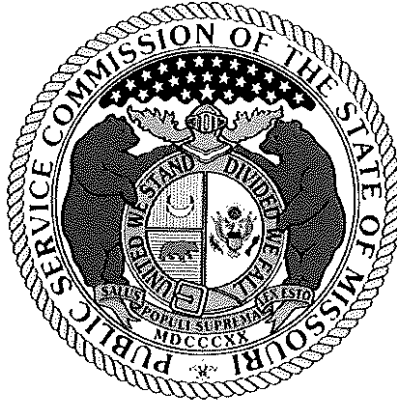


**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**



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

REPORT AND ORDER

Issue Date: July 1, 2008

Effective Date: July 11, 2008

2. Purpose of the Affiliate Transactions Rule

581. The stated “purpose” of the Affiliate Transactions Rule (4 CSR 240-20.015) is “to prevent regulated utilities from subsidizing their non-regulated operations.”⁷³⁷

582. The affiliate transaction rule is premised on asymmetric pricing to prevent a public utility from subsidizing its affiliates.⁷³⁸

583. Pursuant to the affiliate transaction rules, goods and services provided by a public utility to *any* affiliate are to be priced at the higher of market value or the cost to the public utility in providing the goods and services.⁷³⁹

584. Conversely, goods and services provided by *any* affiliate to a public utility are to be priced at the lower of market value or the cost to the public utility in providing the goods and services to itself.⁷⁴⁰

585. The pricing mechanism in the affiliate transaction rule is designed to make the public utility indifferent as to whether it sells or receives goods and services from an affiliate or a third party.⁷⁴¹

586. This concept is appropriate where the transactions involve a public utility and an unregulated affiliate.⁷⁴²

587. If both parties are public utilities subject to the affiliate transaction rule, the rationale underlying the rules does not apply because the utilities already are subject to Commission regulation. In such a utility-to-utility situation, the asymmetric pricing mechanism is also unworkable. If a public utility is to provide a service to an affiliated

⁷³⁷ GPE/KCPL Exh. 39, Giles Additional Supp. Direct, p. 3-4.

⁷³⁸ GPE/KCPL Exh. 15, Giles Surrebuttal, pp. 7-8.

⁷³⁹ *Id.*

⁷⁴⁰ *Id.*

⁷⁴¹ *Id.*

⁷⁴² *Id.*

public utility, the public utilities are on the opposite sides of the asymmetric pricing requirements.⁷⁴³

588. The affiliate transaction rule does not contemplate two regulated utilities owned by the same parent and operated in the manner contemplated by the merger.⁷⁴⁴

589. Rather than the asymmetrical pricing prescribed in the rule, the Applicants request that the Commission grant a waiver from the rules to the extent necessary to allow KCPL and Aquila to provide services at fully distributed costs, except for wholesale power transactions, which would be based on rates approved by FERC.⁷⁴⁵

3. Effect of Application of the Rule to Synergies Generated by the Merger

590. The synergies contemplated by Great Plains Energy in this transaction are premised on the ability of KCPL and Aquila to exchange goods and services at cost. To the extent the asymmetric pricing dictated by the affiliate transaction rules prevents KCPL and Aquila from doing so, the synergies will be reduced to the detriment of the utilities' Missouri customers.⁷⁴⁶

591. Applicants' request for a waiver from the affiliate transactions rule as it might pertain to KCPL and Aquila, if granted, will help the companies achieve synergy savings.⁷⁴⁷

592. Because KCPL and Aquila will each be "regulated electrical corporations" and "public utilities" under Chapter 386, and thus subject to the Commission's jurisdiction, both companies will continue to be subject to the various reporting requirements they operate

⁷⁴³ GPE/KCPL Exh. 15, Giles Surrebuttal, pp. 7-8; Transcript, pp. 2064-2066.

⁷⁴⁴ GPE/KCPL Exh. 39, Giles Additional Supp. Direct, p. 3-4.

⁷⁴⁵ *Id.*

⁷⁴⁶ GPE/KCPL Exh. 15, Giles Surrebuttal, pp. 7-8.

⁷⁴⁷ GPE/KCPL Exh. 39, Giles Additional Supp. Direct, p. 3-4.

under today and the Commission will continue to have access to the books and records of both companies.⁷⁴⁸

4. Staff's Position – Controverting Evidence to the Requested Waiver

593. Staff argues that the waiver of the rule should not be granted because the merger or consolidation of KCPL and Aquila is outside the scope of the proposed transaction in this case, and because Staff believes that they do not have sufficient information to evaluate the requested waiver.⁷⁴⁹

594. Under cross-examination, Staff witness Schallenberg agreed that the purpose of the affiliate transactions rule is to prevent regulated utilities from subsidizing their non-regulated operations and that after the close of the merger, if approved, the Commission will have full access to the books and records of both Aquila and KCPL.⁷⁵⁰ Mr. Schallenberg also indicated that Staff was not generally opposed to transactions between Aquila and KCPL on a cost basis.⁷⁵¹

595. There is no competent or credible evidence in the record that, if the proposed merger is approved, a limited waiver or grant of a variance in the Commission's affiliate transactions rule allowing KCPL and Aquila to provide services at fully distributed costs, except for wholesale power transactions, would in any way cause a detriment to the public interest.

⁷⁴⁸ GPE/KCPL Exh. 39, Giles Additional Supp. Direct, p. 2.

⁷⁴⁹ Staff Exh. 100, Schallenberg Direct, attached Report, pp. 64-68.

⁷⁵⁰ Transcript, pp. 2070-2071.

⁷⁵¹ Transcript, p. 2071.

J. Findings of Fact Regarding Transmission and RTO/ISO Criteria

1. Regional Transmission Organization Participation, Pre- and Post-Merger Considerations

596. Regional Transmission Organizations ("RTOs") were promoted and established, among other reasons, in order to provide benefits and improvements in electric transmission services and in the operation of the bulk power system. These benefits include open and non-discriminatory electric transmission access and pricing, regional Open Access Transmission Tariff ("OATT") administration, regional transmission planning and coordinated regional reliability operations.⁷⁵²

597. If the Commission approves the merger, KCPL employees will operate the transmission systems of KCPL and Aquila following the merger.⁷⁵³

598. Regarding the effect of the merger on the transmission operations of KCPL and Aquila and their RTO participation, KCPL proposes to take the following actions: (1) consolidate transmission control center operations; (2) integrate Aquila's planning functions with KCPL's planning functions; (3) incorporate Aquila's transmission and substation field operations into KCPL's operations; (4) combine the transmission and substation engineering processes; and (5) include the Aquila facilities in the KCPL comprehensive transmission asset management plan in order to achieve Tier I reliability levels for all customers.⁷⁵⁴

⁷⁵² GPE/KCPL Exh. 20, Marshall Direct, p. 7.

⁷⁵³ *Id.* at pp. 6-7.

⁷⁵⁴ *Id.*

performing its balancing test, the Applicants still met their burden of proof that the proposed merger is not detrimental to the public interest.

G. Conclusions of Law Regarding the Commission's Affiliate Transactions Rule⁹⁹⁶

1. The Purpose of the Rule

The purpose of Commission Rule 4 CSR 240-20.015, as explicitly stated in the Rule is as follows:

This rule is intended to prevent regulated utilities from subsidizing their nonregulated operations. In order to accomplish this objective, the rule sets forth financial standards, evidentiary standards and recordkeeping requirements applicable to any Missouri Public Service Commission (commission) regulated electrical corporation whenever such corporation participates in transactions with any affiliated entity (except with regard to HVAC services as defined in section 386.754, RSMo Supp. 1998, by the General Assembly of Missouri). The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities.⁹⁹⁷

2. Waiver Request

As noted previously in this Order, the Commission is granting conditional approval of the proposed transaction, and KCPL and Aquila will ultimately be separate affiliates of Great Plains if they chose to accept the Commission's conditions and finally consummate the transaction. Assuming the Applicants do consummate the transaction, Aquila and

⁹⁹⁶ Refer to Findings of Facts Numbers 568-595 for this section.

⁹⁹⁷ Commission Rule 4 CSR 240.20-015. See also *In re Union Elec. Co.*, Case No. EO-2004-0108, 2005 Mo. PSC LEXIS 190 at 17, Report and Order on Rehearing at 38 (2005) ("... purpose of the affiliate transaction rule is to prevent cross-subsidization, in which a conglomerate including a regulated entity seeks to shift costs of its unregulated activities to its regulated customers"). Prior to the *Union Electric* case, the Commission defended the Rule at the Missouri Supreme Court in *State ex rel. Atmos Energy Corp. v. PSC*, 103 S.W.3d 753, 763-64 (Mo. 2003). The Court noted:

In its brief, the PSC explained that the rules are a reaction to the emergence of a profit-producing scheme among public utilities termed "cross-subsidization," in which utilities abandon their traditional monopoly structure and expand into non-regulated areas. This expansion gives utilities the opportunity and incentive to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers. *Id.*

KCPL will remain separate legal entities, but many of the companies' operation functions will be integrated after the merger closes.⁹⁹⁸ Necessarily the two affiliates will engage in transactions with each other, and the asymmetrical pricing requirements of the Rule, which were designed to prevent cross subsidization of a regulated utility's non regulated operations, would prevent the two regulated affiliates from exchanging goods and services at cost.

Because both Aquila and KCPL will continue to be regulated electrical corporations after approval of the transaction and both meet the Rule's definition of "affiliates," and because many of the synergies to be realized by the Applicants post-merger are premised on the ability of KCPL and Aquila to exchange goods and services at cost, the Rule would actually prevent benefits from accruing to Missouri ratepayers. Consequently, the Applicants have argued that the Affiliate Transaction Rule does not apply to transactions between KCPL and Aquila, or in the alternative that they should be granted a waiver from the rule to the extent it would inhibit transactions at cost between KCPL and Aquila after the close of the merger.

Staff has suggested that the Affiliate Transactions Rule should apply, and that no waiver should be granted because it is unnecessary and beyond the scope of the proceeding since the Applicants have not requested authority to consolidate KCPL and Aquila. The Commission has already determined that Staff's position regarding the scope of this proceeding is incorrect, and under cross-examination, Staff witness Schallenberg agreed that the purpose of the Rule is to prevent regulated utilities from subsidizing their non-regulated operations and that after the close of the merger, the Commission will have

⁹⁹⁸ KCPL's and Aquila's cost allocation manual will set forth how costs are to be allocated among KCPL, Aquila, Great Plains, and any other subsidiary of Great Plains.

full access to the books and records of both Aquila and KCPL.⁹⁹⁹ Mr. Schallenberg also indicated that Staff was not generally opposed to transactions between Aquila and KCPL on a cost basis.¹⁰⁰⁰ Thus, there is no reason to apply the Rule in order to maintain access to the books and records of Aquila or KCPL, or to prevent cost-based transactions between Aquila and KCPL.

Because both Aquila and KCPL will be regulated electrical corporations, transactions between KCPL and Aquila do not involve cross-subsidization and these transactions were not intended to be covered by the Rule. However, because the Commission is imposing a condition on the merger of having KCPL and Aquila execute a joint operators agreement, the issue of cross-subsidization becomes blurred and the Commission concludes that a variance is required.

3. Final Conclusions Regarding the Affiliate Transactions Rule

The Commission determines that substantial and competent evidence in the record as a whole supports the conclusions that: (1) the Commission's Affiliate Transactions Rule, 4 CSR 240.015, applies to KCPL and Aquila because these entities meet the Rule's definition of "affiliates"; (2) the purpose of the Commission's Affiliate Transactions Rule is to prevent cross-subsidization of regulated utility's non-regulated operations, not to prevent transactions at cost between two regulated affiliates; (3) to the extent that the Affiliate Transactions Rule is applicable to transactions between KCPL and Aquila, a variance shall be granted; and (4) more specifically, the variance shall be granted for all transactions except for wholesale power transactions, which would be based on rates approved by FERC.

⁹⁹⁹ Transcript, pp. 2070-2071.

¹⁰⁰⁰ Transcript, p. 2071.

The Commission finds as good cause for the variance to be the need to allow the applicants the ability to attain their projected synergy savings post-merger. The Commission further concludes there is no detriment, or any direct or indirect effect of the transaction, that tends to make the power supply less safe or less adequate, or which tends to make rates less just or less reasonable, that is related to the granting of this variance in 4 CSR 240.015.

The Commission finally notes that although both KCPL and Aquila will continue to be subject to the Commission's recordkeeping requirements for regulated electrical corporations, the sections of 4 CSR 240.015 which relate to recordkeeping will not be waived. Because KCPL and Aquila will be maintaining their records pursuant to the Commission's regulations, one set of records should satisfy all regulatory requirements without being duplicative.

H. Conclusions of Law Regarding Other Potential Conditions to Place on the Approval of the Merger¹⁰⁰¹

1. Transmission and RTO/ISO Criteria, Quantification of Joint Dispatch, and Consolidation of Balancing Authority¹⁰⁰²

In this proceeding, Independence has argued that it is necessary for the Commission to address the rate effects of the Applicants' intent to have Aquila participate in the Midwest ISO rather than the SPP. In particular, Independence has asserted that the Commission should require the Applicants to provide analysis of the rate effects of the merger, effects of joint generation dispatch, and the effects of Aquila's participation in the Midwest ISO as compared to SPP. Independence has also argued that the Commission

¹⁰⁰¹ Refer to Findings of Facts Numbers 596-720 for this entire section.

¹⁰⁰² Refer to Findings of Facts Numbers 596-651 for this sub-section.

10. The Commission grants a limited variance of its Affiliate Transaction Rule to Kansas City Power & Light Company and Aquila, Inc., as described in detail in the Conclusions of Law Section of this Report and Order.

11. The objections to the City of St. Joseph, Missouri's Exhibit 1200, as delineated in the body of this order, are sustained. Exhibit 1200 shall be preserved in the record, but the Commission has not considered this unauthenticated, hearsay exhibit when making its final determinations in this matter.

12. All objections not ruled on are overruled and all pending motions not otherwise disposed of herein are hereby denied.

13. Nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.

14. The Commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.

15. No later than August 11, 2008, Great Plains Energy Incorporated, Kansas City Power & Light Company and Aquila, Inc., shall file with the Commission a pleading indicating if they consummated the merger or exercised their respective rights under the termination clause of the merger agreement or if they took some other alternative action.

16. This Report and Order shall become effective on July 11, 2008.

BY THE COMMISSION

Colleen M. Dale
Secretary

(S E A L)

Murray and Jarrett, CC., concur;
Clayton, C., dissents, with separate
dissenting opinion to follow;
and certify compliance with the provisions
of Section 536.080, RSMo 2000.
Davis, Chm., and Gunn, C., absent.

Dated at Jefferson City, Missouri,
on this 1st day of July, 2008.