cost overruns for the Iatan 1 AQCS. Instead, noting its reliance on its tracking of actual costs against the new higher “current budget estimate” amount, KCPL denies the existence of cost overruns for Iatan 1 AQCS. (Staff emphasis).

39. When actual costs increased to a level that would constitute cost overruns, KCPL simply abandoned its CBE, which was to be based on a definitive estimate. KCPL documented its increases to the CBE for both Iatan 1 AQCS and Iatan 2 through discrete adjustments which it refers to as Risk and Opportunity (R&O) items in order to reconcile the increase of the new “current budget estimate” from the CBE. (Staff emphasis). While large amounts of the budget increase attributed to these R&O items are very general in nature, KCPL never tracked actual costs against these items to determine if these items actually resulted in an overrun, and if so, by

what amount. An example of an R&O package is attached as Schedule 8 to the Report Of Staff Respecting Its Construction Audit / Prudence Review Of Environmental Upgrades To Iatan 1 And Iatan Common Plant filed on December 31, 2009 by Staff in File Nos. ER-2009-0089 and ER-2009-0090.

40. Attachment 3 is the most current Expenditure Summary for the LaCygne Unit 1 SCR System Project. It shows that KCPL did develop and track against a definitive estimate for the LaCygne environmental projects consistent with the KCPL Environmental Regulatory Plan Stipulation And Agreement cost control requirements. Attachment 3 further shows that KCPL is now applying a different cost control system to the Iatan Project thus making its audit more difficult.

41. The Staff has not engaged in delaying completion of the construction audits / prudence reviews that the Commission directed it to perform by the Commission's Orders issued on April 15, 2009 and June 10, 2009, and which the Staff has sought to perform. The Staff believes that it has filed reports on June 19, 2009 and December 31, 2009, which meet or exceed the audit parameters set by the Commission consistent with the time and resources available. The Staff cannot complete and file a final audit on Iatan 1 AQCS and Iatan common plant for the reasons set out in the previous paragraphs. Among other things, significant construction activity continues, as does the incurrence of costs respecting Iatan 1, after the Iatan 1 AQCS has become fully operational and used for service. Audits are final, if the law says they are final, not merely because a party asserts that they are so.⁹ Moreover, Iatan 1 AQCS is a component of an overall Iatan Project. Costs were and continue to be incurred on the Iatan Project level that need to be

⁹ Regarding the matter of a party and/or the Commission revisiting an item, see generally *State ex rel. Capital City Water Co. v. Public Serv. Comm'n*, 850 S.W.2d 903, 909-11 (Mo.App. W.D. 1993); *State ex rel. General Tel.Co. v. Public Serv. Comm'n*, 537 S.W.2d 655, 661-62 (Mo.App. K.C.Dist. 1976); *State ex rel. GTE North, Inc. v. Public Serv. Comm'n*, 835 S.W.2d 356, 371-72 (Mo.App. W.D. 1992).

examined for assignment in part, or in total, to either the Iatan 1 AQCS and/or the Iatan 2 budget segment(s). Since the Iatan 1 AQCS equipment has been declared fully operational and used for service, greater scrutiny of charges is needed to determine the Iatan 1 AQCS relationship and whether the charges should be recorded as project segment costs (capitalized) or expensed. The Staff has found (a) Iatan 1 AQCS costs charged to Iatan 2 and (b) Iatan 2 costs charged to Iatan 1 AQCS. The Staff expects to find more such cost issues as the Staff audits Iatan 2. At the present the Staff has avoided adopting the approach of proposing for the KCPL/GMO rate cases that all costs over the CBE/Definitive Estimate should be disallowed and not allowing for assignment to Iatan 1 the portion of common/joint costs inappropriately entirely charged to Iatan 2 by KCPL. The Staff believes that to adopt these positions on the basis that KCPL/GMO are contending that the Iatan 1 AQCS and Iatan common plant construction audit / prudence reviews are over and done would be premature and that these matters can be addressed by the Staff's near-term audit activities which are planned to be completed in conjunction with KCPL's/GMO's next rate cases.

42. The Staff would note for the Commission the ownership shares of Iatan 1 and Iatan 2 and how that relates to KCPL's/GMO's February 16, 2010 Initial Response. Since KCPL owns a smaller ownership share of Iatan 2 than Iatan 1, 55% versus 70%, it is in KCPL's interest to allocate dollars to Iatan 2 rather than to Iatan 1. Are KCPL/GMO seeking that the Commission preclude the Staff from further looking at matters such as the proper allocation of costs to the Iatan 1 construction versus the Iatan 2 construction? KCPL knows that most of the contracts impacting Iatan 1 AQCS are joint contracts impacting Iatan 2 as well. Will KCPL argue that the Staff's audit is now precluded from looking at dollars that the Staff contends are Iatan 1 dollars but are allocated by KCPL to Iatan 2? Empire does not care because it is

allocated 12% of the dollars regardless of whether the dollars are Iatan 1 or Iatan 2 dollars. GMO does not care because it is allocated 18% of the dollars regardless of whether the dollars are Iatan 1 or Iatan 2 dollars since its predecessor Aquila acquired St. Joseph Light & Power Company in 2001 which owned 18% of Iatan 1 and Aquila owned 18% of Iatan 2. Presumably the Missouri Joint Municipal Electric Utility Commission (“MJMEUC”) cares because it owns 0% of Iatan 1, and 12% of Iatan 2. Presumably Kansas Electric Power Cooperative, Inc. (“KEPCO”) cares because it owns 0% of Iatan 1, and 4% of Iatan 2. (Of the 673 MW of Iatan 1 ownership shares are as follows: KCPL owns 70%; GMO 18%; and Empire 12%. Of the 850 MW of Iatan 2, ownership shares are as follows: KCPL - 465 MW (approximately 55%); GMO - 153 MW (18%); Empire - 102 MW (12%); MJMEUC - 100 MW (approximately 12%); and KEPCO - 30 MW (approximately 4%).)

43. In its February 23 Order Granting Request For An Extension Of Time With Modifications, the Commission directed the Staff to address KCPL’s/GMO’s charge that the Staff has continually delayed completing its construction audit / prudence review of the environmental upgrades to Iatan 1 and Iatan common plant. In addition to the foregoing, the Staff would note that three members of the Commission’s technical Staff, Robert E. Schallenberg, Charles R. Hyneman, and Keith A. Majors, who are responsible for the Staff’s Report filed on December 31, 2009 have been working continually, i.e., daily, on the Staff’s construction audit / prudence review of Iatan 1, Iatan common plant, and Iatan 2 since April 2009 and still are doing so.

WHEREFORE Staff respectfully prays that the Commission deny the requests in KCP&L’s And GMO’s Initial Response To Staff Report Of The Construction Audit/Prudence Review Of Environmental Upgrades To Iatan 1 And Iatan Common Plant that the Commission

find that the Staff's December 31, 2009 Report attempts to alter the Commission's June 10, 2009 Order, that the Staff's December 31, 2009 Report was the Staff's last opportunity to present findings on prudence and reasonableness with regard to Iatan 1 and Iatan common plant expenditures, and that the Staff's construction audit and prudence review concerning Iatan 1 and Iatan common plant is completed and is not permitted to continue.

Respectfully submitted,

/s/ Steven Dottheim

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 9th day of March, 2010.

/s/ Steven Dottheim

ATTACHMENTS 1-3

**THESE DOCUMENTS CONTAIN
CONFIDENTIAL INFORMATION
NOT AVAILABLE TO THE PUBLIC
ORIGINAL FILED UNDER SEAL**