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 Implement its Regulatory Plan.	))))	**Case 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.	))))	**Case No. ER-2010-0356**

STAFF'S REPLY AND TRUE-UP BRIEF

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COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its Reply and True-Up Brief, states as follows:

INTRODUCTION

In this brief Staff presents both its responses to the arguments made by KCPL and GMO in their Initial Brief, and its argument for the true-up. For convenience, this brief largely follows the organization of issues in the Companies' initial brief. Staff has refrained from repeating arguments already presented in its initial brief, except to the extent they bear repeating in response to argument of KCPL and GMO or bear on true-up issues. Since Staff has not changed its position on any issue from that stated in its Initial Brief, Staff has not restated those positions in this brief

ARGUMENT

A. Prudence:

Remember, "*falsus in uno, falsus in omnibus.*"[1]

The reader may be forgiven his or her confusion, based on the initial briefs filed

[1] This legal maxim, meaning "never trust a liar," is Staff's theme. ***Black's Law Dictionary,*** 1636 (1999).

in this case by Staff and the Companies, that they relate to entirely different cases. In the Company's brief, KCPL's management boasts of successfully completing a challenging series of construction projects, culminating in Iatan 2, "the largest construction project in the State of Missouri in over a decade."[2] The project was, we are told, only three months late and only 16% over budget – evidently we are expected to believe that this is a construction management miracle. Staff's brief tells a strikingly different story.

Staff's brief details ***facts*** showing that KCPL's management of the Iatan Project was plagued by poor judgment and padded accounts.[3] Significant cost overruns, unexplained by KCPL's deficient Cost Control System, resulted from a series of decisions lacking in sound judgment and common sense.[4] Additionally, the construction accounts were packed with improper personal expenses, lavish meals and the like, fraudulently charged to the ratepayers.[5] The story of the Advanced Coal Tax Credit alone, redolent with common thievery and mendacity, demands that this Company and this project be subjected to a most careful and searching scrutiny.[6]

The General Assembly has authorized the Commission to determine the value of utility property and, in consideration of all relevant factors, to set just and reasonable rates.[7] The underpaid single mother, desperate to keep the lights on and feed her children at the same time, is not likely to consider it "just and reasonable" to be billed by

[2] ***Post Hearing Brief of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company ("KCPL-GMO Brief"),*** p. 16.

[3] ***Staff's Initial Brief,*** pp. 15-19.

[4] *Id.,* p. 15-17.

[5] *Id.,* p. 18.

[6] *Id.,* p. 19.

[7] Sections 393.230.1, 393.270.4, RSMo.

KCPL for executives' golf trips and personal mileage. It is the Commission's duty to protect the ratepayers from the monopoly market power of the utility, the sole source of electric power, a necessity of life in these United States.[8]

When a utility builds new plant, it is added to rate base at cost as plant in service when it becomes fully operational and used for providing utility service to ratepayers. As part of this process, a construction audit and prudence review is undertaken to determine the amount of the money spent by the utility in constructing the plant that is properly to be included in rate base. The General Assembly has unmistakably placed the burden of proof on the utility in this process.[9] Nonetheless, for the sake of convenience, the utility is accorded a "presumption of prudence" under which the burden shifts to other parties to produce evidence of "inefficiency or improvidence"[10] requiring a closer scrutiny of the utility's accounts.[11] Note that the burden of proof is placed on the utility by statute; the "presumption of prudence" is a mere analytical contrivance.[12]

Staff sought in its initial brief to make clear that imprudence is not the only reason that a construction expenditure may be excluded from rate base. A useful example is provided by a water utility rate case some years ago. In building a much-needed new

[8] ***State ex rel. Crown Coach Co. v. Public Service Com'n,*** 238 Mo.App. 287, ___, 179 S.W.2d 123, 126 (1944) (""[T]he dominant thought and purpose of the policy is the protection of the public while the protection given the utility is merely incidental").

[9] Section 393.150.2, RSMo.

[10] ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 954 S.W.2d 520, 528 (Mo. App., W.D. 1997), *quoting* ***In the Matter of Union Electric Company,*** 27 Mo.P.S.C. (N.S.) 183, 193 (1985).

[11] *Id.* ("[W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. (Citations omitted.)").

[12] This is not contrary to the rule of ***Associated Natural Gas,*** *supra,* which is merely an application of the existing requirement that Commission decisions must be supported by substantial evidence.

treatment plant and in consideration of future growth, the company built two clearwells. Only one of these was necessary to serve the existing customer load and so the Commission allowed only one of them in rate base. While it was undeniably prudent to build two clearwells, it was unnecessary. The matching principle suggests that present customers should not pay for utility plant intended to serve future customers. Another example is lavish appointments in the executive suite. The shareholders may provide these if they so choose, but the ratepayers should not be required to pay for features that do not benefit them. This latter "benefit-to-the-ratepayers" test is applied by Staff to every utility expenditure to determine whether or not it is properly chargeable to the ratepayers.[13]

Staff has performed its construction audit and prudence review and has recommended disallowances amounting to $73.2 million for Iatan 1 and $186.5 million for Iatan 2, a total of $259.7 million out of the roughly two billion dollars spent by KCPL on the project.[14] KCPL has erected three defenses to the disallowances recommended by Staff: First, KCPL asserts that Staff has not carried its initial burden in the prudence analysis. Second, KCPL asserts that Staff is not qualified to audit the Iatan Project and recommend disallowances. Third, KCPL paints a bleak picture of the consequences of any disallowances.

Staff has carried its burden in the prudence analysis:

The prudence analysis has been well-described by Staff in its initial brief.[15] To

[13] An example is utility advertising, which rarely confers any benefit on the ratepayers, while building goodwill for the shareholders. Another example is incentive compensation tied to increases in earnings per share.

[14] ***Staff's Initial Brief,*** p. 11.

[15] *Id.,* pp. 13-15.

recap, the Commission accords a "presumption of prudence" to the utility which must be rebutted by raising "serious doubts" such that the burden shifts back to the utility to show that the challenged items should properly be added to rate base.[16] At all times, the Commission judges the actions and decisions of utility management in the context of the time the actions were taken and the decisions made.[17] An obvious first question is just what quantum of evidence is required to rebut the presumption of prudence?

KCPL makes much of a decision of the Missouri Court of Appeals holding that a disallowance for imprudence must be based upon a "nexus" between a purportedly imprudent decision or action and improper charges to the ratepayers.[18] What the Court actually said was this:

> ANG is not alone in suggesting that, in order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that (1) the utility acted imprudently (2) such imprudence resulted in harm to the utility's ratepayers. This dual requirement is implicitly accepted by the Illinois Court of Appeals in ***Bus. & Prof. People v. Ill. Commerce Com'n,*** 171 Ill.App.3d 948, 121 Ill.Dec. 746, 752, 525 N.E.2d 1053, 1059 (1 Dist.1988),[FN2] *See also* ***New England Power Co.,*** 31 F.E.R.C. 61,047 at 61,089, n. 38 ("Even if there were any imprudence on the part of NEP in 1971 and 1972 in agreeing to a contract which limited its ability to influence BEC's control over the project or to have recourse against BEC, there has been no showing that NEP's acceptance of the contract terms resulted in any injury to its ratepayers ... We agree with the reasoning of NEP's counsel at the oral argument that whether NEP was prudent in 1972 is relevant only if it caused harm to NEP's consumers").[19]

KCPL misunderstands the holding of ***Associated Natural Gas.*** It does not change *Staff's* burden under the prudence analysis described above, which is to raise a "serious doubt" by a showing of "inefficiency or improvidence." Rather, ***Associated***

[16] *See* ***KCPL-GMO Brief,*** p. 25 at ¶ 50.

[17] ***In the Matter of Union Electric Company,*** 27 Mo.P.S.C. (N.S.) 183, 194 (1985).

[18] ***Associated Natural Gas,*** *supra,* 954 S.W.2d at 529-530.

[19] *Id.*

Natural Gas speaks to the *Commission's* burden in supporting a disallowance for imprudence. To be upheld on appeal, the amount disallowed must be shown to be the result of the decision or action found to be imprudent. This is simple common sense based on the notion that imprudencies that do not harm ratepayers are no cause for disallowance.

In the current case, as KCPL describes in its brief, Staff has recommended two distinct types of disallowance. One group, amounting to $51.0 million for Iatan 1 and $81.0 million for Iatan 2, relates to specific enumerated adjustments. The second group, amounting to $22.1 million for Iatan 1 and $105.4 million for Iatan 2, relates to unexplained cost overruns. Staff's burden is to raise sufficient doubts concerning KCPL's performance that the Commission will require KCPL to show why these charges are properly to be added to rate base. And that is what Staff has done.

KCPL is trying to shift the "nexus" requirement from the Commission's report and order, which is where the Court of Appeals placed it in ***Associated Natural Gas***, to Staff's case. Staff does not have to show a "nexus" between the instances of "inefficiency or improvidence" that it identifies and any specific expenditures. That's not how the prudence analysis works. Staff simply has to raise "serious doubts" sufficient to require KCPL to prove up its expenditures. KCPL's failure to carry its burden of proof as to any expenditure will supply the "nexus" necessary to support the Commission's disallowance under the holding of ***Associated Natural Gas.***

Returning to the question stated earlier, "what quantum of evidence is required to rebut the presumption of prudence?," it is clear that KCPL answered incorrectly in its

brief.[20] KCPL, citing to ***Associated Natural Gas,***[21] states that "Staff must provide evidence that the utility's actions caused higher costs than if prudent decisions had been made." In fact, that was not part of the Court's holding. The "nexus" requirement applies, as Staff has shown, to the Commission's order. Staff suggests that the necessary quantum of proof cannot be precisely quantified. In any case, it is whatever is sufficient to cause the Commission sufficient unease to require specific assurance by the utility, through detailed cost accounting, that the expenditures in question are properly chargeable to the ratepayers.

In the present case, with respect to the specific enumerated adjustments, Staff has identified an imprudent decision or action that resulted in the challenged expenditure. However, with respect to the unexplained cost overruns, Staff has identified rather a culture of "improvidence and inefficiency" that Staff believes is sufficient to shift the burden back to KCPL. That is all Staff needs to do. If the Commission agrees that Staff has met its initial burden, the Commission must then decide whether KCPL has carried its burden of proof in showing that these costs are properly to be added to rate base and charged to the ratepayers. Put another way, while imprudencies that are not traceable to specific costs may not support disallowances, they *are* sufficient to raise "serious doubts."

Serious doubts raised by Staff:

Among the "serious doubts" raised by Staff are these:

- The admission by KCPL's expert consultant, Kris Nielsen, that KCPL had

[20] ***KCPL Brief,*** p. 25, ¶ 51.

[21] *Supra,* at 529, quoting a PSC order.

made imprudent expenditures in the course of the Iatan Project.[22]

- The cost overruns in and of themselves, as in the ***Union Electric*** case.[23]
- The fiasco surrounding the Project Manager.[24]
- KCPL's failure to show that it thoroughly assessed the risk and consequences of initiating construction before the project design was substantially completed.[25]
- KCPL's decision to implement a "multi-prime" delivery system whereby KCPL itself would act as the project manager or prime contractor.[26]
- KCPL's decision to "fast-track" the Iatan Project, a construction method in which segments are built simultaneously while other segments are still in engineering.[27]
- KCPL's practice of allowing senior personnel to improperly charge personal expenses and personal mileage to the Iatan Project.[28]
- KCPL's "willful misconduct" with respect to the Advance Coal Tax Credit.[29]
- KCPL's failure to implement a Cost Control System as required by the EARP.[30]

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[22] KCPL Ex. 46.

[23] ***Union Electric****, supra,* at 193.

[24] ***Audit Report,*** at 12, 21; ***Staff's Initial Brief,*** pp. 15-16.

[25] ***Audit Report,*** at 13; ***Staff's Initial Brief,*** p. 16.

[26] ***Audit Report,*** at 21-22; ***Staff's Initial Brief,*** pp. 16-17.

[27] ***Audit Report,*** at 24; ***Staff's Initial Brief,*** pp. 16-17.

[28] ***Audit Report,*** at 25; ***Staff's Initial Brief,*** pp. 18-19. Staff has proposed a specific disallowance of $100,000 to reflect this imprudence. ***Audit Report,*** at 26; ***Staff's Initial Brief,*** pp. 18-19.

[29] *Paul Harrison Surrebuttal,* Ex. KCPL 223 and Ex. GMO 222, Schedule 1-4 (HC); ***Staff's Initial Brief,*** p. 19.

[30] ***Audit Report,*** at 34-37; ***Staff's Initial Brief,*** p. 20.

- KCPL's corporate culture allowing executives in charge of procurement to accept personal gifts from vendors, including clothing, meals, and expensive vacations.[31]

These facts, particularly those involving purposeful deception, are sufficient to raise serious doubts about the corporate culture within which the Iatan Project overruns occurred. Certainly, they are a sufficient basis for the Commission to require KCPL to prove why its unexplained cost overruns are prudent and should be added to rate base.

In a later section, Staff explains that KCPL has not, in fact, met its burden of proof with respect to the unexplained cost overruns.

Staff's competence:

KCPL also attacks Staff's competence. This attack has three prongs: First, the Companies assert that Staff's witnesses are unqualified and that Staff has not complied with Missouri law on expert testimony. Second, the Companies assert that Staff has not complied with Generally Accepted Accounting Standards (GAAS) as directed by the Commission. Third, the Companies assert that Staff performed its construction audit and prudence review improperly.

Staff's witnesses are qualified to testify as experts.

Of course, attacking Staff is a favorite and often-encountered utility defense tactic. Staff is a mandatory party in every Commission case, big or small, and cannot control the amount of work it takes on. Staff is always in the position of doing the best it can with the resources available. Staff's experts are salaried state employees, not

[31] ***Staff's Initial Brief,*** pp. 21-22.

consultants charging – and receiving – lucrative hourly rates.[32] Nonetheless, the Missouri Staff enjoys the services of a fine body of dedicated and knowledgeable public servants who have performed yeoman service in this case.

The Missouri Supreme Court has explained that the standard for the admission of expert testimony in administrative proceedings, as in civil cases, is that set forth in § 490.065, RSMo, which provides:[33]

> 1. In any civil action, if scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise.
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> * * *
>
> 3. The facts or data in a particular case upon which an expert bases an opinion or inference may be those perceived by or made known to him at or before the hearing and must be of a type reasonably relied upon by experts in the field in forming opinions or inferences upon the subject and must be otherwise reasonably reliable.

There can be no question but that the Commission, as the trier of fact, would be assisted in determining this case by specialized knowledge presented through expert testimony. The standard required of an expert is not high. "If the witness has some qualifications, the testimony may be permitted."[34] Any deficiencies in the education, training or experience of Staff's witnesses go to the weight to be accorded their testimony and not to its admissibility.[35] The Commission is authorized to evaluate the

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[32] Many of the consultants encountered in utility rate cases are former employees of this Commission or of other utility regulatory commissions.

[33] ***State Board of Registration for the Healing Arts v. McDonagh,*** 123 S.W.3d 146, 149 (Mo. banc 2003).

[34] ***Whitnell v. State,*** 129 S.W.3d 409, 413 (Mo. App., E.D. 2004).

[35] ***Hord v. Morgan,*** 769 S.W.2d 443, 448 (Mo. App., E.D. 1989): "the extent of an expert's experience

expert testimony presented to it and to choose between the various experts.[36] The record shows that the facts and data upon which Staff's testimony and opinions are based are "of a type reasonably relied upon by experts in the field in forming opinions or inferences upon the subject and [are] otherwise reasonably reliable."[37] Indeed, they are the same facts, data and methods relied upon by KCPL's well-paid consultants.

Testimony does not need to be refuted for the Commission to lawfully disbelieve it.[38] The Missouri Supreme Court in *State ex rel. Rice v. Public Service Commission* (hereinafter referred to as "*Rice*"),[39] clearly stated that the Commission determines the weight of evidence presented to it and may disregard evidence which in its judgment is not credible, even though there is no countervailing evidence to dispute or contradict it:

> Rice objects to the findings of the commission because they ignore his evidence. **He contends since there was no other evidence adduced which contradicted his figures and calculations, or even disputed them, that the commission is bound to accept them as true. Accordingly he contends his evidence is the only substantial evidence in the record. In asserting his contention he overlooks that on cross examination his evidence was discredited to such an extent that the commission held it not entitled to credence. And certainly if evidence is not credible, it does not meet the required test of being substantial. An appellate court as a matter of law passes upon the matter of substance and not of credibility.** In other words an appellate court may say that particular evidence is substantial if the triers of the facts believed it to be true. ***Keller v. Butcher's Supply Co.,*** Mo.Sup., 229 S.W. 173.
>
> Whenever an investigation is conducted by the commission it is required under the statute to make a report in writing which shall state its conclusions and its decision or order. Sec. 5688, R.S.1939, Mo.R.S.A.

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or training in a particular field goes to the weight of the testimony and does not render the testimony incompetent."

[36] ***Associated Natural Gas,*** *supra,* 706 S.W.2d at 882.

[37] Section 480.065.3; *see* ***McDonagh,*** *supra,* 123 S.W.3d at 157.

[38] ***State ex rel. Rice v. Public Serv. Comm'n,*** 220 S.W.2d 61, 65 (Mo. banc 1949).

[39] *Id*.

> Thus it must find and determine the facts. And in doing so **the commission determines the weight of evidence presented to it.** (Cf. ***Ohio Utilities Co. v. Public Utilities Comm.,*** 108 Ohio St. 143, 140 N.E. 497.) **It may disregard evidence which in its judgment is [359 Mo. 117] not credible, even though there is no countervailing evidence to dispute or contradict it. The rule is established in this State that the triers of fact under their duty to weigh the evidence may disbelieve evidence although it is uncontradicted and unimpeached.** ***Wiener v. Mutual Life Ins. Co.,*** 352 Mo. 673, 179 S.W.2d 39; ***Woehler v. City of St. Louis,*** 342 Mo. 237, 114 S.W.2d 985.

(Emphasis added).

In ***Koplar v. State Tax Commission,***[40] the Missouri Supreme Court, citing ***Rice*** among other things, stated that "[n]o one questions the rule that an administrative agency in determining a question of fact may pass upon the credibility of witnesses and where a claimant has the burden of proof may decide a claim solely upon a finding of lack of credibility of uncontradicted and unimpeached testimony offered in support of the claim." (Citations omitted).

In a more recent case respecting the Commission, ***State ex rel. Associated Natural Gas Company v. Public Serv. Commission*****,**[41] the Western District Court of Appeals stated that in evaluating expert testimony the Commission may adopt or reject any or all of any witness' testimony:

> Not only can the Commission select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances, but it also may adopt or reject any or all of any witnesses' testimony. ***In re Permian Basin Area Rate Cases*****,** *supra*, 390 U.S. at 800, 88 S.Ct. at 1377. Evaluation of expert testimony was for the Commission. ***Southwestern Bell Telephone Co.*****,** *supra*, 593 S.W.2d at 445-46. . . .[42]

[40] 321 S.W.2d 686, 694 (Mo. 1959).

[41] ***State ex rel. Associated Nat. Gas Co. v. Public Service Comm'n,*** 37 S.W.3d 287 (Mo. App., W.D. 2000).

[42] *Supra,* 37 S.W.3d at 294.

The Court stated in the 1985 ***Associated Natural Gas*** decision that "[t]he Commission as the trier of fact was free to choose between conflicting testimony."[43]

Evidentiary determinations by the Commission are favored by a strong presumption of validity, which extends to determinations based on expert opinion.[44] The opinion of a qualified expert may amount to competent and substantial evidence.[45] It is up to the Commission to choose between the conflicting evidence of expert witnesses, if the testimony was properly presented to the Commission.

Of the Companies' expert witnesses, Forrest Archibald did not file direct testimony or surrebuttal testimony, so the only opportunity for him to identify his education and training was in his rebuttal testimony. Mr. Archibald does not provide any educational background in his rebuttal testimony. At hearing, he disclosed that he does not hold a degree post secondary education.[46] He is not an engineer and he testified that he did not consider himself to be an expert in matters of accounting.[47]

Brent Davis testified that he is not a professional engineer.[48]

Daniel F. Meyer related that he is not a registered professional engineer, he is not an accountant, and he is not an auditor.[49]

Kris Nielsen testified that he is not a licensed professional engineer nor does he consider himself an expert on matters of ratemaking.[50]

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[43] 706 S.W.2d at 882.

[44] ***State ex rel. Missouri Pub. Serv. Co. v. Pierce***, 604 S.W.2d 623, 625 (Mo. App. 1980).

[45] 37 S.W.3d at 294; 537 S.W.2d at 663 (citing 2 Am.Jur.2d., Adm.Law § 395, p. 201 (1962)).

[46] Tr. 25:2154, lns. 21-23.

[47] Tr. 25:2158, lns. 14-18.

[48] Tr. 15:651, ln. 25 – 15:652, ln. 1.

[49] Tr. 25:2163, lns. 10-20.

[50] Tr. 23:2025, lns. 6-12.

Curtis Blanc testified that was not an expert on prudence reviews, he was not an auditor, did not profess to be an expert in auditing, was not a project cost management / cost engineering expert, was not a construction person, and was not a project procurement management expert.[51]

Robert Bell testified that he is not a professional engineer.[52] He further stated, in part, that he is not a project management professional, is not an expert on matters of accounting, is not an expert on matters of auditing, is not an expert in matters of cost accounting, and is not an expert in matters of cost engineering.[53]

Steven Jones testified that Iatan 2 was the first new baseload generation (Greenfield project) that he worked on. He said that he previously had worked on "retrofits and so on."[54] He further stated that he is not an engineer, is not certified as a project management professional, is not an expert on matters of accounting, is not an expert on matters of auditing, is not an expert on matters of cost accounting, and is not an expert on matters of cost engineering.[55]

Chris Giles testified that he is not an engineer; has never performed a construction audit; has never worked as an auditor, cost engineer, or cost auditor; is not an expert in cost engineering; and is not a project management professional.[56]

William H. Downey identified a project management professional as "someone with a certification with regard to the skills and the educational component of techniques

[51] Tr. 15:434, lns. 16-22; 15:435, lns. 4-11, 22-25; 15:436, lns. 4-7.

[52] Tr. 17:812, ln. 16, - 17:813, ln. 1.

[53] Tr. 17:814, ln. 5 – 17:815, ln. 1.

[54] Tr. 17:928, lns. 10-15.

[55] Tr. 17:930, ln. 18 – 17:931, ln. 11.

[56] Tr. 19:1014, ln. 13 – 19:1017, ln. 7.

for managing large, complex projects or even small projects. There's a discipline to it and they're trained in courses."[57] He testified that he is not a project management professional and that he does not consider himself to be an expert on matters of accounting, auditing, cost accounting, or cost engineering.[58]

Kenneth M. Roberts testified that his testimony is given as an attorney and as a fact witness.[59]

Although some of the KCPL/GMO witnesses were engineers, none were licensed professional engineers.

Staff witness Dave Elliott has a Bachelor of Science degree in Mechanical Engineering. He is not a licensed professional engineer. He was employed by Iowa-Illinois Gas and Electric Company as an engineer from July 1975 to May 1993. He began his employment with the Commission in September 1993.[60]

KCPL in its opening statement sought to attack the Staff's conduct of the audit. KCPL's initial brief is a further attack upon the Staff. In truth, the attack on Staff began in Great Plains Energy Inc.'s acquisition case of Aquila, Inc., when in addition to raising damning questions about the originals terms of the acquisition proposed to the Commission for adoption, the Staff started its inquiry into the spiraling costs and schedule of the Iatan 1 AQCS Project and the Iatan 2 Project. The Staff's concern in the context of the acquisition case was GPE's financial ability to both acquire Aquila under the terms it was proposing and to complete the Iatan Projects if KCPL

[57] Tr. 19:1209, lns. 1-9.

[58] Tr. Vol. 19, p. 1209, lns. 10 – p. 1210, ln. 1.

[59] Tr. Vol. 23, p. 1775, ln. 23 – p. 1776, ln. 11); Roberts Dir., KCPL Ex. 50, p. 1).

[60] ***Staff Audit Report***, KCPL Ex. 205, Elliott Educational Background and Work Experience.

management had lost control of Iatan construction costs and schedule. Staff has proposed adjustments not made by any other party that have not been accepted by KCPL. KCPL again launches its attacks upon Staff who dare to propose an adjustment to the Commission regardless of the fact that the Commission is the decider, not the Staff, of what adjustments are to be made. KCPL finds that there are experts on the Staff, and they are the ones who do not propose adjustments to KCPL's/GMO's cases. KCPL/GMO have proffered no Certified Public Accountants respecting the Iatan Construction Project portion of their cases.

Staff complied with GAAS in its audit.

KCPL/GMO falsely assert at pages 38-40 of their initial brief that the Staff did not comply with Generally Accepted Auditing Standards (GAAS) as ordered by the Commission. Although the Commission's July 7, 2010, Order in File Nos. ER-2010-0355 and ER-2010-0356 is entitled, *Order Regarding Construction And Prudence Audits*, the Order is not limited to the Staff's construction and prudence audits of the Iatan Construction Projects. For example, at page 2 of the Order, the first full paragraph states the Staff shall submit to the Commission a complete list of specific personnel it proposes to be involved with any audit activity of any type, in relation to the proposed rate increases, delineating and distinguishing between all individuals assigned to auditing activity of any type. In the Order the Commission stated at "Ordered Paragraph 4":

> 4. All auditing activity shall be conducted in accordance with generally accepted auditing standards issued by the American Institute of Certified Public Accountants Standards. All Commission staff members conducting audit activity of any type in these matters shall attest by affidavit that all of their auditing activity and reports comply with these standards.

As a consequence, all Staff auditors, i.e., Staff accountants on Iatan issues and Staff accountants on non-Iatan issues, were required to submit affidavits swearing to their compliance with GAAS when submitting portions of the Staff's Iatan Construction Audit and Prudence Review Report, the Staff's Revenue Requirement Cost-of-Service Report, and rebuttal and surrebuttal testimony in File Nos. ER-2010-0355 and ER-2010-0356. Staff non-auditors, i.e., Staff non-accountants -- Staff engineers, Staff economists, Staff financial analysts, and Staff management services specialists -- do not perform their work pursuant to GAAS and, therefore, they do not swear in their affidavits to their compliance with GAAS. Mr. Elliott does not swear in his affidavit attached to the Staff's November 4, 2010, Iatan Construction Audit and Prudence Review Report nor in his affidavit to his surrebuttal testimony, which is KCPL Exhibit No. 214, that he has performed his work pursuant to GAAS. Mr. Elliott had that option, as did the other non-accountants assigned to these proceedings. If KCPL/GMO would have the Commission find Messrs. Hyneman, Schallenberg, and Majors in violation of the Commission's July 7, 2010, *Order Regarding Construction and Prudence Audits*, surely KCPL/GMO would have the Commission find similarly regarding Mr. Elliott.

Curiously, KCPL/GMO in its initial brief appears to have abandoned its rebuttal case position presented through their witness Kris Nielsen that the appropriate standard for a prudence review is not GAAS but Generally Accepted Government Accounting Standards (GAGAS), Comptroller General of the United States, United States General Accounting Office, 2007 Revision.[61] Mr. Hyneman testified that the Staff auditors

[61] Nielsen Reb., KCPL Ex. 46, pp. 34, 46-49.

complied with the applicable provisions of GAAS during the Staff's rate case audit of the books and records of KCPL.[62]

KCPL/GMO in their initial brief at page 39, in the section fo their brief where they assert the Staff did not comply with GAAS, they imply that of the Staff only Mr. Elliott reviewed the Iatan change orders. That is not the case. Mr. Schallenberg related that the Commission, in one of its initial Orders on Iatan—the Commission's 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, directed the Staff to complete a construction audit and prudence review based upon the information that the Staff had received from KCPL. Mr. Schallenberg explained that the Staff auditors interpreted this to mean ***all*** the information that the Staff had received, including the change orders that Mr. Elliott had obtained from KCPL/GMO. The Staff auditors requested, and eventually Mr. Elliott provided to the Staff auditors for their review, all of the change orders he received from KCPL/GMO. These change orders were copied so that they could become part of the Staff auditors' database for the Iatan construction audit and prudence review.[63]

Mr. Hyneman, who has considerable relevant expertise and is a Certified Public Accountant, stated in his direct testimony that GAAS are broad rules and guidelines promulgated by the American Institute of Certified Public Accountants' Auditing Standards Board and that GAAS is utilized in preparing for and performing audits of clients' financial statements. There are ten general, fieldwork, and reporting standards and, separately, the Statements on Auditing Standards (SAS). Mr. Hyneman testifed at

[62] Hyneman Dir., KCPL Ex. 224, pp. 4-7.

[63] Tr. 27:2828, ln. 8 – 27:2829, ln. 12; 27:2508, lns. 16-24.

hearing that there are 220 individual SAS which are individual interpretations of the GAAS field work standards. He further stated in his direct testimony that, while the Staff auditors have conducted the Iatan construction audit and prudence review in accordance with the General Standards of Field Work, they have not necessarily reviewed and applied all of the detailed specific interpretations of the 220 individual SAS to the Iatan construction audit and prudence review because the investment in training and personnel was not viewed as necessary.[64]

Based upon the analysis performed by Pegasus Global Holdings, Inc., Kris Nielsen testified that KCPL's/GMO's management decisions regarding the Iatan Construction Project were reasonable and prudent with two exceptions on the Iatan 2 project, i.e., (1) Alstom – Welding Services, Inc. and (2) Temporary Auxiliary Boiler.[65] Dr. Nielsen asserts that he performed his analysis pursuant to GAGAS.[66] Commissioner Kenney questioned Missouri Retailers Association witness Walter Drabinski on the difference between a financial or performance audit and the analysis that Mr. Drabinski performed. In responding, Mr. Drabinski discussed GAGAS:

> . . . I don't believe I've ever seen a prudence testimony that could be construed as a performance audit because they're just not structured that way. Had it been structured that way, Mr. Nielsen, for example, would have had to have provided all his testimony to the Commission Staff for them to review it and decide whether they like it. That's not the way a regulatory hearing takes place and that's not what occurs. So that, I guess, is different.[67]

At hearing, Kris Nielsen read into the record the use and application of GAGAS audits:

[64] Hyneman Dir., KCPL Ex. 224, p. 4, ln. 18 – p. 5, ln. 16 and Sched. 1-1; Tr. 27:2670, ln. 3, - 27:2672, ln. 8.

[65] Nielsen Reb., KCPL Ex. 46, pp. 15-25.

[66] Tr. 23:2020, ln. 19 – 23:2021, ln. 2.

[67] Tr. 23:1711, ln. 19 – 23:1712, ln. 3.

> Performance Audits 1.25 . . . Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve, program, performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action and contribute to public accountability. Reporting information without following GAGAS is not a performance audit but a non-audit service provided by an audit organization.[68]

He testified that his rebuttal testimony was a substitute for a performance audit report, but he did not provide to KCPL objective analysis to improve program performance and operation, help reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate, or contribute to public accountability. [69]

None of KCPL's/GMO's witnesses, other than Kris Nielsen, have given any indication that their Iatan Construction Project work was performed pursuant either to GAAS or GAGAS. Although GAGAS is seemingly so important to Kris Nielson as a standard, he makes no assertion that the KCPL/GMO Cost Control System meets GAGAS requirements. The word "prudence" does not appear in GAGAS.[70]

The Commission adopted the Uniform System of Accounts for electric corporations, 4 CSR 240-20.030, by original rule filed in the Code of State Regulations on December 19, 1975, effective December 29, 1975. The Commission has never adopted GAGAS by rule or by any other means and only adopted GAAS in its July 7, 2010, Order in File Nos. ER-2010-0355 and ER-2010-0356 entitled *Order Regarding Construction and Prudence Audits*. The Staff's construction audits and prudence reviews of Callaway and Wolf Creek were not performed pursuant to GAGAS and no

[68] GAGAS, 2007 Revision, p.17, KCPL Ex. 273.

[69] Tr. 25:2073, ln. 6 – 25.

[70] Tr. 23:2021, ln. 13 – 15.

one swore they were performed in conformance with GAAS. KCPL/GMO have proffered no CPAs respecting the Iatan Construction Project portion of their cases.

Staff conducted its activities appropriately.

KCPL/GMO in its initial brief at pages 40-42 attempts to argue that some nefarious change in internal Staff procedure occurred involving the responsibilities of the Operations Division and the Utilities Division on the iatan construction audit that resulted in the Staff proposing nefarious adjustments. KCPL/GMO has made this argument for a year regarding the Staff's Iatan Projects audit and, in essence, has been arguing a variant of this argument rdirected at Mr. Schallenberg beginning in Case No. EM-2007-0374, the case where GPE and KCPL sought authority to acquire Aquila,.

In KCPL's first general rate case since the Wolf Creek case in 1985-1986, Case No. ER-2006-0314, Cary G. Featherstone, a Staff auditor, in his direct testimony filed in August of 2006, explained that he, Staff auditor Phillip K. Williams, and Staff engineer David W. Elliott were assigned to review KCPL's generating facilities, and that Staff engineer Michael E. Taylor reviewed the in-service performance testing of each of the KCPL generating units brought on line during the past twenty years. Mr. Featherstone stated that the costs of eight natural gas-fired combustion turbine generators, one heat recovery steam generator and one rebuilt coal-fired baseload generating unit (Hawthorn 5) were to be audited. Due to the number of combustion turbine generating units needing to be reviewed and the complexity and size of the Hawthorn 5 rebuild project, Mr. Featherstone related that the Staff did not have sufficient time to complete its review and stated that it would complete its review in KCPL's next rate case. Mr. Featherstone

noted the unique situation respecting the Hawthorn 5 rebuild, including the fact that the loss of the catastrophic loss of the unit resulted in insurance recoveries for KCPL.[71]

Mr. Elliot testified that at no time in the course of working on the audits of the Iatan Projects was he prevented from conducting any scope of the audits of the Iatan Projects that he wanted to perform.[72] Mr. Wess Henderson, the Commission's Executive Director since January 2005, who has no prepared testimony filed in these proceedings, was called by KCPL/GMO as a witness. Mr. Henderson has a bachelor's degree in accounting and master's degree in public administration and is a certified financial analyst. Mr. Henderson testified that he is not aware of any Staff engineer being excluded from any work he wanted to perform, nor did he receive any complaints from any Staff engineer regarding the Staff engineer's involvement in the audit and review. Mr. Henderson also indicated that the KCPL Regulatory Plan is a unique accommodation to KCPL.[73]

Mr. Elliott testified on the witness stand that he thought there was testimony in these cases that in total there were over 2,700 change orders, and of these he received 647, and only looked in detail at 222. He went on to explain, as he did in his surrebuttal testimony, that he did not look at cost from the perspective of whether the dollars in the change orders were the correct dollars. He was using cost as a screening tool, he was not looking at cost for the purpose of cost analysis.[74] In his surrebuttal testimony, Mr. Elliott disputed KCPL's/GMO's assertions that he, Mr. Elliott, had no difficulties

[71] KCPL Ex. 282, pp. 19-26.

[72] Tr. 27:2504, ln. 7 – 27:2505, ln. 23.

[73] Tr. 25:2280, lns. 11-13; 25:2281, lns. 9-21; 25:2350, ln. 19 – 25:2351, ln. 5; 25:2348, ln. 20 – 25:2349, ln. 5.

[74] Tr. 27:2516, lns. 18-22.

identifying or explaining the cost variances over the Iatan project control budget estimates (CBEs). Mr. Elliott stated in his surrebuttal testimony that he did not identify or explain cost variances over the Iatan project CBEs.[75]

By an engineering review, Mr. Elliott stated that he was looking at matters such as whether something was built twice.[76] KCPL/GMO in their initial brief basically contend that the Staff auditors and the Staff engineers must merrily work hand-in-hand as Siamese twins, wherever one goes, the other must also, in order to produce a construction audit and prudence review. Mr. Elliott clearly indicates that KCPL's/GMO's use of a hagiography of earnest men doing their solemn duty is not necessary for the performance of a construction audit and prudence review, and Mr. Elliott is not a veteran of the Wolf Creek and Callaway cases:

> [MS. KLIETHERMES] Q. Okay. Mr. Fischer was asking you about your work with Commission auditors. Can you personally complete a construction audit in its entirety without auditors?
>
> [MR. ELLIOTT] A. I can do what I do, the engineering review. At some point the auditors either do their review and we meet at the end or the auditors do their review and we both get to the end. It -- I -- I -- the way I view it is that the auditors get -- look at it from a different perspective than I do, so I cannot do what I do and -- and have the thing not be a construction audit.[77]
>
> * * * *
>
> Q. I'm sorry. Have you ever participated in work on a construction audit or prudence review that there weren't also Staff auditors involved on that construction audit or prudence review?
>
> A. At some level or not, auditors were always involved, yes.

[75] Elliott Surr., KCPL Ex. 214, p. 1, lns. 23-27; p. 2, lns. 13-16.

[76] Tr. 27:2509, ln. 17 – 27:2510, ln. 3.

[77] Tr. 27:2510, ln. 16 – 27:2511, ln. 2.

Q. On those prior audits, did Staff auditors always look at construction costs and make adjustments if any adjustments were to be made?

A. I believe so, yes.

Q. You weren't a Commission employee at the time of Wolf Creek and Callaway, were you?

A. No, I was not.[78]

Mr. Elliott has been a Commission employee since 1993 and has never sponsored a dollar adjustment as part of an engineering review that he has performed:

Q. Have you ever sponsored a dollar adjustment as part of an engineering review that you have performed?

A. Specifically I -- I have not made a dollar adjustment. I have perhaps provided numbers to the auditors who have made an adjustment but I have not made one on my own, no.

Q. Have you ever sponsored a dollar adjustment as part of a construction audit you have performed?

A. Again, no. Not specifically in my testimony.[79]

In the Staff's construction audit and prudence review of Empire Energy Center Unit 3 and Unit 4, natural gas combustion turbine generators, in Empire District Electric Company's (Empire) 2004-2005 rate case, Case No. ER-2004-0570, Staff auditor Roberta Grissum and Mr. Elliott both filed testimony, and it was Ms. Grissum, the Staff auditor, who sponsored the Staff's proposed disallowance for imprudence. The issue settled.[80]

[78] Tr. 27:2516, lns. 1-13.

[79] Tr. 27:2520, ln. 20 – 27:2521, ln. 6.

[80] KCPL Ex. 283, pp. 7-17, and KCPL Ex. 284, pp. 6-12, Surr. and Dir. Testimony of Roberta McKiddy in ER-2004-0570.

Robert Schallenberg, who is a veteran of the original Iatan 1 construction audit and prudence review case (Case No. ER-80-48), the Wolf Creek case (Case Nos. EO-85-185, EO-85-224, and ER-85-128), and the Missouri Public Service Company Sibley generating station rebuild case (Case No. ER-90-101), was in charge of the Iatan 1 AQCS, Iatan 2, and Iatan Common Plant construction audit and prudence review. Mr. Schallenberg is a Certified Public Accountant and has considerable other relevant expertise. He testified that Mr. Elliott had been performing his engineering analysis as he had done in the past or as he saw fit and he continued to do so. Mr. Schallenberg stated that Mr. Elliott was allowed to do whatever scope of review he wanted and there was no attempt to interfere in any way or to influence his views. He further related that Mr. Hyneman was assigned to the construction audit and prudence review, and later Mr. Majors was also brought into the project in order to have three auditors on the engagement. Mr. Schallenberg noted that in the cases where Mr. Elliott works with Staff auditors, where there have been adjustments proposed, they have been sponsored by the Staff auditors.[81]

The write-down effect:

As previously noted, KCPL's third defense is simple fear-mongering. The Companies state, "[a]s the Commission considers the various disallowances proposed by Staff . . . the Commission also needs to consider the impact the adoption of these disallowances, particularly prudence disallowances, would have on KCP&L and GMO."[82] Accounting rules, the Companies assert, will require any disallowances to be

[81] Tr. 27:2827, ln. 15-27:2828, ln. 7; 27:2829, lns. 13-25; ***Audit Report,*** Schallenberg Scheds. 1-1, 1-5 and 1-6; ***Re Missouri Public Service Co*.,** 30 Mo.P.S.C.(N.S.) 320, 336 (1990).

[82] ***KCPL-GMO Brief,*** p. 134, ¶ 272.

taken as current-period losses. Under the applicable accounting standard, "the Companies will permanently lose their ability to earn a return on or otherwise recover those disallowed expenditures incurred in building that plant."[83] That's why, we are advised, "these prudence issues in this case are so important to the Companies and their investors who will be called upon in the future to put up additional funds for future projects that will need to be constructed to serve customers."[84]

This is an astonishing defense. Astonishing that the Companies would actually urge the Commission to overlook imprudence, to ignore its statutory duty to disallow imprudent, unnecessary and unbeneficial expenditures in order to avoid discouraging future utility rate base investment. Is this really the Companies' opinion of the Commission?

The Companies presented testimony that a write-down of the magnitude proposed by Staff would jeopardize their financial integrity, impair their creditworthiness and reduce share value.[85] That may be, but the law requires that only "just and reasonable" charges be included in rates.[86] To the extent that the Commission concludes that particular expenditures on the Iatan Project were imprudent, unnecessary or of no benefit to ratepayers, the Commission has no discretion.[87] Those

[83] *Id.,* p. 135, ¶ 273.

[84] *Id*. The Companies go on in their brief at pp. 135-6 to quote testimony of the late Curtis Blanc to the effect that Staff's recommended disallowances are "irresponsible."

[85] Ives True-up Rebuttal, pp. 2-3; cited in ***KCPL-GMO Brief,*** pp. 136-137, ¶¶ 275-8.

[86] ***Associated Natural Gas,*** *supra,* 954 S.W.2d at 528. ("All charges for . . . service must be just and reasonable. Section 393.130.1, RSMo").

[87] *Id.* ("If a utility's costs satisfy the prudence standard, the utility is entitled to recover those costs from its customers").

expenditures may not be added to rate base and may not be charged to the ratepayers.[88]

Unidentified and unexplained cost overruns:

Throughout this case Staff raised has serious doubt as to the prudency of each dollar spent by KCPL in excess of the CBE by demonstrating KCPL's failure to comply with its contractual requirements to identify and explain Iatan project cost overruns. KCPL is tasked with the burden of proving cost overruns to have been prudent by Missouri law. KCPL is also tasked to identify and explain dollars in excess of the definitive estimate by section III.B.1.q. "Cost Control Process for Construction Expenditures" of the KCPL Regulatory Plan Stipulation And Agreement. KCPL failed in its initial brief to provide facts or argument that the cost overruns were prudent because KCPL would necessarily have to be able to identify and explain the cost overruns in order to do so.

> KCPL touts in its initial brief the assertions of KCPL witnesses Daniel Meyer and Kris Nielsen that KCPL's cost control system compares favorably to other cost control systems. These assertions mean nothing. The Staff noted in its initial brief the holding of the Commission in the Wolf Creek case:The Commission reiterates its position set out in *Re Union Electric Co.,* 27 Mo.P.S.C.(N.S.) 183 (1985). Industry comparisons do not establish a standard of prudence. General statements regarding regulatory changes do not explain cost overruns. Finally, general statements regarding the complexity of the project with respect to design evolution and fast track construction do not explain cost overruns.[89]

KCPL asserts in its initial brief that it "provided or made available to Staff all of the documentation and information that "'identifies and explains'" the Iatan Project's cost overruns. Even if this assertion were true, KCPL accepted in the form of additional

[88] *Id.*

[89] 28 Mo.P.S.C.(N.S.) at 281.

amortizations millions dollars of ratepayer money for the obligation to "develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate" Over the term of the KCPL Regulatory Plan. *See paragraph III.B.1.q. of the KCPL Regulatory Plan Stipulation And Agreement.* When new rates go into effect as a result of File No. ER-2010-0355 KCPL will collect on an annual basis $146.7 million in additional amortizations per annum.[90]

KCPL's citation to *State ex rel. Public Counsel v. Public Serv. Comm'n*, 274 S.W.3d 569 (Mo.App. W.D. 2009) is inapposite. In *Re Union Electric Co., d/b/a AmerenUE*, Case No. ER-2007-0002, Report And Order (May 22, 2007), there was nothing akin to the KCPL Regulatory Plan. AmerenUE had not entered into a regulatory plan where in exchange for hundreds of millions of dollars in additional amortizations, i.e., ratepayer funds, AmerenUE agreed to develop and have a cost control system in place that identified and explained any cost overruns above the definitive estimate during the construction period. The Western District Court of Appeals held in the case cited by KCPL that as the trier of fact, since the testimony of both experts was properly presented to the Commission, the evaluation of expert testimony is left to the Commission, which may adopt or reject any or all of any witness'.[91]

Using the items KCPL refers to in its initial brief may enable an auditor to identify changes to a given contract, but there is no linkage to whether the dollars for that contract or the work covered under that contract was included in the CBE. **[redacted]

[90] Featherstone True-Up Dir,, KCPL Ex. , p. 12, ln. 1.

[91] *Id*. at 587, citing ***State ex rel. Associated Natural Gas Co. v. Public Serv. Comm'n***, 37 S.W.3d 287, 294 (Mo.App. W.D. 2000).

[redacted] **

KCPL's responses to DRs 331 and 360 each provide two lists. In one, the company has a contract with the vendor but has not issued a purchase order. In the other, the Company does not have a contract with the vendor. In other words, these are lists of contracts - or of charges to the Iatan project - where there was either not a purchase order or not a contract in place. There are hundreds of contracts or charges that would be identified in KCPL's cost control system as change orders, completely irrespective of whether or not these contracts or the work performed were included in the CBE. KCPL's prudence witness, Dr. Nielsen admitted that he was aware of these charges, and did not investigate them.[93]

KCPL let the Kissick contract for $1, though that contractor was eventually paid significantly more than $1.[94] This major contract was let for $1 despite KCPL's anticipation that they would be doing more than $1 worth of work.[95] This major contract was let for nominal value, even through the work that was intended to be performed under the contract was within the initial scope of the Iatan Project, and should have

[92] McDonald Deposition, p. 80, L 15, to p. 81, L 9.

[93] Tr. 25:2064. L 10 – 14.

[94] Tr. 26:2067, L 4 – 6 (HC). KCPL waived HC during the hearing, see Tr. 25:2069, L 4 – 13; Tr. 25:2068, L 3 – 6.

[95] Tr. 25:2069, L 15 - 18.

been reflected in the CBE.[96] Thus, all payments to Kissick for all of its work – including work that should have been budgeted for in the CBE - appear in KCPL's cost control system as change orders.

KCPL has not provided any explanation for how Staff auditors can be expected to distinguish "cost overrun" change orders from "work that was intended to be performed within the initial scope of the Iatan Project, for which KCPL budgeted money in the CBE, but made no attempt to distinguish dollars included in the CBE from dollars in excess of the CBE" change orders.

Staff's engineering department did use cost as a screening tool in selection of specific change orders for review. However, given the manner in which KCPL used change orders – as a proxy for executed contracts to cover work that was included in the CBE – it is impossible to determine whether the change orders reviewed by Staff's engineering department covered work that constituted any of the cost overruns. Mr. Elliott indicated that the categories that he used for change orders was just a way to sort the change orders: "the categories was just a way to sort them into – into things."[97]

Having adopted the KCPL Regulatory Plan Stipulation And Agreement with the section III.B.1.q. "Cost Control Process for Construction Expenditures," the Commission is being asked to have ratepayers pay a previous blank check for which KCPL has finally written in the amount and KCPL is telling the Commissioners that the Staff auditors have the burden of proof that the amount written on the check is prudent because KCPL has experts that say it is and that should be good enough for the

[96] Tr. 25:2069 L 19 - 22.

[97] Tr. 27:2506, L 8 – 11.

Commissioners because any member of the Staff that challenges what KCPL does is unqualified to question KCPL's performance.

KCPL's prudence witness admitted that he might consider it reasonable to recommend a whole or partial disallowance pending verification of outstanding data.[98] Kris Nielsen further conceded that he could conceive of a situation where he would make a recommendation for an interim whole or partial disallowance pending provision of adequate records.[99]

KCPL simply did not track dollars spent to dollars planned to be spent. This needless impediment to Staff's audit of the Iatan Project, especially in light of KCPL's commitments in the KCPL Regulatory Plan, raises "serious doubts" such that the burden of going forward with evidence and establishing the prudency of the dollars spent in excess of the CBE falls on KCPL. KCPL has not, and apparently cannot, even identify what expenditures are cost overruns, much less prove the prudency of those expenditures. KCPL's ratepayers should not bear the burden of KCPL's failure to reasonably, appropriately, prudently develop and manage the Iatan construction cost control system and Construction Project.

Specific disallowances proposed by Staff:

In its initial brief, KCPL attempts to smokescreen its imprudent decisions that gave rise to Staff's recommended disallowance of the discreet Iatan adjustments. KCPL repeatedly incorrectly implies or asserts that Staff engineers effectively signed off on or approved KCPL's decision making – which is simply not true. Mr. Elliott did not affirmatively recommend that any plant be included in this case. [v 27 p 2501 L 17 –

[98] Tr. 25:20840, L 7 – 11.

[99] Tr. 25:2084, L 22, to 2085, L 2.

22]. Staff has raised serious doubt as to the prudency, reasonableness, and benefit to ratepayers of KCPL's decisions underlying each of the discrete adjustments. Thus, KCPL is tasked with the burden of proving each of the questioned expenditures to have been prudent. KCPL did not even attempt in its initial brief to provide facts or argument that the decisions giving rise to these adjustments were prudent, nor did it do so in prefiled testimony or at the evidentiary hearing. Further, KCPL did not provide compelling facts or law in its initial brief to dissipate the serious doubt that Staff has raised. In general, KCPL's initial brief sections on these adjustments fail for these reasons, thus Staff does not take the opportunity of this reply brief to address KCPL's initial brief separately on these discrete adjustments, except as noted below.

ALSTOM Unit 1 Settlement Agreement:

Staff continues to propose the disallowance of **$[redacted]** in Iatan Construction Project costs which represents the amount of liquidated damages that KCPL should have received from Alstom. KCPL failed to collect **[redacted]** in liquidated damages that it was due because Alstom failed to meet the original contract date for Iatan 1 Provisional Acceptance.

Staff proposes the disallowance of **[redacted]** in costs that KCPL is charging to the Iatan Construction Project for a **[redacted]** settlement payment KCPL made to Alstom. Staff has found no documentation supporting KCPL's decisions respecting these matters.[107]

In a settlement agreement between KCPL and Alstom executed on July 18, 2008, KCPL and Alstom agreed to settle all existing claims by KCPL paying Alstom

[107] Ex. KCP&L-205, p. 57.

[redacted], an amount that exceeded the high end of KCPL's contingency range.[108]

KCPL's assertion that the Staff failed to "raise serious doubt" concerning this matter is incorrect. Staff has asserted that it was unable to find, and KCPL failed to provide, documentation to support its decisions in the above referenced matters.[109] Additionally, KCPL's own analysis reported that it was entitled to receive liquidated damages from Alstom in the amount of **[redacted]** if Alstom continued to fall behind schedule,[110] which in fact it did.

Staff asserts that it has serious doubts that KCPL investigated the causes of the delays that were the result of the 2008 Settlement Agreement reached by KCPL and Alstom. Specifically, KCPL failed to provide documentation regarding an investigation of any delays that may have been caused by Burns & McDonnell.[111] Staff's reviews of various audit reports including a report from Ernst & Young uncovered serious issues with Burns & McDonnell's performance.[112]

Staff has raised serious doubt regarding the prudence of the cost of the Alstom Settlement Agreement. Staff testified that they were not convinced that Alstom's claims against KCPL were not the fault of the KCPL project management team.[113] Staff's review of the Alstom Power Contract Audit revealed, "Alstom is unable to meet the CTO milestone dates and contractual milestone dates, and is less than cooperative in

[108] Testimony of Mr. Carl Churchman, KCPL's then Vice President of Construction, in Case No. ER-2009-0089.

[109] Ex. KCPL-205, p.57 and Staff's initial brief p. 47.

[110] Ex. KCP&L-205, p. 54, lines 26-28.

[111] Ex. KCP&L-205, p. 57, lines 14-16 and Ex. KCP&L-205, p. 57, lines 18-20.

[112] *See* Ex. KCP&L-205, p. 57-61.

[113] Tr. 2742, line 19 to 2743, line 6.

working with the Project Team."[114] KCPL is correct when it notes that there was room for improvement, especially in light of the audit. Measures used to correct the deficits did not change the fact that the project had millions of dollars in cost overruns, and the measures implemented were not sufficient to stop the cost overruns.

KCPL raises questions regarding Mr. Hyneman's qualifications; however during the hearing, the Judge overruled the objection, subject to review.[115] In making its determination, the Commission may adopt or reject any or all of any witness' testimony.[116] Mr. Hyneman is a CPA, MBA with 18 years experience in evaluation of all types of utility costs, including plant costs, revenues and expenses. Additionally, he has 18 years of direct experience in making evaluations of reasonableness, appropriateness and prudence of including utility costs in rate base (as KCPL is seeking with Iatan) and cost of service.

Staff's review raises serious doubts of KCPL's prudence with respect to the Alstom I Settlement. KCPL's own internal audit identified that Alstom was **[redacted][117]** KCPL paid out **[redacted]** to the detriment of the ratepayers.[118]

KCPL's internal audit revealed that, **"[redacted]

[114] Ex. KCP&L-205, p. 61, lines 13-17.

[115] Tr. 2562: 18-21.

[116] ***State ex rel. Associated Natural Gas Co. v. Public Service Commission,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

[117] Ex. KCPL-205, p. 61, line 18-p.62, line 7.

[118] Ex. KCPL-205, p. 63, lines 14-16.

[redacted][119]** Staff proposed the disallowance of **[redacted]** which represents the amount of liquidated damages KCPL chose not to seek from Alstom. Under every scenario that KCPL raises, the facts remain the same. KCPL failed to collect money due pursuant to its Liquidated Damages contract provision, and KCPL paid additional incentive money to Alstom despite Alstom not meeting its contractual deadlines. KCPL failed to provide proof that its settlement with Alstom was beneficial to the ratepayers.[120]

While KCPL explained why it was it believes it was forced into making the Unit 1 and Unit 2 settlements, it never provided any reasons why ratepayers should absorb the cost of these settlements. Staff has provided substantial evidence showing KCPL did not have an experienced construction management team in place – its auditors even told them this. Its auditors also told KCPL that Alstom was taking advantage of KCPL (Marano audit).

The Staff is taking no position on the prudency of the decision to enter into a settlement but Staff is asserting that charging the settlement costs to ratepayers is imprudent and unreasonable. KCPL has never produced evidence to show why KCPL's ratepayers should pay for the additional costs of the Alstom settlements. These settlements were caused by substandard performance by KCPL and the other contractors on the site. It is KCPL and these contractors, including Burns and McDonnell, who should pay for these settlements.

Therefore the Commission's Report and Order should contain language that disallows the **[redacted]**, which represents the amount of liquidated damages

[119] Ex. KCPL-205, p.61, lines 13-17.

[120] Ex. KCPL-205, p. 63, lines 14-16.

KCPL chose not to seek from Alstom. The Commission should also disallow **[redacted]** in costs that KCPL is charging to the Iatan Construction Project for a **[redacted]** settlement payment KCPL made to Alstom.

ALSTOM Unit 2 Settlement Agreement:

The Commission should not allow KPCL to recover the **[redacted]** in incentive payments paid out to Alstom and should impute **[redacted]** in forgone liquidated damages.

The law places the burden of proving the appropriateness of amounts proposed to be placed into rate base upon the Company: "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation[.]"[121] Because the Company bears the burden of proof, any failure of proof must be held against the Company.[122]

Further, Staff did not conclude KCPL's decision to enter into a settlement was imprudent. KCPL may have been forced to enter into a settlement through its mismanagement of the construction contractors. What Staff found to be imprudent and unreasonable is KCPL charging its ratepayers for its decision.

Staff raises serious doubt regarding the rationale for KCPL's failure to enforce it rights under the Liquidated Damages contract provision. Staff believes Alstom contributed to project delays and that KCPL failed to protect itself and enforce its rights

[121] Section 393.150.2, RSMo.

[122] ***State ex rel. GS Technologies Operating Co. v. Public Serv. Comm'n***, 116 S.W.3d 680, 693-94 (Mo. App., W.D. 2003).

under the contract.[123] **[redacted]** **[redacted]**[127]

Staff raises serious doubt with the terms of KCPL's and Alstom's negotiated settlement agreement. **[redacted]** KCPL never explained why it needed to create new milestones for Alstom to perform in accordance with its contract. Only relatively minor milestones were met and they were met prior to KCPL's and Alstom's agreement setting these milestones. KCPL did not explain why it needed to revise Alstom's milestones or who was responsible for the delays. However, KCPL paid Alstom for meeting milestones Alstom failed to meet. As shown in the true-up direct testimony of Staff witness Hyneman, KCPL paid incentives to Alstom when Alstom was significantly late in meeting the major milestone dates.

[123] Ex. KCP&L-308HC, *Hyneman* True-up Direct, at lines 17-23.

[124] *Id.* at p. 5, lines 13-15.

[125] *Id.* at line 12.

[126] *Id.* at lines 15-18.

[127] *Id.* at p. 6, lines 3-6.

[128] *Id.* at p. 63, line 30 – p. 64, line 2.

[129] *Id.* at p. 64, lines 3-5.

KCPL determined that it did not need to explain to the Commission why it made these payments or why that KCPL's ratepayers should be responsible for these costs. KCPL has failed to provide evidence for its failure to access liquidated damages for Alstom's failure to meet provisions.

Therefore, the Commission should disallow **[redacted]** for the Iatan Unit 2 costs. The Commission should also disallow the incentive payments to Alstom because Alstom failed to meet the requisite milestone dates.

Schiff Hardin Adjustments

As stated in Staff's initial brief, because of Schiff Hardin's (Schiff) pattern of excessive charges, KCPL's failure to manage the contract with Schiff, and Schiff's blatantly self-serving manipulation of the KCPL/Schiff relationship, the Commission should disallow **[redacted]** related to costs the Company incurred to Schiff. The Company has not met its burden of showing that these costs are properly to be added to rate base.

The Company argues that $20 million funneled to a law firm is not worth the Commission's time or worry. Payments to Schiff's were slightly less than one percent of the total cost of this materials, technology, labor, and engineering intensive construction project. Maybe KCPL does not think this paltry $20 million warrants actively managing its contract with a vendor. The fact of the matter is the Company and Schiff did not follow the terms of their contract and the Company failed to adhere to its own policies

and procedures regarding the retention of Schiff.[130] Schiff had unfettered discretion in the amount of time and workload it was allowed to charge for throughout the project.[131]

While KCPL's witnesses discussed the "value" of Schiff's services, the Company has failed to show that it was prudent to incur over $20 million in expenses for the law firm. The Company has failed to meet its burden of proving that the amount of Staff's disallowance, **[redacted]**, was in fact prudently incurred, necessary and beneficial to ratepayers.

The Company took Staff expert Charles Hyneman's testimony out of context regarding his expertise in evaluating legal fees. An accurate reading of the transcript follows:

[KCPL Counsel]	Q.	Okay so you do consider yourself an expert on legal fees. Correct?
[Witness Hyneman]	A.	Yes.
	Q.	And you do consider yourself an expert on the quality of legal work. Correct?
	A.	No.[132]

At no point has Mr. Hyneman made an adjustment based upon the quality of Schiff's work product. Mr. Hyneman's adjustments are based upon excessive legal fees and failure to provide adequate documentation showing the expenditures were necessary and proper. Furthermore, Mr. Hyneman has successfully made adjustments for legal expenses in other rate cases before this Commission. In particular, the

[130] *See* Tr. p. 507, lns. 15-19; p. 1799-1800.

[131] Tr. p. 518, lns. 9-10.

[132] Tr. p. 2649, ln. 21 – p. 2670, ln. 1.

Commission accepted Mr. Hyneman's adjustments in a Missouri Gas Energy (MGE) general gas rate increase case, Case No. GR-2004-0209.[133] In that case, MGE choose a New York City law firm to litigate its rate case before the Commission. The Commission determined, based upon Mr. Hyneman's testimony, that while the utility may choose its representation, the ratepayers of Missouri need not bear the expenses of a firm with geographically higher rates. That case is very similar to the one here. KCPL choose a law firm based out of Chicago, whose hourly rates are substantially higher than the rates of attorneys in the greater Kansas City, Missouri area.[134] KCPL's Missouri retail customers should not have to bear the expense of a law firm with geographic rates substantial higher than those in its service territory. Therefore, based on its acceptance of his testimony in prior cases, the Commission has already determined Mr. Hyneman's expert testimony to be credible.

KCPL questioned Mr. Hyneman on the sources he used to determine the appropriate hourly rate for legal services in the Kansas City area. The Company then tried to discredit Mr. Hyneman for failing to look at AmLaw 200 or the Missouri Lawyer's Weekly annual publication addressing average earnings,[135] yet the Company failed to adduce any evidence that those sources provide different and substantially more accurate representation of hourly rates than the Laffey Matrix. The Company's attempt to discredit Mr. Hyneman for not using these other sources is fruitless, as it did not provide any evidence to as to legal rates in the Kansas City area.

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[133] *In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service,* Case No. GR-2004-0209, Issued September 21, 2004, Effective October 2, 2004.

[134] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 65, lines 16-17.

[135] Tr. p. 2754, lns. 1-8.

Here the Company tries to attack the credibility of a Staff to deflect attention from the real issue. Mr. Hyneman had to make a determination as to the reasonableness and prudency of legal fees charged to the Iatan project because the Company failed to take any action to verify the reasonableness and prudency of those expenditures. The Company took no steps to ensure it was not paying imprudent, unreasonable, and excessive legal fees. The Commission should focus its attention on the reasonableness of the Schiff fees, not on Mr. Hyneman's expertise, as the Commission has already determined in the MGE case that he is an expert at auditing legal fees.

The Company points to Mr. Leonard Ruzikca's testimony on the Jeffrey Energy Center prudency disallowance, that while he was General Counsel at FruCon Corporation, he frequently hired law firms without using the RFP process. However, FruCon is not a regulated entity; it is a large international company not held to the same standards under Commission regulations. FruCon is a competitive company where imprudent, excessive and unreasonable legal fees are absorbed by FruCon's shareholders and not recovered from captive ratepayers in a rate proceeding. In this case, the Commission acts as the surrogate for competition and is the only protection for KCPL's customers from being forced to absorb imprudent, unreasonable, and excessive legal fees. More importantly, Mr. Ruzicka never testified that he hired Schiff for all the construction projects he oversaw when he was General Counsel at FruCon. Here again, the Company's attempt to provide meaningful evidence falls short.

The Company tries to persuade the Commission into believing that, because KCPL reviewed a selective two-month sample of Schiff expense receipts that did not reveal anything out of the ordinary, the other 60 months plus would not produce

something out of the ordinary to warrant Staff review.[136] Two months is hardly a representative sample given the exorbitant fees Schiff charged the Company. Further, KCPL failed to provide Staff with the two-month random sample for Staff review.

The Company has failed to meet its burden of showing that the payments to Schiff disallowed by Staff were reasonable and proper, necessary, prudent, or beneficial to ratepayers. Thus, the Commission should disallow ** [redacted] ** in costs the Company incurred in payments to Schiff Hardin.

Campus Relocation:

As regards KCPL's argument on the campus relocation, Mr. Elliott did not characterize the movement of the trailers as engineering-related changes in his review.[144]

JLG Accident:

Staff has nothing further on this issue.

Construction Resurfacing Project:

Staff has nothing further on this issue.

May 23, 2008 Crane Accident at Iatan 1:

KCPL's own witness, Brent Davis, admitted KCPL was not at fault for the crane incident.[145] Yet, in this case, KCPL seeks to include costs it might not recoup during private litigation with the contractor responsible for the crane accident. KCPL has failed to provide any evidence to show that these costs are properly to be added to rate base. The ratepayers have not seen, and will not see, a benefit for the costs KCPL seeks to

[136] Ex. KCP&L-8, Blanc Rebuttal, p. 36, lns. 19-23; p 37, lns. 1-3.

[144] Ex. 89 (HC).

[145] Ex. KCP&L-205, *Construction Report and Prudence Review Staff Report as of June 30, 2010,* p. 41, lines 7-8; Tr. p. 755, L 1 to p. 756, L 1; Ex. KCP&L-205, p. 41, lines 13-15.

recover in this case. Thus, the Commission should disallow **[redacted]** in costs related to the May 23, 2008 crane accident at the Iatan Project site.[146]

Cushman Project Management:

Again, KCPL tries to distract the Commission from the real issue behind Staff's proposed adjustment. Staff's adjustment to the Cushman & Associates charges to the project is based on the fact that KCPL failed to take any action to determine whether Cushman's rates were reasonable. Staff's analysis is based on the fact that LogOn Consulting – a project management firm with more experience than Cushman – had an hourly rate that was far less than Cushman's. Consequently, Staff determined that KCPL paid Cushman excessive hourly rates. Staff's adjustment had nothing to with whether or not Mr. Cushman was competent. Yet again, KCPL awarded a contract on a sole-source basis, in violation of its own procurement policies.[147] KCPL has failed to show that the excessive hourly rates charged to the Iatan Project by Cushman were reasonable and prudent.[148] Staff's adjustment to Cushman's charges provides some assurance that KCPL's ratepayers will not bear the burden of paying in rates more than a reasonable amount for the service actually provided.

Adjustment from KCC Staff Audits:

Staff has nothing further on this issue.

Affiliate Transaction Adjustment:

Staff has nothing further on this issue.

[146] Ex. KCP&L-205, p. 41, lines 6-7.

[147] *Id. at* p. 96.

[148] *Id. at* p. 97.

Welding Services Inc. Change Order:

Staff recommends the Commission disallow 12.7 million of imprudent cost from KCPL's rate base. Staff's recommendation stems from Dr. Nielsen's recommendations. Dr. Nielsen was KCPL's prudence consultant. Dr. Nielsen asserted that that expenditures paid to Alstom in connection with work performed by WSI in an effort to overcome Alstom's failure to adhere to schedule were imprudent. He determined that costs incurred by KCPL in connection with the Alstom/WSI work were imprudent.[149] Dr. Nielsen believed that Alstom was responsible for costs due to delays unless the delays were the result of actions by KCPL or a third party responsible to KCPL.[150] Staff reviewed relevant WSI change orders and concurs with Dr. Nielson's report. KCPL's ratepayers should not bear financial responsibility for these charges that should have been appropriately borne by Alstom or that were the result of KCPL's imprudence.

Therefore, Staff recommends Staff recommends the Commission disallow 12.7 million of imprudence cost from KCPL's rate base.

Employee Mileage Charge Adjustment:

Staff has nothing further on this issue.

Inappropriate Charges:

Staff has nothing further on this issue.

KCPL Direct Costs:

--Allowance for Funds Used During Construction (AFUDC):

It appears from the Company's Initial Brief that it agrees with Staff that the Commission's determination on Allowances for Funds used During Construction

[149] ***Audit Report,*** at 100-101.

[150] *Id.*

(AFUDC) for Staff's discrete adjustments should follow the Commission's determination on each of the discrete adjustments. However, the Company did argue that the incremental AFUDC accrued for the Iatan 1 AQCS should be allowed for the Iatan 1 turbine trip and that Advanced Coal Tax Credits should not be used as an off-set to the Iatan 2 carrying cost.

AFUDC is the non-cash cost of financing a particular construction project associated with financing costs incurred during construction and prior to in-service.[151] The Iatan 1 turbine start-up failure was not related to the construction of the Iatan 1 ACQS or Iatan 2. It was during a planned-outage start-up that, due to vibrations in the turbine beyond operating parameters, caused the Iatan 1 turbine to trip, forcing an additional outage.[152] It took thirty-three days to repair the Iatan 1 turbine and place it back in-service.[153] This restoration was not within the scope of the Iatan 1 AQCS project.[154] The fact that the Iatan 1 turbine repair was simultaneous with the Iatan 1 AQCS does not mean KCPL can garner additional AFUDC from ratepayers. Staff is not attempting to penalize the Company for the turbine failure, Staff is only applying appropriate ratemaking treatment to the Iatan 1 turbine trip. It was outside the scope of the Iatan Construction Project, thus it is inappropriate to apply AFDUC to the expenses incurred for a non-construction related activity. In other words, it is an Operating & Maintenance expense and not a construction cost that should be capitalized into rate base.

[151] Ex. KCP&L-205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 89, lines 17-20.

[152] *Id.,* p. 90, lines 13-15.

[153] *Id.,* p. 90 lines 18-19.

[154] *Id.,* p. 90, lines 15-17.

The Commission should disallow the **[redacted]** KCP&L and **[redacted]** of AFUDC costs accrued during the Iatan 1 unplanned outage that resulted because of a turbine trip during start-up.

--Section 48A Advanced Coal Project Tax Credit AFUDC:

The Commission should also remove the AFUDC cost related to KCPL's failure to off-set its AFUDC from its Section 48A advanced coal investment tax credits (ITC). KCPL was awarded $125 million in ITC from the IRS.[155] In 2007, KCPL stated it generated and used $29,151,586 of the ITC.[156] In 2008, KCPL generated $46,921,017 ITC and in 2009, KCPL generated $31,214,900 ITC.[157] AFUDC is designed to compensate a utility for financing the cost of building a power plant. Since KCPL had a free source of cash from the Section 48 advanced coal investment credits, it had access to free cash flow to offset the financing costs of construction for Iatan 2. Thus the Commission should remove the AFUDC cost related to KCPL's Section 48A advanced coal investment tax credits.

B. The Write-Down Effect:

This issue is discussed above at pages 27-29.

C. Iatan Regulatory Assets:

The Staff does not dispute that the Commission approved, Non-Unanimous Stipulation and Agreement in the 2009 KCP&L and GMO Rate Cases, Case Nos. ER-2009-0089 and ER-2009-0090, authorized KCP&L and GMO to record in a regulatory

[155] Discussed elsewhere in this brief at page 72 ff.

[156] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 94, lines 3-5.

[157] Ex. KCP&L -205, *Staff Report Construction Audit and Prudence Review as of June 30, 2010,* p. 94, lines 5-6.

asset carrying costs related to Iatan 1 AQCS and Iatan Common Plant. However, the Company believes that, if the Commission accepts Staff's adjustments based upon unidentified and unexplained costs, it should still receive carrying costs on those disallowances in rates. This rationale is completely backwards and should not be adopted by this Commission.

If the Commission accepts Staff's position on unidentified and unexplained costs, then those costs should not be passed on to ratepayers and should be treated as if they do not exist for ratemaking purposes. Similarly, if the Commission accepts Staff's discrete adjustments, those adjustments would not receive the benefit of Allowance for Funds Used During Construction (AFUDC) and regulatory asset carrying costs.

AFUDC and regulatory asset carrying costs are not the same costs. AFUDC is the carrying costs of the plant prior to in-service.[158] Whereas, regulatory asset carrying costs are the carrying costs that are incurred after the plant is in-service.[159] While AFUDC and regulatory asset carrying costs are similar concepts, the carrying cost associated with each of them is for a different point in time and at a different rate.[160] Thus, if the Commission accepts Staff's disallowances on Iatan 1 AQCS, Iatan Common, and Iatan 2, both the AFUDC component and the regulatory-asset-carrying-cost component for the accepted disallowance must also be disallowed. This is not, as the Company asserts, "double-dipping"; it is proper ratemaking treatment.

Staff requests that the Commission remove any amounts included in regulatory assets associated with Staff's disallowances relating to Iatan 1, Iatan 2, and Iatan

[158] Tr. p. 3253, lines 16-19.

[159] Tr. p. 3253, lines 19-22.

[160] Tr. p. 3254, lines 3-5.

Common Plant the Commission accepts.

D. Cost of Capital

Return on Common Equity (ROE):

KCPL's expert, Samuel Hadaway, has used unsustainable growth rates in his analysis to produce an extremely high recommended ROE.[161] As usual, Mr. Hadaway also suggests an "adder" to push the ROE still higher. Michael Gorman, expert witness for the Industrial Intervenors, has produced a recommendation that falls between Staff's and the Companies' as he generally does. Mr. Gorman's recommendation is, for the first time, below 10.00%. It is closer to Staff's position than to the Companies'. The experts' recommendations are set out below:

Expert	Party	Recommendation[162]
Hadaway[163]	KCPL-GMO	10.75%[164]
Gorman[165]	Industrials	9.65%
Murray[166]	Staff	9.00%

The Companies level merciless criticism at Mr. Murray. His recommendation of 9.0% is, we are advised, "well beyond the zone of reasonableness."[167] His reliance on a group of only 10 proxies "is inconsistent with the Supreme Court's decision in

[161] The Companies state in their initial brief, "[t]he most significant factor differentiating Dr. Hadaway from the other two cost of capital witnesses is their use of unreasonably low growth rates." ***KCPL-GMO Brief,*** p. 147, ¶ 312.

[162] Midpoints.

[163] Hadaway Rebuttal Testimony, p. 23.

[164] With 25-basis point adder, worth about $7 million.

[165] Gorman Direct Testimony, p. 37.

[166] Murray Direct Testimony.

[167] ***KCPL-GMO Brief,*** p. 146, ¶ 308.

Bluefield and the cases that follow it."[168] His growth rate of 4.0% to 5.0% is a "subjective formulation . . . rejecting data relied upon by the other two cost of capital witnesses, [and] must be rejected as without proper foundation and not based upon sources reasonably relied upon by expert witnesses."[169]

These criticisms are mere Staff-bashing. The "zone of reasonableness" referred to by the Companies is their own peculiar creation, unrelated to the analytical tool of the same name used in past cases by this Commission.[170] The Companies cite to no authority supporting their assertion that the size of Mr. Murray's proxy group somehow violates ***Bluefield,*** nor can they – there is no such authority. Nor do they provide any analysis based on ***Bluefield*** to support their criticism. As for Mr. Murray's growth rate, one has only to consider the still-sluggish economy, the still-high level of unemployment, to understand that near-term growth is not at all likely to be vigorous, particularly for a mature company in a mature industry. Just where, one wonders, is all the growth expected by Mr. Hadaway to come from?

Interestingly enough, the Companies' Initial Brief criticizes Mr. Murray's lack of direct experience with the capital markets in an attempt to discredit his adjustment to the cost of GPE's equity units. In support of the Companies' criticism, Mr. Cline attached Schedule 5 to his testimony, which is a document Mr. Cline had specifically

[168] *Id.,* p. 147, ¶ 311. *See* ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia,*** 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923) ("***Bluefield***")..

[169] *Id.,* p. 148, ¶ 314.

[170] The Commission has used a "zone of reasonableness" in the past as a way of comparing expert ROE recommendations to the trend of utility ROE awards as reflected by the recent average in the industry under consideration. The zone used by the Commission extended 100 basis points above and 100 basis points below the national average. The Commission has shown little interest in this sort of benchmarking recently.

requested from Goldman Sachs after Staff filed its Cost of Service Report.[171] GPE hired Goldman Sachs as a Joint Book Running Manager in conjunction with its May 2009 dual-tranche offering of GPE's equity units and common equity. Both the common equity and equity units were issued in May 2009. In November 2010, GPE was able to request and receive capital market analysis from Goldman Sachs to criticize Staff's approach to adjusting the cost of equity units. While Staff certainly believes Goldman Sachs is well-qualified to provide reliable analysis on the capital markets,[172] it is the Goldman Sachs analysis that the Companies' rate-of-return witnesses did not attach to their testimonies that should be of particular interest to the Commission.

Specifically, Goldman Sachs provided an April 6, 2009, presentation to the GPE Board of Directors regarding its May 2009 common equity and equity unit offering.[173] According to the Goldman Sachs presentation, the median implied cost of equity estimate for the electric utility industry was ** [redacted] ** in early 2009.[174] Based on Staff's analysis of the price-to-earnings ("P/E") ratios of its comparable group in December 2010 compared to the P/E ratios analyzed by Goldman Sachs in its April 6, 2009, presentation, Staff concluded that a current Goldman Sachs' cost of equity estimate for the electric utility industry would be closer to Goldman Sachs' low cost of equity estimate of ** [redacted] ** provided in its presentation.[175]

Although Staff provided its opinion on the impact the loosening of the capital markets may have had on Goldman Sachs' estimate of the electric utility industry's cost

[171] Hearing Tr. pp. 2898-2899.

[172] Hearing Tr. p. 3005.

[173] Murray Surrebuttal Testimony, Schedule 6

[174] *Id.,* at p. 21.

[175] *Id.,* at p. 21-22.

of equity, it would have been helpful if the Companies had requested such information from Goldman Sachs, just as it requested Goldman Sachs' opinion on the cost of equity units.

Staff urges the Commission to reflect on the implications of the Goldman Sachs presentation. The cost of equity is not a quantity whose value changes depending on the circumstances in which it is used.[176] Samuel Hadaway, hired by the Companies for the purpose of obtaining a rate from this Commission, estimates a cost of equity of 10.75% in the current capital market environment. Goldman Sachs, hired by the Companies to provide expert financial advice to guide their board of directors, estimated a median cost of equity for the electric utility industry of ** [redacted] ** in early 2009, a period of tighter capital markets.[177]

What does this mean? It means that, contrary to the Companies' attempt to portray Staff as an outlier when estimating the cost of equity for the electric utility industry, compared to others estimating the cost of equity in utility rate cases,[178] Staff's cost of equity estimate is actually the closest to the mainstream of electric utility cost of equity estimates of the investment firms that evaluate and participate in the capital markets on a daily basis and, in fact, specifically underwrote hundreds of millions of dollars of capital on behalf of Great Plains Energy in May 2009. The Companies actually urge the Commission to accept the capital market expertise of Goldman Sachs

[176] An example of such a flexible value would be price; another is cost. For example, a forced, quick sale will bring less than a sale under normal market conditions, showing that price is a flexible concept – it is what a buyer is willing to pay and a seller is willing to accept under the circumstances driving each party to the transaction. Cost or value is similar. Replacement cost, for example, is necessarily higher than "as is" or depreciated cost.

[177] *Id.,* at pp. 21-22.

[178] Hearing Tr., pp. 2910-2914.

in their initial brief in respect to the evaluation of the cost of equity units. Why not on the cost of common equity? In fact, if anything, based on Goldman Sachs' median implied cost of equity estimates of **[redacted]** in May 2007, it seems that although Staff's cost of equity estimates have at times been lower than other parties cost of equity estimates, it certainly has been higher than those estimated by one of the most well recognized investment banks in the United States.

ROE Enhancements:

The Companies rely on their "excellent performance in the areas of reliability and customer service" as their basis for requesting that the Commission add 25-basis points to the midpoint of their requested ROE, which is also the high end of their requested ROE. The Companies want the Commission to focus on their 2010 J.D. Power & Associates residential consumer satisfaction survey scores -- but that is not the whole story. KCPL's 2010 score, while higher than its 2009 score, is actually considerably lower than its scores in three of the last four years.[179] Further, electric utility scores went up across the board in 2010, compared to 2009, so there is nothing unique, special, exceptional or significant about KCPL's increased score from 2009 to 2010.[180]

Year	Raw Score
2006	679
2007	697
2008	667
2009	646
2010	**655**

[179] Tr. 29:2962.

[180] As indicated by JD Power's July 14, 2010 press release ". . . Residential customers of electric utility providers indicate that their monthly electric bill amounts have declined and power reliability has improved from 2009, resulting in a notable increase in overall satisfaction . . . Residential customer satisfaction with utility companies averages 630 on a 1,000 point scale in 2010 – increasing from 618 in 2009." Ex. KCP&L—227, Rebuttal Testimony of Lisa A. Kremer, p 16.

The Companies continually blame their increasing level of customer complaints on the current economic recession. But no other large regulated Missouri electric utility, dealing with the same economy, is seeing the same sort of significant increase in customer complaints that KCPL has experienced. Staff witness Lisa Kremer indicated in her hearing testimony that KCPL was the only company to see such a dramatic increase.[181] "If I calculated this correctly, they (KCP&L) are actually 48 percent higher in residential complaints from 2010 to 2008. Empire has declined. Ameren has I would say remained relatively constant. GMO, a little bit of increase."[182]

Lastly, the Companies state that Staff witness Brossier admitted KCPL's service was "very reliable," but the transcript actually reads that he had "not seen a trend upward in reliability" and he had not "seen a trend downward in reliability over the past five years."[183] Mr. Brossier's testimony means that the companies' reliability has stayed at a constant level; Mr. Brossier never characterized the reliability level as either "very reliable" or "very unreliable."

Capital Structure:

Staff expert witness David Murray filed true-up testimony to update capital structure, embedded cost of debt and rate of return.[184] Those figures are:[185]

[181] Tr. 29:2962.

[182] *Id*.

[183] Tr. 29:2964.

[184] David Murray, True-Up Direct Testimony ("Direct"), p. 1. References are to Mr. Murray's true-up testimony in both cases.

[185] *Id.,* pp. 1-2.

Component	KCPL	GMO
Long Term Debt	48.57%	48.87%
Preferred Equity	0.61%	--
Mandatory Convertible Equity Units	4.52%	4.55%
Common Equity	46.30%	46.58%
TOTAL:	**100.00%**	**100.00%**
Rate of Return (Range):	7.78% – 8.24%	7.63% - 8.10%
Rate of Return (Midpoint):	8.01%	7.86%

A controversy emerged during true-up with respect to the cost of debt. GPE issued $250 million worth of 3-year bonds, at an annual coupon rate of 2.75%, on August 13, 2010.[186] All of this debt was assigned to GMO[187] and the proceeds were used to pay off GMO's existing short-term debts.[188] The effect of this maneuver was to cause GMO's embedded cost of debt to drop to 6.42% from 7.07%, compared to KCPL's embedded cost of debt of 6.82%.[189] Staff is concerned because, although GMO is weaker financially than KCPL, its embedded cost of debt is now ***lower*** **than KCPL's** because GPE used the bond proceeds to pay off all of GMO's short-term debt.[190]

Why does this matter? Because GMO's bonds, were GMO a stand-alone, would be rated as junk.[191] If GMO were to have issued the debt in question in this true-up proceeding, which it has not done, then GMO's debt would have been guaranteed by GPE. Instead of GMO issuing its own debt, GPE issued the 2.75% debt and assigned

[186] *Id.,* pp. 2-3. Staff did not include this debt issue in the capital structure of either KCPL or GMO. *See* Murray, True-Up Rebuttal Testimony ("Rebuttal"), p. 2.

[187] Response to Staff DR No. 0159. *See* Murray, Direct, p. 4.

[188] Murray, Direct, p. 3.

[189] Murray, Rebuttal, pp. 2-3. Unchanged from June 30, 2010.

[190] Murray, Rebuttal, p. 3..

[191] *Id.*

the debt proceeds to GMO. GPE's credit quality made this 2.75% debt possible .[192] GPE, in turn, maintains its credit by support from KCPL – its only other asset.[193] This effectively reduces KCPL's credit capacity and increases its cost of money, to the detriment of its ratepayers.[194] Staff believes this is unfair and has suggested that a consolidated GPE cost of debt may be used in future KCPL and GMO ratemaking.[195]

In what way is this maneuver unfair? Although the debt could only be issued at 2.75% because it was ultimately supported by KCPL, none of it was used to benefit KCPL or its ratepayers.[196] GPE has an incentive to carry short-term debt at KCPL rather than GMO because KCPL has access to the commercial paper markets and GMO does not; the cost of commercial paper is lower.[197] For example, on June 30, 2010,[198]

KCPL's commercial paper rate was: 0.44%

GMO's credit facility rate was: 1.625%

Staff objects because GPE is acting to maximize wealth for its shareholders rather than looking out for the best interests of each subsidiary.[199] Why should the ratepayers underwrite this scheme?

In the present case, Staff has recommended using the actual embedded cost of debt for KCPL, 6.825%. For GMO, Staff has recommended using The Empire District

[192] Tr. 45:4880-81.

[193] Murray, Rebuttal, p. 3.

[194] *Id.,* p. 4.

[195] Murray, KCPL Direct, p. 5 and GMO Direct, p. 4

[196] *Id.,* pp,. 4-5.

[197] *Id.,* p. 5.

[198] *Id.*

[199] *Id.*

Electric Company's embedded cost of debt for a proxy, 6.36%.[200] If the Commission does not adopt Staff's proxy cost-of-debt recommendation for GMO, Staff has suggested a ***fair*** alternative based on use of a consolidated GPE cost of debt for both KCPL and GMO.[201] Staff emphasizes that this is an alternative to be used only if the Commission rejects Staff's recommended proxy cost of debt for GMO.[202] If the Commission adopts GMO's proposed cost of debt rather than Staff's, it should use 6.598% as the cost of debt for KCPL. The rate of return would then be 7.67% to 8.13%, midpoint 7.90%.[203]

E. Off-System Sales Margins:

Include OSS margins in rates at the 40th percentile.

Staff recommends that OSS Margins[204] be "baked into" KCPL's rates at the 40th percentile as determined by KCPL expert witness Schnitzer.[205] That figure, updated by Mr. Schnitzer in his true-up testimony, is **[redacted].[206] Staff believes that this treatment is appropriate now that the Iatan Project is completed. During the course of that project, the Company was accorded special treatment to ensure its completion while maintaining the Company's credit. Now that the project is done, the balance must shift back toward the ratepayers.[207]

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[200] *Id.,* p. 6.

[201] *Id.,* pp. 6-8.

[202] *Id.*

[203] *Id.*

[204] "OSS Margins" are profits on sales of un-needed electricity on the wholesale market.

[205] Cary Featherstone, True-Up Direct Testimony, p. 13.

[206] *Id.;* Tr. 46:4839, 4843.

[207] David Murray, True-Up Rebuttal, p. 4:

"Q. Did KCPL's ratepayers pay higher rates than traditional cost of service ratemaking during the period of KCPL's Experimental Alternative Regulatory Plan ("Regulatory Plan")?

Mr. Schnitzer assured the Commission in his true-up testimony that his analysis included the additional generation from Iatan 2, as well as other additional generation at Spearville 2, at Wolf Creek, and amounts released by the expiration of significant contracts such as the MJMEUC contract.[208] Staff is at a loss to understand why Mr. Schnitzer's forecast of OSS margins has declined despite the undeniable fact that KCPL will have more power to sell.[209] As Mr. Schnitzer testified, "Other things being equal, it is more likely that KCPL will make a higher volume of off-system sales than it would without the addition of Iatan 2 because there are additional megawatts to sell."[210]

According to KCPL witness Schnitzer, the Iatan 2 addition will result in **[redacted]** of off-system sales alone.[211] The Iatan 2 levels added to the 2010 actual results of **[redacted]** totals **[redacted]**.[212] This level does not reflect the termination of the MJMEUC contract, nor the increase in sales for Spearville 2, nor the increase in Wolf Creek's generating capacity. Therefore, reflecting the Iatan 2 level of off-system sales margins added to the 2010 actual results would be too low to consider in rates.

Another important point to consider in determining the proper level of off-system

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A. Yes.

Q. Why was this allowed?

A. Signatory parties to KCPL's Regulatory Plan, which was approved by the Commission in Case No. EO-2005-0329, had the understanding that this consideration would be used to target benchmark credit metrics consistent with a 'BBB+' credit rating."

[208] Tr. 45:4823-24. However, he admitted that he excluded OSS from purchases for resale. In 2010, purchased power that was resold made up [redacted] of all OSS [redacted]. This is a significant amount to exclude from his model. It should be noted that Mr. Schnitzer modeled the data KCPL gave him – it was KCPL's decision not to provide him with the purchases for resale data.

[209] V. William Harris, True-Up Rebuttal Testimony, p. 4.

[210] Tr. 45:4823.

[211] Tr. 4820, line 3.

[212] Harris, Ex. KCPL 296, Schedule 1.

sales margins to include in this case is that Mr. Schnitzer did not even consider purchases for resale in his model. Mr. Schnitzer testified that he was told by KCPL that these purchases were insignificant so he did not include those off-system sales transactions in his projections.[213] In reality, these types of off-system sales represented **[redacted]** of total dollar sales and **[redacted]** of total energy sold on a megawatt hour basis for 2010 (purchases for resale total **[redacted]** compared to total sales of **[redacted]** and total purchases for resale total **[redacted]** megawatt hours energy sold compared to total off-system sales of **[redacted]** megawatt hours energy sold).[214] Both the 2010 actual levels and KCPL's proposed amount for off-system sales margins at the 25th Percentile level are overly conservative. The actual 2010 results do not include the additional capacity of Iatan 2 and Spearville 2 wind generation as well as the added capacity at Wolf Creek. When you consider that Mr. Schnitzer's projections do not include purchases for resale, KCPL's proposed off-system sales results are too low. All of the above supports the higher Staff recommendation of **[redacted]** level instead of the amount proposed by KCPL in this case.

With respect to GMO, Staff urges the Commission to require GMO to engage in an appropriate level of OSS. The figures produced since the acquisition of Aquila by KCPL indicate that little attention is paid to OSS by GMO. That situation must change.

Therefore, the level of off-system sales determined by Staff for GMO (both MPS and L&P) should be used to set rates in the GMO rate case. Staff witness Harris

[213] Tr. 4862.

[214] KCPL Ex. 296, Harris True-up Rebuttal, Schedule 1.

recommended the use of a two-year average based on actual results for off-system sales for 2007 and 2008.[215]

Exclude the SPP Line Loss Charge adjustment:

Staff continues to oppose the Companies' proposed adjustment for SPP line loss charges. The Companies presented nothing of note on this issue in their initial brief.[216] Staff reiterates that, because of the associated charges, KCPL would not make these sales unless the sales price included a net profit.[217] Since KCPL is thus already receiving the amount of the charges from the customers who buy the power, the Companies should not receive a double recovery from the ratepayers.[218]

F. Fuel & Purchased Power Expense:

Allocation Factors:

Staff expert Erin Maloney filed true-up testimony in order to describe the true-up allocation factors used for annualizing fuel expense between MPS and L&P, GMO's two, non-contiguous service areas.[219] Those factors are:[220]

** [redacted] **
** [redacted] **

Ms. Maloney described an increase of 1.5% for L&P and a corresponding decrease of 1.5% for MPS because L&P experienced a higher rate of load growth between the end of the test year and the true-up date.[221]

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[215] GMO Ex. 220-- Harris Rebuttal, page 4.

[216] ***KCPL-GMO Brief,*** pp. 158-159, ¶¶ 343-344.

[217] *Id.,* p. 3.

[218] *Id.*

[219] Erin Maloney, True-Up Direct Testimony, p. 1.

[220] *Id.*

[221] *Id.,* at p. 2.

The assignment of Iatan 2 generation to GMO's service areas, for the purpose of recalculating the allocation factors, is as follows:[222]

[redacted]

There was no cross-examination of Ms. Maloney.[223]

Natural Gas Costs:

Staff has no dispute with the Companies on this issue.

Wolf Creek Oil Expense:

Staff has no dispute with the Companies on this issue.

MJMEUC Load:

Staff has no dispute with the Companies on this issue.

Spot Market Prices:

Staff continues to oppose the use of the methodology proposed by the Companies for determining spot-market prices. Staff's method is based upon historical test-year data as required by the Commission's use of a historical test year in this case.

The Companies complain that Staff's model "does not consider the impact of other market price drivers, such as natural gas prices, environmental allowances or other factors of electric production."[224] Staff responds that the Companies rely upon a "host of other forecasted inputs"[225] that are "only as good as the input assumptions."[226]

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[222] *Id.*

[223] Tr. 43:4771.

[224] ***KCPL-GMO Brief,*** at 161-162, ¶356, *quoting* Burton Crawford, KCPL Rebuttal Testimony, p. 6.

[225] *Id.,* pp. 1-2.

[226] Crawford, *Direct Testimony* (Case No. ER-2010-0356), p. 4.

The Companies' method adds "another level of possible inaccuracy"[227] and should be rejected.

G. Transition Cost Recovery:

Staff believes it is unreasonable to allow KCPL and GMO to recover these costs twice. KCPL is incorrect in their statement that there has been no testimony by any party which challenges or even questions the reasonableness or prudence of the merger transition costs. Staff does not challenge the prudence and reasonableness of KCPL *incurring* the transition costs; Staff does challenge including those costs in the cost of service if those costs have already been fully recovered. Staff agrees with KCPL that it would be unreasonable to recover again those transition costs that were recovered through retained synergies by means of regulatory lag.[228]

Staff has maintained that those transition costs have been recovered and provides uncontroverted evidence throughout its testimony to that effect. KCPL, GMO and GPE shareholders have received benefits from the acquisition of Aquila since July 2008. Because of regulatory lag, they will continue to enjoy this benefit for over 33 months until the full value of the synergies are reflected in rates on May 4, 2011, and June 4, 2011, for KCPL and GMO, respectively.[229]

In addition, Staff Witness Majors provided proof and testimony that shows that the balance of savings will be further skewed in the company's favor if the Commission were to authorize the company to reflect the amortization in the cost of service.[230]

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[227] Maloney, *supra,* p. 2.

[228] Tr. 3471:4-9.

[229] Ex. KCP&L 230, *Keith Majors Rebuttal testimony, ER-2010-0355, page 6.*

[230] Ex. KCP&L 231, *Keith Majors Surrebuttal testimony,* ER-2010-0355, page 13.

Staff has not ignored the standard established by the Commission. However, the Staff is also guided by the law, which holds that "[t]he Commission is not limited to prudence determinations and prudence disallowances."[231] Further, "[a]t any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation[.]"[232] Because the Company bears the burden of proof, any failure of proof must be held against the Company.[233] As previously stated, Staff believes it is unreasonable to allow KCPL and GMO to recover these costs twice. Staff believes it would be unreasonable to recover transition costs in rates that have already been recovered through regulatory lag.[234]

It is Staff's duty to comply with Commission orders, including ones that state that the "Commission reserves the right to consider any ratemaking treatment to afforded the transactions herein involved in a later proceeding."[235] However, that is not the sole reason for the Staff's position that the Company's double recovery is wholly unreasonable. Staff also performed an analysis of the Administrative & General (A&G) expenses for KCPL and GMO, and other electric utilities in the region.[236] The results of Staff's uncontroverted analysis shows that KCPL and GMO, on a combined company basis, have the highest A&G expenses per customer, per megawatt hour sold, and per

[231] ***State ex rel. Laclede Gas Co. v. Public Serv. Comm'n,*** 600 S.W.2d 222, 228-29 (Mo. App., W.D. 1980), app. diss'd, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981); ***State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n,*** 645 S.W.2d 44, 55-56 (Mo. App., W.D. 1982).

[232] Section 393.150.2, RSMo.

[233] ***State ex rel. GS Technologies Operating Co. v. Public Serv. Comm'n*****,** 116 S.W.3d 680, 693-94 (Mo. App., W.D. 2003).

[234] *See* Tr. p. 3497.

[235] *See* Merger Order at 284.

[236] Ex. KCP&L 231, *Surrebuttal testimony of Keith Majors,* page 16 lines 7-11

dollar of operating revenue.[237] Neither KCPL nor GMO made any attempt to challenge this analysis or its results.

Substantial and competent evidence in the record as a whole supports the fact that the transition costs have already been recovered. KCPL and GMO have not provided evidence that shows that those costs have ***not*** already been recovered. Nor has KCPL or GMO denied that, because of regulatory lag, they will continue to enjoy this benefit for over 33 months until the full value of the synergies are reflected in rates on May 4, 2011, and June 4, 2011, for KCPL and GMO, respectively.[238]

Therefore, the Staff believes that the Commission's Report and Order should contain the following finding of fact: Substantial and competent evidence in the record as a whole supports the fact that the transition costs have already been recovered.

H. Rate Case Expense:

What is the appropriate level of rate case expense to include in this proceeding?

The Company's *Post Hearing Brief* did not raise any points left unaddressed by the *Staff's Initial Brief*. To the extent the issue's importance requires repeating, it remains the Staff's position that rate case expense became a true-up issue due to the delay by both KCPL and GMO in providing invoices for the Staff's review of prudence and reasonableness. The Staff's direct case cannot support any level of rate case expense for several vendors because it did not receive actual invoices, which were originally requested in June 2010 for KCPL and in July 2010 for GMO, until November 29, 2010, after the filing deadlines for Staff's direct case in both cases. Prior to that

[237] *Id.,* at 16, line11, through p. 17, line 10

[238] Ex. KCP&L 230, *Keith Majors Rebuttal testimony,* ER-2010-0355, page 6.

time, KCPL and GMO had only provided “face sheets” to invoices, which makes no mention of the hourly rates charged, the number of hours worked, a description of the work done and by whom, or any additional expenses incurred by the vendor to perform the work; information necessary for any review of prudence or reasonableness.

Even the delay experienced by the Kansas Corporation Commission (KCC) supports the Staff’s position that this issue became a true-up issue; the KCC’s Report and Order states that “**Staff noted an adjustment for rate case expense could not be reasonably estimated at the time Staff’s testimony was filed and stated these costs can be trued-up later in the proceeding.**” And the Staff’s uncontested testimony at the evidentiary hearing supports the Commission’s issuance of an Order with such a finding. But should the Commission accept both KCPL and GMO’s position that rate case expense remained as part of the direct case, then the Commission should also accept the Staff’s disallowances of rate case expense filed as part of its direct case. It is the Staff’s recommendation that for the Commission to do otherwise would be in effect penalizing the ratepayers who will bear the brunt of any significant increase in costs allowed, while rewarding the Companies for their inappropriate behavior.

True-up:

This issue took on the nature of a true up item due to the Companies’ delay in providing information to the Staff to support its level of rate case expense. The Staff suggests that the Commission not ignore the fact that in two back-to-back similar rate cases, both the Staff of this Commission and that of the KCC experienced difficulty in obtaining information from the Companies to support their request.

The KCC noted that “[t]he attempt to determine rate case expense is hampered

by a lack of detailed information in the record … Because that detailed information is not contained in this record, *the Commission has considered denying recovery of all rate case expense in this proceeding*."[239] The burden of proof is upon the Companies to support their level of expense when requesting that the customers carry the costs in rates. The Staff's timeline contained within its surrebuttal testimony, as well as the true-up exhibits,[240] demonstrate the difficulty in obtaining information from the Companies. The Staff requested information from the Companies on several occasions only to wait, five (5) months for GMO and six (6) months for KCPL, to receive the information covered in the initial request.[241] Even then, certain requests received a "go fetch" response, even though the Company had the specific documents requested readily available for the Staff's review.[242]

Between the Missouri and Kansas jurisdictions, KCPL seeks the recovery of approximately $18 million in rate case expense. And even conceding the complex nature of the proceedings, one must be particularly struck by the level of rate case expense requested from the ratepayers; an anticipated $11 million between KCPL and GMO in Missouri. It is unreasonable for the Company to expect the Staff to audit rate case expense at such a large magnitude on one-twenty fifth (1/25) of the time when compared to Staff's original discovery requests of the Companies.

The Commission is not limited to disallowing costs for imprudence. The Commission can disallow costs that are not of benefit to ratepayers, and there does not

[239] KCPL--231,Surrebuttal Testimony of Keith Majors, Sch. 5-8. (emphasis added).

[240] KCPL—318 through KCPL—327.

[241] *Id.*

[242] KCPL—327, KCPL—321.

need to be a showing of bad faith or abuse of discretion for the Commission to disallow costs.[243] Given KCPL's fondness to cite the KCC Order as precedent for other issues in the current Missouri rate cases, the Commission should also consider what the KCC determined for reasonable rate case expenses. Both the Staff's True-Up testimony and the KCC Order support the following disallowances of expenses for Morgan, Lewis & Bockius, Schiff Hardin, NextSource, and the Communication Counsel of America due to excessiveness or duplication of services:

	KCPL	GMO-MPS	GMO-L&P
Total Deferred Expense	4,593,427	2,001,855	1,175,870
Communication Counsel of America	(17,737)	(16,195)	(4,627)
Morgan Lewis & Bockius	(194,938)	(110,931)	(60,634)
Schiff Hardin	(415,603)	(45,759)	
NextSource	(226,937)	(78,943)	(32,357)
Adjusted Rate Case Expense	3,738,211	1,750,026	1,078,252

As to the charges of Morgan, Lewis & Bockius, the hourly rates were significantly higher than the highest paid attorney from a Missouri firm in this case. Also, some charges related to attorneys not known to be involved in the current rate cases. In addition to the hourly rates, duplication of services is an issue with this vendor. The KCC also found this vendor's services to be duplicative. The KCC noted the duplicative nature of Ms. Barbara Van Gelder's services for the firm and noted she was retained to cross-examine one particular Staff witness, but that four capable attorneys for KCPL were in the hearing room while she did so.[244] The KCC reasoned, "KCPL is free to decide how it will present its case, but this firm's involvement clearly duplicated work

[243] ***State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*****,** 600 S.W.2d 222, 228-29 (Mo. App., W.D. 1980), *app. dis'd*, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981); ***State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n,*** 645 S.W.2d 44, 55-56 (Mo. App., W.D. 1982).

[244] KCPL—231, Surrebuttal Testimony of Keith Majors, Sch. 5

being performed by other very capable attorneys. Allowing expenses for Morgan Lewis to be recovered from ratepayers in rate case expense would be unjust and unreasonable."[245]

Similarly, during the cross-examination on rate case expense, Company witness Weisensee identified two external counsel and two internal counsel present for KCPL and GMO.[246] Also, during the April 2010 proceedings related to File No. EO-2010-0259, several KCPL outside attorneys were present at one time or another, including Mr. Riggins, former general counsel at KCPL, an attorney from SNR Denton, an attorney from Fischer & Dority, an attorney from Stinson, Morrison & Hecker, and an attorney from Morgan, Lewis & Bockius.

The Staff is also recommending disallowance of portions of Schiff Hardin's charges due to the excessiveness of the rates charged and duplicity of services. Again for support, the KCC found the expenses requested for Schiff Hardin "particularly troubling."[247] The hourly rate charged by Schiff Hardin in the KCC case exceeded those for experienced attorneys in the Kansas City metropolitan area.[248] In this case, Schiff Hardin charged hourly attorney fees in excess of the hourly rates of experienced attorneys who regularly practice before the Commission. And, while the KCC noted the case contained complex issues concerning the construction of a major generating facility, it found it "unreasonable to require ratepayers to be responsible for the entire rate case expense costs being sought by KCPL."[249] The Staff adjusted the amount of

[245] *Id.*

[246] Tr. 35:3629-3632.

[247] KCPL—231, Surrebuttal Testimony of Keith Majors, Sch. 5-13

[248] *Id.*

[249] KCPL—231, Surrebuttal Testimony of Keith Majors, Sch. 5

Schiff Hardin fees to an hourly rate billed by another vendor providing similar testimony in this case.

The Staff's disallowance for NextSource remains the same as recommended in its rebuttal testimony for the duplicative work performed by Mr. Chris Giles, a contractor hired through NextSource. However, the Staff has allocated the disallowance within the true-up to 67% to KCPL, 23% to GMO-MPS and 10% to GMO-L&P. The KCC did not include any expenses for NextSource as KCPL could not explain why its own employees could not perform the work done by this vendor.[250]

In regards to the Communication Counsel of America (CCA) expense, the Staff recommends disallowance of these fees as duplicative of other services performed by KCPL and GMO's attorneys. The Staff understands that the CCA provided witness development and coaching services, routine tasks typically performed by retained counsel, internal or otherwise. The KCC also disallowed expenses from the CCA as unjust and unreasonable.[251] The CCA also trained KCPL witnesses for the KCC hearing.[252] While the KCC noted witness preparation as important, "such preparation is routinely part of the service counsel performs before a hearing."[253]

The Staff's True-Up testimony also supports the disallowance of the other hourly attorney fees in excess of the hourly rates of experienced attorneys whom regularly practice before the Commission. For this rate case, KCPL and GMO procured legal services from no less than nine vendors, all of whom were charged to Missouri rate

[250] KCPL-231, Sch p. 5-11

[251] *Id.*

[252] *Id.*

[253] *Id.*

case expense.[254] In Case No. GR-2004-0209, the Commission reduced the amount of rate case expense incurred by Missouri Gas Energy (MGE) by the disallowance of certain attorney fees. In that Report and Order, the Commission recognized the unfairness of charging ratepayers high attorney fees:

> In this case, MGE, or perhaps Southern Union, chose to hire the Kasowitz, Benson, Torres & Friedman law firm out of New York. MGE explained that it chose that firm because it had previously represented Southern Union in other complex litigation and the company was very pleased with the results obtained in that case. The other litigation for which the Kasowitz firm had represented Southern Union was, however, a merger and acquisition case and this case was the firm's first litigated regulatory rate case.
>
> Eric Herschmann and Michael Fay of the Kasowitz firm did a good job of representing their client at the hearing. But the firm charged up to $690 per hour for its work. That rate is far higher than the typical rates charged by lawyers appearing before this Commission. The company is certainly entitled to hire lawyers with whom it is comfortable, but it would not be fair to require ratepayers to pay such high rates. The Commission will reduce the rate to $200 per hour, which is the rate charged by MGE's local counsel. The $16,250.75 in expenses incurred by the Kasowitz firm will be allowed. The total allowed for representation by Kasowitz, Benson, Torres & Friedman is $188,200.75.

The Commission also took a similar position in Case No. WR-93-212, ***In the matter of Missouri-American Water Company for authority to file tariffs reflecting increased rates for water service in the Missouri service area of the Company***. The Commission found that where the record regarding expenses for expert witnesses and legal counsel reflected no effort at cost containment, the record consequently did not support that these expenses were prudently incurred.

The KCC ultimately decided that $4.5 million of the $7.2 million rate case

[254] KCP&L—231, Surrebuttal Testimony of Keith Majors, p.29, GMO—230, Surrebuttal Testimony of Keith Majors, p. 28.

expense amount was an appropriate amount for recovery by KCPL.[255] The KCC reasoned that, while KCPL is free to decide how it will present its case, it would be unjust and unreasonable for ratepayers to pay for duplicative fees and excessive rates. The Staff takes the same position in this case. Therefore, the Staff recommends that the Commission issue an Order that at a minimum adopts the specific disallowances provided in the above chart, as well as reduces the hourly rates for attorney fees to a level comparable to that of KCPL's local counsel, Fischer and Dority.[256]

I. Hawthorn 5 Settlement:

Should the Hawthorn SCR settlement payments be included in either the depreciation reserve or plant cost?

As stated in the *Staff's Initial Brief*, it remains the Staff's position that KCPL's customers should receive the benefit of the Warranty Settlement payment received by the Company for the defective SCR in service. The Staff's uncontested testimony at hearing supports a finding by the Commission that KCPL's customers have paid increased capital and operation and maintenance costs in past rates. The Company's current rates reflect the higher capital and operation and maintenance costs resulting from the failure of the SCR to perform to the level contracted for by KCPL for the re-building of Hawthorn 5 in June 2001. Rates determined in this case will reflect higher costs as well. In fact, customers will continue to pay such higher costs until the retirement of the defective plant. As such, the Staff recommends that the Commission issue an Order that allows the ratepayers, instead of the Company's shareholders, to receive the benefit of the Warranty Settlement.

[255] KCPL—231, Surrebuttal Testimony of Keith Majors, Sch p. 5-14

[256] KCPL—321 HC, Staff Data Request 141.3; KCPL—327, Staff Data Request 627.

The Company's *Post Hearing Brief* did not raise any points not addressed by the *Staff's Initial Brief*. To the extent the issue's importance requires repeating, the customers have paid in rates the increased costs experienced by KCPL. The Staff stated within its unchallenged testimony that it included in this case, and past rate cases, increased fuel and purchased power, maintenance and capital costs for the SCR failure. The Company's own witness could not profess he was an expert in determining the Company's cost of service, had never worked on the area of fuel or determined how fuel costs were determined in a rate case, was neither qualified as an accountant or auditor, has neither examined the Company's books and records to develop a cost of service, nor managed the Company's books and records for recording liability and asset amounts.

It is disingenuous for KCPL to argue that the Staff has not captured these increased costs in rates during any of the Company's four rate cases since 2005. In fact, it is more than disingenuous to suggest as KCPL does, that customers are not paying higher costs in current rates as well as the rates that will be established in this case for both the SCR and transformer failures. Numerous Company responses identify the increased costs KCPL anticipates to incur over the life of the plant and as a direct result of the SCR's failed performance standards. And by the Company's own admission, it has not only sought damages for certain increased costs, but has used Company employees to aid in obtaining the settlement proceeds. Had the Company not removed the settlement proceeds to "below the line" prior to the Company's 2010 rate increase request, the Staff would have specifically reviewed the settlement line items as part of the Company's filing.

Therefore, the Staff recommends that the Commission issue an order directing KCPL to file tariffs containing the specific adjustments on this issue as proposed by the Staff within its *Cost of Service Report*.

Should the Hawthorn Transformer Settlement payment be included in either the depreciation reserve or plant cost?

As stated in the *Staff's Initial Brief*, it remains the Staff's position that KCPL customers should receive the benefit of the Transformer Settlement payment received by the Company for the defective plant in service. The Staff's uncontested testimony at hearing supports a finding by the Commission that KCPL's customers have paid the costs to replace the defective transformer, in addition to the increased purchased power costs for the power KCPL acquired to serve its customers during the Company's outage. Therefore, the Staff recommends that the Commission issue an Order that allows the ratepayers, instead of the Company's shareholders, to receive the benefit of the Transformer Settlement payment.

The Company's *Post Hearing Brief* did not raise any points not addressed by the *Staff's Initial Brief*. To the extent the issue's importance requires repeating, the customers have paid in rates the increased costs experienced by KCPL. The Staff stated within its unchallenged testimony that KCPL customers have paid higher costs for the substandard plant performance due the transformer failure. The Company's witness testified that besides his related recommendation in this case, he had never proposed adjustments in a rate case for fuel costs, nor had he proposed adjustments in a rate case for purchase power costs. By this lack of experience, the witness was just plain unaware that through the Staff's method of outage and purchase power calculations, increases in fuel and purchased power costs relating to the transformer

failure were first reflected in rates in Case No. ER-2006-0314—the 2006 rate case. Higher costs were also included in the 2007 rate case and again in the 2009 rate case. The Staff normalized, **which does not mean exclude** as argued by the Company, these higher costs for the transformer failure in the last three rate cases. In other words—the higher fuel and purchased power costs in the past were reflected in Missouri rates starting with the 2006 rate case and continued to the 2009 rate case. Thus, the current rates are based on higher fuel costs and capital costs for both the SCR and transformer failures.

It is disingenuous for KCPL to argue that the Staff and the Company have not included the higher costs for the transformer failure within the last three rate cases. The Commission's Report and Order in the ER-2006-0314 case, where the Order states "KCPL has accepted the Staff's fuel and purchased power numbers," supports the Staff's position that both the Staff and the Company have included the higher costs within the fuel models for the last three cases. Both the 2006 and 2007 transformer related outages continue to be included in both the Staff's and the Company's outage averages used in the fuel model calculation. These outages result in higher outage rates and therefore, higher fuel costs. It is with certainty that the August 2005 transformer failure was reflected in the forced outage rate of the 2006, 2007 and 2009 rate cases (the basis for existing rates). This forced outage rate continues to be used as part of the average for the maintenance outage schedule for the fuel model—the basis for the fuel expense used in this case.

The customers have also paid increased capital costs, maintenance expense and depreciation expense. By the Company's own admission, it has not only included

an increased capital amount in the rate base of this case by way of the new GE Transformer, but has incurred increased costs in maintenance expense due to the transformer defect. KCPL has also admitted using Company employees to aid it in obtaining the Transformer Settlement proceeds.

Therefore, the Staff recommends that the Commission issue an order directing KCPL to file tariffs containing the specific adjustments on this issue as proposed by the Staff within its *Cost of Service Report*.

J. Fuel Switching:

Should the Commission adopt MGE's fuel switching proposal?

In response to MGE's *Post-Hearing Brief*, MGE fails to address two important points of Staff's testimony, that is: (1) the Commission should not allow the involuntary adoption of a demand-side program by KCPL and GMO as proposed by a competitor; and (2) KCPL and GMO should only adopt demand-side programs that the Company has analyzed and reviewed through the Chapter 22 Integrated Resource Planning integration analysis.

As to involuntary adoption, MGE's witness points to several companies with such a fuel switching program to support its position. However these "comparable" companies differ drastically from both KCPL and GMO; where KCPL and GMO are electric service providers only, MGE's comparables include diversified companies (electricity, natural gas, pipelines and energy marketing), or combined companies (provider of both electric and natural gas services).[258] Additionally, both KCPL and GMO are strong summer peaking utilities, while at least two of MGE's comparable

[258] KCP&L—239, Rebuttal Testimony of John. A. Rogers, pp. 10-11; GMO—240, Rebuttal Testimony of John A. Rogers, pp. 19-21.

companies are winter peaking utilities.[259] Fuel switching programs for these comparable companies would result in money moving from "one pocket to the other" within the utility. But, MGE's proposed fuel switching program results in money moving from KCPL's and GMO's pockets to the pocket of MGE. The Commission should not interfere with the market forces at play to artificially increase the demand for natural gas. MGE has pointed to no market failure that would require the Commission to take such a drastic measure.

Perhaps even more detrimental to MGE's position is its failure to consider the need for company demand-side programs to undergo scrutiny and review within a Chapter 22 Electric Utility Resource Planning integration analysis. Evaluation of demand-side resources in Missouri must be in compliance with the Commission's Chapter 22 Electric Utility Resource Planning rules.[260] Such rules evaluate all supply-side and demand-side resources on an equivalent basis through comprehensive resource analysis, integration analysis, risk analysis and strategy selection.[261] The electric utility uses the Total Resource Cost (TRC) test only in the screening of DSM measures and DSM programs.[262] The electric utility then forwards on the demand-side programs that pass the TRC screening test for consideration as demand-side resources in the utility's Chapter 22 integrated resource analysis.[263] MGE has neither evaluated its proposed fuel switching program through a Chapter 22 integrated resource analysis,

[259] *Id.*

[260] KCP&L—239, Rebuttal Testimony of John. A. Rogers, p 12; GMO—240, Rebuttal Testimony of John A. Rogers, p. 21.

[261] KCP&L—239, Rebuttal Testimony of John. A. Rogers, p 12; GMO—240, Rebuttal Testimony of John A. Rogers, p. 21.

[262] *Id.*

[263] *Id.*

nor performed any analysis of the cost effectiveness of the proposed fuel switching program for KCPL or GMO.

The Staff will not deny that there are some advantages to fuel switching in the appropriate situations. However, the Staff does not consider the proposal by a competitor within a utility's rate case one of them. Therefore, the Staff recommends that the Commission not approve the fuel switching program as proposed by MGE.

K. Demand-Side Management (DSM):

Should KCPL's DSM investments be included in rate base in this proceeding?

As stated in the *Staff's Initial Brief*, it remains the Staff's position that the Commission should not include DSM investments in rate base in this proceeding. The Staff's uncontested testimony at hearing supports this finding by the Commission.

The Company's *Post Hearing Brief* did not raise any points left unaddressed by the *Staff's Initial Brief*. To the extent the issue's importance requires repeating, KCPL made a commitment within the Stipulation and Agreement of Case No. EO-2005-0329 for "….the creation of a regulatory asset for the stated [DSM] programs, the amortization of that asset, and the financial return the Company can earn on that asset."[264] KCPL also committed to "….cooperate in defending the validity and enforceability of this Agreement and the operation of this Agreement according to its terms."[265] KCPL cannot pick and choose certain provisions of the Agreement that it feels no longer applies without the support of all other parties to the Agreement.

The Company's *Post Hearing Brief* states "KCP&L has not taken any action in this rate case beyond what is currently in place and was established in the Regulatory

[264] KCP&L-226, Surrebuttal Testimony of Charles Hyneman, p. 60.

[265] *Id.,* p.. 61.

Plan with regard to DSM investments."[266] KCPL's proposal is in essence a request to be "excused" from the terms and conditions of a contract that the Company obligated itself to carry out, and to which other parties relied in settlement of various issues. The Staff recommends that the Commission issue an Order that: (1) does not allow KCPL to unilaterally change the provisions of the Agreement entered into by numerous parties; and (2) directs KCPL to continue the Agreement's treatment of DSM programs through this case by accumulating the costs of certain DSM programs in an asset account, amortizing the account over a ten (10) year period with a return not greater than KCPL's AFUDC rate.

How should DSM amortization expense be determined in this case?

Both KCPL and the Missouri Department of Natural Resources (MDNR) agreed to the treatment of the DSM regulatory asset within Case No. EO-2005-0329. Staff's Adjustments E-144.4 through E-144.7, and E-144.8 through E-144.11 contain the ratemaking calculations for the Company's DSM deferrals and AFUDC returns.[267] The Staff calculated "Vintage 4" by using the agreed upon ten (10) year amortization period for deferrals.[268] Now, both KCPL and MDNR suggest it proper to alter the binding settlement Agreement to allow the reduction of the amortization period from ten (10) years to six (6) years. And both KCPL and DNR argue that the Staff's netting calculation is improper, but have not suggested that the resulting deferral amount and return are incorrect. For the reasons stated above in item a, the Staff recommends that the Commission issue an Order that: (1) does not allow KCPL to unilaterally change the

[266] *Post Hearing Brief of Kansas City Power & Light Company And KCP&L Greater Missouri Operations Company,* p. 191.

[267] KCP&L—225, Rebuttal Testimony of Charles Hyneman, as updated in true-up.

[268] KCP&L—225, Rebuttal Testimony of Charles Hyneman.

provisions of the Agreement entered into by numerous parties; and (2) directs KCPL to continue the Agreement's treatment of DSM programs through this case by accumulating the costs of the certain DSM programs in an asset account, amortizing the deferral amount as determined by the Staff over a ten (10) year period with a return not greater than KCPL's AFUDC rate.

Should the Company be required to fund DSM programs at the current level?

Neither the Company's *Post Hearing Brief*, nor MDNR's *Initial Brief* raise any points not addressed by the *Staff's Initial Brief*. To the extent the issue's importance requires repeating, the Missouri Energy Efficiency Investment Act (MEEIA) is Missouri state law and utilities within the Commission's jurisdiction must comply with MEEIA, regardless of whether or not proposed rules under the law become effective. This is by the Companies' own admission.[269] They both also admitted that neither Company has filed reasoning to suggest that the Companies' preferred DSM programs are no longer cost effective.[270] Yet, both Companies have affirmatively stated that they will not do so without the "appropriate" cost recovery mechanisms; all in violation of MEEIA.

Despite the success and forward momentum created by the implementation of their existing DSM programs, both KCPL and GMO have expressed a position to slow spending for the programs.[271] This decision comes even though both Companies realize that they, as well as the ratepayers, stand to benefit from continuing efforts to achieve more DSM programs and improved DSM penetration.[272] In the case of KCPL,

[269] Tr. 32:3547, line 1-4.

[270] Tr. 32:3551, lines 17-24, 32:3552, lines 16-20.

[271] KCP&L—239, Rebuttal Testimony of John A. Rogers, p. 6-7; GMO—240, Rebuttal Testimony of John A. Rogers, pp. 12, 15.

[272] *Id.*

increasing DSM funding is preferred to curtailing program spending when evaluating the need for additional supply-side resources over the next 25 years.[273] GMO also made statements regarding the curtailing of current DSM programs and delaying implementation of planned DSM programs.[274]

Both KCPL's and GMO's curtailing of DSM programs goes directly against MEEIA's statutory mandate to "implement commission-approved demand-side programs proposed pursuant to this section *with a goal of achieving all cost-effective demand-side savings.*" While, the Companies argue that an appropriate cost recovery mechanism must be in place to pursue the DSM programs, both have failed to recommend in these rate proceedings what they consider to be an "appropriate" cost recovery mechanism. In the case of GMO, why does the Company even argue for a change in a cost recovery mechanism when the Company does not currently have an approved adopted resource plan with DSM programs in place?

The Staff recommends that the Commission issue an order directing both KCPL and GMO to comply with the MEEIA goal of achieving all cost-effective demand-side savings by continuing to fund and promote, or implement, the DSM programs in the 2005 Agreement (KCPL only), and in its last adopted preferred resource plan (both KCPL and GMO), unless the Companies can demonstrate the continuation or implementation of their respective programs no longer promotes MEEIA's goal of achieving all cost-effective demand-side savings.

[273] *Id.*

[274] *Id.*

Should KCP&L and GMO be required to make a compliance filing with the Commission regarding MEEIA legislation as proposed by Staff?

Neither the Company's *Post Hearing Brief*, nor MDNR's *Initial Brief* raise any points left unaddressed by the *Staff's Initial Brief*. To the extent the issue's importance requires repeating, the Missouri Energy Efficiency Investment Act (MEEIA) is Missouri state law and utilities within the Commission's jurisdiction must comply with MEEIA, regardless of whether or not proposed rules under the law become effective. This is by the Companies' own admission.[275] Both KCPL and GMO also admitted that neither has filed reasoning to suggest that the companies' preferred DSM programs are no longer cost effective.[276] Yet the companies have failed to implement all DSM programs to date, have affirmatively stated that they will not do so without the "appropriate" cost recovery mechanisms, and are curtailing certain current DSM programs; all in violation of MEEIA. Neither Company proposed in this case what they consider an "appropriate" cost recovery mechanism to be. For the reasons stated above in item e, the Commission should issue an order directing both KCPL and GMO within a prescribed amount of time to make compliance filings as to why the continuation or implementation of their respective DSM programs no longer promotes MEEIA's goal of achieving all cost-effective demand-side savings.

L. Low-Income Weatherization Program Funding:

Staff believes this rate case is the proper forum to discuss the issue of the Low Income Weatherization Program funding. The Customer Program Advisory Group, (CPAG), which includes Staff, the Office of the Public Counsel, the Missouri Department

[275] Tr. 32:3547, line 1-4.

[276] Tr. 32:3551, lines 17-24, 32:3552, lines 16-20.

of Natural Resources, the City of Kansas City, and Praxair, Inc., has tracked, discussed, and overseen the implementation and evaluation of KCPL's Low-Income Weatherization Program.[277] The GMO Advisory Group (GMOAG), which includes Staff, the Office of the Public Counsel, the Missouri Department of Natural Resources, the City of Kansas City, and the Sedalia Industrial Energy Users Association, has tracked, discussed, and overseen the implementation and evaluation of GMO's Low-Income Weatherization Program.[278] However, as the name implies, these are *advisory* groups for implementing and evaluating the demand-side programs. The advisory groups cannot and should not decide the budget for low-income energy efficiency programs. The actual decision regarding the funding of energy efficiency programs is KCPL's and GMO's responsibility.[279]

KCPL and GMO request the Commission to move forward to implement the cost recovery issue expeditiously, including the recovery of lost revenues associated with the specific DSM programs.[280] Yet, the Companies reject the idea of the rate case being the forum to discuss Low Income Weatherization Program funding. KCPL and GMO suggest it would be unlawful for the Commission to mandate specific funding for low income weatherization without a mechanism for the Companies to recover mandated expenditures. However, Staff's recommendations stem from programs and policies that KCPL and GMO previously set in place.

[277] KCPL-GMO Low Income Weatherization Program Evaluation, Opinion Dynamics Corporation, August, 2010.

[278] *Id.*

[279] Surrebuttal Testimony of Henry E. Warren, p.2of both ER-2010-0355 and ER-2010-0356

[280] *See* Hearing Exhibit KCP&L-55 (NP), Rush Rebuttal at p. 8.

KCPL's argues that the Commission can't order spending without a cost recovery mechanism. The Commission has required spending by other utilities and the amount is included in the case as an expense.[281]

KCPL has utilized, approximately **[redacted]** of the funds that it budgeted and allocated for Low Income Weatherization.[282] GMO has only utilized **[redacted]** of the 2007 through 2010 budgeted funds for weatherization.[283]

Staff recommends that KCPL continue its current level of funding and recommends that GMO provide **[redacted]** to the Low Income Weatherization Program. Staff also recommends that KCPL and GMO continue the Low Income Weatherization programs under the advice of the KCPL Customer Program Advisory Group (CPAG) and the GMO Advisory Group as provided in the respective resource plans.

Staff further recommends that KCPL and GMO deposit into an EIERA account any budgeted money that has not been disbursed at the end of each fiscal year and that has been specifically targeted for the Low Income Weatherization Program to be utilized by the Community Action agencies or other local agencies. Additionally, any funds that have not been spent as included in KCPL's regulatory plan and GMO's 2007 through 2010 budget should be put in an EIERA account. Staff also recommends that funds expended will be placed in the DSM regulatory asset account at the time it is provided to the weatherization agency or when sent to EIERA.

[281] Case No. ER-2008-0318.

[282] Tr. 3609, lines 21-23.

[283] Direct Testimony of Henry E. Warren (HC), p.154, Staff Report, Revenue Requirement Cost of Service.

Therefore, Staff believes that the Commission's Report and Order should contain the Staff's aforementioned recommendations as a finding of fact.

M. Pension and OPEB Trackers:

Staff has nothing further on this issue.

N. Other Issues:

Advanced Coal Tax Credit:

It is disturbing that GMO and KCPL speak in unison on these advanced coal tax credits issues in their initial brief and throughout the cases, since ***GMO has not only realized no benefit from KCPL's actions regarding advanced coal tax credits for Iatan 2, so far KCPL has deprived GMO of any benefit from those credits***. GMO and KCPL are separate legal entities, a fact not merely inconvenient to their arguments, but fatal. Even during the evidentiary hearing when these issues were heard on Monday, February 14, 2011, counsel for KCPL and GMO, Karl Zobrist, failed to recognize the distinction between KCPL and GMO stating, "I mean GMO and KCP&L are part of the same company."[291]

As Staff pointed out in its initial brief, and therefore will only restate briefly here, there is nothing in the record to show that if GMO were even now to seek the relief The Empire District Electric Company sought and obtained through arbitration, it would not get similar relief—a reallocation of advanced coal tax credits from KCPL to GMO based on GMO's ownership share relative to other federal-income-tax-paying owners, i.e., $26.5 million.

[291] Tr. 36:3902.

Staff does not agree with KCPL's and GMO's last sentence in the first paragraph of their initial brief, "Whatever the Commission does with regard to this issue, it must not create a normalization violation that could cost both KCP&L [KCPL] and GMO, as well as their customers over $134 million." While the Commission should not have as a goal creation of a normalization violation nor should it set out to "punish" KCPL for pursuing the advanced coal tax credits, this Commission exists to protect the retail customers of the utilities it regulates both from overreaching by those utilities and from the consequences of those utilities' imprudence. If the imprudence of GMO or KCPL causes the Commission to make one or more ratemaking decisions that result in a normalization violation, then it is KCPL and GMO, their parent GPE and the shareholders of GPE who should suffer the consequences of the imprudence, not KCPL's or GMO's retail customers.

Given that unused credits may generally be carried forward 20 years and back one year (26 U.S.C. §39), and that, for ratemaking purposes, KCPL and GMO plan to amortize the advanced coal tax credits over a 50-year estimated life of Iatan 2,[292] KCPL's and GMO's speculative statement on page six of their initial brief that follows, "It is likely, however, that Aquila burdened by substantial net operating losses, did not apply for the tax credits because it would have been unable to use them," is very likely erroneous. If one wants to engage in speculation, a more likely scenario is that GMO initially was unaware of the availability of the credits and when it learned of them from KCPL, GPE chose for GMO not to seek them, because KCPL could use them sooner to confer an earlier benefit on the shareholders of their parent, GPE.

[292] Ex. KCP&L—63, Direct Testimony of John P. Weisensee, pp. 33-34.

Another more likely scenario is that GMO, then operating as Aquila, would eventually be able to use the tax credits since it would be unreasonable to believe that Aquila's operations would generate taxable losses during all of the 50-year life of Iatan 2. It is not speculation to suggest that KCPL simply did not want to share the tax credits generated by Iatan 2 with its joint owner—GMO.

If the Commission allows some amount of money for KCPL's defense of the claims of Missouri Joint Municipal Electric Utility Commission and Kansas Electric Power Cooperative, Inc., it should be substantially less than the over $617,240 in attorneys' fees that KCPL incurred as of October 31, 2010,[293] since both of their claims were denied on the obvious basis that neither the Missouri Joint Municipal Electric Utility Commission nor the Kansas Electric Power Cooperative, Inc., incurs or pays federal income taxes. As argued in Staff's initial brief, KPCL's actions toward The Empire District Electric Company are inexcusable, imprudent and shocking.

The authority that KCPL and GMO rely on for their assertion that reallocating part of the advanced coal tax credits to GMO would be a normalization violation is readily distinguishable. As they state, the fact pattern in that authority was the sale and transfer of assets from one public utility to another. (KCPL and GMO initial brief p. 3). Here, the fact pattern is three federal-income-tax-paying owners of a qualifying asset where the IRS has authorized for one of the three owners advanced coal tax credits that exceed its proportionate ownership share.

Regardless, given that the IRS has already agreed to reallocation of advanced coal tax credits from KCPL to The Empire District Electric Company based on

[293] Ex. KCPL—231, Surrebuttal Testimony of Keith Majors, pp. 18-19.

ownership interests in the qualifying asset, Staff believes it likely the IRS would agree to a further, similar reallocation of advanced coal tax credits from KCPL to GMO also based on ownership interests in the asset, even without a Commission order for them to seek such a reallocation, i.e., they could voluntarily do so. In fact, as KCPL and GMO acknowledge in their initial brief, the current memorandum of understanding with the IRS specifically provides that it may amended: "This MOU may be amended by deletion or modification of any provisions, provided such amendment is in writing and is signed by all parties to the MOU."[294]

Neither KCPL nor GMO have articulated why they cannot voluntarily approach the IRS regarding amendment of the current memorandum of understanding. The only statement KCPL and GMO make on this question is in response to a question from Commissioner Davis where their witness Ms. Hardesty testifies, "We believed at that time that it would be difficult for the IRS to reallocate credits to GMO without an arbitration order, like we had with Empire. And that was – and if we didn't get the reallocation to Empire and GMO and we had to write a check, that that would be a normalization violation and the harm that that would cause was substantial."[295] That the arbitration order was of such significance to the IRS is not shown in the record in this case. In fact, review of the entirety of Schedule 3 to the surrebuttal testimony of Staff witness Harrison, which is the same as Schedule 2 to the surrebuttal testimony of Staff witness Majors, shows that the IRS characterized the reallocation as being based on an

[294] Ex. KCP&L—223, Surrebuttal Testimony of Paul Harrison, Sch. 3-5 to 3-9; Ex. KCPL—231, Surrebuttal Testimony of Keith Majors, Sch. 2-5 to 2-9.

[295] Tr. 36:3927-28.

agreement between KCPL and The Empire District Electric Company, not a final arbitration decision.[296]

In their initial brief, KCPL and GMO tout that KPCL's actions in pursuing and defending the $125 million of advanced coal tax credits for Iatan 2 that KCPL obtained for itself were prudent and diligent. Based on contract law, in the final arbitration award the three arbitrators unanimously stated: **[redacted]** and **[redacted]** While based on contract law, it appears the facts as set out in the final arbitration decision that KCPL was in a superior position of knowledge; as contemplated in the owners agreement, the other joint owners were relying on KCPL to manage the construction project, including the financial aspects of the project; KCPL intentionally neither informed them of the advanced coal tax credits nor sought the credits on their behalf; and both The Empire District Electric Company and GMO were injured by not getting their share of the advanced coal tax credits for Iatan 2, would support an action against KCPL in tort for fraud.[297]

[296] Ex. KCP&L—223, Surrebuttal Testimony of Paul Harrison, Sch. 3-1 to 3-11, in particular pages 3-3 to 3-9; Ex. KCPL—231, Surrebuttal Testimony of Keith Majors, Sch. 2-1 to 2-11, in particular pages 2-3 to 2-9.

[297] ***Richards v. ABN AMRO Mortgage Group, Inc.***, 261 S.W.3d 603 (Mo. App. 2008) ("To make a submissible case of fraudulent misrepresentation, a plaintiff is required to prove nine essential elements: (1) a representation; (2) its falsity; (3) its materiality; (4) the speaker's knowledge of its falsity or ignorance of its truth; (5) the speaker's intent that it should be acted on by the person and in the manner reasonably contemplated; (6) the hearer's ignorance of the falsity of the representation; (7) the hearer's reliance on the representation being true; (8) the hearer's right to rely thereon; and (9) the hearer's consequent and

For the reasons stated in Staff's initial brief and above, the Commission should adopt Staff's adjustments in both of these cases to impute to GMO's cost of service $26.5 million in advanced coal federal income tax credits and it should reduce the advanced coal tax credits in KCPL's cost of service to $80,787,500. Further, the Commission should disallow from KCPL's cost of service the legal expenses KCPL has incurred in contesting The Empire District Electric Company's entitlement to a share of the $125 million of advanced coal tax credits for Iatan 2, legal expenses that totaled $617,240 as of October 31, 2010.

Spearville 2:

Fully Operational and Used for Service:

Staff recommends that the Commission find the Spearville II Wind Energy Facility ("Spearville II") to be fully operational and used for service as required by § 393.135, RSMo 2000.[298] The Commission approved in-service criteria for the Spearville II project in Case No. EO-2005-0329.[299] The complete in-service criteria can be found in Appendix H from the Stipulation and Agreement in that case.[300] Staff has found that all in-service criteria were met on or before December 31, 2010.[301] No pending legal issues prevent the generating unit from being considered "fully operation and used for service." Staff believes Spearville II has met all in-service criteria, and recommends the Commission find it to be, "fully operational and used for service."

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proximately caused injury." "'[A] party's silence in the face of a legal duty to speak replaces the first element; the existence of a representation.'")

[298] KCP&L—295, True-up Direct Testimony of Staff Witness Noumvi Ghomsi.

[299] *Id.,* p. 3.

[300] *Id.,* p. 4.

[301] *Id*.

Legal Costs

In direct testimony filed June 4, 2010, KCPL stated it planned to enter into a new purchased power agreement for 100 MW of wind energy to be in place by December 31, 2010.[302] Previously, KCPL contracted with Enexco, a wind developer, to build 100.5 MW of wind generation near Spearville, Kansas, consisting of 67 wind turbines each having a capacity of 1.5 MW.[303] Enexco completed that project and turned it over to KCPL in September of 2006 ("Spearville 1").[304] In July of 2008, KCPL contracted with Enexco to build a second 100.5 MW of wind generation. In the fall of 2008, KCPL sought to terminate that contract, but Enexco disputed KCPL's right to do so. Through mediation of that dispute in early 2009, KCPL acquired 32 wind turbines each having a capacity of 1.5 MW and **[redacted]**[305]

KCPL planned on transferring ownership of the 32 wind turbines to the successful bidder for the new purchased power agreement it planned to be in place by December 31, 2010. To further that plan, KCPL applied to the Commission (File No. EO-2010-0353) for authority to transfer ownership of the 32 wind turbines to the successful bidder. After Staff opposed KPCL's request, KCPL agreed to continue to own the 32 wind turbines and to install and operate them adjacent to Spearville 1. The installed 32 wind turbines are called Spearville 2.[306]

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[302] Ex. KCP&L—7, Direct Testimony of Curtis D. Blanc, p. 19.

[303] KCPL witness Giles, Tr. Vol. 43, p. 4581-84; Ex. KCP&L—306, True-Up Direct Testimony of Noumvi G. Ghomsi, p. 2; Ex. KCP&L—308, True-Up Direct Testimony of Charles R. Hyneman, p. 12; Ex. KCP&L—7, Direct Testimony of Curtis D. Blanc, pp. 14-15.

[304] *Id.*

[305] Ex. KCP&L—7, Direct Testimony of Curtis D. Blanc, p. 18.

[306] Ex. KCP&L—308, True-Up Direct Testimony of Charles R. Hyneman, p. 13.

Staff is not challenging KCPL's costs to construct Spearville 2, nor is Staff challenging all of the costs KCPL has characterized as legal costs it is charging to Spearville 2; however, Staff is challenging Schiff Hardin's fees that KCPL has charged to Spearville 2. For some perspective, of the total legal costs of **[redacted]** KCPL has charged to Spearville billed by five different outside law firms, Staff is proposing the Commission disallow the **[redacted]** charged by Schiff Hardin.[307] Staff is proposing to disallow Schiff Hardin's charges for four reasons: (1) KCPL did not solicit bids for legal services so that the prudency of Schiff Hardin's fees cannot be determined, (2) KPCL's decision to seek to terminate its contract with Enexco in the fall of 2008 was imprudent, (3) there is no benefit to KCPL's retail customers from the legal costs KCPL incurred for the mediation and subsequent requests for proposals KCPL issued in late 2009, and (4) over $2.5 million in legal costs for the second, smaller Spearville 2 facility is unreasonable.

As Staff pointed out in its initial brief at page 30 in the Iatan Unidentified and Unexplained Cost Overruns section, in Missouri, the Commission is not limited to disallowing costs for imprudence; for example, the Commission can disallow costs that are not of benefit to ratepayers, and there does not need to be a showing of bad faith or abuse of discretion for the Commission to disallow costs.[308] In the following paragraphs, Staff addresses each of its four bases for recommending the Commission disallow from KCPL's cost of service, Schiff Hardin's charges for Spearville 2.

[307] *Id.,* pp. 14-16.

[308] ***State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*****,** 600 S.W.2d 222, 228-29 (Mo. App., W.D. 1980), *appeal dismissed*, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981); ***State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n,*** 645 S.W.2d 44, 55-56 (Mo. App., W.D. 1982).

First, KCPL retained Schiff Hardin without soliciting bids for services related to the Spearville wind turbine projects. Among other activities, such as contract negotiations, Schiff Hardin charged KCPL for services for KCPL's mediation with Enexco over termination of the July 2008 contract to acquire, install and transfer ownership to KCPL of 67 wind turbines adjoining Spearville 1.[309] Because KCPL did not solicit bids for legal services, the prudency of Schiff Hardin's fees cannot be determined; therefore, Staff recommends the Commission disallow them on that basis.[310]

Second, KPCL's only stated basis for seeking to terminate, in the fall of 2008, the contact it had entered into with Enexco in July of 2008 is "KCP&L determined that it would be prudent not to proceed with a wind project in 2008 primarily due to concerns about the Company's access to capital markets. Had the Company tied up its existing lines of credit at that time, it might have jeopardized its ability to respond to a significant, unanticipated event, *e.g.*, an ice storm."[311] Without an explanation of how KCPL's existing lines of credit would have been affected to such an extent it potentially would have put KPCL into an untenable financial position, particularly where, through the Regulatory Plan, it was getting additional amortizations from its retail customers for building projects such as the Iatan 1 AQCS, Iatan 2, and Spearville 2, this stated basis is insufficient to overcome the apparent imprudence of seeking to terminate the contract in a way that resulted in the acquisition of 32 wind turbines and paying Enexco **[redacted]

[309] Ex. KCP&L—112, True-Up Rebuttal Testimony of Chris B. Giles, p. 14; KCPL witness Giles, Tr. 43: 4585; Ex. KCP&L—308, True-Up Direct Testimony of Charles R. Hyneman, pp. 13 and 15.

[310] Ex. KCP&L—308, True-Up Direct Testimony of Charles R. Hyneman, p. 15.

[311] Ex. KCP&L—7, Direct Testimony of Curtis D. Blanc, p. 18, Sch. CDB2010-1, p. 19.

[redacted]** Staff recommends the Commission find KCPL's decision to seek to terminate its contract with Enexco in the fall of 2008 was imprudent,

Third, even if the Commission finds KCPL's decision to seek to terminate its contract with Enexco in the fall of 2008 was prudent, Staff still recommends the Commission disallow Schiff Hardin's fees associated the mediation and 2009 requests for proposals that followed that decision, since KCPL's retail customers received no benefit from the legal costs KCPL incurred for the mediation and subsequent requests for proposals issued in late 2009.

Fourth, Staff recommends the Commission disallow Schiff Hardin's over $2.5 million in legal costs for the second, smaller Spearville 2 facility because that level of legal costs for such a project, where the contractor provided the engineering, procurement and construction, and had previously built the adjoining Spearville 1 facility on the same basis, is unreasonable.[312]

Although not a primary basis for Staff's recommendation that the Commission disallow Schiff Hardin's fees for Spearville 2, in a verified response to a Staff data request issued June 11, 2010, KCPL provided a copy of a "2009 Spearville 2 RFP and a 2009 2010-2000 RFP, the second bearing the title "Request for Proposals (RFP) 2010-2011 Wind Resources" and a date of December 1, 2009. As part of its response to that Staff data request, KCPL stated, **[redacted]**[313] Schiff Hardin, LLP's November 30, 2009, invoice to KCPL shows charges for [redacted]

[312] Ex. KCP&L—308, True-Up Direct Testimony of Charles R. Hyneman, pp. 15 and 16.

[313] Ex. KCP&L—314, p. 2 of 4 to response, responses 5 and 6 D.

[redacted]**[314] Thus, it appears that the work Schiff billed for was either not done at all or was not authorized.

For all the foregoing reasons, Staff recommends this Commission disallow the legal fees KCPL has charged to the Spearville 2 project for work performed by Schiff Hardin, in particular those for the costs of the mediation with Enexco for KCPL's termination of the July 2008 wind project and for charges for wind requests for proposals.

WHEREFORE, by reason of all the foregoing, Staff prays that the Commission will issue its Report and Order determining each of the contested issues in accordance with the position taken here by the Staff; and granting such other and further relief as the Commission deems just in the premises.

Respectfully submitted,

s/ Kevin A. Thompson
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[314] Ex. KCP&L—315.

Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **18th day of March, 2010,** on the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

s/ Kevin A. Thompson