BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan.	)))))	**File No. ER-2010-0355**
In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service.	))))	**File No. ER-2010-0356**

STAFF'S RESPONSE TO KANSAS CITY POWER & LIGHT COMPANY'S AND KCP&L GREATER MISSOURI OPERATIONS COMPANY'S APPLICATION FOR REHEARING AND REQUEST FOR CLARIFICATION REGARDING REPORT AND ORDER CONCERNING ADVANCED COAL TAX CREDITS

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and responds to Kansas City Power & Light Company's ("KCPL") and KCP&L Greater Missouri Operations Company's ("GMO") application for rehearing and request for clarification of the Commission's *Report and Order* concerning advanced coal tax credits as follows:

RESPONSE TO APPLICATION FOR REHEARING

1. Staff disagrees with the assertion made in paragraph 4 of the pleading that "Ordered Paragraph 3 is itself a normalization violation." 26 C.F.R. § 1.46-6(f)(3) provides: "A credit is disallowed—(i) When the first final inconsistent determination is put into effect and (ii) When any inconsistent determination (whether or not final) is put into effect after the first final inconsistent determination is put into effect." And 26 C.F.R. § 1.46-6(f)(8) provides:

> i. *Types of determinations.* For purposes of this paragraph—
> ii. (i) The term "inconsistent" refers to a determination that is inconsistent with section 46(f) (1) or (2) (as the case may be). Thus, for example, a determination to reduce the taxpayer's cost of service by more than a ratable portion of the credit would be a determination that is inconsistent

with section 46(f)(2). As a further example, such a determination would also be inconsistent if section 46(f)(1) applied because no reduction in cost of service is permitted under section 46(f)(1).

iii. (ii) The term "consistent" refers to a determination that is consistent with section 46(f) (1) or (2) (as the case may be).

iv. (iii) The term "final determination" means a determination with respect to which all rights to appeal or to request a review, a rehearing, or a redetermination have been exhausted or have lapsed.

v. (iv) The term "first final inconsistent determination" means the first final determination put into effect after December 10, 1971, that is inconsistent with section 46(f) (1) or (2) (as the case may be).

Section 46(f)(1) and (2) provide:

> (f) *Limitations* —(1) *In general.* This paragraph provides rules relating to limitations on the disallowance of credits under section 46(f)(4). Key terms are defined in paragraphs (f) (7), (8), and (9) of this section.
>
> (2) *Disallowance postponed.* There is no disallowance of a credit before the first final inconsistent determination is put into effect for the taxpayer's section 46(f) property.

2. In Ordered Paragraph 3, the Commission states:

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

3. Staff believes Ordered Paragraph 3 is not an "inconsistent determination" as defined by the IRS above, since it merely expresses the Commission's present intent as to action it may take in a future circumstance that may not come to pass. However, Staff believes that if the Commission imputes an amount of credits as a reduction to GMO's cost of service, when its order doing so became final, there would be a normalization violation at that time.

4. The Commission's *Report and Order* does not attempt to impute tax credits to GMO, it merely indicates the Commission will do so, if certain circumstances occur.

Regardless, the *Report and Order* is not, as KCPL and GMO allege, unjust, unreasonable, arbitrary, capricious, an abuse of discretion, nor is the Order unsupported by competent, substantial evidence upon the whole records, nor is it unconstitutional in any material matter of fact or law. On the contrary, the *Report and Order* is well supported by the record. The Order does send a clear message to KCPL and GMO, one they apparently do not like.

5. Staff disagrees with KCPL and GMO that the Commission would be penalizing KCPL and GMO if their effort to amend KCPL's memorandum of understanding with the IRS fails and the Commission imputes advanced coal tax credits to GMO. What the Commission would be doing is to give GMO's customers the benefit of what GMO should have done, as finding of fact no. 24 of its *Report and Order* makes clear: "If the advanced coal tax credits are imputed to GMO, it will lower the cost of service for GMO and also lower rates." Any "punishment" is visited by the IRS, not the Commission, and would be the result of actions of KCPL that a three person arbitration panel unanimously found to be "willful misconduct" and the imprudent inaction of GMO.

RESPONSE TO REQUEST FOR CLARIFICATION

6. Staff has no objection with KCPL's and GMO's request for clarification of ordered paragraph no. 3, but Staff does not find the paragraph ambiguous.

7. Having proposed an increase in KCPL's cost of service in this case attributable to $26,562,500 of coal tax credits imputed to GMO and reducing its cost of service, Staff does not object to KCPL's request in paragraph 11 of its pleading for Commission guidance from the Commission "as to whether its credits will be reduced by a like amount."

REPLY TO KCPL'S AND GMO'S RESPONSE TO STAFF'S MOTION

8. Staff appreciates KCPL's and GMO's willingness to "provide Staff with advance copies of all letters to the IRS concerning the modification of the MOU." However, Staff would also like to have the opportunity to attend all meetings and telephone calls between KCPL/GMO and the IRS on this subject, not to participate, but to monitor and provide input if requested.

9. Staff vigorously opposes GMO's and KPL's request in paragraph 14 of their pleading that the Commission not impute any coal tax credits to GMO in File No. ER-2010-0356 before the IRS makes a decision. It would be unfair to GMO's retail customers not to do so.

10. GMO and KPCL already have had ample opportunity to seek from the IRS agreement to reallocation of coal tax credits to GMO, and to seek an order from this Commission if needed before going to the IRS. They knew of the three member arbitration panel's December 30, 2009, final arbitration award shortly after it was made. (Ex. GMO—222, Surrebuttal Testimony of Paul R. Harrison, Sch. 1; Ex. KCP&L—223, Surrebuttal Testimony of Paul R. Harrison, Sch. 1). Staff raised the issue to them at a September 9, 2010 meeting with KCPL personnel (Ex. GMO—222, p. 10; Ex. KCP&L—223, pp. 8-9), again in its Revenue Requirement Cost of Service Reports filed in File Nos. ER-2010-0355 and ER-2010-0356 on November 10, and 17, respectively, and again in the rebuttal and surrebuttal testimony of Paul R. Harrison in both cases. (Ex. GMO—210, pp.189-90; Ex. KCP&L—210, pp. 178-80). Both GMO and KCPL were imprudent in putting themselves in this position where they might suffer what they describe as "severe consequences" if the Commission imputes tax credits to GMO as it should for setting rates.

11. Staff disputes KCPL's and GMO's statement in paragraph 15 of their pleading that if a normalization violation occurs "both GMO and KCP&L rate payers and shareholders

would suffer severe consequences." GMO's and KCPL's retail customers would only suffer any consequences due to the loss of tax credits resulting from a normalization violation if the Commission permits the impacts of the loss of those credits to flow to the costs of service of GMO and KCPL. This Commission was created to protect the public from utilities, including protecting their retail customers from the impacts of their imprudence.

12. In addition to reallocating advanced coal tax credits from KCPL to GMO for cost of service purposes, the imprudence of GMO and the "willful misconduct" of KCPL are a factor the Commission could rely on to choose a lower return on equity than it might otherwise, and Staff believes that doing so would not be a normalization violation that would cause the loss of investment tax credits. (Ex. GMO—222, pp. 16-17; Ex. KCP&L—223, pp. 15-16) That belief is based on 26 C.F.R. § 1.46-6(b)(4)(iv) which provides an example the IRS has said does not create a normalization violation:

> iv) This paragraph (b)(4)(iv) describes a situation that is not an indirect reduction to cost of service or rate base by reason of all or a portion of a credit. The ratemaking treatment of credits may affect the financial condition of a company, including the company's ability to attract new capital, the cost of that capital, the company's future financial requirements, the market price of the company's securities, and the degree of risk attributable to investment in those securities. The financial condition may be reflected in certain customary financial indicators such as the comparative capital structure of the company, coverage ratios, price/earnings ratios, and price/book ratios. Under the facts and circumstances test of paragraph (b)(4)(iii) of this section, the consideration of a company's financial condition by a regulatory body is not an indirect reduction to cost of service or rate base, even though such condition, as affected by the ratemaking treatment of the company's investment tax credits, is considered in the development of a reasonable rate of return on common shareholders' investment.

13. KCPL has raised the spectre of dire consequences—the loss of investment tax credits—by a Commission order before. In a 1980 rate case KCPL did so with regard to the treatment of income tax expense deduction. In its *Report and Order* the Commission responded to KCPL, "We cannot be limited in our decisions by assertion of a 'potential violation' when

attempting to apply proper regulatory principles. The commission finds that staff's methodology for computing interest expense is sound." *Re Kansas City Power & Light Company*, 23, Mo.P.S.C.(N.S.) 474, 498 (1980), accord, *Union Electric Company v. Federal Energy Regulatory Commission*, 668 F.2d 389, 393-95 (8th Cir. 1981).

Wherefore, the Staff of the Public Service Commission of Missouri responds to *Kansas City Power & Light Company's and KCP&L Greater Missouri Operations Company's Application for Rehearing and Request for Clarification regarding Report and Order Concerning Advanced Coal Tax Credits* as set forth above.

Respectfully submitted,

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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 29th day of March 2011.

/s/ Nathan Williams