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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2010-0356

REBUTTAL TESTIMONY

OF

CURTIS D. BLANC

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City, Missouri
December 2010

KCPL Exhibit No. GMO-5
Date 2/14/11 Reporter LMB
File No. ER-2010-0356

REBUTTAL TESTIMONY

OF

CURTIS D. BLANC

Case No. ER-2010-0356

Q: Please state your name and business address.

A: My name is Curtis D. Blanc. My business address is 1200 Main Street, Kansas City, Missouri 64105.

Q: Are you the same Curtis D. Blanc who prefiled Direct Testimony in this matter?

A: Yes, I am.

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to provide an overview of the Company's response to Staff's November 17, 2010 Revenue Requirement Cost of Service Report ("COS Report"). In particular, I address (i) the unreasonableness of Staff's recommended return on equity ("ROE") for KCP&L Greater Missouri Operations Company ("GMO" or the "Company"); (ii) Staff's proposed adjustment to increase from 5% to 25% the portion of any incremental, net fuel cost increase that GMO is not permitted to recover; (iii) Staff's request to require GMO to rebase its fuel costs; and (iv) Staff's proposal to allocate 100 MW of Iatan 2 to the former St. Joseph Light & Power ("L&P") service territory.

I also address Greg Meyer's recommendation on behalf of certain industrial customers to reduce GMO's annual depreciation expense by depreciating Iatan 2 over 60 years.

Finally, I repeat my testimony from the pending rate case of Kansas City Power & Light Company ("KCP&L"), Case No. ER-2010-0355, concerning Staff's November 3, 2010 Construction Audit and Prudence Review for the Iatan Construction Project ("Iatan Report"). My understanding is that Iatan prudence will only be litigated once, that is, in the KCP&L case. However, to ensure that the record in this proceeding is complete, I repeat that testimony here.

<u>STAFF'S RECOMMENDED ROE IS UNREASONABLE, UNSUPPORTED, AND WOULD ULTIMATELY BE HARMFUL TO GMO AND ITS CUSTOMERS.</u>

Q: Why is Staff's recommended ROE unreasonable?

A: Staff recommends an ROE range for GMO of 8.5% - 9.5%. The flaws in Staff's analysis to arrive at that range is discussed in the Rebuttal Testimony of Dr. Hadaway. I speak to the general reasonableness of Staff's recommendation.

Q: Please explain.

A: Staff's recommended ROE does not balance the interest of GMO and its customers. Staff's recommendation is also inconsistent with the ROEs this Commission has recently awarded. It is also inconsistent with the ROEs currently being awarded elsewhere in the country. Although unreasonably low ROEs are often described as a shareholder problem, that is a shortsighted and oversimplified view. If common stock and fixed-income investors have concerns about whether a utility will receive fair and reasonable ratemaking treatment, a likely implication is a higher cost of capital, which, in turn, would ultimately be borne by the utility's customers.

Q: How does the data indicate that Staff does not balance the interests of GMO and its customers?

A: Staff's entire range is below the customer recommended ROE of 9.65% sponsored by Mr. Gorman on behalf of certain industrial customers. Although Mr. Gorman reduced his recommendation to 9.5% in the KCP&L case and might also do so here, that would still be at the very top of Staff's proposed range and 50 basis points above Staff's midpoint. If Staff is balancing the interests of GMO and its customers, its ROE recommendation should not be the lowest. It should be in the middle—between what the Company and its customers believe is appropriate.

Q: **Is it unusual for Staff to recommend an ROE lower than that recommended by consumer advocates?**

A: No. In fact, Staff consistently recommends a lower ROE than the ROE recommendations of OPC or other consumer advocates in the cases. In Schedule CDB2010-1, I summarize the ROE recommendations in electric utility rate cases for the last five years. Staff's ROE recommendation is consistently the lowest.

Q: **How does Staff's recommended ROE compare to the ROEs being awarded by other public utility commissions elsewhere in the country?**

A: Staff's recommended ROE range of 8.5%-9.5% is significantly lower than the ROEs other public utility commissions are awarding elsewhere in the country. As noted in Staff's COS Report, the average authorized ROE for electric utility companies for the first three quarters of 2010 was 10.36%, 86 basis points more than the top of Staff's range, and 186 basis points more than the bottom of their range.

Q: **How does the 10.36% national average for an awarded ROE for the first three quarters of 2010 compare to ROEs awarded in recent years?**

A: According to SNL Financial, the average ROE awarded in 2009 for electric utilities was 10.52%. In 2008, the average was 10.37%. In 2007, it was 10.31%. In 2006, it was 10.35%, all as summarized in Schedule CDB2010-1.

Q: **Are you aware of the national average ever dropping below 10%?**

A: I reviewed SNL data going back to 1989. In no year did the national average awarded ROE for an electric utility drop below 10%.

Q: Did your review of other ROEs recently awarded elsewhere in the country turn up any examples that would be of interest to this Commission?

A: Yes. On August 25, 2010, the Indiana Utility Regulatory Commission ("IURC") issued a rate case order in a Northern Indiana Public Service Company ("NIPSCO") rate case that is rather informative, especially with respect to the reasonableness of Staff's recommended ROE range in this case. The portion of the IURC's order addressing NIPSCO's authorized ROE is attached as Schedule CDB2010-2. In the NIPSCO case, the IURC authorized an ROE of 9.9%--one of the lowest in the country. However, it is clear from the order that the IURC viewed an authorized ROE of 9.9% as both punitive and temporary. The IURC noted that "NIPSCO was in the bottom quartile of the J.D. Power studies in 2007 and 2008, and one of the worst-rated utilities in 2009." *NIPSCO Order*, at p. 32. The IURC noted that it

> has a unique role in regulating its jurisdictional utilities, which at times requires us to send a clear and direct message to utility management concerning the need for improvement in the provision of its utility service. Our determination of the authorized cost of common equity capital can be a very direct means to incent improved service. We anticipate that NIPSCO will respond accordingly and therefore anticipate that such authorized cost of common equity capital will apply for a limited duration as identified below.

NIPSCO Order, at p. 32. The IURC then directed NIPSCO to file a rate case no later than September 30, 2010, recognizing that "a higher return may be appropriate if NIPSCO is able to demonstrate improved company performance in its next base rate proceeding."

Q: How is the NIPSCO Order relevant here?

A: This Commission is clearly not bound by the rationale or conclusions reached by another commission. However, for perspective, it is important to note that Staff's entire recommended ROE range of 8.5%-9.5% is below an ROE that another Commission found to be both punitive and temporary. In the NIPSCO Order, the IURC authorized an ROE as low as 9.9% "to send a clear and direct message to utility management concerning the need for improvement in the provision of its utility service." It is also important to note that GMO's J.D. Power results are very good, in stark contrast to the issues the IURC was trying to address in the NIPSCO case. The IURC's rationale in the NIPSCO Order also supports GMO's request for a 25 basis point adder in this case. If it was appropriate for the IURC to reduce NIPSCO's authorized ROE due to poor customer satisfaction results, it would also be appropriate for this Commission to recognize GMO's strong customer satisfaction results.

<u>STAFF'S PROPOSAL TO INCREASE FROM 5% TO 25% THE PORTION OF ANY INCREMENTAL, NET FUEL COST INCREASE THAT GMO IS NOT PERMTTED TO RECOVER</u>

Q: Do you agree with Staff's proposal to change the "sharing" mechanism under GMO's fuel adjustment clause ("FAC") from 95%/5% to 75%/25%?

A: No. Staff argues that such a change is needed to give GMO "a more appropriate incentive to keep its fuel and purchased power cost down." COS Report, at p. 191. However, Staff makes no showing as to why the current methodology does not create a sufficient incentive. In fact, Staff explains that it "has filed two prudence review reports concerning its review of the costs of the Company's FAC and found no evidence of imprudent decisions by the Company's management related to procurement of fuel for generation, purchased power and off-system sales." COS Report, at p. 193. That being the case, it is clear that GMO does not need any <u>additional</u> incentive to manage its fuel and purchased power costs. GMO is prudently managing its fuel and purchased power costs. Increasing the portion of its incremental, net costs that the Company cannot recover from 5% to 25% would not alter how GMO manages its fuel and purchased power costs. It would only penalize the Company by prohibiting it from recovering even more of the cost it prudently incurs to serve its customers.

Q: Please explain.

A: Staff has already determined that it "found no evidence of imprudent decisions by the Company's management related to procurement of fuel for generation, purchased power and off-system sales." COS Report, at p. 193. Nonetheless, GMO has not been allowed to recover 5% of its incremental costs. Those costs have been prudently incurred. GMO should be permitted to recover 100% of those costs. There is no indication that those costs would be lower if the Commission were to increase the amount GMO is not permitted to recover. Staff merely makes the unsupported claim that the current incentive is "insufficient." COS Report, at p. 198.

The current 5% of incremental, net fuel costs that GMO is not permitted to recover is a penalty. According to Staff's figures, GMO has not been permitted to recover approximately $2 million annually in prudently incurred fuel costs under the existing "sharing" mechanism. COS Report, at p. 198. Increasing that percentage to 25% is a much harsher penalty (approximately $10 million annually according to Staff) and is wholly unwarranted, particularly where there is no indication that GMO is not properly managing its fuel costs. This issue is further discussed in the Rebuttal Testimony of Tim Rush.

STAFF'S PROPOSAL TO REQUIRE GMO TO REBASE ITS FUEL COST

Q: Do you agree with Staff's request that GMO be required to rebase its fuel costs?

A: No. I do not understand Staff's rationale for the proposal, particularly in light of its arguments in support of changing the "sharing" mechanism from 95%/5% to 75%/25%. Staff's argument for changing the "sharing" mechanism is to give GMO an additional incentive to manage its fuel costs. If Staff is correct that increasing the amount the Company is unable to recover creates such an incentive, rebasing fuel cost would seem to largely mitigate that objective. By rebasing, Staff's 25% would be applied to a much smaller incremental fuel cost, thus eliminating the incentive Staff argues justifies increasing the percentage in the first place. The wiser course would be to continue the current FAC sharing mechanism, let the Company decide whether it places so much risk on the Company as to necessitate rebasing, and continue reviewing the Company's fuel procurement practices to ensure those costs are prudently incurred. In the mean time, customers continue to benefit from never having to pay millions of dollars that the Company prudently incurs to serve them. As above, there is no indication that GMO is mismanaging its fuel procurement, or that requiring it to rebase its fuel costs would result in less costly fuel. That being the case, there is no reason to change the FAC as filed by the Company. This issue is further discussed in the Rebuttal Testimony of Tim Rush.

IATAN 2 ALLOCATION BETWEEN L&P AND MISSOURI PUBLIC SERVICE ("MPS")

Q: Do you agree with Staff's proposal to reallocate L&P's and MPS's respective shares of Iatan 2?

A: No. GMO owns an 18% interest in Iatan 2, which based on a generating capacity of 850 MW equates to 153 MW. Of that 153 MW, GMO allocated 41 MW to L&P and

112 MW to MPS. GMO based its allocation on a balancing of the respective companies' baseload capacity needs and the impact on the rates of their respective customers, as discussed in the Rebuttal Testimonies of Burton Crawford and Tim Rush. Staff's proposal disregards both of those objectives by proposing to allocate 100 MW to L&P and 53 MW to MPS. Such an allocation unnecessarily places too large of a burden on the customers in the L&P service territory.

Q: What was Staff's rationale for allocating so much of Iatan 2 to L&P?

A: Staff explains that it looked at three factors to arrive at its recommendation: (i) the capacity needs of MPS and L&P; (ii) the ownership "rights" to Iatan 2; and (iii) the impact on customer rates. COS Report, at p. 98. Staff claims that a review of those factors support its recommendation to allocate 100 MW of Iatan 2 to L&P. That is not correct. A reasonable consideration of those factors supports GMO's allocation of Iatan 2—41 MW to L&P and 112 MW to MPS.

Q: Do the generation needs of MPS and L&P support Staff's proposed allocation of Iatan 2?

A: No. Staff acknowledges that it "does not know GMO's exact needs to separately serve its MPS and L&P customers." COS Report, at p. 98. Staff also acknowledges that MPS needs the baseload capacity offered by Iatan 2. Staff also appears to acknowledge that L&P does not. Instead, Staff appears to base its recommendation on the assumption that because L&P could potentially sell excess energy on the market that it "may have chosen to add more base load." COS Report, at p. 99. Such speculation is not a sound basis to allocate Iatan 2 between MPS and L&P.

As discussed in the Rebuttal Testimony of Burton Crawford, MPS needs more of Iatan 2 than does L&P. As Staff indicates, "the best way to determine how to allocate Iatan 2 investment and costs between [MPS and L&P] for ratemaking purposes would be to base the allocation on resource planning by GMO performed separately for MPS and L&P." COS Report, at p. 96. GMO agrees. That kind of resource planning is the basis for the Company's recommendation.

Q: Staff also suggests that the ownership "rights" to Iatan 2 support its recommendation to allocate a disproportionate share to L&P. Do you agree?

A: No. As a preliminary matter, GMO holds the ownership interest in Iatan 2—not L&P or MPS. So from my perspective, this factor is irrelevant. However, to the extent it is relevant, Staff's logic is flawed and unsupported. Staff makes the unsubstantiated claim that "KCPL would not have considered GMO as a potential partner" so it is some how appropriate to favor L&P for getting GMO's toe in the door. That argument is not factually correct and disregards how Iatan 2 came to be. Through the collaborative process that lead up to KCP&L's Regulatory Plan, it was broadly recognized that there was a regional need for additional baseload capacity, which explains why the project has five joint owners, including Aquila, Inc. ("Aquila"), GMO's predecessor—not L&P. Aquila, now GMO, owns an 18% interest in Iatan 2. L&P does not. As a result, the issue of ownership rights, as argued by Staff, has no barring on the appropriate allocation of Iatan 2 between MPS and L&P.

Q: Staff also suggests that the impact on customer rates somehow supports its recommendation to allocate a disproportionate share of Iatan 2 to L&P. Do you agree?

A: No. Allocating 100 MW of Iatan 2 to L&P has an unnecessary and disproportionally detrimental impact on L&P's rates. This rationale strikes me as the least defensible of Staff's arguments. Staff acknowledges that its proposed allocation of 100 MW of Iatan 2 to L&P "will potentially cause the rate increase to L&P customers to be almost four times the rate increase to MPS customers." COS Report, at p. 102. "Staff realizes that economic conditions are tough and the rate impact of adding 100 MW of Iatan 2 investment and costs in L&P's revenue requirement will not be easy for many of its customers." COS Report, at p. 95. GMO agrees that the rate impact of Staff's proposal on L&P's customers would be disproportionately detrimental. In support of its proposed allocation despite such a severely disparate impact, Staff simply speculates that L&P might benefit in the long term and that L&P might have ended up with a similar result had it not been acquired by Aquila in 2000. COS Report, at pp. 102-03. That is not a sound basis for allocating to L&P a larger interest in Iatan 2 than its customers need.

INDUSTRIALS' PROPOSAL TO REDUCE GMO'S DEPRECIATION EXPENSE

Q: What is your response to the Industrials' proposal to depreciate Iatan 2 over 60 years, as opposed to the Company's recommendation of 50 years?

A: Iatan 2 was the cornerstone of KCP&L's Regulatory Plan to which GMO's predecessor, Aquila, Inc. was a party. There was a collective recognition that the region needed additional, base load, coal-fired generation capacity and that KCP&L was in the best position to build it. KCP&L took on the risk of building the plant. GMO's predecessor, Aquila, Inc. signed on to become a partner in Iatan 2 with an 18% ownership interest. Now, five years later, when the plant is complete and providing power to the region, the Industrials propose to prolong GMO's and KCP&L's recovery of the costs it incurred to build the plant. Over the next 50 years, the Commission will have countless opportunities to adjust the depreciation rate for Iatan 2 if it appears the unit will run for more than 50 years, which is significant given the potential for carbon legislation at some point that could impact the lives of coal-fired power plants. To presume a 60-year life now penalizes GMO and KCP&L from a cash flow perspective and sends the wrong signal to utilities and the investment community about how large-scale utility construction projects are treated in the State of Missouri.

Q: Is the Industrials' proposal to reduce GMO's depreciation expense reasonable?

A: No. John Spanos provides a detailed, technical response to the Industrials' proposed depreciation treatment. In addition to those technical deficiencies, it is important to note the practical impact of the recommendation on the Company. Without increasing rates, a utility's annual depreciation expense largely reflects the amount a utility can spend on replacement capital projects. Replacement capital spending is intended to maintain or replace existing infrastructure. Additional capital is needed to build new infrastructure, such as to satisfy new demands on the system or to satisfy new mandates. Practically speaking, if an adequate depreciation expense is not allowed in a utility's rates, capital that might otherwise be spent on new infrastructure will need to be allocated to maintain existing infrastructure. With renewable mandates in Missouri, required environmental investments on the horizon, as well as continued investments to maintain the reliability of our transmission and distribution system, GMO will need to make significant capital investments over the next several years.

Inadequate depreciation expense would also reduce cash flow and hurt GMO's credit metrics, as it would decrease the Company's funds from operations and increase its debt requirements. The ratio of funds from operations to debt and the ratio of total debt to total capitalization are two of the key metrics credit rating agencies consider when assessing a company's creditworthiness. Although reducing a utility's depreciation expense might appear to be an attractive way to mitigate a rate increase request, the resulting cash flow impacts would ultimately be negative for the utility and its customers.

STAFF'S IATAN REPORT

Q: How would you describe Staff's Iatan Report?

A: Staff's Iatan Report, particularly with respect to Iatan 2, contains two very different and distinct approaches to reviewing prudence. At one end of the spectrum, Staff conducts a construction audit and prudence review, arriving at a recommended prudence disallowance of $37 million. Although KCP&L strenuously disagrees with Staff's recommended disallowance, Staff appears to have attempted to follow the requisite two-step process for a prudence review—first, to identify an imprudent act or decision, and second, to quantify any impact that act or decision had on the cost of the project. In Schedule 1-1 to Staff's Iatan Report, Staff identifies seventeen acts or decisions by KCP&L concerning Iatan 2 that Staff believes were imprudent. Staff then attempts to quantify the impact of those acts or decisions on the cost of Iatan 2.

At the other end of the spectrum, Staff recommends a wholly unsupported prudence disallowance for Iatan 2 of more than $93 million based upon nothing more than the observation that it is in excess of the December 2006 control budget estimate ("CBE") of $1.685 billion. The sum of the proposed $37 million and $93 million disallowances is how Staff arrives at its overall recommended prudence disallowance of $130 million for Iatan 2.

Q: What is KCP&L's response to Staff's recommended prudence disallowance of $37 million for Iatan 2?

A: KCP&L strongly disagrees with Staff's allegation that the seventeen acts or decisions by KCP&L listed in Schedule 1-1 were imprudent or resulted in $37 million in unnecessary costs to Iatan 2, as described in the Rebuttal Testimony of the following Company witnesses:

- William Downey, who speaks to KCP&L's management of the Iatan projects, executive oversight, and settlements reached with certain vendors, which Staff alleges were imprudent;
- Chris Giles, who speaks to the regulatory history of the projects, including the unprecedented transparency into the projects that resulted from the Regulatory Plan;
- Brent Davis, who speaks to KCP&L's day-to-day management of the Iatan projects;
- Forrest Archibald, who speaks to the project's cost control system;
- Bob Bell, who speaks to KCP&L's management of the Iatan projects, both in the context of his significant power plant construction experience, as well as what was occurring in the industry while Iatan 2 was being built;
- Steve Jones, who speaks to procurement;
- Ken Roberts, who speaks to Staff's incorrect application of the prudence standard, as well as KCP&L's management of the Iatan projects, including the Alstom settlement payments, which Staff seeks to disallow;
- Daniel Meyer, who provides extensive testimony supporting KCP&L's prudent management of the project; and

- Kris Nielsen, an independent prudence expert, who reviewed the prudence of KCP&L's management of the project.

Although I testify later in this testimony to certain of the seventeen allegedly imprudent decisions or acts, that is not the primary point of my testimony. The primary point of my testimony with respect to Staff's Iatan Report is to point out the inadequacy of Staff's recommended $93 million "plug" disallowance for Iatan 2.

Q: Why do you describe Staff's proposed prudence disallowance of $93 million as a "plug"?

A: I call it a "plug" because it is not based on any alleged imprudent acts or decisions by KCP&L, but rather is simply a mathematical computation.

Q: Please explain.

A: Staff's Iatan Report looks at actual costs incurred as of June 30, 2010 for Iatan 2, which was approximately $1.815 billion on a total project basis ("June 30, 2010 Actuals"). Staff then subtracts from that figure the CBE of $1.685 billion to arrive at a recommended prudence disallowance of $130 million. Then, to avoid double counting the impact of the seventeen allegedly imprudent acts or decisions referenced above, Staff subtracts the $37 million from the $130 million to arrive at what I describe as the $93 million "plug" disallowance.

Q: How does Staff describe the $93 million "plug" disallowance?

A: In Schedule 1-1 to the Iatan Report, Staff describes its $93 million recommended prudence disallowance as a "Net Unidentified / Unexplained Cost Overrun adjustment."

Q: Does Staff explain how it arrives at its "Net Unidentified/Unexplained Cost Overrun adjustment"?

A: Yes. In Note A to Schedule 1-1, Staff explains that it does the computation I describe above. Staff begins with the $130 million difference between the June 30, 2010 Actuals and the December 2006 CBE, which Staff describes as the "Gross Unidentified / Unexplained Cost Overrun adjustment," then subtracts its proposed disallowance of $37 million, which it describes as the "Staff disallowance adjustments" to arrive at the $93 million "Net Unidentified / Unexplained Cost Overrun adjustment."

Q: Does KCP&L take issue with how Staff arrives at the $93 million "Net Unidentified / Unexplained Cost Overrun adjustment"?

A: Yes, we do. That figure is unsupported. It is not tied to any alleged imprudent acts or decisions by KCP&L. It is inconsistent with the Commission's prior handling of construction audits and prudence reviews. It does not satisfy Staff's initial burden of proof to raise "serious doubt" concerning prudence. It also incorrectly presumes that any money spent over a budgeted amount is imprudent.

If it was Staff's intent simply to recommend to disallow every dollar spent above the December 2006 CBE, it could have saved itself, KCP&L, and the Commission a lot of time, trouble, and expense by saying so at some point prior to its November 3, 2010 Iatan Report. To my knowledge prior to its Iatan Report, Staff never explained to KCP&L, or more importantly the Commission, its intent to adopt such a simplistic approach. Had Staff done so, KCP&L would have disputed Staff's approach as inadequate at that time, and the Commission could have given Staff guidance as to whether its approach was consistent with how the Commission intended Staff to conduct its construction audit and prudence review of Iatan 2. Instead, the dispute has arisen now—

- 5 ½ years after the Commission approved the Regulatory Plan, which contemplated (i) the construction of Iatan 2, (ii) KCP&L's development of a cost control system, and (iii) the timing of this rate case;
- more than 4 years after construction began on Iatan 2;
- more than 4 years after KCP&L first presented its cost control system to the Staff;
- about 4 years after the CBE was established;
- about 4 years after KCP&L began reporting to Staff on a quarterly basis detailed status updates for Iatan 2, including a cost report that compared current spending on Iatan 2 to the CBE, which KCP&L subsequently began providing to Staff on a monthly basis; and
- <u>Only about 5 months before</u> the Commission will issue an order determining what amount of Iatan 2 KCP&L gets to include in its Missouri rates.

Staff's simplistic approach places the Commission in the untenable position of having to make a decision concerning $93 million in capital costs with little to no insight from its Staff. As the Commission noted on page 5 of its order dated April 15, 2009 in Case No. ER-2009-0089, "the Commission does not have the option to delay evaluating a relevant issue or factor in a case setting rates."

Staff's simplistic approach also irresponsibly jeopardizes KCP&L's financial integrity. Under accounting rules KCP&L would have to immediately write off its books any portion of Iatan 2 costs that this Commission concludes cannot be included in the Company's Missouri rates. To so cavalierly put a utility in the position of having to write off such significant sums is irresponsible, particularly when that recommendation comes from the Staff, who is supposed to balance the interests of KCP&L and its customers.

Q: Do you have a similar concern with respect to Staff's audit of the Iatan 1 projects?

A: Yes. With respect to the Iatan 1 project, Staff's recommended disallowance of $69.7 million is similarly comprised of two audit methods. Staff recommends that $51.3 million be disallowed based on eighteen allegedly imprudent acts or decisions by KCP&L. Staff then adds to that a recommended "plug" disallowance of $18.4 million. Staff's "plug" disallowance for the Iatan 1 project suffers from the same flaws as Staff's "plug" disallowance for Iatan 2, and should similarly be rejected.

Q: Do you have any concerns about Staff's approach as the case progresses?

A: Yes, I do. Since the $93 million "plug" disallowance for Iatan 2 is based on the difference between the June 30, 2010 Actuals and the December 2006 CBE, I am concerned that when Staff updates its case for actual expenditures as of October 31, 2010, it will simply subtract the December 2006 CBE from those actuals to arrive at a larger, unsupported "plug." I do not believe that is what the Commission had in mind when it established a deadline for its Staff to complete "all audit activity, of any type, involved with the Iatan II generating facility, including any common plant shared between Iatan I and II [by] January 30, 2011." Order Regarding Construction and Prudence Audits, File Nos. ER-2010-0355 and ER-2010-0356 ("July 7, 2010 Order"), Ordering ¶ 9. If Staff remains consistent in the true-up phase of this case and Iatan 2 ultimately costs what it is presently projected to cost, the unsubstantiated "plug" component of Staff's proposed disallowance could go from $93 million to as much as $226 million, which would significantly exacerbate the issues I have described being concerned about.

Q: Why do you believe the unsubstantiated "plug" component of Staff's proposed disallowance could go from $93 million to as much as $226 million?

A: The current cost estimate for Iatan 2 is $1.948 billion. While that is a $40 million reduction from the most recent cost estimate of $1.988 billion, it is $263 million, or $15.6% more than the December 2006 CBE. If Staff sticks to its simplistic approach, and if Iatan 2 ultimately costs $1.948 billion, then I am concerned that Staff will simply subtract the $1.685 billion CBE from $1.948 billion to arrive at a total recommended disallowance of $263 million. Then, to avoid double counting as it did in the Iatan Report, Staff would subtract its proposed disallowance of $37 million to arrive at a new increased "plug" disallowance of $226 million. Such a proposal would be absurd, but unless Staff changes its methodology, I am concerned that is what Staff will ultimately recommend.

Q: Is Staff's approach to the construction audit and prudence review of Iatan 2 consistent with what the Commission directed Staff to do?

A: The methodology Staff used to arrive at its $37 million recommended prudence disallowance appears to be consistent with the Commission's directive for Staff to conduct a construction audit and prudence review of Iatan 2. However, I do not see how Staff's proposed $93 million "plug" disallowance could be consistent with the Commission's directive. Simply subtracting the December 2006 CBE from the actual dollars spent on the project at any given time could be done without doing any audit work at all. That is not how I read the Commission's orders, and I would not think that is what the Commission had in mind.

Q: How does Staff justify using the simplistic approach of subtracting the December 2006 CBE from the June 30, 2010 Actuals to arrive at its recommended disallowance?

A: Staff has two separate but related explanations as to why it believes it was appropriate to take such a simplistic approach. First, Staff alleges that KCP&L "disregarded [its] responsibility" under the Regulatory Plan to "develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate." Iatan Report, pp. 33-34. Second, Staff explains that it "considers KCP&L responses to be nonresponsive to certain Staff Data Requests." Iatan Report, p. 35. Instead, Staff claims KCP&L "merely advises Staff how it can track budget variances." Id.

Q: Let's take Staff's explanations in turn. Do you agree that KCP&L "disregarded [its] responsibility" under the Regulatory Plan to "develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate?"

A: No. As explained in the Rebuttal Testimony of KCP&L witness Forrest Archibald, KCP&L satisfied its obligation under the Regulatory Plan by developing and having in place a cost control system that identifies and explains cost overruns above the December 2006 CBE. Staff's Iatan Report reads as though it expected the cost control system to be a piece of paper that lists and explains every dollar spent over the December 2006 CBE. That is an overly simplistic notion and does not accurately represent the purpose of a cost control system, which is to manage the cost of a project, which KCP&L's system effectively did.

KCP&L's cost control system is a complex and sophisticated system designed not only to manage the review and payment of tens of thousands of invoices from hundreds of vendors, but also to track cost and schedule trends to identify potential concerns on the horizon before they have a chance to impact the project. That is what is necessary to manage a multi-year, nearly $2 billion construction project.

To my knowledge, no previous utility construction project in Missouri has had such an elaborate, sophisticated, transparent cost control system in place as the one KCP&L has used for the Iatan projects. If KCP&L's cost control system is not adequate for Staff to perform its audit of Iatan 2, it is not clear to me how Staff was able to audit projects built prior to Iatan 2. In addition, it is my understanding that Staff has reached out to other utilities in the state requesting that they implement cost control systems similar to the one KCP&L used for the Iatan projects. That seems inconsistent with Staff's argument here that KCP&L's system prevents it from doing its audit work.

My understanding from the discovery and hearings in Case No. EO-2010-0259 is that Staff significantly changed its approach to construction audits and prudence reviews part way through the construction of Iatan 2 by making the Services Division responsible for conducting the audit, as opposed to the Operations Division, which had historically been responsible for construction audits. Prior to the Iatan projects, Staff's construction audits and prudence reviews were premised on an engineering review from the Operations Division. Here, the engineers' review of the Iatan projects has been largely cast aside as a "non dollar adjustment." Iatan Report, p. 28.

Staff's audit of the Iatan projects seems to be the exact opposite of what has historically occurred. Before, the Operations Division, that is the engineers, audited the project with support from the Services Division. For Iatan, the Services Division ran the audit with limited coordination with or input from the engineers in the Operations Division.

Q: Did the Operations Division, *i.e.*, the engineers, audit Iatan 2?

A: Yes. According to Staff's Iatan Report, the Operations Division reviewed "construction project change orders associated with the project for the following:

- To understand the reason for the change at the point in time when the change order was issued;
- To determine whether the change corrected an engineering-related problem, resulted in a better design, or improved the operation or construction of the plant; and
- To determine whether the change resulted in a safety concern, caused unnecessary construction, or caused unnecessary duplication of facilities or work."

Iatan Report, at p. 28. After reviewing 647 change orders, the Operations Division ultimately concluded that it "found no engineering concerns with any of the Iatan 2 or Iatan common plant change orders reviewed." Iatan Report, at p. 29. Since many of the expenditures in excess of the CBE relate to design changes or design maturation, as explained in the Rebuttal Testimony of Forrest Archibald, the findings of the Operations Division are contrary to Staff's recommendation to disallow every expenditure in excess of the CBE.

Q: Does KCP&L's cost control system fulfill its obligations in the Regulatory Plan?

A: Absolutely. The Regulatory Plan obligated KCP&L to develop a "system" to identify and explain costs incurred in excess of the December 2006 CBE. As Mr. Archibald explains in his Rebuttal Testimony, KCP&L's cost control system does just that. It might not be on a single piece of paper, as Staff intimates it should be, but KCP&L's cost control system contains all the data one needs to identify and explain costs incurred in excess of the CBE.

Q: Are you surprised by the timing of Staff's allegation that KCP&L "disregarded [its] responsibility" under the Regulatory Plan to "develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate"?

A: Yes. Although Staff has requested and received on several occasions an explanation as to how the cost control system works and how costs can be tracked through the system, to my knowledge the November 3, 2010 Iatan Report is the first time Staff has told KCP&L, or more importantly the Commission, that it believes KCP&L "disregarded," or somehow failed to satisfy its obligation in the Regulatory Plan to implement an adequate cost control system. Staff briefly discussed KCP&L's cost control system in its August 6, 2010 report for Iatan 1, but Staff did not claim that KCP&L had disregarded or otherwise violated its commitments under the Regulatory Plan.

Q: When did KCP&L first present its cost control system to Staff?

A: KCP&L first presented its cost control system to Staff in July of 2006. KCP&L's cost control system has been the basis for the cost section of each quarterly CEP update report provided to Staff since the fourth quarter of 2006. KCP&L has worked diligently to answer Staff's questions about how the cost control system works. I have personally observed Mr. Archibald explain the system to members of the Staff on several occasions. I do not understand why Staff would wait until now to say that KCP&L has not fulfilled its obligations under the Regulatory Plan concerning the cost control system, especially since Staff appears to believe it cannot complete its audit because the cost control system is inadequate. Such a significant allegation should have been raised long before now, for the Commission's sake as well as the Company's.

Q: Turning to Staff's second explanation, do you agree that KCP&L's responses to Staff data requests were nonresponsive because they "merely advise Staff how it can track budget variances"?

A: No. Consistent with what KCP&L has been explaining to Staff since it began its audit work on Iatan 2, understanding how to "track budget variances" in the cost control system is how Staff can use the system to identify and explain costs in excess of the CBE, precisely what Staff claims to be unable to do. That is the point of the system from an audit perspective. Staff's request for "**a list** that shows the amount of each cost overrun and an explanation of each cost overrun" supports my concern that Staff has an overly simplistic understanding of what a cost control system is or does. Iatan Report, at p. 34 (emphasis added). Staff appears to want a single document, a "list" that "shows the amount of each cost overrun and an explanation of each cost overrun" over the December 2006 CBE. No such list exists, nor could KCP&L easily create one for the Staff. More importantly, that is not what a cost control system is or should be, and it does not reflect KCP&L's obligation under the Regulatory Plan. Furthermore, if such a list existed, there would be little audit work for Staff to do. The Commission could read the list for itself and make a determination as to whether the explanations provided by KCP&L justified the costs comprising the list.

As recognized by Staff in the Iatan Report, KCP&L has consistently maintained that although no such "list" exists, the cost control <u>system</u> contains all the necessary data to identify and explain those expenditures. Iatan Report, at p. 34 ("KCP&L indicated that its cost overruns are reported in its Cost Portfolio and the supporting documents of the overruns were provided in previous responses to Staff Data Requests."). Specifically, as accurately quoted by Staff in its Iatan Report, KCP&L stated in response to Data Request 970 in Case No. EO-2010-0259:

> all variances from the [CBE] are captured in, and reported from, the Cost Control System. The System provides the detailed tracking process in the Cost Portfolio, which includes the [CBE] as well as each budget change, the Committed Costs, the Uncommitted Costs, the Current Forecast Total Cost At Completion and the Actuals Including Accruals. These details are maintained by Budget Line Item and the supporting documentation is voluminous. There is not a single set of output documents resulting from the process.
>
> Utilizing the April 2010, Iatan 2 K(a) Cost Report, the Control Budget Estimate (Column A) is $1,685.0 billion. As of April 2010, the Actuals Including Accruals (Column M) total $1,782.4 billion. The justification for the additional $97.4 million is located within the documentation previously provided to staff in multiple data requests. As discussed above, the variance is explained within the documentation previously provided in data requests such Contingency Logs, PO logs, Change Order logs, Reforecast Presentations and supporting documentation, Budget Transfer Logs, etcetera.
>
> (a) The K Cost Reports are routinely provided in hard copy in the Strategic Infrastructure Investment Status Reports on a quarterly basis and has been provided in Microsoft Excel format in data requests question series number 0622.
>
> A drawing illustrating how to track variances is attached, "Example for DR 0970 Rev 1.xls." Mr. Forrest Archibald has walked through the portfolio in previous meetings and would be able to provide the assistance again if requested.

Iatan Report, at p. 36.

Q: When did KCP&L receive Data Request 970 and provide the response to quoted above?

A: KCP&L received Date Request 970 from Staff on July 13, 2010 and responded on July 30, 2010.

Q: Does anything strike you about the timing of Staff's Data Request?

A: Yes. July 13, 2010 strikes me as extremely late in the process to be asking such a fundamental question, especially in light of the fact that Staff contends it was unable to conduct its construction audit and prudence review based upon KCP&L's alleged "nonresponsiveness" to this data request. I would think that the majority of Staff's audit work would have been completed by then.

Q: Does KCP&L take issue with Staff's explanation that KCP&L's alleged nonresponsiveness to a data request justifies Staff using such a simplistic approach?

A: Yes, we do. Staff claims that because KCP&L did not provide a "list" of each dollar spent over the CBE with an explanation for each expenditure, (i) KCP&L "disregarded" its commitments in the Regulatory Plan and (ii) Staff is justified in simply proposing to disallow all expenditures in excess of the December 2006 CBE. Staff's position is concerning and unreasonable for several reasons.

- First, the Regulatory Plan did not require KCP&L to create the "list" Staff now insists it needs to complete its review of the Iatan projects.
- Second, prior to the November 3, 2010 Iatan Report, Staff did not inform KCP&L, or more importantly the Commission, that KCP&L creating such a "list" was critical to Staff's audit work. Staff did not even ask for it until July of 2010.
- Third, the Commission went so far as to establish monthly status hearings to discuss discovery issues to avoid problems like this from arising, making it even more concerning that Staff would wait until its Iatan Report to allege that KCP&L's failure to provide the list in response to a data request prevented Staff from doing what the Commission directed it to do.

With respect to this third point, in its July 7, 2010 Order, the Commission ordered that "Any discovery disputes shall be taken up immediately at these [status] hearings. Any discovery dispute not timely raised at the status hearings shall be deemed waived." Ordering ¶ 5. Staff never raised at a status hearing that KCP&L was nonresponsive to a Staff data request by failing to provide the list Staff now says it needs. It would appear that Staff has waived the right to make that argument now.

Q: Did KCP&L make available to Staff the type of information Staff was apparently attempting to obtain on the "list" it requested?

A: Yes. All of the information Staff needed to audit the construction project was available in the cost control system. Staff's dispute really seems to be with the format in which the information was available. That is not a valid reason to reject the information. And it does not justify the simplistic approach Staff seeks to adopt here.

Q: Did the Kansas Staff require such a list to complete its review of the Iatan projects?

A: No, the consultant hired by the KCC completed his review of the Iatan projects without such a list. He was able to conduct his audit with the same information made available to the Missouri Staff. I should also add that the Operations Division did its audit work without such a list, as did Kris Nielsen and Daniel Meyer, who discuss their audit work in their testimony in this case.

Q: Is Staff's rationale for its proposed Iatan 2 prudence disallowance consistent with the Commission's prior handling of construction audits and prudence reviews?

A: No. As far as I am aware, Staff has never suggested and the Commission has certainly never adopted an approach that would disallow every expenditure in excess of a project's control budget estimate. In Wolf Creek, for example, the control budget estimate for the project was approximately $1 billion. The plant ultimately cost nearly $3 billion. To do what Staff has done here, the Commission would have been asked to disallow nearly $2 billion in cost overruns. That would have been unreasonable, and it is not what occurred.

In Wolf Creek, the Staff did a comprehensive construction audit and prudence review involving numerous witnesses covering numerous disciplines to arrive at a recommended prudence disallowance of approximately $200 million—about 7% of total project costs and only about 11% of the excess costs above the control budget estimate. The primary basis for that recommendation was an engineering review.

It is worth taking a moment to compare the Wolf Creek project to Iatan 2. Wolf Creek was more than two years behind schedule and cost almost 200% more than its definitive estimate. By comparison, Iatan 2 satisfied its in-service criteria on August 26, 2010, less than three months after the June 1, 2010 target date provided in the Regulatory Plan. In addition, Iatan 2 is forecasted to cost only about 15.6% more than the December 2006 CBE. Despite these differences, Staff proposes to disallow a similar amount, as a percentage of total project costs, and a more severe disallowance as a percentage of the cost above the definitive estimate. The following table compares the cost, schedule, and ultimate ratemaking treatment of Wolf Creek to Staff's proposal for Iatan 2:

	Wolf Creek	Iatan 2
Definitive Estimate	$1.033 billion	$1.685 billion (December 2006 CBE)
Cost to Complete	$2.9 billion	$1.948 billion (current estimate)
Costs Above the Definitive Estimate	181%	15.6%
Schedule	> 2 years late	< 3 months after June 1, 2010 Regulatory Plan Target Date
Prudence Disallowance (in Dollars)	$200 million	$130 million (potentially $263 million)
Disallowance (% of Cost to Complete)	7%	7% (potentially 14%)
Disallowance (% of Costs Above the Definitive Estimate)	11%	100%

I include assumptions of what Staff's proposed disallowance could be if it continues to seek to disallow every expenditure above the December 2006 CBE to illustrate that the larger Staff's unsupported "plug" disallowance becomes, the more unreasonable Staff's recommendation also becomes when compared to what the Commission did in Wolf Creek.

Staff is proposing to treat the Iatan 2 project significantly worse than the Commission treated the Wolf Creek project when Iatan 2 was essentially completed on time and on budget compared to Wolf Creek's cost and schedule. Staff's approach here is not only fundamentally different from the Commission's approach in Wolf Creek, but it results in an outcome that on its face is unreasonable when compared to the Commission's findings concerning Wolf Creek.

Q: **How should the Commission address the $37 million and $93 million prudence disallowances recommended by Staff?**

A: Staff conducted a construction audit and prudence review of Iatan 2. The result of which is a recommended prudence disallowance of $37 million. The Commission should weigh Staff's evidence concerning the seventeen items that comprise that proposed disallowance against the Company's evidence concerning those items and make a determination. The remainder of Staff's proposed $130 million disallowance, that is, the unsupported $93 million "plug," is <u>not</u> the result of a construction audit and prudence review and should be disregarded. Any attempts by Staff to subsequently increase its "plug" disallowance should similarly be disregarded.

Q: Did the KCC express an opinion about Iatan 2 costing more than the December 2006 CBE.

A: Yes, in its recent order in KCP&L's companion Kansas rate case to this one, the KCC found that "Given the magnitude of the project, the timeline under which the project was constructed, and the range permitted for a definitive type of cost estimate, the Commission finds that this factor does not indicate imprudence on the part of KCP&L." KCC Docket No. 10-KCPE-415-RTS, at p. 22 (Nov. 22, 2010) (citing AACE International Recommended Practice No. 18R-97, p.6 (noting the range of accuracy for a definitive estimate to be -5 to +15%)). It is also noteworthy that the KCC was looking at a larger amount of excess above the CBE when it made that statement. At the time of the Kansas hearings, the estimate to complete Iatan 2 was $1.988 billion. That figure has now been reduced to $1.948 billion.

Q: Did the KCC made any findings concerning the prudence of KCP&L's management of Iatan 2?

A: Yes. In its November 22, 2010 order, the KCC found that KCP&L "built a strong and credible case in defense that its actions were not imprudent." The KCC had hired an outside prudence consultant, Walter Drabinski of Vantage Consulting, a witness in this case to conduct a construction audit and prudence review of the Iatan projects. In its order, the KCC rejected its own expert's analysis in part because it "hinges on a hindsight analysis, which is clearly prohibited," Kansas Order, at p. 15, and instead disallowed $20.4 million on a total project basis ($5.1 million on a Kansas jurisdictional basis).

SPECIFIC PROPOSED IATAN DISALLOWANCES

Q: You noted that you would speak to several of the allegedly imprudent acts or decisions that comprise Staff's proposed prudence disallowance of $37 million. Which of those will you speak to?

A: Four of Staff's seventeen allegedly imprudent acts or decisions concerning Iatan 2 relate to Schiff Hardin. One relates to Cushman and Associates ("Cushman"). Staff also has a proposed disallowance from the cost of the Iatan 1 project related to employee mileage reimbursement, as well as companion proposed disallowances for Iatan 1 and Iatan 2 based upon an arbitrary sum for each unit to address the potential for what Staff describes as "inappropriate" charges. In this portion of my testimony, I speak to those proposed disallowances.

Schiff Hardin's Fees And Expenses Were Prudently Incurred

Q: Why does Staff seek to disallow Schiff Hardin fees and expenses?

A: Although Staff dedicates 24 pages of the Iatan Report to Schiff Hardin (pages 65-89), Staff's criticisms boil down to the following:

(i) Schiff Hardin's rates in Staff's opinion are too high, and relatedly that Schiff Hardin was not hired primarily to perform legal services in support of the Iatan projects;

(ii) KCP&L should have solicited bids and undertaken a formal Request for Proposal ("RFP") process to select a provider of legal services for the Iatan projects;

(iii) KCP&L should have sent written approval to Schiff Hardin of changes in the hourly rates of its lawyers; and

(iv) KCP&L should have required Schiff Hardin to submit with its invoices for legal services a copy of every receipt for travel-related expenses.

Although I will respond to each of these criticisms specifically, my general observation is that Staff's criticisms are based on the incorrect notion that KCP&L should procure legal services in the same manner it procures offices supplies or some other fungible commodity. I disagree. KCP&L treats the procurement of legal and other professional services differently. That is not only appropriate but it is in the best interest of KCP&L and its customers.

Q: If the Commission would find in favor of the Staff that a portion of Schiff Hardin's fees and expenses should be disallowed, do you agree with the calculations made by Staff to compute those disallowances?

A: No, I do not. As I discuss below, the calculation of Staff's proposed disallowances suffers from significant flaws.

The fees KCP&L paid Schiff Hardin for its work in support of the Iatan projects are reasonable.

Q: Please respond to Staff's allegation that Schiff Hardin's rates were too high.

A: Staff's proposal to disallow a portion of Schiff Hardin's fees on the basis that the hourly rates charged by its lawyers and contractors are too high is flawed in several respects. First, the comparisons Staff does, specifically the Laffey Matrix and the hourly rates of Kansas City law firms, are not a reasonable benchmark against which to measure Schiff Hardin's fees. Second, Staff's claim that only 20% of the work Schiff Hardin did in support of the Iatan projects constituted legal services, is arbitrary, unsupported, and incorrect. Third, Staff's claim that "the selection of Schiff was primarily influenced by KCPL management's desire to be prepared to defend and protect itself from any charges of unreasonable, inappropriate or imprudent decisions and not about conducting the day-to-day project management work required to complete a significant construction project on time and on budget" is similarly unsupported and incorrect. Iatan Report, at p. 73. Schiff Hardin's role was to support KCP&L in its efforts to complete the Iatan projects on time and on budget. Schiff Hardin fulfilled that role very well. Fourth, Staff's claim that KCP&L could have demanded and Schiff Hardin would have accepted a discounted fee arrangement is similarly arbitrary and unsupported.

Q: **What has KCP&L paid Schiff Hardin for its services in support of the Iatan projects?**

A: KCP&L has paid Schiff Hardin approximately $20 million for its work in support of the Iatan projects.

Q: **Why were Schiff Hardin's fees and expenses prudently incurred in the context of the Iatan projects?**

A: $20 million is a significant amount of money. However, one must view it in context, that is, the scope of the work performed, the value of that work, and what was at stake. As a preliminary point, it is important to note that the fees paid to Schiff Hardin amount to less than 1% of the cost of the Iatan projects. For the level and quality of the support Schiff Hardin provided for the Iatan projects, 1% is a reasonable amount, as testified to by Bob Bell and Daniel Meyer in their Rebuttal Testimony. In addition, as explained in the testimony of William Downey, Schiff Hardin's support for the Iatan projects was extensive, including legal services related to developing RFPs, contract negotiation, contract administration, project controls, review and management of change orders and claims, dispute avoidance, and dispute resolution, among other things—all over a several-year period.

Moreover, one would be hard pressed to find a team as experienced and knowledgeable as Schiff Hardin when it comes to large-scale construction projects such as the Iatan projects. One also must consider what was at stake. Without highly competent legal representation, the Iatan projects could have gotten bogged down in vendor disputes, potentially including litigation. Although no one can prove what would have happened had Schiff Hardin not been involved in the Iatan projects, it is clear that the costs and delays associated with vendor disputes and litigation could easily have surpassed the fees paid to Schiff Hardin. Staff fails to take any of these considerations into account.

Q: Why does Staff's rate comparison analysis fail to support its claim that Schiff Hardin's rates were so high as to be imprudently incurred?

A: Staff fails to acknowledge that an hour of one lawyer's time might legitimately be more valuable than an hour of another lawyer's time based upon their respective knowledge and experience. Schiff Hardin brought a tremendous amount of knowledge and experience to the Iatan projects. Staff's hourly rate analysis fails to take that into account.

The real question is <u>not</u> how Schiff Hardin's hourly rates compare to the Laffey Matrix, which is not applicable here, or how Schiff Hardin's hourly rates compare to the rates of other law firms that might or might not have been capable of doing the work Schiff Hardin did in support of the Iatan projects. The real question is whether the services KCP&L received from Schiff Hardin are worth the fees KCP&L paid, or put another way, whether those fees were prudently incurred. The answer to that question is an emphatic yes.

Q: Do you agree with Staff's use of the Laffey Matrix or the rates of Kansas City area law firms to measure the reasonableness of Schiff Hardin's hourly rates?

A: No, I do not. The Laffey Matrix does not apply in cases such as this, and the rates charged by Kansas City area law firms are not relevant. Neither is a proper baseline for evaluating the reasonableness of Schiff Hardin's hourly rates for legal services relative to the Iatan projects. Both approaches fail to take into consideration the unique nature of the project and the significant experience and industry-specific knowledge that the Schiff Hardin team possesses, all of which legitimately impact the hourly rate for legal services.

Q: What is the Laffey Matrix?

A: The Laffey Matrix represents the prevailing market rates for legal fees charged by federal court litigators in the Washington, D.C. area on an hourly basis. It is based on the number of years a lawyer has been able to practice as of a given year. Thus, for example, the matrix provides an hourly rate for all lawyers that graduated from law school four years ago as of 2008.

Q: In what types of cases is the Laffey Matrix intended to be used?

A: As indicated on the USAO website, the Laffey Matrix is intended to be used in cases involving fee-shifting statutes, those limited instances in which the law allows the prevailing party to shift the burden of its attorneys' fees to the losing party. The USAO website identifies a few examples of such statutes, including the Civil Rights Act, the Freedom of Information Act, and the Equal Access to Justice Act. It is my understanding that the Laffey Matrix has been applied most frequently in civil rights cases. There is no indication that the Laffey Matrix was intended to represent the prevailing market rates in every State, without regard to the subject matter of the legal services at issue.

Q: **Has this Commission or any Missouri court applied the Laffey Matrix as Staff proposes here?**

A: No. I am only aware of one Missouri case that even mentions the Laffey Matrix—*White v. McKinley*, 2009 WL 813372 (W.D.Mo. 2009). The court did not endorse or approve the Laffey Matrix but simply noted that it was one of the bases upon which the plaintiff based its claim for attorneys fees. Notably, *White* is a civil rights case.

Q: **Has the Laffey Matrix been applied by other courts in the Eighth Circuit?**

A: Only in certain limited circumstances. I am only aware of a few references to it. District courts in Minnesota, for example, have considered the Laffey Matrix and expressly rejected it as "unpersuasive and of little value in determining a reasonable hourly rate." *Olson v. Kramer*, 2008 WL 1699605 (D. Minn. 2008). The *Olson* court criticized the Laffey Matrix specifically for not distinguishing between the rates charged by lawyers who specialize in one field of law versus another, which is one of the key matters at issue here concerning the reasonableness of Schiff Hardin's rates.

Q: **Why do you believe that the Laffey Matrix fails to take into consideration the nature of an attorney's experience?**

A: The USAO clarifies on its website that the years of experience reflected in the matrix represents the number of years since a lawyer graduated from law school. In other words, the hourly rate specified by the Laffey Matrix does not take into consideration the actual experience that a lawyer may have acquired, but rather uses the lawyer's law school graduation data as a proxy for experience. So, for example, the Laffey Matrix would recommend the same hourly rate an attorney who graduated from law school in 1975, regardless of whether the attorney had thirty-five years of experience in civil rights litigation or whether the attorney had practiced for 5 years, left the practice of law for 25 years, and then decided to practice law again. The Laffey Matrix would recommend the same hourly rate for any lawyer who graduated from law school in 1975, regardless of whether the lawyer had successfully tried dozens of civil rights cases, had lost dozens of cases, or had no trial experience at all. How qualified or effective the lawyer is simply not a factor.

Q: **Is it appropriate for the Commission to consider an attorney's degree of knowledge and experience when evaluating the reasonableness of his or her hourly rate?**

A: Not only is it appropriate, it is critical. The simple fact is that not all lawyers are created equal. An hour of one lawyer's time is legitimately worth more than an hour of another lawyer's time based upon his or her knowledge and experience. That is particularly true in specialized areas of the law such as large-scale construction. As explained above, the Laffey Matrix as applied here by Staff would suggest that any lawyer that graduated in 1975 should charge the same rate for his or her services. That does not make sense and does not reflect reality. Different lawyers charge different hourly rates, even if they happened to graduate law school the same year. Supply and demand and how the market values a particular lawyer's services based on his or her knowledge and experience has significantly more to do with a given lawyer's rates than does the year he or she graduated from law school.

Q: Should the Commission determine the reasonableness of Schiff's hourly rates based on the hourly rates charged by Kansas City law firms?

A: No. In fact, the Missouri courts in the *White* case I previously mentioned, as well as in *Hendrickson v. Branstad*, 934 F.2d 158 (8th Cir. 1991), found that when attorneys have specialized skills, it is appropriate to compare the rates to those of non-local attorneys in other states or nationwide, as the case may be. In *Hendrickson*, for example, the Eighth Circuit held that the attorney's fees should be compared to other nationally prominent federal civil rights counsel rather than local Iowa counsel. Even more applicable to the present situation, the Missouri district court in *White* found that Chicago rates, rather than Kansas City rates, were the proper baseline for determining reasonable attorney's fees because that case involved unique circumstances (*e.g.*, unsympathetic clients, difficult facts, and allegations of conspiracy surrounding the alleged civil rights violations). In light of those unique circumstances, the Court found that it was appropriate for the party to seek legal services from attorneys in Chicago that specialize in difficult civil rights cases and awarded attorneys fees based on Chicago rates.

Q: Do you believe that there are unique circumstances on this project that would justify legal fees higher than those charged by local law firms?

A: Yes. The Iatan projects are among the largest and most complex construction projects the region has seen for many years. Recognizing that fact, it would not have been prudent for KCP&L to hire the least cost construction counsel or favor local counsel without regard to their knowledge or experience. Simply put, there are not many firms in the United States that have significant experience with projects as large and complex as the Iatan projects.

KCP&L needed to seek out construction lawyers that possess the requisite skill, knowledge and experience to handle the legal issues that arise during the construction of a large coal-fired power generation facility, regardless of where they are based. KCP&L recognized that it would need guidance from construction lawyers who know the issues, know how to avoid them, know how to handle them when they arise, and know how to maximize the returns and minimize the losses. Lawyers who know the industry and the select number of qualified vendors on these projects can provide better guidance to a project owner than lawyers who do not. Lawyers who are familiar with the obligations and limitations imposed on regulated utilities can provide better counsel to a regulated utility than those who do not. KCP&L recognized that and hired Schiff Hardin.

Schiff Hardin's team for the Iatan projects possesses the requisite skill, knowledge and experience to handle a project as large and complex as the Iatan projects. Few firms in the United States have significant experience with these types of projects. Schiff Hardin also has specific experience and knowledge with respect to the vendors on the Iatan projects. Under these circumstances, as the *White* court recognized, it is appropriate for KCP&L to seek out lawyers who specialize in this type of work even if their hourly rates are higher than other lawyers.

Q: **Staff's rationale for its Schiff Hardin disallowance aside, do you have any concerns about how Staff attempted to quantify its disallowance?**

A: Yes, I do. Staff came up with what it believes to be reasonable hourly rates for legal and non-legal services. Staff then concluded that only 20% of Schiff Hardin's work in support of the Iatan projects was legal and that the rest—80% was non-legal. Finally, Staff applied what it determined to be reasonable hourly rates to the ratios it developed for Schiff Hardin's legal and non-legal work. As I discuss above, KCP&L disagrees with Staff's attempt to develop proxy hourly rates. Here, I discuss the flaws in the ratios Staff developed for Schiff Hardin's legal and non-legal work.

Q: What rationale did Staff use to reduce the amounts billed for services provided that they considered "non-legal"?

A: Staff contended that 80% of the services provided by Schiff Hardin was for work that could be considered "project control" and that such services could have been provided at a lower cost by other qualified professional firms.

Q: What rationale did Staff use to reduce the amounts billed for services provided that they considered "legal"?

A: Staff contended that only 20% of the services provided by Schiff Hardin were for work that was legal in nature and that KCP&L did not consider the use of other qualified legal firms, which might have charged lower hourly rates.

Q: What issues do you have with Staff's positions?

A: Staff's estimate of the breakdown of Schiff Hardin services between legal and non-legal services is significantly misstated, with a disproportionate portion being assigned to the non-legal category, which significantly overstates Staff's recommended disallowance. In addition, Staff calculates the reduction in hourly rates using assumptions that are not supported by an analysis of the actual invoiced costs.

Q: Why do you believe that Staff's estimate of the breakdown of Schiff Hardin services between legal and non-legal services is significantly misstated, with a disproportionate portion being assigned to the non-legal category?

A: KCP&L completed an analysis of invoices paid to Schiff Hardin from July 2007 through April 2010, the period used by Staff in its August 6, 2010 Report. Although Staff's August 2010 Report focused solely on charges to the Iatan 1 AQCS project, KCP&L's analysis covered all charges to both the Iatan 1 and Iatan 2 projects. The results of this analysis are shown in Schedule CDB2010-3.

Q: What did this analysis show?

A: For the period reviewed, labor costs for services provided totaled $9.9 million for slightly more than 36,000 hours. These amounts include services provided by Schiff Harden's subcontractors, the primary of which was J. Wilson & Associates, Inc. Based on the information identified on the individual invoices, the hours incurred pertained to Iatan Oversight (23%), Iatan Project Control (35%), Contracts (7%), Contract Administration (33%) and other (1%). Of the hours identified as "project control", 79% were incurred by J. Wilson & Associates.

Q: How does this breakdown compare with Staff's breakdown?

A: As discussed beginning on page 80 of its Report, Staff contended that only 20% of the total costs incurred by Schiff Hardin, after excluding all out-of pocket costs, related to legal services while 80% applied to non-legal services such as project controls. KCP&L's analysis indicates that only 35% of the hours billed relate to project controls, and that those hours were substantially incurred, *i.e.*, 79%, by J. Wilson and Associates.

Q: Why is it significant that the majority of project control services were provided by J. Wilson & Associates?

A: As shown on the analysis, the average billing rate by J. Wilson & Associates over the period reviewed was $174 per hour. In Staff's disallowance workpapers, they assign the project control work (estimated at 80%) to four specific Schiff Hardin employees, computing a weighted billing rate of $322 per hour. The weighted rate was calculated using assumptions regarding the percent of time incurred by each individual multiplied by that individual's 2009 billing rate. Staff compared the $322/hour weighted billing rate with the $185/hour weighted billing rate of LogOn Consulting, an excess of $137/hour, and computing an adjusted rate of 58% ($185/$322). Staff applied this 58% adjusted rate to 80% of the incurred costs, after eliminating the out-of pocket costs. This resulted in a proposed disallowance of 42% or $5,353,124 for both Iatan 1 AQCS and Iatan 2. In actuality, if the $174/hour weighted billing rate of J. Wilson & Associates was compared with the $185/hour weighted billing rate of LogOn Consulting, there would be no recommended disallowance.

Q: How would the total hours have been distributed if only the hours incurred by Schiff Hardin personnel had been considered?

A: If only hours incurred by Schiff Hardin personnel were considered, then the statistics would reflect Iatan Oversight (32%), Iatan Project Control (10%), Contracts (10%), Contract Administration (46%) and other (2%).

Q: Why is this significant?

A: Staff contended that only 20% of the costs incurred by Schiff Hardin for Iatan projects were legal in nature. KCP&L believes that it derived substantial benefit from having a single construction law firm deliver the wide-range of required construction-related services. Regardless, KCP&L believes that a substantially higher proportion of services were legal in nature and could not have been completed equally well by non-lawyers. As shown above, only 10% of services provided by Schiff Hardin related to project control.

Q: How did Staff calculate the value of its proposed disallowance?

A: As explained beginning on page 87 of the Iatan Report, Staff computed an estimated weighted billing rate for four specific Schiff Hardin personnel, using assumptions regarding the percent of time incurred by each individual multiplied by that individual's 2009 billing rate. This resulted in an assumed weighted billing rate of $434 per hour. Next, they computed comparable weighted billing rates for each person using the Laffey Matrix, a listing of hourly rates for attorneys and paralegals of varying experience levels. These comparable rates were reduced by 10% to apply an assumed volume discount that Staff believed should have been negotiated for a project of this size. These two previous steps resulted in a weighted billing rate of $305 per hour. The $305/hour represented 70% of the estimated Schiff Hardin weighted rate of $434. The 70% was applied to the 20% of costs previously determined to be legal in nature to arrive at adjusted costs and a 30% proposed disallowance totaling $936,179.

Q: Do you agree with the method used to calculate this proposed disallowance?

A: No. KCP&L believes that the rates paid to Schiff Hardin for services provided were reasonable and appropriate. That being said, Staff used assumptions that were inappropriate. The calculation of the weighted billing rate for Schiff Hardin was based on only four lawyers and one paralegal. Additionally, the proportion of time for each of these four individuals was estimated without supporting analysis. As indicated above, the majority of the project control work was performed by J. Wilson & Associates. Only 2,700 of the 26,000 hours charged by Schiff Hardin personnel were for project control. The remainder of the hours charged by the more than 17 people who charged time to the project was for project oversight, contracts and contract administration. The actual weighted hourly rate for the complete group of individuals was $297/hour as opposed to the $434/hour weighted rate computed by Staff for the small subset of four people.

In addition, it would appear that Staff fundamentally misunderstands Schiff Hardin's role. Staff's claim that "the selection of Schiff was primarily influenced by KCPL management's desire to be prepared to defend and protect itself from any charges of unreasonable, inappropriate or imprudence decisions and not about conducting the day-to-day project management work required to complete a significant construction project on time and on budget" is similarly unsupported and incorrect. Iatan Report, at p. 73. In fact, the exact opposite is true. Schiff Hardin's role was to support KCP&L in its efforts to complete the Iatan projects on time and on budget. Schiff Hardin fulfilled that role very well. It is not clear to me on what Staff bases its assertion.

Q: **How does this actual weighted rate/hour based on KCP&L's analysis of the actual billed costs compare with the Staff's weighted rate/hour based on the Laffey Matrix?**

A: The actual $297/hour weighted rate for Schiff Hardin personnel is slightly less than the $305/hour rate calculated by Staff, even after applying a presumed volume discount to the Laffey Matrix values. Consequently, such a comparison if done correctly would result in no disallowance.

Q: **Do you have any other issues with how Staff calculated its proposed disallowance of Schiff Hardin Costs?**

A: Yes. Staff disallowed $2.8 million because they had not yet been provided copies of the underlying invoices.

Q: **Do you agree with this proposed disallowance?**

A: No. The Company routinely accrues costs prior to the payment of the underlying invoices. The amounts disallowed by Staff were accrued in June 2010, the Staff's cutoff date, based on estimates received from Schiff Hardin of amounts not yet invoiced. Subsequent to that time, all invoices disallowed by Staff have been received from and paid to Schiff Hardin and have been provided to Staff.

It was unnecessary and consistent with KCP&L policies not to solicit bids for the services Schiff Hardin provided in support of the Iatan projects.

Q: Please respond to Staff's allegation that KCP&L should have solicited bids and undertaken a formal RFP process to select a provider of legal services for the Iatan projects.

A: As a preliminary point, Staff's claim that KCP&L's decision not to solicit bids for this work is a "violation of [KCP&L's] own procurement policies" is not correct. Iatan Report, at p. 78. KCP&L's procurement policies authorize the Company to procure professional or highly technical services without undertaking a formal RFP process. As I discuss above, KCP&L recognized that the construction of the Iatan projects would be challenging and complex. KCP&L recognized that it needed highly competent legal counsel with knowledge and experience specific to projects similar to Iatan projects. One would be hard pressed to find a team with as much expertise and experience in power plant construction issues as Schiff Hardin.

The real question is whether Schiff Hardin's fees were reasonable in the context of the facts and circumstances of their work in support of the Iatan projects. As I discuss above, it was not only reasonable but prudent to hire Schiff Hardin even if other lawyers could have been hired at a lower hourly rate. KCP&L was not required to solicit bids for legal support for the Iatan projects and Staff's analysis fails to raise serious doubts that imprudent costs were incurred as a result of KCP&L's decision to hire Schiff Hardin without undertaking a formal RFP process.

It was unnecessary and consistent with KCP&L's contract with Schiff Hardin not to provide written approval of changes to Schiff Hardin's hourly rates.

Q: Please respond to Staff's allegation that KCP&L should have sent written approval to Schiff Hardin of changes in its rates.

A: As a preliminary point, Staff's claim that "KCPL intentionally decided not to enforce the terms and conditions of its contract with Schiff that require rate increases to be approved in advance" is not correct. Iatan Report, at p. 76. Staff's criticism is that KCP&L did not provide written approval to Schiff Hardin in response to notifications of its changes in rates. KCP&L's contract with Schiff Hardin did not require written approval of such changes. In addition, my experience both at two large law firms and as in-house counsel is that many lawyers change their hourly rates on an annual basis, and that while that is always communicated to the client, I am not aware of it being a common practice for the client to provide a written response to the lawyer "approving" the new rate. The more common practice is to discuss the change with the client, and the client formally accepts the change by paying the bill on which the new rates appear.

More to the point, the real question, which Staff's criticism does not really speak to, is whether Schiff Hardin's fees were reasonable in the context of the facts and circumstances of their work in support of the Iatan projects. As I discuss above, Schiff Hardin's rates were reasonable and their fees were prudently incurred. The mechanism by which KCP&L approved changes in hourly rates seems to have very little to do with that.

It was unnecessary and consistent with KCP&L's contract with Schiff Hardin not to require Schiff Hardin to provide with its invoices a copy of the receipt for each expense.

Q: Please respond to Staff's allegation that KCP&L should have required Schiff Hardin to submit with its invoices for legal services a copy of every receipt for expenses.

A: As a preliminary point, Staff's claim that KCPL failed to enforce the terms and conditions of its contract with Schiff Hardin or violated its own procurement practices by not requiring Schiff Hardin to provide copies of receipts with its invoices is not correct. On this basis, Staff proposes to disallow 100% of Schiff Hardin's expenses. Staff's recommendation is unreasonable and extreme. Staff is in essence saying that not a single penny of Schiff Hardin's expenses should be recovered, not because they were imprudent or excessive, but because Staff did not have receipts to look at. Again, the real question, which Staff's allegations do not speak to, is whether Schiff Hardin's fees, including expenses, were reasonable in the context of the facts and circumstances of their work in support of the Iatan projects. As I discuss above, Schiff Hardin's fees, including expenses, were reasonable and those costs were prudently incurred.

Q: Did KCP&L apply reasonableness checks before reimbursing Schiff Hardin for these expenditures?

A: Yes. Each invoice submitted by Schiff Hardin included a section itemizing expenses, including the date incurred, description of the expenditure, person incurring the expenditure, city in which incurred, and the amount. Descriptions included local travel, telephone tolls, duplicating and binding, meals, and other travel expenses for air/lodging/car rental/parking/taxi. A summary of expenses by type was also provided. KCP&L reviewed both the itemized and summarized listings to verify the reasonableness of the charges. KCP&L also requested and received from Schiff Hardin two months of expense receipts, which KCP&L also provided to Staff. KCP&L audited those expense receipts and found no irregularities or other causes of concern.

Q: Is that consistent with your experience working at law firms?

A: Yes. Consistent with what Schiff Hardin has done here, the bills of the law firms I have worked for included a list or summary of expenses, but not the actual receipts for those expenses. Like here, expenses usually account for a very small portion of the bill.

Q: What portion of the fees KCP&L paid to Schiff Hardin is for the expenses Staff seeks to disallow?

A: About 6% of the fees paid to Schiff Hardin have been to reimburse the firm for expenses it has paid out in support of it work on the Iatan projects.

<u>Cushman & Associates' Fees Were Prudently Incurred</u>

Q: Does Staff recommend to adjust the per hour rate of any vender other than Schiff Hardin?

A: Yes, Staff also proposes an adjustment based upon the allegation that the hourly rates of Cushman & Associates ("Cushman") were too high. Cushman is a consulting firm hired to assist KCP&L in the development of the Iatan Project Execution Plan. Staff again attempts to benchmark one professional service provider's hourly rate against another without taking into account that there could be legitimate reasons for differences in their rates. Staff simply comes up with what it believes Cushman's rate should have been and proposes to disallow anything paid in excess of that rate.

Q: Do you agree with Staff's proposed disallowances?

A: No. KCP&L determined that Cushman was the best qualified firm to perform the services required because of its previous consulting assistance to KCP&L on the Hawthorn 5 boiler rebuild project.

Q: If the Commission were to find in favor of Staff's position that the rate paid to Cushman was not reasonable, do you agree with Staff's calculation of the amount of the proposed disallowance?

A: No. I believe Staff's calculation is overstated for two reasons. First, Staff computed a weighted hourly rate for Cushman estimating that higher priced services provided by Mr. Cushman were 70% of the total engagement while the lower priced services provided by Mr. Cushman's associate represented 30% of the total costs. An analysis of the actual invoiced amounts for services provided indicates that costs were incurred with a 57% to 43% ratio. Second, because Mr. Cushman and his associate were billed on a fixed cost per day rate, Staff had to translate the daily rate to an hourly rate for comparison with the hourly rate of LogOn Consulting. They did this assuming an 8-hour work day. I believe that it would be more realistic to assume that these consultants worked a minimum 10-hour day. Both of these factors lead to the conclusion that Staff's calculation of its proposed disallowance is overstated, assuming the Commission endorses the underlying rationale for the disallowance.

<u>It Was Appropriate for KCP&L to Provide Mileage Reimbursement For Employees Commuting To The Iatan Project Site</u>

Q: Do you agree with Staff's recommendation to disallow $59,136 from the Iatan 1 project for mileage reimbursement paid by KCP&L to workers traveling to the Iatan project site?

A: No, I do not. Staff's adjustment is comprised of two parts, both of which are problematic for different reasons. First, Staff proposes to disallow $51,113 of mileage reimbursements because the Iatan project site was designated as the recipient employees' primary work location. As KCP&L has explained to Staff, even though the Iatan project site was designated as the employees' primary work location, the employees were assigned to Iatan on a temporary basis during the construction and start up of the project. It is appropriate to reimburse mileage costs for these temporary assignments because it is more cost effective than relocating the employees for a five-year period. To require employees to work at the Iatan project site on a temporary, five-year project without compensation for mileage costs would not have been equitable and likely would have been viewed as a deterrent to working on the Iatan projects.

The remainder of Staff's proposed disallowance ($8,023) is derived by arbitrarily disallowing 10% of all other employees' mileage reimbursements, i.e., those employees who did not have the Iatan project site designated as their primary work location. Staff's rationale for disallowing 10% is the potential for errors or miscoding of mileage reimbursements. KCP&L has a process in place to review mileage reimbursements. KCP&L supervisors review employee mileage reimbursements for reasonableness. KCP&L recognizes that some errors may not be detected in such a review. However, it would not be cost effective to audit each reimbursement of every individual employee's mileage records to the degree Staff suggests is necessary.

<u>The Commission Should Reject As Arbitrary And Unsupported Staff's Proposed Disallowance To Address "Inappropriate" Charges That Potentially Might Exist</u>

Q: Do you agree with Staff's recommendation to disallow $25,000 and $75,000 for Iatan 1 and Iatan 2, respectively, for what Staff describes as "inappropriate" charges?

A: No, I do not. This adjustment is similar to the arbitrary proposed disallowance of mileage reimbursements. Obviously any project of this size and scope will have some errors in coding of charges. However, other than the specific ones Staff has brought to the Company's attention and KCP&L has corrected there is no basis for this adjustment. Staff arbitrarily chose $25,000 and $75,000 for Iatan 1 and Iatan 2, respectively, because that amount "should be adequate in the Staff's opinion … ." That is not the sound basis for a disallowance and disregards the requirement for Staff to identify an imprudent act or decision, then quantify its impact on the cost of the Iatan projects. It is not apparent that any more "inappropriate" charges exist than those Staff has identified and the Company has corrected. Staff's proposal to disallow potential "inappropriate" charges that might exist is arbitrary, unsupported and should be rejected.

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of KCP&L Greater Missouri Operations Company to Modify Its Electric Tariffs to Effectuate a Rate Increase	)))	Docket No. ER-2010-0356

AFFIDAVIT OF CURTIS D. BLANC

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Curtis D. Blanc, being first duly sworn on his oath, states:

1. My name is Curtis D. Blanc. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Senior Director – Regulatory Affairs.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of KCP&L Greater Missouri Operations Company consisting of fifty (50) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

Curtis D. Blanc

Subscribed and sworn before me this 15th day of December, 2010.

Nicole A. Wehry
Notary Public

My commission expires: Feb. 4, 2011

" NOTARY SEAL "
Nicole A. Wehry, Notary Public
Jackson County, State of Missouri
My Commission Expires 2/4/2011
Commission Number 07391200

Summary of ROE History in Missouri Electric Rate Cases (2005-present)

Year	Company	Utility Requested ROE (%)	Staff ROE (Using Midpoint) (%)	OPC ROE (Using Midpoint) (%)	Intervenor ROE (Using Midpoint) (%)	MPSC Awarded ROE (%)	National Average Awarded ROE (%)	Case No.	Filing Date
2009	Empire	11.00	9.40	NA	NA	**NA**		ER-2010-0130	10/29/2009
	Ameren	10.80	9.35	10.20	10.00	**10.10**		ER-2010-0036	7/24/2009
	2009 Average	***10.90***	***9.38***	***10.20***	***10.00***	***10.10***	***10.52***		
2008	KCP&L	10.75	9.75	10.30	NA	**NA**		ER-2009-0089	9/5/2008
	GMO	10.75	9.75	10.30	NA	**NA**		ER-2009-0090	9/5/2008
	Ameren	10.90	9.50	NA	10.20	**10.76**		ER-2008-0318	4/4/2008
	2008 Average	***10.80***	***9.67***	***10.30***	***10.20***	***10.76***	***10.37***		
2007	Empire	11.60	9.98 [1]	NA	10.00	**10.80**		ER-2008-0093	10/1/2007
	KCP&L	11.25	9.72	10.10	NA	**10.75**		ER-2007-0291	2/1/2007
	2007 Average	***11.43***	***9.85***	***10.10***	***10.00***	***10.78***	***10.31***		
2006	Ameren	12.00	9.25	9.65	9.80	**10.20**		ER-2007-0002	7/7/2006
	GMO	11.50 [2]	9.625	NA	10.00	**10.25**		ER-2007-0004	7/3/2006
	Empire	11.70	9.35 [3]	9.65	NA	**10.90**		ER-2006-0315	2/1/2006
	KCP&L	11.50	9.37	9.90	9.00	**11.25**		ER-2006-0314	1/31/2006
	2006 Average	***11.68***	***9.40***	***9.73***	***9.60***	***10.65***	***10.35***		
2005	GMO	11.50	9.00	9.95	9.80	**NA**		ER-2005-0436	5/24/2005
	Empire	11.65	8.75	9.185	NA	**11.00**		ER-2004-0570	4/30/2004
	2005 Average	***11.58***	***8.87***	***9.57***	***9.80***	***11.00***	***10.51***		
	Overall Average	***11.28***	***9.43***	***9.98***	***9.92***	***10.66***			

[1] Later revised to 10.28%

[2] Later revised to 11.25%

[3] Later revised to 9.55%

Schedule CDB2010-1

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF NORTHERN INDIANA PUBLIC SERVICE COMPANY ("NIPSCO") FOR (1) AUTHORITY TO MODIFY ITS RATES AND CHARGES FOR ELECTRIC UTILITY SERVICE; (2) APPROVAL OF NEW SCHEDULES OF RATES AND CHARGES APPLICABLE THERETO; (3) APPROVAL OF REVISED DEPRECIATION ACCRUAL RATES; (4) INCLUSION IN ITS BASIC RATES AND CHARGES OF THE COSTS ASSOCIATED WITH CERTAIN PREVIOUSLY APPROVED QUALIFIED POLLUTION CONTROL PROPERTY PROJECTS; (5) AUTHORITY TO IMPLEMENT A RATE ADJUSTMENT MECHANISM PURSUANT TO IND. CODE § 8-1-2-42(a) TO (A) TIMELY RECOVER CHARGES AND CREDITS FROM REGIONAL TRANSMISSION ORGANIZATIONS AND NIPSCO'S TRANSMISSION REVENUE REQUIREMENTS; (B) TIMELY RECOVER NIPSCO'S PURCHASED POWER COSTS; AND (C) ALLOCATE NIPSCO'S OFF SYSTEM SALES REVENUES; (6) APPROVAL OF VARIOUS CHANGES TO NIPSCO'S ELECTRIC SERVICE TARIFF INCLUDING WITH RESPECT TO THE GENERAL RULES AND REGULATIONS, THE ENVIRONMENTAL COST RECOVERY MECHANISM AND THE ENVIRONMENTAL EXPENSE MECHANISM; (7) APPROVAL OF THE CLASSIFICATION OF NIPSCO'S FACILITIES AS TRANSMISSION OR DISTRIBUTION IN ACCORDANCE WITH THE FEDERAL ENERGY REGULATORY COMMISSION'S SEVEN-FACTOR TEST; AND (8) APPROVAL OF AN ALTERNATIVE REGULATORY PLAN PURSUANT TO IND. CODE § 8-1-2.5-1 *ET SEQ.* TO THE EXTENT SUCH RELIEF IS NECESSARY TO EFFECT THE RATEMAKING MECHANISMS PROPOSED BY NIPSCO.

CAUSE NO. 43526

APPROVED: AUG 25 20[illegible]

BY THE COMMISSION:
David E. Ziegner, Commissioner
Aaron A. Schmoll, Senior Administrative Law Judge
Angela Rapp Weber, Administrative Law Judge

FINAL ORDER

equity" is inconsistent with the *Indiana Bell* case and "our guidance [from the Court] could not be clearer").

Here, the Commission finds that NIPSCO's actual capital structure shall be used to determine NIPSCO's cost of capital. Therefore, the Commission will use the capital structure set forth in Petitioner's Exhibit LEM-5 (2nd Revised), p. 1, but adjusted to include the long-term debt amount of $906,631,137 shown on Petitioner's Exhibit VVR-2, p. 1. The adjustment reflects the actual terms of the August 25, 2008 bond remarketing, which are discussed below. Rea Direct at 7.

While we approve NIPSCO's actual capital structure for purposes of determining NIPSCO's weighted cost of capital in this Cause, we note that NIPSCO is approaching the edge of what this Commission finds to be a reasonable capital structure for a large investor-owned electric utility. Going forward, we would encourage NIPSCO to take prudent steps to reduce its equity to debt ratio.

B. Cost of Capital.

(1) Petitioner's Evidence. Ms. Miller calculated NIPSCO's weighted cost of capital to be 8.37%, based on NIPSCO's December 31, 2007 actual capital structure, as adjusted, a debt cost rate of 6.56% and a common equity cost rate of 12.00%. Miller Direct at 44; Petitioner's Ex. LEM-5 (2nd Revised), p. 1. The 6.56% debt cost rate included an estimate of the interest rate and transaction costs that would be incurred in remarketing $254 million of Jasper County tax-exempt bonds. Rea Direct at 7. Mr. Rea testified that the remarketing occurred only four days before NIPSCO's case-in-chief was to be filed and NIPSCO did not have time to revise its case-in-chief to incorporate the actual terms. However, he provided a schedule showing the effect on the amount of debt and the weighted cost of debt when the Jasper County debt cost estimates were trued-up to actual. Id. at 7-8; Petitioner's Ex. VVR-2, p. 1. There was only a minor difference, i.e., $906,631,137 instead of $906,997,137 and 6.52% instead of 6.56%. Dr. Woolridge used the estimated 6.56% debt rate. Public's Ex. JRW-1. Mr. Gorman used the actual amount and rate. IG Ex. MPG-1. Although the impact on NIPSCO's cost of capital is very slight, we find the actual amount and rate shown in Petitioner's Exhibit VVR-2, p. 1, should be used in determining NIPSCO's cost of capital.

NIPSCO proposed a cost of common equity rate of 12.00% through the testimony of Mr. Moul. Mr. Moul considered the risk factors that affect electric utilities in general and NIPSCO in particular. He noted that electric utilities, including NIPSCO, face substantial increases in operating and capital costs due to increasingly stringent environmental regulations including future greenhouse gas regulation. He noted environmental investments increase risk without adding to a utility's generating capacity and this risk is aggravated by the "moving target" nature of evolving environmental regulation. He said NIPSCO's risk profile is strongly influenced by the magnitude of its sales to industrial customers that represent 53% of its sales in kWh but are less than 1% of its customers. Mr. Moul testified that NIPSCO's industrial sales far exceed the utility average. He said 64% of NIPSCO's industrial sales are to steel-related industries that face international competition, increased costs and fluctuating demand for their products. Mr. Moul pointed out that the credit rating agencies have cited Indiana's high level of industrial employment and high concentration of steel, chemical, metals, auto parts and refining businesses as creating risks for NIPSCO. According to Mr. Moul, NIPSCO is exposed to significant sales and bad debt risk because of the magnitude of its industrial load and the reliance of its service area on heavy industry. Moul Direct at 7-8. Mr. Moul also discussed NIPSCO's substantial future capital expenditure requirements and stated a fair rate of return will be key to attracting the capital necessary to meet NIPSCO's needs. *Id.* at 9.

Mr. Moul developed a proxy group of publicly traded utility companies ("Electric Group" or "Group") for use in the models he applied to estimate NIPSCO's cost of equity. These companies are all included in Value Line Investment Survey ("Value Line"), have electric utility subsidiaries that are Midwest ISO members or formerly had transmission assets that were transferred to separate Midwest ISO-participating transmission companies, have not recently reduced their common dividend and are not the target of a merger or acquisition. Moul Direct at 4; Petitioner's Ex. PRM-2, p. 7. Mr. Moul then compared NIPSCO and the Group with respect to nine separate risk factors. He concluded that on some counts NIPSCO's risk is higher than the Group and on other counts lower or approximately equal. On balance, he considered the factors to average out so that, in Mr. Moul's opinion, the Group provides a reasonable basis for measuring NIPSCO's cost of equity.

Mr. Moul first applied the discounted cash flow approach. This model considers the cost of equity to be equal to a stock's dividend yield plus expected long-term growth. In applying the model, Mr. Moul used a divided yield of 4.54% based on the average dividend yield for the Electric Group for the six months ended May 2008 adjusted to a forward-looking basis using three generally accepted methods to reflect the prospective nature of dividends. Mr. Moul used a growth rate of 6.50% after analyzing historical and forecasted per share growth in earnings, dividends, book value and cash flow for the members of the Electric Group. Mr. Moul gave the greatest emphasis to projected earnings per share ("EPS") growth because he considered it to be the principal focus of investor expectations. Moul Direct at 18-19.

Mr. Moul said the historical rates were not good measures for the Electric Group because they include many negative rates of change that provide no reliable guide to gauge investor expectation of future growth. He explained rational investors expect positive returns on their investments. Moul Direct at 22. Mr. Moul commented that Professor Myron Gordon, the foremost proponent of the use of the DCF model in rate cases, concluded EPS forecasts were the best measure of the DCF growth rate. *Id.* at 25. Mr. Moul added a flotation cost adjustment of 0.17% to cover issuance expenses. *Id.* at 28; Petitioner's Ex. PRM-1, Appendix E. To support the flotation cost adjustment, Mr. Moul provided issuance expenses in public offerings of electric utility stocks from 2003 to 2007. Petitioner's Ex. PRM-2, p. 14, Sch. 8. The result of Mr. Moul's DCF analysis was a cost of equity rate of 11.21%, i.e., 4.54% + 6.50% + 0.17. *Id.*

Mr. Moul also performed a risk premium analysis. This method determines the cost of equity by adding a premium to corporate bond yields to account for the fact that the equity investor is exposed to greater risk than debt capital. Moul Direct at 28-29. In this approach, Mr. Moul used a 6.00% estimate of the prospective yield on long-term A-rated public utility bonds. The 6.00% yield was based on consensus forecasts of 30-year treasury bond yields reported in Blue Chip Financial Forecasts ("Blue Chip") plus 1.50% representing the spread between returns on utility bonds and treasury bonds during recent three month, six month and twelve month periods. *Id.* at 30. Mr. Moul developed a 5.50% equity risk premium by first comparing the difference in market returns on utility stocks in the S&P Public Utility Index and market returns on utility bonds during four different historical time periods, each of which began with a financial market defining event. Mr. Moul then made a downward adjustment for the risk differences between the S&P Public Utility Index and his Electric Group. *Id.* at 32-33. He then added the 0.17% flotation cost adjustment to derive a risk premium result of 11.67, i.e., 6.00% + 5.50% + 0.17%. Moul Direct at 34.

Mr. Moul also applied the Capital Asset Pricing Model ("CAPM") approach which measures the cost of equity as the yield on a risk-free interest bearing obligation plus an equity risk premium proportional to the non-diversifiable or systematic risk of an investment. Moul Direct at 34; Petitioner's Ex. PRM-1, Appendix H, p. H-1. Mr. Moul used a 4.50% risk-free rate based on recent historical yields on long-term treasury bonds, Blue Chip forecasts and the recent trend. *Id.* at 35-36. In the CAPM, systematic risk is represented by a company's beta which measures how the stock price changes compared to the overall market. Mr. Moul used a beta of 0.85 which is the average of the Value Line betas for the companies in the Electric Group. *Id.* at 35. Mr. Moul selected a market premium of 8.44% by averaging the difference between (a) historical market returns and treasury bond returns (6.5%) and (b) the difference between forecasted market returns and treasury bond returns (10.37%). The historical market premium was derived from data published by Ibbotson Associates in Stocks, Bonds, Bills and Inflation Yearbook ("SBBI") for the period 1926-2007. Mr. Moul said arithmetic mean returns were used because the CAPM is a single period model. He quoted an explanation from SBBI as to why arithmetic returns must be used. Petitioner's Ex. PRM-1, Appendix H, p. H-6. Mr. Moul added a size premium of 0.92% to adjust for the size of the Electric Group. This adjustment reflects the size premium for mid-capitalization stocks published in SBBI. He also added the 0.17% flotation cost adjustment. These inputs produced a CAPM result of 12.76%, i.e., 4.50% + (0.85 × 8.44%) + 0.92% + 0.17%.

Mr. Moul also pointed out that in *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923), the United States Supreme Court held a public utility is entitled to rates that will permit it to earn a return on the value of its property equal to that generally being made on investments in other business undertakings which are attended by corresponding risks. Therefore, Mr. Moul testified, it is important to identify the returns earned by comparable risk companies that compete for capital with the public utility and are subject to competitive marketplace forces. Moul Direct at 38-39. To implement this approach, Mr. Moul applied the following screening criteria to identify non-utility companies followed by Value Line that reflect the risk of the Electric Group – Timeliness Rank, Safety Rank, Financial Strength, Price Stability, Betas and Technical Rank. *Id.* at 39. Mr. Moul considered a ten year business cycle for these firms consisting of five historical years and five projected years. The historical return on equity of 15.4% and the projected return on equity of 16.0% were averaged to produce a Comparable Earnings result of 15.70%. *Id.* at 40-41.

Mr. Moul then considered the results of each of his approaches to analyzing NIPSCO's cost of equity. He recommended that the Commission find a cost of common equity for NIPSCO of 12.00% to be reasonable. He explained that the average of the DCF and CAPM results were 11.99%, the average of the three market models (DCF, CAPM and Risk Premium) was 11.88% and the average of all four methods was 12.84%. Moul Direct at 6. Mr. Moul said his proposed 12.00% cost of equity made no provision for the prospect that the rate of return may not be achieved due to unforeseen events such as unexpected spikes in costs, abrupt changes in customer usage and abnormal weather. *Id.*

(2) OUCC's Evidence. Dr. Woolridge testified in support of the OUCC's recommendation that the Commission find NIPSCO's cost of common equity to be 10.00%. Dr. Woolridge first discussed the effect of the current financial crisis on the difference

in yields on treasury bonds and utility bonds, noting that the differential increased significantly due to tightening credit markets and the flight to quality that drove treasury yields to historic lows. But he stated the differential has declined over the past several months. Woolridge Direct at 7. Dr. Woolridge recognized that the credit market for corporate and utility debt experienced higher rates due to the credit crisis and that the long-term market remains tight, but he said the market has improved in response to unprecedented actions by the federal government. Id. at 10-11. Dr. Woolridge expressed his opinion that the Obama administration is committed to bringing the economy around, utilities are likely to benefit under an Obama administration, the worst of the credit crisis appears to be over and credit spreads, while still high, have declined. Id. at 11-12. Dr. Woolridge asserted his viewpoint that the volatility of stocks relative to bonds has declined recently and relied on an article authored by employees of McKinsey & Co., a consulting firm, expressing the opinion that the financial crisis has not significantly changed McKinsey's long-term estimate of the equity risk premium.6 Id. at 12-14. Dr. Woolridge also believed utility stocks have held up well compared to the overall market. Id. at 15.

Dr. Woolridge used two market-based models to estimate NIPSCO's cost of equity – a DCF model and a CAPM. To apply these models, he selected a nine member Electric Proxy Group consisting of companies that are listed as an electric utility or combination electric and gas company by AUS Utility Reports, listed as an electric utility by Value Line, have at least 75% regulated electric revenues, have operating revenues less than $10 billion, have a 3-year history of paying dividends with no actual or pending cuts, and have an investment grade bond rating. Woolridge Direct at 15-16.

Before applying his models, Dr. Woolridge testified that in equilibrium the market value of a firm's securities will be equal to book value and that when a firm earns a return on equity in excess of its cost of equity, investors respond by valuing the firm's equity in excess of book value. Woolridge Direct at 23-24. In support, he cited a 1988 article by the founder of consulting firm Marakon Associates that said the value of a company is determined by its cash flow which is in turn affected by its return on equity and a 1987 Harvard Business School case study which concluded higher returns on equity provide higher market-to-book ratios. *Id.* 23-24.

Dr. Woolridge said he relies primarily on the DCF model to estimate the cost of equity capital. Woolridge Direct at 29. In his DCF analysis, he used a dividend yield of 5.4% which is the mid-point of the proxy group average for the six months ending April 2009 and the proxy group average in April 2009, adjusted for one-half year of expected growth. *Id.* at 33; <u>Public's Ex. JRW-10</u>, p. 1. Dr. Woolridge selected a growth rate of 5.0% after considering historical growth rates for the proxy companies in EPS, dividends per share ("DPS") and book value per share ("BVPS") as measured by both means and medians. He also considered Value Line's projections of EPS, DPS and BVPS, projected internal growth rates calculated by Dr. Woolridge from Value Line's projected retention rate and return on equity, and analyst EPS growth rate forecasts. *Id.* at 36-38. However, he discounted the analyst forecasts because of his belief that

[6] Dr. Woolridge referred to this document as a study. A review of his workpapers shows he relies upon a 5 ½ page document on a McKinsey website expressing the subjective opinion that "there is no evidence of a substantial increase in the cost of long-term capital" but which acknowledges: "we cannot be certain that its cost will not increase over the next several years as the recession develops," cash flow "uncertainty has increased significantly," and "[i]t is particularly unclear what a normal level of growth and returns on capital will be in the future." *Id.* at pp. 5, 6.

they have an upward bias. *Id.* at 39. His DCF result was a common equity cost rate for NIPSCO of 10.4%, i.e., 5.4% + 5.0%.

In his CAPM, Dr. Woolridge used a risk free rate of 4.00% which was the upper end of the range of yields in 10-year and 20-year treasury bonds that he thought was reasonable for the near future. *Id.* at 43. He used a beta of 0.68 which was his proxy group average. *Id.* at 44; Public's Ex. JRW-11, p. 3. Dr. Woolridge used an equity risk premium of 4.61%. He stated that the "traditional way" to measure the equity risk premium was to use the difference between historical average stock and bond returns. This approach, Dr. Woolridge said, is often called the "Ibbotson approach" after Professor Roger Ibbotson, and usually suggests an equity risk premium of 5%-7% above the long-term treasury bond rate. *Id.* at 45. Dr. Woolridge asserted that some academic studies using "ex ante models" and "puzzle research" compute lower expected returns using market data without regard to historical returns. *Id.* at 46-48. According to Dr. Woolridge, the historical returns are "biased upwards" because "the expected equity risk premium has declined [as] stock prices have risen." *Id.* at 48. Dr. Woolridge's equity risk premium of 4.61% is an average of four different averages: (a) seven historical studies for periods beginning as early as 1872, most with both arithmetic results and geometric results included in the average; (b) 25 ex ante puzzle research studies, many with multiple low, high and midpoint results, published between 1999 and 2009; (c) four surveys of forecasters, Chief Financial Officers and academics; and (d) two estimates using the "building blocks" methodology, one of which was performed by Dr. Woolridge for this case. Public's Ex. JRW-11, p. 5. Dr. Woolridge's building blocks calculation derived an expected equity return for the market of 7.90% by adding a real growth rate of 2.50%, a dividend yield of 3.00% and an inflation rate 2.40%. Public's Ex. JRW-11, p. 7. Dr. Woolridge then deducted a recent 30-year treasury yield rate of 3.83% to derive an equity risk premium of 4.07%. *Id.* at 55-56. However, this is but one of 83 percentages included in the averages and averages of averages used to compute his 4.61% equity risk premium. Public's Ex. JRW-11, p. 5. Using the equity risk premium of 4.61%, Dr. Woolridge computed a CAPM result of 7.1%, i.e., 4.00% + (0.68 × 4.61%).

Although his calculated range was 7.1%-10.4%, Dr. Woolridge recommended an equity cost rate of 10.0% for NIPSCO, stating that the upper end of the range should be used due to the current volatile capital market conditions. Woolridge Direct at 59.

Dr. Woolridge also discussed his disagreements with Mr. Moul's testimony. With respect to the proxy group, Dr. Woolridge said Mr. Moul's Electric Group companies were not particularly good proxies for NIPSCO because five were combination gas and electric companies with an average only 57% of revenues from electric operations. He cited Avista, CMS, Integrys, NiSource and Vectren as companies with substantial gas operations. He also said Mr. Moul's group had lower common equity ratios and higher coefficients of variation of earned returns on common equity than NIPSCO. Woolridge Direct at 63-64.

With respect to Mr. Moul's DCF analysis, Dr. Woolridge criticized Mr. Moul's adjustment to state the dividend yield on a forward-looking basis by compounding quarterly dividends to the end of the year. Dr. Woolridge argued that compounding should not be used because the investor has the option of reinvesting the dividends as he or she chooses. Woolridge Direct at 66. Dr. Woolridge also criticized Mr. Moul's 6.50% growth rate on the ground that it gave too much weight to analysts' forecasts of EPS growth. Dr. Woolridge contended analysts' forecasts are overly optimistic and biased upwards. Dr. Woolridge said this was demonstrated by a comparison he made of forecast and actual EPS growth rates since 1988 for the companies in the I/B/E/S data base. *Id.* at 68. Dr. Woolridge maintained that his findings indicated forecast errors for the long-term estimates were predominately positive which he interpreted as showing upward bias. *Id.* at 69. Although he recognized that analysts' EPS growth rate forecasts have subsided somewhat since 2000 and new regulations against conflicts of interest were adopted in 2003, in Dr. Woolridge's opinion, analysts' forecasts continue to be overly optimistic. *Id.* at 70. In support, he cited two Wall Street Journal articles, one of which reported on Dr. Woolridge's opinions about Wall Street analysts. *Id.* at 70-71; Public's Ex. JRW-13, p. 4. Dr. Woolridge testified that the upward bias is not as pronounced for electric utility companies but, in his opinion, analysts' projected electric growth rates still exceed the actual rates. *Id.* at 71-72. Dr. Woolridge also believes Value Line is upwardly biased which he attributed to its reluctance to forecast negative growth rates. *Id.* at 73.

Dr. Woolridge also opposed Mr. Moul's flotation cost adjustment on a variety of grounds: the Company has not identified any flotation costs; investors are not entitled to flotation costs when market prices exceed book value; underwriting spreads need not be recovered through the regulatory process; and brokerage fees that investors pay in secondary market transaction are not included in the DCF analysis. Woolridge Direct at 73-75.

Dr. Woolridge opposed Mr. Moul's use of a risk premium analysis because utility bonds are subject to interest rate risk and credit risk which do not apply to equity investors. *Id.* at 76. He reiterated his position discussed above that risk premiums based on historical returns are overstated. *Id.* at 77. He also contended historical bond returns were biased downward because of capital losses; geometric means only should be used; investors could not achieve the historical market returns because of transaction costs and without rebalancing their portfolios every month; stock index returns are affected by survivorship bias and the "Peso Problem" (less disruption in U.S. markets than other markets around the world); and market conditions today are different than in the past which has resulted in a decrease in the equity premium over bond yields. *Id.* at 78-87.

With respect to Mr. Moul's CAPM, Dr. Woolridge contended Mr. Moul's risk-free rate was overstated. He objected to the consideration of historic risk premiums for reasons previously mentioned. He also criticized Mr. Moul's prospective risk premium because of its reliance on forecasts of EPS growth by analysts and by Value Line (both of which Dr. Woolridge deems to be upwardly biased), because Mr. Moul considered only dividend-paying stocks and because the stocks are weighted equally. Woolridge Direct at 89-92. He said Mr. Moul's use of an 11.29% growth rate in his calculation of the prospective equity risk premium is excessive because it exceeds the historical nominal growth rate in gross domestic product ("GDP") of 7.20%. *Id.* at 93. Dr. Woolridge also asserted Mr. Moul's size adjustment is inappropriate for regulated electric utilities. *Id.* at 95-96.

Dr. Woolridge disagreed with Mr. Moul's Comparable Earnings analysis on the basis that it did not measure long-term earnings expectations. *Id.* at 97.

(3) IG's Evidence. IG Witness Michael Gorman used multiple methods to estimate NIPSCO's cost of common equity–three different versions of the DCF model, two versions of the Risk Premium model, and the CAPM. In applying his models, he used the same proxy group as Mr. Moul. Mr. Gorman recommended that the Commission find

that NIPSCO's cost of common equity is 10.3% with a capital structure that uses NiSource's capitalization ratios and 9.8% with NIPSCO's actual capital structure.

Mr. Gorman first used a constant growth DCF model with a dividend yield of 5.93% and a growth rate of 6.00% resulting in a cost of equity estimate of 11.77%. The dividend yield was calculated from average stock prices during the 13-week period ended March 13, 2009 and annualized dividends adjusted for next year's growth. Gorman Direct at 40-41. The growth rate came from security analysts' earnings growth forecasts available on March 17, 2009. *Id.* at 42. Mr. Gorman testified that analysts' forecasts have been shown to be more accurate predictors of future returns than growth rates derived from historical data and influence stock observable prices more than historical data. *Id.* at 41-42. The average forecast growth rate for the proxy group was 8.99%. *Id.* at 43. However, Mr. Gorman believed this growth rate was too high and substituted a 6.00% growth rate, which was the median of the proxy group growth rates. He said use of this lower growth rate was appropriate because it excluded the impact of the two highest growth rates (Empire District and Integrys) and was more consistent with consensus projections of GDP growth that he believed should be a "ceiling" on a utility's growth rate. *Id.* at 44. He said economists expect GDP growth over the next five to ten years of no more than 5.1%. *Id.* at 43. In support of his position that there should be a GDP growth ceiling on a utility's growth rate, Mr. Gorman cited the 2007 edition of the Brigham and Houston text, Fundamentals of Financial Management. *Id.* at 45. During cross-examination, Mr. Gorman stated he deleted from the quote in his testimony a statement by the authors on a GDP growth basis one might expect the dividends of an average or normal company to grow at a rate of 5% to 8% a year. Tr. at DD-80. Mr. Gorman said he deleted this statement because it was based on outdated information, and he did not believe the authors would have that same view today. Tr. at DD-80–DD-82.

Mr. Gorman also contended that even after substituting the lower median for the average, the 6.00% growth rate was not sustainable. Therefore, he performed a second DCF calculation using a growth rate of 4.21% which he said was the sustainable growth rate.[7] This rate was based on Value Line projections of returns on equity, payout ratios and earnings retention. *Id.* at 47. The result of the "sustainable growth" DCF model was 10.13%.

Mr. Gorman also performed a third DCF calculation that used decreasing growth rates for (a) the first five-years, (b) the next five-years and (c) year 11 through perpetuity. *Id.* at 48. The rates used in the first stage were the analysts' forecasts described above; the rates used in the second stage represented the difference between the analysts' forecasts and the Blue Chip 5 to 10 year GDP growth projection of 5.1%; and the rate used in the third stage (year 11 forward) was the 5.1% GDP growth estimate. Gorman Direct at 49. The result of the multi-stage DCF model was 11.23%. *Id.* at 50.

For his ultimate DCF recommendation, Mr. Gorman averaged his sustainable growth and multi-stage DCF results (10.13% and 11.23%) and rounded the average up to 10.70%. *Id.* at 50.

In his Risk Premium models, Mr. Gorman calculated the difference between regulatory commission-authorized returns for electric utilities in each year since 1988 as reported by

[7] Mr. Gorman's testimony states that he used a 4.21% sustainable growth rate to derive a 10.13% DCF result. Gorman Direct at 48. However, IG Ex. MPG-13 appears to show that a growth rate of only 3.77% was used in the 10.13% calculation.

Regulatory Research Associates and average yields on treasury bonds and A-rated utility bonds in each of those same years. This method produced an average risk premium over treasury bonds of 5.10% and over A-rated utility bonds of 3.68%. IG Ex. MPG-16; IG Ex. MPG-17. Mr. Gorman then selected ranges of 4.40% to 6.01% for the treasury spread and 3.03% to 4.39% for the utility bond spread by focusing on where most of the annual results fell. Gorman Direct at 52. Mr. Gorman then added the treasury risk premium range to a projected treasury bond yield of 4.30% and the utility bond risk premium range to a current 13-week average yield on A-rated and Baa-rated utility bonds of 7.85%. From these results, Mr. Gorman recommended a 9.91% rate for the treasury bonds analysis (a rate between the mid-point and high end of his range) and a rate of 10.40% for the utility bond analysis (the low end of his range). *Id.* at 54-55. Mr. Gorman said he used the low end of the utility bond range to reflect his belief that yields would decline to more normal levels once economic conditions strengthen. *Id.* at 55.

In his CAPM, Mr. Gorman used a 4.30% risk-free rate based upon a Blue Chip projected treasury bond yield and a beta of 0.73 based on the average of the Value Line proxy group beta estimates. Gorman Direct at 56, 57. Mr. Gorman derived a forward looking market risk premium of 7.00% and a historical market risk premium of 6.50%. *Id.* at 58. The forward looking premium was determined by subtracting the 4.30% risk-free rate from Mr. Gorman's estimate of the expected return on the S&P 500 Index which was calculated by adding an estimated inflation rate of 2.1% to the long-term historical arithmetic average real return on the market as reported in the Valuation Edition of SBBI. Mr. Gorman's CAPM results are 9.05% to 9.41% with a midpoint of 9.20%. *Id.* at 60.

Based on the results of all of his analyses, Mr. Gorman recommended a return on equity range of 9.80% to 10.70% with the low end being the average of his risk Premium and CAPM results and the upper end being his DCF result. Gorman Direct at 61. He testified that if NIPSCO's actual capital structure was used (as proposed by NIPSCO), he recommended 9.80%, the low end of the range, because there is less financial risk. But if his proposed NiSource capital structure is used, he recommended 10.30%, the midpoint of his range. *Id.* Mr. Gorman contended his recommendations would support investment grade credit ratings under S&P's credit metric benchmarks. *Id.* at 62. However, he acknowledged S&P's new credit metrics are not as transparent as its former metrics and do not clearly identify utility-specific credit metric guidance ranges based on its business risk assessment. *Id.* at 62.

Mr. Gorman also commented on Mr. Moul's testimony. He said Mr. Moul's DCF growth rate of 6.50% was too high to be sustainable in the long run. Mr. Gorman asserted academics have found, and investors understand, long-term sustainable growth cannot exceed GDP growth over sustained periods of time. Gorman Direct at 74-75. Mr. Gorman argued the financial risk of a utility is based on book value leverage, not market value leverage, and analysts do not consider market value leverage to be of significance. *Id.* at 71. He said Mr. Moul's flotation cost adjustment was not appropriate because it was not based on NIPSCO's actual expenses. *Id.* at 73.

Mr. Gorman disputed the 5.50% risk premium used by Mr. Moul in the Risk Premium approach on the ground it was not based on observable and verifiable market evidence of NIPSCO's risk as compared to the proxy group. *Id.* at 77.

Mr. Gorman also objected to Mr. Moul's size adjustment in the CAPM. According to Mr. Gorman, a size adjustment is not proper because the SBBI mid-cap deciles used in the adjustment include stocks with an average beta of 1.12 which is higher than the proxy group. *Id.* at 79. Mr. Gorman concurred with Mr. Moul's historical market risk premium of 6.50% but considered his prospective market risk premium of 10.37% to be excessive because the Value Line and S&P growth used by Mr. Moul project growth in excess of GDP growth.

Finally, Mr. Gorman disagreed with Mr. Moul's Comparable Earnings analysis on the grounds that it measures book returns instead of market required returns and includes non-regulated companies not comparable to NIPSCO. *Id.* at 82.

(4) Petitioner's Rebuttal Evidence. Mr. Moul responded to Dr. Woolridge's discussion of the credit crisis. Mr. Moul said that in response to the credit crisis investors have become more risk adverse thereby increasing their required return. He explained that market volatility is much higher than it was prior to the beginning of the financial crisis and yield spreads and debt costs have increased. Mr. Moul testified attracting capital would be more difficult for NIPSCO if the Commission accepted the returns proposed by Dr. Woolridge and Mr. Gorman. Moul Rebuttal at 8-11. Mr. Moul also provided updates of this cost of equity models using the latest information available. His updated results were as follows:

	Direct Testimony	Update
DCF	11.21%	12.62%
RP	11.67%	12.44%
CAPM	12.76%	11.24%
Comparable Earnings	15.70%	14.30%
Average	12.84%	12.65%
Median	12.22%	12.53%
Mid-point	13.46%	12.77%

Id. at 12. He said the DCF and Risk Premium results increased because of increasing dividend yields and widening spreads over treasury yields. The CAPM result declined due to lower betas and a reduction in the market premium. The Comparable Earnings result was lower because of the recession. Because the average of the market-based models is 12.10% and the average of the DCF and CAPM methods is 11.93%, Mr. Moul concluded a rate of return of no less than 12.00% is still reasonable. Id. at 12-13.

Mr. Moul criticized Dr. Woolridge's proxy group because the companies have few characteristics that are comparable to NIPSCO. He said Dr. Woolridge should have considered combination companies and should not have included companies with speculative bond ratings, delivery-only utilities and utilities with significant hydro generation. Moul Rebuttal at 14-15.

Mr. Moul described Dr. Woolridge's criticism of Mr. Moul's quarterly compounding method of determining the dividend yield in the DCF as a "tempest in a teapot" because Dr. Woolridge's method produces precisely the same result. Moul Rebuttal at 16. However, for purposes of his rebuttal, Mr. Moul used Dr. Woolridge's method in his rebuttal updates. Id.

Mr. Moul reaffirmed his position that analysts' forecasts of EPS growth are the best measure of growth in the DCF model and should be given primary weight. He said they are the primary determinant of investor expectations. Moul Rebuttal at 16-17.

Mr. Moul noted that the results of Mr. Gorman's constant growth DCF model (the form previously used by this Commission) and Mr. Gorman's multi-stage model are both well above 11%. Moul Rebuttal at 17-18. He cited eight factors that contribute to investors' expectations of earnings growth that are not considered by Mr. Gorman's "sustainable" or "retention growth" model which only considers book value changes and accretion from the sale of stock. Id. at 18. Mr. Moul asserted BVPS growth, or its surrogate retention growth, does not represent a proper financial variable because utility stocks typically do not trade at book value. Id. at 8-19. Mr. Moul also said Mr. Gorman relies on projections not shown to be sustainable beyond the identified periods and has not provided recognition of transition growth through 2012 and growth beyond 2014. Id. at 19. Further, Mr. Gorman's result is entirely dependent upon his assumed return on equity of 10.15%. According to Mr. Moul, that is like having to know the end result in order to calculate it. Id. at 20.

Mr. Moul testified that Mr. Gorman has been inconsistent in his use of the multi-stage DCF model, citing cases since 2001 where Mr. Gorman used the model and others where he did not. Mr. Moul rejected Mr. Gorman's opinion that analysts' earnings forecasts cannot be reasonable estimates when in excess of current 5 and 10 years forecasts of GDP growth. Mr. Moul said Mr. Gorman has not shown any cause and effect relationship or linkage of these variables. Mr. Moul said one could as easily assume dividend growth and GDP growth understate investors' expectations of proxy group growth, thereby showing the need to use analysts' forecasts. Id. at 19-22.

Mr. Moul testified GDP growth is not the sole determinant of earnings growth. He described GDP as having a "product side" and an "income side," both of which are made up of many components. He contrasted Mr. Gorman's 5.1% GDP growth rate with Value Line's Industrial Composite earnings growth forecast of 6.5% and Blue Chip's forecasts of growth in pre-tax profits of 7.0% for 2011-2015 and 5.5% for 2016-2020. Mr. Moul said this showed future corporate profit growth will exceed GDP growth which has also been true historically. Moul Rebuttal at 22-23. Mr. Moul also pointed out FERC has rejected use of a two-stage DCF model for electric companies because objective measures showed electric companies do not display growth characteristics that fit a multi-stage model. Id. at 23. While FERC does use a two-stage model for natural gas pipelines, Mr. Moul showed that the FERC approach, if followed here, would raise Mr. Gorman's median result to 11.44% and his group average to 13.74%. Id. at 24.

Mr. Moul disputed Dr. Woolridge's contention that analysts' forecasts of EPS growth are biased. He considered Dr. Woolridge's opinions out-of-date because of the 2003 final judgment in the Global Research Analyst Settlement required Wall Street firms to separate their research and investment banking services. Moul Rebuttal at 25. Mr. Moul also considered Dr. Woolridge's position on analyst bias to be inconsistent with his DCF model which uses analysts' forecasts (Public's Ex. JRW-10, pp. 4 and 5) and Dr. Woolridge's reliance on the Claus and Thomas study that measures expected cash flow by using analysts' forecasts (Woolridge Direct at 25-26). Finally, Mr. Moul testified that regardless of what Dr. Woolridge thinks about their accuracy, analysts' forecasts are what investors actually use in their decisions to buy, sell or hold stocks. Id. at 26. Even if there were bias suggesting a downward adjustment might be appropriate, stock prices would likewise require a downward adjustment because the growth rate must be synchronized with the price investors establish when valuing a stock. Id. at 26.

Mr. Moul criticized Dr. Woolridge's use of Value Line DPS forecasts in determining the DCF growth rate. Mr. Moul said the low DPS growth rates are attributable to Value Line's forecast of declining dividend payout ratios for Dr. Woolridge's proxy companies. Moul Rebuttal at 26. With respect to Dr. Woolridge's reliance on historical growth rates, Mr. Moul said analysts consider historical growth rates in the process of developing forecasted growth rates to assess how the future may diverge from historical practices. Id. at 27. Mr. Moul disagreed with the retention ratios of Dr. Woolridge and Mr. Gorman because they did not convert year-end book values to average book values in determining the return on equity. Mr. Moul said this causes an understatement of retention growth and that FERC requires this adjustment. Id. at 28-29. Mr. Moul testified Dr. Woolridge's and Mr. Gorman's retention growth calculations have an additional downward bias because they ignore future growth from external stock financing. Id. at 29.

Mr. Moul testified the analysts' forecasts of EPS growth for Dr. Woolridge's proxy companies average 6.52% and, if this rate of growth is used in Dr. Woolridge's DCF model, the result is an common equity cost rate of 11.99%. Moul Rebuttal at 29-30.

Mr. Moul said a flotation cost adjustment is appropriate because Value Line forecasts show the utilities will be issuing new common stock in the future and that has been historically true. Moul Rebuttal at 30. Mr. Moul stated flotation costs must be considered because only stock sale proceeds net of the underwriting spread and out-of-pocket expenses are available for utility investments. Id.

Mr. Moul criticized Dr. Woolridge for not using the Risk Premium method because it considers a company's own borrowing rate. Moreover, the Risk Premium approach considers additional risk, which is not reflected in the beta measure of systematic risk. Moul Rebuttal at 31. Mr. Moul believed this method was particularly pertinent today because of the credit crisis, which has significantly affected utility debt costs. Id. at 31-32. While Mr. Gorman used the Risk Premium method, his use of regulatory authorized returns to determine the risk premium is of limited usefulness because it reflects an arbitrary time period beginning in 1986. Id. at 32. Mr. Moul showed Mr. Gorman's premiums would be substantially higher if authorized returns since 1999 or 2004 were used. Id. Mr. Moul also said Mr. Gorman's approach was deficient because it mixed book equity returns with market-determined bond yields; does not synchronize the rate orders with the time of the evidentiary record (creating a potential time period mismatch); authorized returns do not necessarily reflect investor-required returns because they can be influenced by policy, political factors and regulatory practices; and past authorized returns do not reflect the risks faced by electric utilities today. Id. at 32-33.

Mr. Moul disagreed with each of the reasons Dr. Woolridge raised against the Risk Premium method. Mr. Moul also elaborated on the justification for using arithmetic means in the Risk Premium method. Moul Rebuttal at 34-38.

With respect to Dr. Woolridge's opinion that the risk return relationship that existed in the past no longer applies today, Mr. Moul provided a graph showing the historical performance of the Chicago Board of Options Exchange Volatility Index ("VIX") since 1990. Moul Rebuttal at 39-40. Because the volatility of the market is higher today (as shown by the VIX), Mr. Moul concluded there has been no shrinkage in the equity risk premium. Id. at 41.

Although Mr. Moul agreed with the historical equity risk premium used by Mr. Gorman in the CAPM, he criticized Mr. Gorman for failing to also consider a prospective premium that reflected expected future market returns. Moul Rebuttal at 41. Mr. Moul criticized both Mr. Gorman and Dr. Woolridge for failing to include a size adjustment in their CAPM calculations. Mr. Moul described Dr. Woolridge's 7.1% CAPM result as "simply not credible" as evidenced by the fact that it is lower than the May 2009 Baa-rated utility bond yield of 7.76%. Id. at 42. He said Dr. Woolridge's CAPM assumes an expected market return of only 7.90% (Woolridge Direct at 54, l. 8), which is totally unrealistic as shown by Value Line's Industrial Composite forecasts. Id. at 43. Because Dr. Woolridge computes a DCF return for his proxy group of 10.4%, Mr. Moul said it is not possible for the total market return to be only 7.9%. Id. at 44.

With respect to the size adjustment, Mr. Moul testified that, contrary to Dr. Woolridge's opinion, the beta of the SBBI mid-cap decile provides no basis to reject the adjustment. He opined the Wong article relied on by Dr. Woolridge is not relevant because it relies on data going back to the 1960s when the utility business was fundamentally different. He cited the famous Fama/French study as identifying size as a separate risk factor not compensated for by the beta. Moul Rebuttal at 44-45.

Mr. Moul defended his Comparable Earnings analysis on the ground that it was supported by the underlying premise of rate regulation and was consistent with the views of the financial community that the regulatory process must consider returns achieved by the non-regulated sector to ensure regulated companies can compete effectively in the capital markets. Moul Rebuttal at 46. He noted investors would not be motivated by an opportunity to earn a 10% return for NIPSCO when they could obtain higher returns on alternative investment opportunities of equal risk. Id. at 46. Mr. Moul disputed Dr. Woolridge's contention that low cost of equity rates can be justified because market-to-book ratios typically exceed 1.0. Id. at 46-47.

(5) Discussion and Findings. The record contains a number of different methods of estimating NIPSCO's cost of common equity. We recognize the cost of common equity cannot be precisely calculated and estimating it requires the use of judgment. Due to this lack of precision, the use of multiple methods is desirable because no single method will produce the most reasonable result under all conditions and circumstances.

In summary, the parties have presented evidence that the cost of equity could be as low as 7.1% and as high as 12.76%, and recommended a cost of common equity between 9.80% and 12.00%. Having considered the evidence of record and giving such weight to the evidence as we deem appropriate, we find that a cost of equity range of 9.90% to 10.50% is reasonable and appropriate for NIPSCO in today's economic climate. This is comparable with our cost of equity findings in Duke Energy Indiana's (formerly PSI Energy, Inc., hereinafter referenced as "PSI") most recent rate case in Cause No. 42359 (finding 10.5% to be appropriate), our approval of the settlement agreement in I&M's rate case in Cause No. 43306 (approving 10.5% as part of the settlement), and our approval of the settlement agreement in Vectren South's rate case in Cause No. 43111 (approving 10.4% as part of the settlement).

Having found an appropriate range, we now turn to determining a specific return to apply to NIPSCO's common equity. In our Order in Cause No. 42359 concerning PSI's rates, we recognized that a utility's operational and financial performance were appropriate considerations in determining a utility's cost of equity. The Commission has previously expressed concerns with the soundness of NIPSCO's managerial and operational decisions. For example, in Cause No. 42194, the Commission analyzed NIPSCO's plan to consolidate and close Local Operating Areas, or maintenance facilities, in its gas and electric service areas. The Commission questioned whether NIPSCO properly and thoroughly evaluated the impact of its plan on NIPSCO's ability to provide reasonably adequate service prior to the plan's implementation. Specifically, the Commission stated, "[T]he lack of any evidence on the part of NISPCO that demonstrates that it undertook a careful and thoughtful review of the [plan] vis-à-vis its possible impact on customers and service quality, has resulted in uncertainties regarding its implementation." *In Re: An Emergency Complaint Against N. Ind. Pub. Serv. Co.*, Cause No. 42194 at 56 (Aug. 10, 2005). As a result, the Commission found that NIPSCO should not implement its plan.

The Commission continues to have concerns regarding NIPSCO's managerial and operational decisions. To illustrate, in the present case, NIPSCO developed new tariff provisions without consulting its industrial customers—the customers who would be most affected by the new provisions and who comprise the majority of NIPSCO's load. While we have seen recent positive efforts by senior management to address customer and operational shortcomings, the Commission will continue to monitor and evaluate managerial efforts, and we will review and revisit those efforts in NIPSCO's next rate case.

Further, in Cause No. 42359, we determined that PSI's reliability and quality customer service warranted some consideration in our ultimate cost of equity determination. The evidence showed that PSI, and its parent Cinergy Corp., scored in the top quartile of the most recent J.D. Power and Associates customer satisfaction studies. In contrast, the evidence presented in this Cause demonstrated that NIPSCO was in the bottom quartile of the J.D. Power studies in 2007 and 2008, and one of the worst-rated utilities in 2009. While we are hesitant to place undue weight on customer surveys, the three-year trend of poor customer satisfaction cannot be ignored.

We must also consider the effect tracking mechanisms have in reducing risk in order to ensure that these reduced risks are properly reflected in NIPSCO's cost of equity. See Order, Cause No. 42359 at 53. NIPSCO has a number of trackers in place currently, and we have approved additional trackers in this Cause. No witness for NIPSCO addressed the effects of trackers on NIPSCO's cost of capital, which could be considered a fatal failing of its analysis.

The Commission has a unique role in regulating its jurisdictional utilities, which at times requires us to send a clear and direct message to utility management concerning the need for improvement in the provision of its utility service. Our determination of the authorized cost of common equity capital can be a very direct means to incent improved service. We anticipate that NIPSCO will respond accordingly and therefore anticipate that such authorized cost of common equity capital will apply for a limited duration as identified below.

Based on the entirety of the evidence at issue, and giving such weight to the evidence as we deem appropriate, we find that NIPSCO's cost of common equity capital shall be 9.9% and NIPSCO's overall weighted cost of capital to be 7.29%, determined as follows:

Description	Amount	Percent	Cost	Weighted Average Cost
Common Equity	$ 1,395,245,772	49.95%	9.90%	4.94%
Long-Term Debt	$ 906,631,137	32.46%	6.52%	2.12%
Customer Deposits	$ 63,684,199	2.28%	6.00%	0.14%
Deferred Income Taxes	$ 294,780,249	10.55%	0.00%	0.00%
Post-Retirement Liability	$ 102,637,766	3.67%	0.00%	0.00%
Post-1970 ITC	$ 30,350,460	1.09%	8.57%	0.09%
Totals	$ 2,793,329,583	100.00%		7.29%[8]

The cost rate we have assigned to the post-1970 investment tax credits is the overall weighted cost of investor-supplied capital determined as follows:

Description	Amount	Percent	Cost	Weighted Average Cost
Common Equity	$ 1,395,245,772	60.61%	9.90%	6.00%
Long-Term Debt	$ 906,631,137	39.39%	6.52%	2.57%
Totals	$ 2,301,876,909	100.00%		8.57%

This is consistent with the methodology adopted by the Commission in Indianapolis Power & Light Co., Cause No. 37837, p. 18 (Aug. 6, 1986). Applying the weighted cost of capital to NIPSCO's original cost rate base, we find a net operating income level for NIPSCO of $192,425,533 is just and reasonable.

The Commission recognizes that a 9.9% return reflects the low end of the range discussed above, and that a higher return may be appropriate if NIPSCO is able to demonstrate improved company performance in its next base rate proceeding. In order for NIPSCO's level of performance to be reevaluated by the Commission, NIPSCO is hereby directed to file a new base rate case with the Commission no later than September 30, 2012.

[8] In comparison, PSI Energy of Indiana's weighted cost of capital in Cause No. 42359 was 7.30%, while I&M's weighted cost of capital, based on settlement approved in Cause No. 43306, was 7.62%, and SIGECO's weighted cost of capital, based on settlement approved in Cause No. 43111, was 7.32%.

Analysis of Costs for Iatan 1 and Iatan 2 Billed by Shiff Hardin through April 2010

	Dollars (c) - Labor Only	Hours	% of Total	Group 1 (a) Hours	Group 1 (a) % of Group	Group 2 (b) Hours	Group 2 (b) % of Group	Other Schiff-Hardin Hours	Other Schiff-Hardin % of Group	Subtotal Schiff Hardin	Subtotal Schiff Hardin %	J. Wilson & Assoc Hours	J. Wilson & Assoc % of Group	Other Hours	Other % of Group
Iatan Oversight	$3,170,497	9,231	25%	2,321	36%	5,553	41%	378	6%	8,253	32%	0	0%	978.25	100%
Iatan Project Controls	$2,308,645	12,755	34%	81	1%	1,502	11%	1,071	18%	2,654	10%	10,101	100%	0.00	0%
Contracts	$989,694	2,577	7%	746	11%	1,704	13%	127	2%	2,577	10%	0	0%	0.00	0%
Contract Administration	$3,206,089	11,982	32%	3,201	49%	4,631	34%	4,150	71%	11,982	46%	0	0%	0.00	0%
Kiewit & Boiler Tube	$200,298	475	1%	155	2%	163	1%	158	3%	475	2%	0	0%	0.00	0%
	$9,875,222	37,019	100%	6,504	100%	13,552	100%	5,883	100%	25,940	100%	10,101	100%	978	100%
Percent - Group 1 and 2 only				32%		68%									
Staff Assumption				20%		80%									
Percent- All Billed Hours		100%		18%		37%		16%		70%		27%		3%	
Weighted cost per hour		$267		$401		$286		$208		$297		$174		$322	
Staff Assumption				$434		$322									

a) Per Staff Report, the individuals in this group were performing true "legal" work.
b) Per Staff Report, the individuals in this group were performing "project control" rather than true "legal" work.

c) Dollars reflect total amounts billed for direct labor, excluding expenses. Disbursements made by Schiff Hardin to its subcontractors were omitted from the analysis of Schiff Hardin costs and were reflected separately in the analysis based on invoices submitted to Schiff Hardin by the subcontractors. Costs and hours are for the total project before allocation to joint partners.