Crossroads Power Plant Discussion

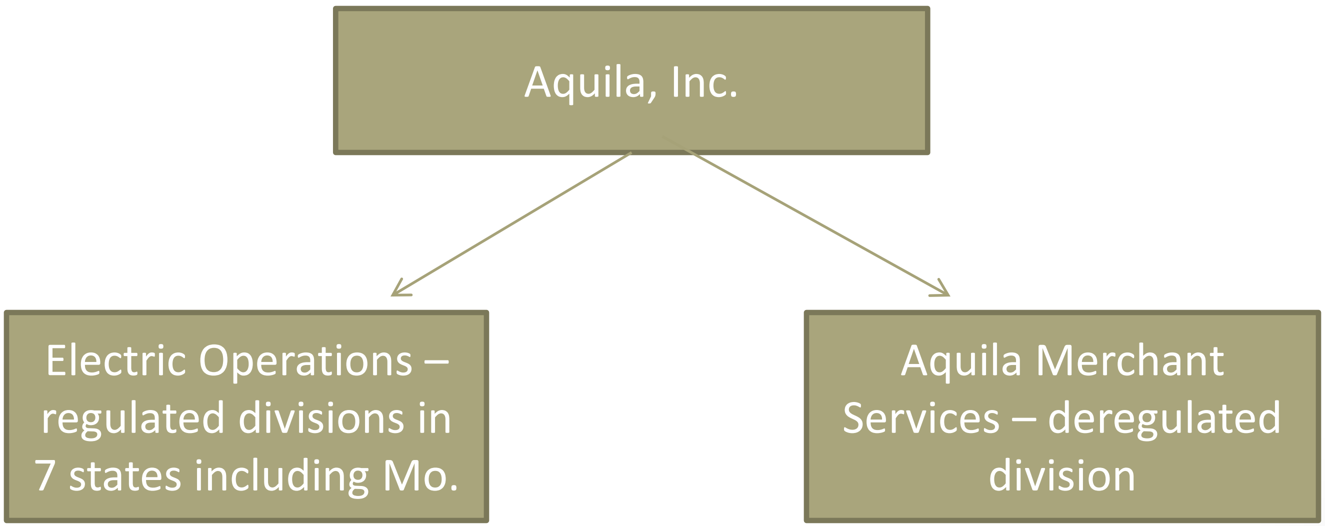
David Woodsmall - Midwest Energy Consumers' Group
Lena Mantle – Office of the Public Counsel

Presentation

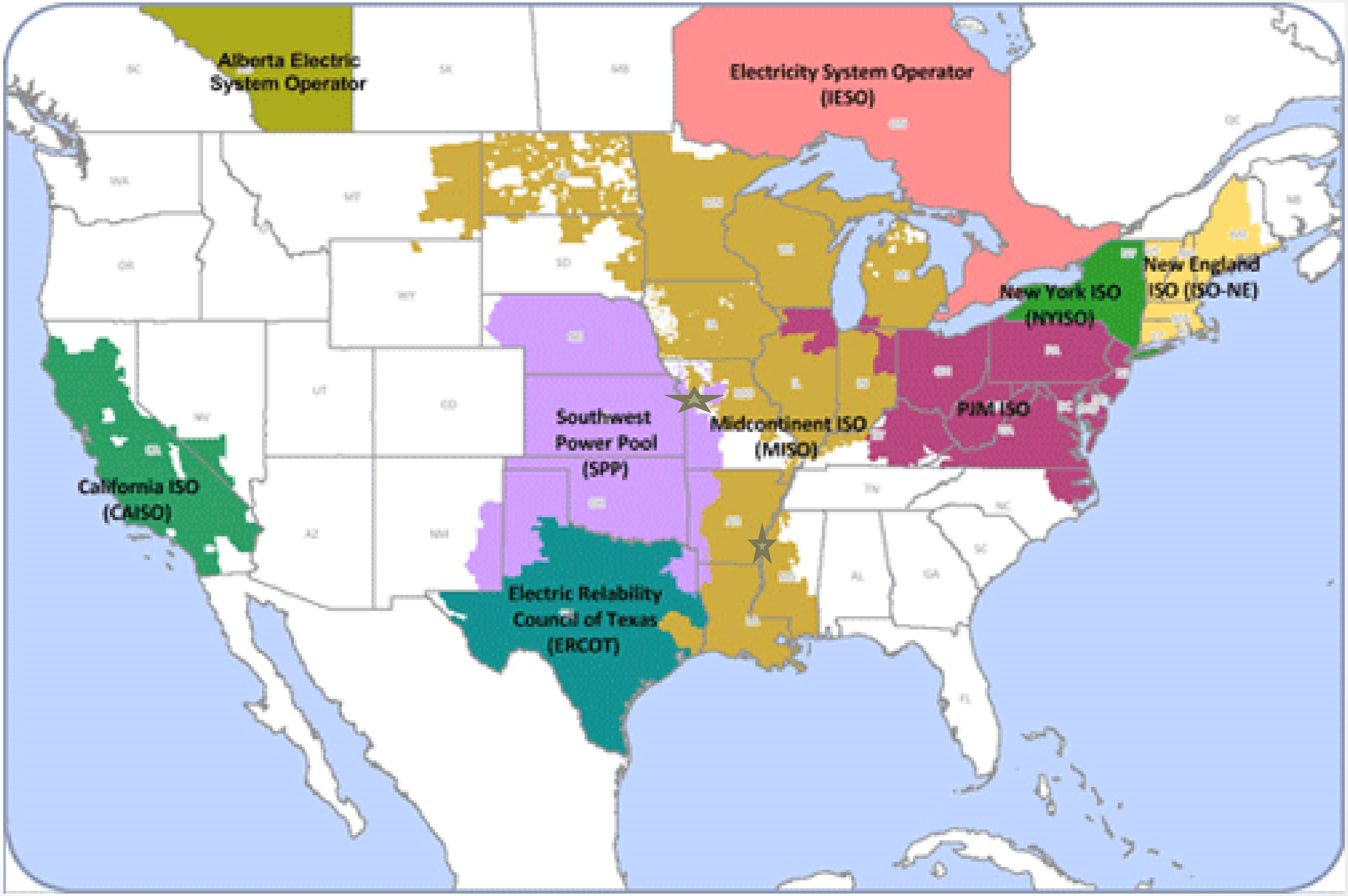
1) Give background on Crossroads; where it is located relative to GMO service area; and how it was acquired.
2) Explain GMO's historic need for capacity and Aquila's generation capacity decisions. Aquila hadn't built any capacity for 20 years.
3) Valuation Issues – GMO historically sought a rate base value for Crossroads above the market value
4) Transmission Issues – GMO historically sought to include transmission costs associated with transmitting power from Crossroads to GMO customers.
5) Commission valuation was based upon combustion turbines located in the same RTO as the customers. As such, there were no additional transmission costs.

Background

- Crossroads consists of four 75 MW gas-fired CT's.
- Constructed in 2002 by Aquila Merchant – a deregulated subsidiary of Aquila.



Crossroads Location



Crossroads Location

- Crossroads was located in Clarksdale to take advantage of transmission constraints. These transmission constraints in Mississippi made the purchase of outside energy cost prohibitive.

- Those same transmission constraints now make it expensive to transmit the energy from Crossroads to GMO.

Crossroads Acquisition

- The collapse of Enron resulted in a destabilization of the deregulated electric market. In 2005 and 2006, Aquila began to sell its regulated electric and gas service areas in Colorado, West Virginia, Iowa, Michigan, Kansas and Nebraska.
- In addition, Aquila Merchant was selling its deregulated operations. This included Raccoon Creek and Goose Creek CTs to AmerenUE. SEC filings indicate that Aquila repeatedly tried to sell Crossroads. Because of the transmission constraints, Aquila could not even get a bid for Crossroads.
- In 2007, Great Plains (KCPL and GMO parent) agreed to buy the remainder of Aquila and Aquila Merchants including its Missouri operations and its merchant plant at Crossroads.
- Further efforts by Great Plains Energy to sell Crossroads were a failure.

GMO Historic Need for Capacity

- In the late 90s, Aquila had a corporate policy not to build generation assets for its regulated utility operations. All construction was deregulated with the desire to sell power to regulated operations.

  "Although every other investor-owned electric utility in Missouri built generation, Aquila, Inc. had a corporate policy not to build regulated generating units that it followed until it built South Harper in 2005. Instead, Aquila, Inc. relied exclusively on purchased power to meet its retail customers' increasing demands for electricity." [Order ER-2010-0356, Page 80]

GMO Historic Need for Capacity (cont.)

- Constructed the 580 MW Aries (now Dogwood) in 2001 as a deregulated plant. 500 MW PPA with MPS that expired in May 2005. Prior to that, GMO conducted an IRP which showed that the least cost plan was the construction of 5 combustion turbines with a capacity of 525 MWs <u>in GMO's service territory</u>.

- GMO did not build to its least cost plan. Instead of building 5 combustion turbines (525 MWs), GMO only built 3 combustion turbines (315 MWs at South Harper). The rest of GMO's capacity needs were met through a long-term contract with NPPD and short-term contracts with GMO's Merchant Plant Crossroads. GMO's capacity needs continued to grow.

MPS Historic Need for Capacity

Chairman Davis dissent:

- “There are ample grounds for questioning the prudence of Aquila’s management, past and present. These include: management decision to pursue unregulated business ventures that eventually caused Aquila to hemorrhage money, lose its investment grade status and some would say neglect its customers for years.”
- “There is no question Aquila’s decisions have been detrimental to its ratepayers.”
- “These issues will continue to haunt Aquila management for years to come regardless of who’s in charge.”
  - *Concurring Opinion of Chairman Davis*, Case No. ER-2007-0004, pages 11 and 12 (issued July 9, 2007).

Perfect Marriage??

- Great Plains Energy had two situations colliding:
  - First, Great Plains had a deregulated facility that it couldn't sell with capacity of 300 MWs.
  - Second, MPS had a need for capacity nearing 300 MW when the contract with NPPD ended.

Not Quite!

Problem 1: Timing

Crossroads was fulfilling capacity needs known in 2002 at a cost well above the costs GMO would have incurred had it built the five CTs its least cost plan called for in 2002.

Problem 2: Crossroads Valuation

- GMO sought a value for Crossroads based upon its book value at time of construction ($117.9 million).
- Great Plains SEC filings reflect the fact that Crossroads could not be sold and had a depressed value of $51.6 million.

> "The preliminary internal analysis indicated a fair value estimate of Aquila's non-regulated Crossroads power generating facility of approximately $51.6 million. This analysis is significantly affected by assumptions regarding the current market for sales of units of similar capacity. The $66.3 million adjustment reflects the difference between the fair value of the combustion turbines at $51.6 million and the $117.9 million book value of the facility at March 31, 2007. Great Plains Energy management believes this to be an appropriate estimate of the fair value of the facility." <u>SEC filing from 5-8-2007</u>.

Crossroads Valuation

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

- *Smyth v. Ames*, 169 U.S. 466, 546-547 (1898) (emphasis added).

Problem 3: Transmission Costs

There were, and still are, significant problems and expense associated with transmitting energy from Crossroads (Mississippi) to customers (Missouri).

- A Special Protection Scheme for the Crossroads plant was necessary due to transmission constraints.
- At the time that Crossroads was transferred to GMO rate base, Clarksdale, Mississippi was surrounded by Entergy service area. Therefore, GMO paid the Entergy transmission rate. At the time, $1.55 / kW – month.
- During the 2012 GMO rate case, Entergy had applied for membership in MISO. MISO had a much more expensive transmission rate. At the time, $3.10 / kW – month.
- GMO was aware of the likely increase in the Crossroads transmission costs in its 2012 rate case.

Prior Commission Decisions

- The Commission has twice considered the Crossroads valuation and transmission issues.
- In 2010 / 2011 (Case No. ER-2010-0356), the Commission rejected both GMO's valuation as well as its request to recover transmission costs.
- In 2012 / 2013 (Case No. ER-2012-0175), the Commission, including Commissioners Hall, Stoll and Kenney, again rejected GMO's valuation and transmission costs.

Prior Commission Decision – Valuation

"It is **incomprehensible** that GPE would pay book value for generating facilities in Mississippi to serve retail customers in and about Kansas City, Missouri. And, it is a **virtual certainty** that GPE management was able to negotiate a price for Aquila that considered the distressed nature of Crossroads as a merchant plant which Aquila Merchant was unable to sell despite trying for several years. Further, it is equally likely that GPE was in as good a position to negotiate a price for Crossroads as AmerenUE was when it negotiated the purchases of Raccoon Creek and Goose Creek, both located in Illinois, from Aquila Merchant in 2006." [Case No. ER-2010-0356, Report and Order, ¶271]

Prior Commission Decision – Valuation

- The Goose Creek / Raccoon Creek turbines, also built by Aquila Merchant, were the same as the Crossroads combustion turbines.
- Crossroads, built in 2002, acquired by Great Plains in 2007.
- Raccoon Creek / Goose Creek, built in 2003, acquired by AmerenUE (third party transaction) in 2006.
- Perfect proxy transaction, excluding location, to determine fair market value of Crossroads.
  - Raccoon Creek: 340,000 kW sold for $71 million
  - Goose Creek: 510,000 kW sold for $104 million
    - TOTAL: 850,000 kW for $175 million ($205.88 / kW)

- Therefore, Crossroads (300,000 kW) ($205.88 / kW) =
    - **$61,764,000 - fair market value**

Prior Commission Decision – Transmission Costs

- "Paying the additional transmission costs required to bring energy all the way from Crossroads and including Crossroads at net book value with no disallowances, is not just and reasonable." (Case No. ER-2010-0356, Report and Order, page 91).
- "It is not just and reasonable to require ratepayers to pay for the added transmission costs of electricity generated so far away in a transmission constricted location. Thus, the Commission will exclude the excessive transmission costs from recovery in rates." (page 100).
- "In addition to the valuation, the Commission concludes that but for the location of Crossroads, customers would not have to pay the excessive cost of transmission. Therefore, transmission costs from the Crossroads facility . . . shall be disallowed from expenses in rates and therefore also not recoverable through GMO's fuel adjustment clause (FAC)." (page 99).

Commission Valuation Includes Exclusion of Transmission Costs

- The Commission's proxy sale involved the sale of combustion turbines that were in the same RTO as AmerenUE.

	CT Location	Service Area	Transmission Costs	Fair Market Value
Proxy Sale	MISO	MISO	Same RTO – no transmission costs	$205.88 / kW
Crossroads Acquisition	Inside Entergy	SPP	Different RTO – Therefore costs to transmit across Entergy to SPP	$205.88 / kW

- In order to make an apples to apples comparison, the Commission eliminated all transmission costs.

Court Actions Regarding Prior Commission Decisions

- The Western District Court of Appeals considered reasonableness and lawfulness of the Commission's decision to disallow recover of Crossroads transmission costs and affirmed decision.
  - "We have no difficulty understanding the basis for the PSC's decision to disallow excessive transmission costs from recovery in rates. . . . The PSC found that it would not be just and reasonable to require ratepayers to pay for the added transmission ccosts of the electricity generated at Crossroads. Because the PSC made the decision on the recoverability of transmission costs based on a prudency analysis that considered both the prudence of including the transmission costs and the resulting harm to the ratepayers if such costs were included, the PSC's decision denying recovery was lawful." 408 S.W.3d 153, 162-163 (Mo.App. W.D. 2013).
- The Missouri Supreme Court and the United States Supreme Court refused to consider this matter and upheld Court of Appeals decision.